

2024



Annual
Report

Community Commitment in Action



10 Days of Giving | Winona



Community Picnic | Goodview



Habitat for Humanity | Eau Claire



10 Days of Giving Barrel Drop Off | Cottage Grove & Winona



Pancake Breakfast | Winona



Festival of Toys Drive | Eau Claire



Chamber of Commerce Dinner | Winona



Holiday Stroll | Red Wing



Trinona | Winona



Community Clean Up | Eau Claire



Food Drive | La Crescent



Feed My Starving Children | Winona



Golf Outing | Red Wing



Crazy Daze | Northfield



Habitat for Humanity | Winona



Smooth Summer Nights | Rochester



Rock'n on the River | Eau Claire

We're proud to serve our communities and share photos from volunteer efforts and events in 2024.



Memorial Park Clean Up | Red Wing



Community Picnic | Spring Grove



Middle School Rally | Winona



Heritage Celebration and School Supply Drive | Northfield



WSU Game Day Experience | Winona



Community Impact Month | Company-wide



Teacher Appreciation Breakfast Delivery | Caledonia



Habitat for Humanity | Winona



Morrie Miller Athletics | Winona



Holiday Open House | Cannon Falls



Habitat for Humanity | Northfield



Community Showcase | Cottage Grove



Feed My Starving Children | Edina



Pet Supply Drive | Rosemount



Meals on Wheels | Rochester



Highway Clean Up | Rochester and St. Charles

A Letter From Our Chief Executive Officer



Greg Evans

President & Chief Executive Officer
Merchants Financial Group, Inc.
and Merchants Bank, NA

Market forces tempered our performance forecast from the onset in 2024, and unexpected credit risk elevation in the second half of the year compounded what was a challenging year for Merchants Financial Group, Inc. The resulting net income of \$18.54 million was disappointing by our performance standard, but in line with performance metrics for the banking industry, which continues to be impacted by tight liquidity and compressed margins.

Despite the challenges, I'm tremendously proud of our team. Our year-end performance aligned with median performance metrics for bank peers because of our discipline in adapting to the challenging market environment. That discipline allowed us to reposition our consolidated balance sheet for what we forecast to be a healthy rebound of financial performance in 2025.

Given the hangover from 2023 bank failures, evaporation of virtually all excess liquidity in the banking system and rapidly rising interest rates crushing the interest margin of most banks, our focused priorities in 2024 were clearly on liquidity and margin improvement.

In her annual report letter, Chief Financial Officer Sue

Savat details the levers we used to drive improvement and the accelerated progress during the second half of the year. Our company-wide focus on deposits resulted in year-over-year growth of \$249 million (11.5%); an extraordinary accomplishment in an environment with all banks competing hard and paying up to attract deposits.

Year-over-year loan growth was flat, as we intentionally focused on pricing and terms associated with new business opportunities to replace runoff. As a result, our liquidity and margin positions are more favorable to support 2025 loan growth goals.

Credit Challenges - Isolated But Severe

Unfortunately, the identification of elevated credit risk as the year played out offset the improving liquidity and interest margin. The financial impact associated with charge-offs on one large commercial real estate credit facility in St. Paul primarily drove the need to bolster Allowance for Credit Loss (ACL) significantly during the last two quarters of the year. We are focused on work-

ing out a small number of problem credits, but have identified only a moderate shift in the credit cycle and economic impact on the broader borrowing base.

Provision for ACL adjustments throughout the year exceeded forecast by \$9 million. Net charged-off loans totaled .37%, within tolerance of broad industry benchmark performance but a significant increase from .03% in 2023. Total delinquencies greater than 30 days at year-end were .54% of total loans (compared to .47% year-end 2023). Non-performing loans were .33% of total loans and 2.18% of regulatory capital (.44% and 3.15% respectively in 2023). Classified and criticized loans were 36.90% and 49.37% of regulatory capital, respectively, compared to 17.73% and 28.48% in 2023. To accommodate the identified risk profile, ACL was bolstered to 1.43% of total loans at year-end compared to 1.30% at year-end 2023.

The return to a more normal credit cycle after years of low interest rates and pristine credit metrics drove strategic assessment of our credit administration and risk management systems. We have adapted to the environment with modest changes in how credit is approved, including more centralization of risk monitoring and mitigation. Overall, our credit risk profile remains strong, but indicators dictate heightened diligence to monitor the impact of persistent inflation on consumers and higher interest rates on borrowers' ability to meet repayment obligations.

Business Design, Efficiency & Managing Risk

The intense focus on credit quality and balance sheet transformation didn't prevent significant progress on important strategic initiatives in alignment with customer experience, digital transformation and performance optimization.

Digital utility was expanded in the form of end-to-end online deposit account opening for existing customers in the third quarter. Uptake exceeded expectations for the soft launch of the solution, which will be rolled out for non-customers by mid-2025. A project to automate consumer credit underwriting and fulfillment also launched, and that will mature into online consumer credit account opening by late 2025. Supporting these initiatives is the maturation of our centralized Customer Engagement Center business unit, which provides omni-channel customer care and support for all locations.

Several business design transformations occurred in 2024 to optimize customer experience and performance for retail (consumer) banking. We added a new

Director of Residential Mortgage Sales, the Company's second largest driver of revenue, to optimize performance, production and profit contribution when the housing market rebounds. We also broadened and centralized leadership for our retail banking team with subject matter experts to drive consistency in all locations for performance, customer experience and risk management.

We continue to find opportunities to drive operational efficiency, leverage technology and automation, and reduce overhead expense. In 2024, personnel expense was 25.74% of revenue compared to 29.86% in 2023. Impact on performance was masked to a degree by the market forces that caused the drag on earnings.

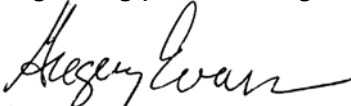
2025 Outlook - Optimism & Earnings Rebound

This year Merchants will celebrate 150 uninterrupted years of providing financial services to the friends, neighbors, and local business-owners, and unparalleled leadership in our communities. The significance of that is not lost on our Leadership Team. From our very first year in 1875, your Company has been a community and employee-owned institution. There are not many local businesses with a 150-year history of relevance, and the loyalty of our local Shareholders has consistently been the foundation of our success.

A year ago, I indicated that 2023 was a hard year. I didn't anticipate that 2024 would prove to be more challenging, but the headwinds we encountered did not derail our strategic focus, another year of book value growth (albeit modest), or the sense of optimism I have about our long-term relevance in a consolidating industry.

As we continue to accelerate investment in technology and digital tool enhancements that consumers and businesses expect from their Bank today, we believe that community banking remains a people business. I am privileged to work with extraordinary, caring people who are uncompromising in the fulfillment of our mission to help our customers and communities realize their financial hopes and dreams.

Despite the challenges that clearly impacted our performance in 2024, be assured that Merchants remains undeniably strong - resilient, well-capitalized, well-managed and well-supervised by our regulators. Thank you for the trust and confidence you continue to place in our team and its ability to fulfill our obligation in growing your meaningful investment.


Gregory M. Evans

A Letter From Our Chief Financial Officer



Sue Savat

**Senior Vice President &
Chief Financial Officer**

Merchants Financial Group, Inc.

As we reflect on 2024, I am pleased to present our annual report, detailing the financial performance and strategic initiatives that have shaped the past year's journey. It was a period marked by challenge, resilience, prudent financial management, and positioning for future sustainable growth.

A Year of Challenge & Positioning for Growth

Despite the challenging economic environment for the industry, we made significant progress in repositioning the balance sheet across key financial metrics. Our total assets increased to \$2.78 billion, a 6.85% increase from the previous year.

Our team's focus on growing deposits and tempering loan growth allowed us to take advantage of attractive yields for the investment portfolio. Our overnight excess funds were up \$132 million from 2023 year-end. Investments were up 33.04% or \$79.3 million. Total loans were down 2.10%, however yield on loans was up 51 bps from 2023 year-end. Total deposits were up 11.5% or \$249 million year-over-year. While our priority focus is the continued growth of core non-maturity deposits due to increasing rates and a competitive time deposit (CD) pricing market, the majority of our

growth came in that category. That included many of our loyal core deposit customers moving money into higher-yielding instruments. The inverted yield curve was fortuitous, as 69% of our time deposits carry a duration of 11 months or less, and rates for those terms have come down significantly from the high at the end of 2023.

Our net income for 2024 declined by 27.3%, ending at \$18,539,332 compared to \$25,502,129 in 2023. This decline was primarily driven by tight liquidity and margins in the first half of the year and credit quality challenges in the second half. We are pleased with the increased revenue generation and effective cost management the organization was able to achieve.

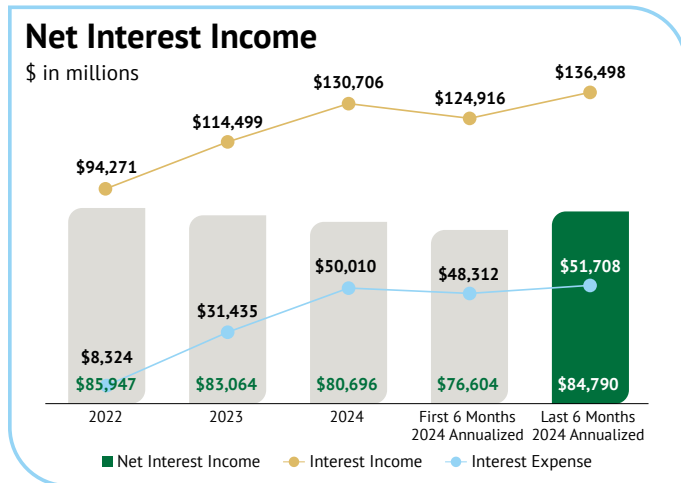
Our commitment to maintaining a strong capital position is evident in our Tier 1 capital ratio, which stands at 11.73%, well above regulatory requirements. This solid capital base ensures that we are well-positioned to navigate future uncertainties and capitalize on future growth opportunities, including pursuit of acquisitions.

Levers to Drive Balance Sheet Improvement

We are fortunate to have great bankers that meet the lending needs of our communities and customers. That has historically led to maintaining a higher loan-to-deposit ratio than many smaller community banks, while minimizing any wholesale borrowing required to meet those needs. We have been prudent in maintaining options for secondary liquidity through other banking partners, if needed.

When liquidity dried up in 2023, it was imperative to pivot as quickly as possible. Our banking leaders supported an enhanced level of credit and pricing diligence for loan requests. Our Treasury Management team was out in full force with our bankers to connect with customers and prospects and share the great tools we offer. Truly everybody on the banking team gave their all to attract, retain and grow deposit relationships.

These efforts were successful in 2024 and created a balance sheet that positions us for opportunities to be presented in 2025. Our net interest income decreased by 2.8%, for the year, but improved 10.7% in the latter half of the year as a result of prudent asset-liability management and favorable interest rate movements.



Non-Interest Revenue Streams

Non-interest revenue increased in certain areas and decreased in others. Due to decreased new commercial loan activity, associated fee income was down 37% from 2023. Consumer fee income increased 48% and mortgage servicing and sales income was up 18%, even though volume was down 1.3% year-over-year. Both Treasury Management and Wealth Management generated year-over-year increases of 15% and 12%, respectively. Strategic gains in non-interest income categories were a result of diversified fee-based services and strategic partnerships.

Expense Management

Expense management was a challenge in 2024. Our

group health insurance costs increased nearly 11% and computer expenses, while 2.8% below budget for the year, increased 7.4% from 2023 as we continue to invest in customer-focused technology, and internal automation and efficiency. Loan related expenses were up 43.8% and legal fees were up 76.4% due to costs associated with stressed credits. FDIC fees increased \$421,000, or 43%, due to balance sheet growth and our higher liquidity risk profile. We continue to monitor all cost levels, and the strategies implemented are done with long-term expense management optimization in mind.

Risk Management

In an increasingly complex and interconnected world, robust risk management is more critical than ever. We have and continue to strengthen our risk management framework to identify, assess, and mitigate potential risks proactively. This includes enhancing our cybersecurity measures, stress testing our financial resilience, and maintaining a diversified asset portfolio.

Our comprehensive risk management approach ensures that we are well-equipped to handle potential disruptions while protecting the interests of our stakeholders.

Looking Ahead

As we look to the future, we remain optimistic about the opportunities ahead. Our strategic priorities for the coming year include furthering our digital transformation and continuing to deliver exceptional value to our customers and shareholders.

We are confident that our strong financial foundation and dedicated team position the company for sustainable future growth and that will result in continued long-term Shareholder value.

Appreciation

In closing, I would like to express my sincere gratitude to our Shareholders for their unwavering support and trust. I also extend my heartfelt thanks to our employees for their hard work, dedication, and resilience in the face of challenges. Their commitment to excellence is a cornerstone of our success and the reason we can look forward to celebrating our 150th year as a strong community bank.

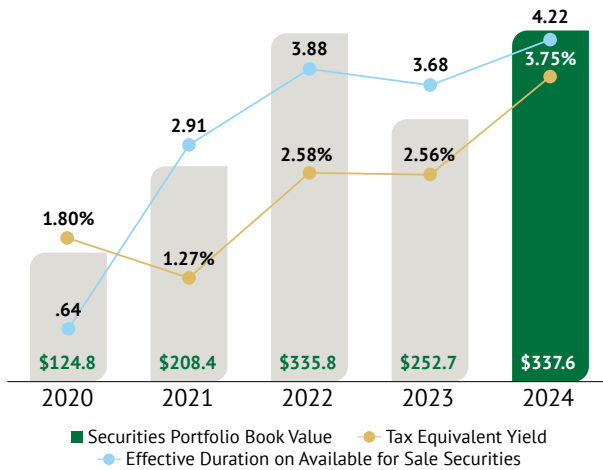
I am excited about the future and look forward to another year of growth and achievements.

Susan M. Savat
Susan M. Savat

2024 Financial Charts

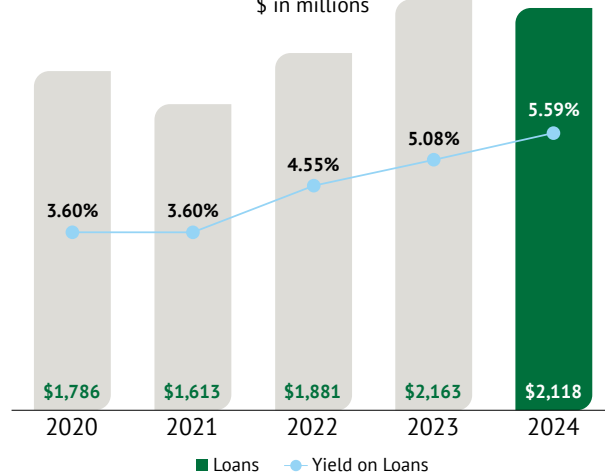
Securities Portfolio

\$ in millions



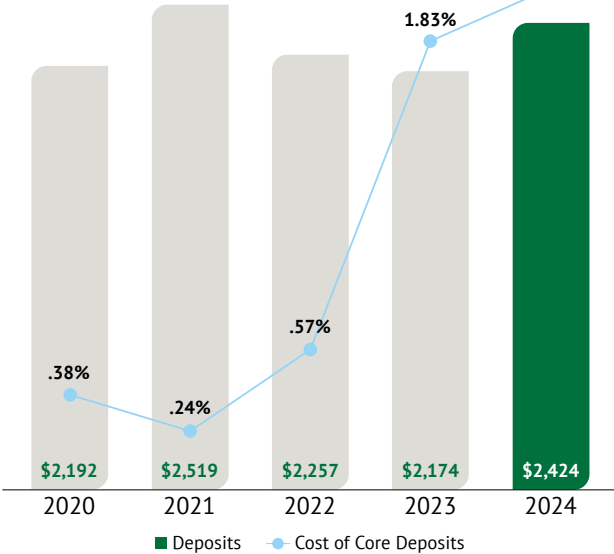
Total Loans and Leases

\$ in millions



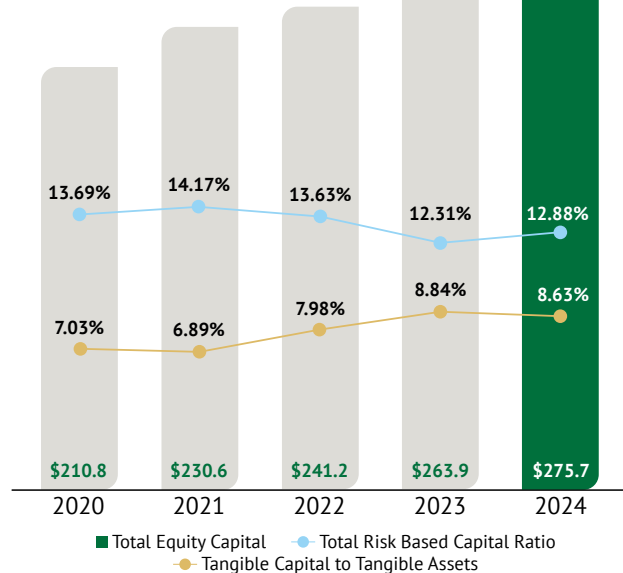
Total Deposits

\$ in millions



Capital

\$ in millions



Total Net Income

\$ in millions



Consolidated Financials

Condensed Consolidated Statement of Condition

Assets	12/31/24	12/31/23
Cash and Cash Equivalents	\$ 177,794,293	\$ 39,055,718
Investments	319,205,180	239,936,189
Loans and Leases, Net	2,086,285,266	2,131,665,132
Banking Houses, Furniture and Fixtures	24,835,199	25,728,081
Other Assets	173,986,842	163,968,895
Total	<u>2,782,106,780</u>	<u>2,600,354,015</u>
Liabilities & Equity		
Deposits	\$ 2,423,758,047	\$ 2,174,408,649
Federal Funds Purchased	-	94,690,563
Other Liabilities	82,629,107	67,318,613
Equity	275,719,626	263,936,190
Total	<u>2,782,106,780</u>	<u>2,600,354,015</u>

Condensed Consolidated Statement of Income

Income	12/31/24	12/31/23
Interest Income	\$ 130,706,341	\$ 114,499,201
Interest Expense	50,009,989	31,434,909
Net Interest Income	80,696,352	83,064,292
Other Operating Income	31,729,136	29,300,621
Other Operating Expense	88,013,157	78,392,784
Income Before Taxes	24,412,331	33,972,129
Income Taxes	5,872,999	8,470,000
Net Income	<u>\$ 18,539,332</u>	<u>\$ 25,502,129</u>
Earnings Per Share*	\$ 2.34	\$ 3.23
Book Value Per Share*	\$ 34.79	\$ 33.38
Shares Outstanding	8,178,741	8,178,741

*Based on weighted average of shares outstanding for the year.

Executive Leadership Team

Merchants' strong reputation as a community banking leader reflects the strength of an extraordinary team of people and unwavering commitment to fulfilling our mission, driven by the Company's Executive Leadership Team. With Board oversight, we focus on objectives that align with our core values and three strategic pillars defined in our long-range plan: Consistently deliver exceptional customer experiences; embrace teamwork and responsibility as "One Merchants;" and deliver the revenue growth and earnings optimization necessary for long-term relevance in an intensely-competitive industry so we may earn the opportunity to fulfill the hopes and dreams of our customers and communities for years to come.



Greg Evans

President & Chief Executive Officer,
Merchants Financial Group, Inc. and
Merchants Bank, NA

- In banking since 1989
- Joined Merchants in 1989



Cat Breet

Chief Human Resource Officer

- In human resources since 1997
- Joined Merchants in 2022



Andrew Guzzo

Chief Banking Officer & President
(Winona)

- In banking since 2006
- Joined Merchants in 2017



Cindy Harrison

Chief Credit Officer

- In banking since 1992
- Joined Merchants in 1992



Erick Maki

Regional President, South Region

- In banking since 2001
- Joined Merchants in 2022



Dan Massett

Regional President, North Region

- In banking since 1991
- Joined Merchants in 2014



Steve Molander

Chief Information Officer

- In banking since 2001
- Joined Merchants in 2024



Sue Savat

Chief Financial Officer

- In banking since 1992
- Joined Merchants in 2000 (also from 1992-1995)



Dave Schlauderaff

President, Merchants Bank
Equipment Finance

- In equipment finance since 1998
- Joined Merchants in 2022



Dr. Julie Van Der Wilt

Chief Risk Officer

- In banking since 2007
- Joined Merchants in 2024

Market President Team



Larry Bodin
President, La Crescent and Onalaska

- In banking since 1986
- Joined Merchants in 2020



Bruce Goblirsch
President, Cottage Grove and Hastings

- In banking since 1986
- Joined Merchants in 2002



Ken Graner
President, Lanesboro and Rushford

- In banking since 1981
- Joined Merchants in 2009



Andrew Guzzo
Chief Banking Officer & President (Winona)

- In banking since 2006
- Joined Merchants in 2017



Jarett Jones
President, Rochester

- In banking since 1999
- Joined Merchants in 2020



Kirk Muhlenbruck
President, Northfield

- In banking since 1988
- Joined Merchants in 2021



Tom Pasch
President, Red Wing

- In banking since 2009
- Joined Merchants in 2021



Dave Schlauderaff
President, Merchants Bank Equipment Finance

- In equipment finance since 1998
- Joined Merchants in 2022



Matt Schuldt
President, Caledonia and Spring Grove

- In banking since 2009
- Joined Merchants in 2014



Seth Sundeen
President, Eau Claire

- In banking since 2003
- Joined Merchants in 2023



Dan Vlasak
President, Apple Valley, Lakeville and Rosemount

- In banking since 1989
- Joined Merchants in 2009

Tailored Solutions for Business Growth



Judd Grafe

**Owner
Grafe Auction**

Growing up in the auction industry, Judd Grafe learned from his father that having a strong banking relationship is crucial to business success. That lesson has proven true time and time again, and today, Grafe Auction relies on Merchants Bank for financial expertise and strategic guidance.

“Having a bank that serves as a financial partner—not just a service provider—is incredibly valuable,” says Judd. “Our banker understands the importance of relationships, not just transactions. That approach has made a real impact on our ability to grow and adapt over the years.”

Grafe Auction, a leader in commercial and industrial equipment auctions, often faces unique financial challenges, from managing large transactions to handling the complexities of business transitions. Merchants Bank has consistently provided tailored solutions to meet those evolving needs.

“The team at Merchants has always been proactive, bringing forward financial solutions that align with our business strategy,” says Judd. “It’s not just about managing accounts; it’s about having a partner we can trust to help us make informed decisions.”

With a clear, relationship-focused approach, Merchants Bank continues to support businesses like Grafe Auction, helping them navigate growth, change, and opportunity with confidence.

Building Business Succession Plans



Annie & Rich Larson

Owners
KYMN Radio

The KYMN radio station in Northfield, MN has been a staple in the community for over 60 years. When the opportunity presented itself for the station's News Director, Rich Larson, and his wife, Annie, to buy the station from the retiring owner, the Larsons jumped at the chance to carry on the station's legacy.

"I've never loved a job as much as I've loved working in radio. As soon as I started working at KYMN, we decided that if we had the chance, Annie and I would buy the place," explains Rich. "I love that our complete focus is on Northfield and how we can give back to the community through our work."

The Larsons approached Merchants Bank to help finance purchasing the business. Their Commercial Banker recommended a loan program through the Small Business Administration (also known as an SBA loan) and handled all the steps in the process, including coordinating several funding sources, and kept them up to date along the way.

"We knew exactly what was going on and had complete confidence in Merchants. The loan closed in November, and it means everything to us to realize this dream," Rich shares. "We get to spend the rest of our lives in the town we love. We get to contribute and give back to a town that has done amazing things for us."

Making Business Operations Efficient



Kelly Boice

**Controller
Saint Mary's University
of Minnesota**

With campuses located in Minneapolis, Rochester and Winona, MN, Saint Mary's University is a private, national university with over 4,500 students enrolled. Kelly Boice is the Controller for the University and leads a team of six who manage all financial affairs.

"Everything financial-related feels urgent, whether it's someone having trouble with their payroll deposit or a student wondering about their loan," explains Kelly. "To have a financial partner in the community like Merchants that can support the needs of our University - that's huge."

As Merchants has added more financial products and tools over the last ten years, the University has taken advantage of many options to make managing finances easier. This includes Treasury Management services to help make quicker deposits, protect accounts from fraud and even provide FDIC insurance on deposits over the regular limit. Having access to these types of sophisticated financial tools and a local team of banking experts has created efficiency and peace of mind for the Business Office team.

Kelly says simply, "We continue to stay with Merchants Bank because of the positive experiences we've had over the last decade. The Merchants team is very consistent and always there for us. They make our jobs easier. Period."

Home Ownership Dreams Come True



Dean Paxton

Homeowner

For Dean Paxton, realizing his dream of finding a new home was a bit of a puzzle. Timing, location, the right property and an affordable source of funding all had to come together.

“I found myself in a unique situation when buying a home,” shares Dean. “I wanted a fixer upper that I could reasonably afford as a single person nearing retirement, which wasn’t easy to find. I spent a couple of years working with my realtor and Merchants Bank Mortgage Lender looking for the right place.”

Ultimately, a property popped up in the perfect location (across from the golf course!) but the long list of renovation needed included new floors, new appliances, fixing a water leak and repairing damaged ceilings. With the property’s condition a challenge and Dean’s needs in mind, his lender found a financing solution that put the puzzle pieces together.

Dean explains, “My lender suggested a loan program that truly allowed me to get into this house. I don’t know that another lender would have spent the time or had access to the financing options to make it happen.”

After months of work, Dean’s 1960’s rambler has become the beautiful home he envisioned. “I’m very appreciative to the team at Merchants for making home ownership a reality for me. Although I don’t know if I can thank them for the never-ending homeowner to-do list,” Dean says with a smile.

Merchants Financial Group Board of Directors



Richard T. Lommen, Jr.
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President & Owner
Courtesy Corporation



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Vice Chair of the Board
Senior Vice President & General Counsel
Saint Mary's University of Minnesota



Michael F. Cichanowski
Founder & Chief Executive Officer
Wenonah Canoe, Inc.



Gregory M. Evans
President & Chief Executive Officer
Merchants Financial Group, Inc. and
Merchants Bank, NA



Molly K. Jungbauer, CPA
Chief Executive Officer
Hollstadt Consulting, Inc.



John H. Killen
President
WinCraft, a Fanatics brand



Bradley J. Peterson
Chairman
Mississippi Welders Supply Co., Inc.



James A. Rogers III
CEO, Digital Pathology
Senior Administrator, Generative AI
Mayo Clinic



Bruce E. Ryan
President
Ryan Windows & Siding, Inc.



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President
CP Advisors, LLC

Merchants Bank Charter Board of Directors



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Chair of the Board
President & Owner
Courtesy Corporation



Ann E. Merchlewitz
Vice Chair of the Board
Senior Vice President & General Counsel
Saint Mary's University of Minnesota



Michael F. Cichanowski
Founder & Chief Executive Officer
Wenonah Canoe, Inc.



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Merchants Financial Group, Inc. and
Merchants Bank, NA



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Mayo Clinic



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North Region/Northfield



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International
Association



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VP/Risk &
Insurance Advisor
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Owner, Falck
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Chris J. Kennelly
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Developer &
Entrepreneur
Trek Properties
NCC Builders
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Rebound Partners



Kristin L. Yahnke
Attorney & Partner
Schmitz Ophaug, LLP

North Region/Twin Cities Area



Ben E. Gathje
Owner/Operator
Culver's of
Cottage Grove



Peggy P. Johnson
Community
Relations Director
Dakota Electric
Association



Molly K. Jungbauer, CPA
Chief Executive Officer
Hollstadt Consulting, Inc.



James A. Trenda
President
CP Advisors, LLC



Richard H. Welshons
Twin Cities Manager
The Title Team/
DCA Title

Merchants Bank Advisory Boards

South Region/La Crosse Market Area



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President & Chief
Executive Officer
Truss Specialists, Inc.



Derek S. Cortez, Ph.D.
Chief Executive Officer
Chileda, Inc.



Stephen D. Loehr
Retired Vice President
of Government &
Industry Relations
Kwik Trip, Inc.



Brian D. Wieser
Owner/Vice President
Wieser Brothers General
Contractor, Inc.

South Region/Rochester



John C. Beatty
Attorney
Dunlap & Seeger, PA



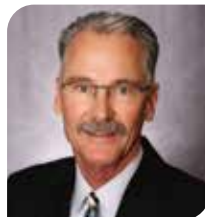
Aaron J. Benike
Vice President
of Operations
Benike Construction



Joselyn A. Raymundo
Entrepreneur,
Founder-CEO, Investor



James A. Rogers III
CEO, Digital
Pathology
Senior Administrator,
Generative AI
Mayo Clinic



Bruce E. Ryan
President
Ryan Windows
& Siding, Inc.

South Region/Rural Market Area



Adam P. Augedahl
Owner
Winona Controls, Inc.



John D. Diersen
Owner & Farmer
Minnigan Hills Farm



**Creighton M.
Horihan**
Owner
Horihan Companies



Joel B. Nelson
Farmer & Owner
Lanesboro Sales Commission
Decorah Sales Commission

Consolidated Financial Report

December 31, 2024

Merchants Financial Group, Inc. and Subsidiaries

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102 East Third Street • Winona, MN 55987
(507) 457-1100 • www.merchantsbank.com

Independent Auditor's Report

Audit Committee and Board of Directors
Merchants Financial Group, Inc. and Subsidiary

Report on the Audit of the Financial Statements

Opinion

We have audited the consolidated financial statements of Merchants Financial Group, Inc. and Subsidiary (the Company), which comprise the consolidated balance sheets as of December 31, 2024 and 2023, the related consolidated statements of income, comprehensive income, 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 accompanying financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2024 and 2023, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with auditing standards generally accepted in the United States of America (GAAS), the Company's internal control over financial reporting as of December 31, 2024, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated February 13, 2025, expressed an unmodified opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion

We conducted our audits in accordance with GAAS. Our responsibilities under those standards are further described in the "Auditor's Responsibilities for the Audit of the Financial Statements" section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable).

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Other Information Included in the Annual Report

Management is responsible for the other information included in the annual report. The other information comprises the information included in the annual report but does not include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.

RSM US LLP

Sioux Falls, South Dakota
February 13, 2025

Merchants Financial Group, Inc. and Subsidiary

Consolidated Balance Sheets

December 31, 2024 and 2023

(In Thousands, Except Share Information)

Assets	2024	2023
Cash and cash equivalents (Note 2)	\$ 177,566	\$ 39,056
Federal funds sold	228	-
Available-for-sale securities (Notes 3 and 10)	283,149	202,215
Held-to-maturity securities (Notes 3 and 10)	36,057	37,721
Loans held for sale (Note 4)	1,049	1,929
Loans and direct financing leases, net (Notes 5, 10, 14 and 16)	2,086,285	2,131,665
Operating lease assets, net (Note 6)	16,896	20,365
Premises and equipment, net (Note 7)	24,835	25,728
Investment in restricted stock	5,397	9,430
Other real estate and other personal property owned (Note 8)	6,457	1,005
Accrued interest receivable and other assets	32,933	20,165
Cash value of life insurance	60,735	59,753
Mortgage servicing rights, net (Note 4)	14,801	15,339
Goodwill (Note 1)	35,665	35,665
Intangibles (Note 1)	54	317
Total assets	\$ 2,782,107	\$ 2,600,353
Liabilities and Stockholders' Equity		
Liabilities		
Deposits (Note 9):		
Noninterest-bearing	\$ 463,169	\$ 482,293
Interest-bearing	1,960,589	1,692,116
Total deposits	2,423,758	2,174,409
Federal funds purchased	-	94,690
Repurchase agreements (Note 10)	15,060	15,064
Notes payable (Note 11)	11,900	7,262
Subordinated debentures (Note 12)	28,351	28,351
Deferred taxes (Note 13)	1,865	1,617
Accrued interest payable and other liabilities (Note 13)	25,453	15,024
Total liabilities	2,506,387	2,336,417
Commitments, Contingencies and Credit Risk (Note 14)		
Stockholders' Equity (Note 17)		
Common stock, par value \$0.008 per share; 25,000,000 shares authorized; shares issued: 8,178,741 in 2024 and 2023	68	68
Additional paid-in capital	10,242	10,274
Retained earnings	286,011	273,170
Accumulated other comprehensive loss (Note 3)	(12,655)	(12,598)
Unearned Employee Stock Ownership Plan (ESOP) shares (Note 15)	(7,946)	(6,978)
Total stockholders' equity	275,720	263,936
Total liabilities and stockholders' equity	\$ 2,782,107	\$ 2,600,353

See Notes to Consolidated Financial Statements.

Merchants Financial Group, Inc. and Subsidiary

Consolidated Statements of Income
Years Ended December 31, 2024 and 2023
(In Thousands, Except Per Share Information)

	2024	2023
Interest income:		
Loans	\$ 116,541	\$ 100,203
Securities	8,297	7,072
Direct financing leases	1,663	1,673
Other	4,206	5,550
	<u>130,707</u>	<u>114,498</u>
Interest expense:		
Deposits	45,825	27,776
Notes payable, federal funds purchased and repurchase agreements	2,605	941
Subordinated debentures	1,580	2,719
	<u>50,010</u>	<u>31,436</u>
Net interest income	80,697	83,062
Credit loss expense (Note 5)	<u>10,101</u>	<u>1,380</u>
Net interest income after credit loss expense	70,596	81,682
Noninterest income:		
Trust department	3,154	2,746
Service charges and other fees	7,002	7,018
Loan servicing fees	6,867	6,998
Net loss on sale of available-for-sale securities (Note 3)	(1,175)	(134)
Net gain on sale of loans	2,999	2,142
Net loss on sale of other real estate and other personal property owned including writedowns (Note 8)	(33)	(8)
Operating lease income	6,303	5,979
Other	6,612	4,560
	<u>31,729</u>	<u>29,301</u>
Noninterest expenses:		
Salaries and employee benefits (Note 15)	41,146	42,034
Occupancy	13,533	13,229
Depreciation expense on operating leases	5,094	4,919
Mortgage servicing rights (Note 4)	2,659	3,053
Other	15,481	13,776
	<u>77,913</u>	<u>77,011</u>
Income before income taxes	24,412	33,972
Provision for income taxes (Note 13)	5,873	8,470
Net income	\$ 18,539	\$ 25,502
Earnings per common share (Note 1)	<u>\$ 2.34</u>	<u>\$ 3.23</u>

See Notes to Consolidated Financial Statements.

Merchants Financial Group, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income
Years Ended December 31, 2024 and 2023
(In Thousands)

	2024	2023
Net income	\$ 18,539	\$ 25,502
Other comprehensive income, net of reclassification adjustments and income tax effect:		
Change in unrealized gains on securities	240	2,464
Unrealized loss on interest rate swap	(297)	(163)
Total other comprehensive income (loss)	(57)	2,301
Comprehensive income	\$ 18,482	\$ 27,803

See Notes to Consolidated Financial Statements.

Merchants Financial Group, Inc. and Subsidiary

Consolidated Statements of Stockholders' Equity

Years Ended December 31, 2024 and 2023

(In Thousands, Except Per Share Information)

	Common Stock	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unearned ESOP Shares	Total
Balance, December 31, 2022	\$ 68	\$ 10,255	\$ 254,087	\$ (14,899)	\$ (8,352)	\$ 241,159
Net income	-	-	25,502	-	-	25,502
Other comprehensive income (Note 3)	-	-	-	2,301	-	2,301
ESOP shares released for allocation (Note 15)	-	19	-	-	1,374	1,393
Cash dividends declared (\$0.70 per share)	-	-	(5,535)	-	-	(5,535)
Change in accounting principle (Note 1)	-	-	(884)	-	-	(884)
Balance, December 31, 2023	68	10,274	273,170	(12,598)	(6,978)	263,936
Net income	-	-	18,539	-	-	18,539
Other comprehensive loss (Note 3)	-	-	-	(57)	-	(57)
ESOP shares purchased	-	-	-	-	(2,680)	(2,680)
ESOP shares released for allocation (Note 15)	-	(32)	-	-	1,712	1,680
Cash dividends declared (\$0.72 per share)	-	-	(5,698)	-	-	(5,698)
Balance, December 31, 2024	<u>\$ 68</u>	<u>\$ 10,242</u>	<u>\$ 286,011</u>	<u>\$ (12,655)</u>	<u>\$ (7,946)</u>	<u>\$ 275,720</u>

See Notes to Consolidated Financial Statements.

Merchants Financial Group, Inc. and Subsidiary

Consolidated Statements of Cash Flows Years Ended December 31, 2024 and 2023 (In Thousands)

	2024	2023
Cash Flows From Operating Activities		
Net income	\$ 18,539	\$ 25,502
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization and accretion of bond premiums and discounts	(17)	41
Credit loss expense	10,101	1,380
Net gain on sale of loans	(2,999)	(2,142)
Net change in fair value of loans held for sale	(10)	74
Proceeds from sales of loans held for sale	203,168	160,387
Originations and purchases of loans held for sale	(200,848)	(155,313)
Net loss on sale of available-for-sale securities	1,175	134
Mortgage servicing rights (Note 4)	2,658	3,053
Depreciation expense	6,517	6,497
Net charge-offs/write-downs of other real estate owned (OREO) (Note 8)	33	8
Deferred income taxes (Note 13)	270	(2,572)
Release of shares to ESOP	1,680	1,393
Increase in cash value of life insurance	(982)	(1,556)
Increase in accrued interest and other assets and other liabilities	(2,372)	(2,778)
Net cash provided by operating activities	36,913	34,108
Cash Flows From Investing Activities		
Cash flows from securities (Note 18)	(80,211)	75,509
Net purchases (sales) of restricted stock	4,033	(2,267)
Net (increase) decrease in federal funds sold	(228)	277
Net decrease (increase) in loans and direct financing leases	29,214	(282,318)
Purchases of operating lease assets	(1,599)	(3,726)
Purchases of premises and equipment	(530)	(918)
Purchases of mortgage servicing rights	(551)	(487)
Proceeds from sales of OREO and foreclosed assets	554	140
Net cash used in investing activities	(49,318)	(213,790)
Cash Flows From Financing Activities		
Net increase (decrease) in deposits	249,349	(82,892)
Net (decrease) increase in federal funds purchased	(94,690)	94,690
Net (increase) decrease in short-term borrowings (Note 10)	(4)	3,045
Repayment of long-term borrowings	(10,362)	(4,858)
Redemption of trust preferred securities (TRUPS)	-	(12,903)
Proceeds from long-term borrowings	15,000	-
ESOP shares purchased	(2,680)	-
Cash dividends paid	(5,698)	(5,535)
Net cash provided by (used in) financing activities	150,915	(8,453)
Net increase (decrease) in cash and cash equivalents	138,510	(188,135)
Cash and Cash Equivalents		
Beginning	39,056	227,191
Ending	\$ 177,566	\$ 39,056

See Supplemental Cash Flow Disclosures (Note 18)

See Notes to Consolidated Financial Statements

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation

Nature of business: Merchants Financial Group, Inc. is a bank holding company with one wholly owned bank subsidiary, Merchants Bank, National Association (the Bank). The Bank has branch operations in Winona, Goodview, Rushford, Lanesboro, St. Charles, Rochester, La Crescent, Caledonia, Spring Grove, Cannon Falls, Red Wing, Hampton, Hastings, Apple Valley, Lakeville, Cottage Grove, Rosemount, and Northfield, Minnesota; and Onalaska and Eau Claire, Wisconsin. The Bank provides retail, commercial loan and deposit services principally to customers within a 50-mile radius of its locations. The Bank has a leasing division, Merchants Bank Equipment Finance, which operates in the Minneapolis–St. Paul, Minnesota metropolitan area.

Principles of consolidation: The accompanying consolidated financial statements include the accounts of Merchants Financial Group, Inc. and its wholly owned Subsidiary. These entities are collectively referred to herein as the Company. All significant intercompany balances and transactions have been eliminated in consolidation.

Segment reporting: The Company's chief financial officer makes company wide resource allocation decisions and assessments of performance based on a collective assessment of the Company's operations. Substantially all of the Company's operations involve the delivery of loan and deposits products to customers. Accordingly, all of the Company operations are considered by management to be aggregated in one reportable operating segment.

Use of accounting estimates: The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term due to economic and legislative changes relate to the determination of the allowance for credit losses, valuation of securities and the fair value of mortgage servicing rights.

Trust and investment assets: The Bank operates trust and investment services. Assets under management by the trust and investment departments, other than trust cash on deposit at the Bank, are not included in these consolidated financial statements because they are not assets of the Company. Total fiduciary accounts and other accounts (individual retirement accounts, health savings accounts, and other similar accounts) were \$382,558 and \$102,827 as of December 31, 2024, respectively. Total fiduciary accounts and other accounts (individual retirement accounts, health savings accounts, and other similar accounts) were \$353,792 and \$89,098 as of December 31, 2023, respectively. This reflects an annual increase of 9.59%.

Cash, cash equivalents and cash flows: For purposes of reporting cash flows, cash and cash equivalents includes cash on hand and amounts due from banks, including interest-bearing deposits in the Federal Reserve Bank. Cash flows from loans, federal funds sold/purchased, deposits and repurchase agreements are reported net. The Bank maintains cash in deposit accounts which, at times, may exceed federally insured limits. The Bank has not experienced any losses in such accounts. The Bank's primary correspondent bank account is with U.S. Bank.

Federal funds: The Company has federal funds sold/purchased with correspondent financial institutions intended to support short-term liquidity needs. Interest income and expense on federal funds sold/purchased is included in other interest income and notes payable, federal funds sold, and repurchase agreement interest expense in the consolidated statement of income.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation (Continued)

Securities: On January 1, 2023, the Company adopted ASU 2016-13 *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, as amended, which replaces the incurred loss methodology with an expected loss methodology that is referred to as the current expected credit loss (CECL) methodology. The measurement of expected credit losses under the CECL methodology is applicable to financial assets measured at amortized cost, including held-to-maturity debt securities. The Company's held-to-maturities debt securities are primarily issued by U.S. government-sponsored agencies and entities. These securities are implicitly guaranteed by the U.S. government and are consistently highly rated by major rating agencies with very little risk to default. There was no credit loss on held-to-maturity debt securities as of December 31, 2024 and 2023. Accrued interest receivable was \$946 and \$560 at December 31, 2024 and 2023, respectively, and is not included in the estimate of credit losses.

Past due information for securities held-to-maturity as of December 31, 2024 and 2023, respectively, supports the Company's conclusion to not record any credit loss for the held-to-maturity securities portfolio as payments are current for the covered periods.

Debt securities for which the Company has both the positive intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost. Amortization of premiums and accretion of discounts, computed by the interest method over their contractual lives, are included in interest income.

Securities classified as available-for-sale include debt securities that the Company intends to hold for an indefinite period of time, but not necessarily to maturity. Any decision to sell a security classified as available-for-sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. Securities available for sale are carried at fair value with unrealized gains or losses reported net of the related deferred tax effect in other comprehensive income. The amortization of premiums and accretion of discounts, computed by the interest method over their contractual lives, are recognized in interest income. Purchase premiums are recognized in interest income using the effective interest method to the first call date. Realized gains or losses, determined on the basis of the amortized cost of specific securities sold, are included in net income.

As of December 31, 2024 and 2023, the fair value of our available-for-sale securities portfolio was approximately \$283,149 and \$202,215 respectively. Factors beyond the Company's control can significantly influence the fair value of securities in the portfolio and can cause potential adverse changes to the fair value of these securities. Additional factors include, but are not limited to, rating agency downgrades of the securities, defaults by the issuer or individual mortgagors with respect to the underlying securities, and instability in the credit markets. Any of the foregoing factors could result in the recognition of a loss through earnings. Because of changing economic and market conditions affecting interest rates, the financial condition of issuers of the securities and the performance of the underlying collateral, we may recognize realized and/or unrealized losses in future periods, which could have an adverse effect on our financial condition and results of operations.

As of December 31, 2024 and 2023, the Company had \$18,760 and \$19,147 in net unrealized losses in the debt securities available for sale portfolio, and \$3,493 and \$3,673 in net unrealized losses in the held to maturity debt securities portfolio, respectively. If the Company is forced to liquidate any of those investments prior to maturity, including because of a lack of liquidity, it would recognize as a charge to earnings the losses attributable to those securities. The securities portfolio has an average duration of 4.3 years.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation (Continued)

The assessment of whether such impairment has occurred is based on management's case-by-case evaluation of the underlying reasons for the decline in fair value. Management considers a wide range of factors in making this assessment. Those factors include, but are not limited to, the length and severity of the decline in value and changes in the credit quality of the issuer or underlying assets. 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 values 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 income.

Loans held for sale: Loans the Company originates with the intent to sell in the secondary market are classified as held for sale. Loans held for sale consist of first mortgage loans that are secured by residential real estate. The Company elected the fair value option for loans held for sale, and accordingly, all loans held for sale are recorded at fair value.

The fair value of the loans held for sale also includes the fair value of mandatory delivery commitments to an end investor that are considered derivatives. These commitments include the investor's purchase price of a specific loan or pool of loans to be delivered to an investor by a certain date.

The fair value of loans held for sale is determined using current secondary market prices for loans with similar coupons, maturities and credit quality.

Loans and direct lease financing receivables (loans): Loans are stated at the amount of unpaid principal reduced by unearned income and an allowance for credit losses.

Interest on loans is recognized over the terms of the loans using the simple-interest method on principal amounts outstanding. The Company determines a loan to be delinquent when payments have not been made according to contractual terms, typically evidenced by nonpayment of a monthly installment by the due date. Accrual of interest is discontinued when management believes, after considering collection efforts and other factors, that the borrower's financial condition is such that collection of interest is doubtful. The accrual of interest is generally discontinued at the time the loan is 90 days delinquent, unless the credit is well-secured and in the process of collection. Cash collections on nonaccrual loans are credited to the loan receivable balance, and no interest income is recognized on those loans until the past-due principal balance has been collected. Accrual of interest is generally resumed when the customer is current on all principal and interest payments and has been paying on a timely basis for a period of time.

The Company's leasing operations consist of the leasing of various types of equipment and trucks used in manufacturing, construction and agricultural operations. For direct financing leases, the total net rentals receivable and the estimated residual value of the leased equipment, net of unearned income, are recorded as a net investment in direct financing leases, and the unearned income is recognized each month as it is earned so as to provide a constant periodic rate of return on the unrecovered investment.

Accrual of interest on individually evaluated loans and leases is discontinued when management believes the borrower's financial condition is such that collection of interest is doubtful. Individually evaluated loans also include loans that have been renegotiated in a modification. Cash collections on individually evaluated loans are generally credited to the loan balance, and no interest income is recognized on those loans until the principal balance has been determined to be collectible.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation (Continued)

A loan or lease is classified as a modification when a borrower is experiencing financial difficulties that lead to a restructuring of the loan or lease, and the Company grants concessions to the borrower in the restructuring that it would not otherwise consider. These concessions may include rate reductions, principal forgiveness, extension of maturity date, and other actions intended to minimize potential losses. A loan or lease that is modified at a market rate of interest may no longer be classified as a modification in the calendar year subsequent to the restructuring if it is in compliance with the modified terms. Performance prior to the restructuring is considered when assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual at the time of the restructuring or after a shorter performance period.

Allowance for loan and lease losses: On January 1, 2023, the Company adopted ASU 2016-13 *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, as amended, which replaced the incurred loss methodology with an expected loss methodology that is referred to as the current expected credit loss (CECL) methodology. The measurement of expected credit losses under the CECL methodology is applicable to financial assets measured at amortized cost, including loan receivables and held-to-maturity debt securities. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments) and net investments in leases recognized by a lessor in accordance with Topic 842 on leases.

The Company adopted ASC 326 using the modified retrospective method for all financial assets measured at amortized cost, net investments in leases and off-balance sheet (OBS) credit exposures. The Company recorded a net decrease to retained earnings of \$884 as of January 1, 2023 for the cumulative effect of adopting ASC 326. The transition adjustment included an impact due to adjusting the calculation to forecast the loss over the life of the loan or lease to comply with currently applicable Generally Accepted Accounting Principles (GAAP) standard versus at a specific point in time under previously applicable GAAP.

The allowance for loan and lease losses is established through a provision for credit losses charged to expense. Loans and direct financing leases are charged against the allowance for loan and lease losses when management believes that collectability of the principal is unlikely. Subsequent recoveries, if any, are credited to the allowance. The allowance is an amount that management believes will be adequate to absorb estimated losses on existing loans, based on evaluation of the collectability of loans and prior loan loss experience. Management estimates the allowance using relevant available information from internal and external sources, relating to past events, current conditions, and reasonable and supportable forecasts. The Company uses historical credit loss experience and benchmark data to provide a basis for expected credit losses. Qualitative adjustments to historical loss information are made for differences in current loan-specific risk characteristics such as: changes in the lending policies and procedures, including underwriting standards and collection, charge off, and recovery practices; changes in the nature and volume of the loan portfolio; changes in the experience, ability and depth of lending management and staff; changes in the quality of the institution's loan review system and the degree of oversight of the institution's board of directors; the existence and effect of any concentrations of credit, and changes in the level of such concentrations; the effect of external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the institution's current portfolio.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation (Continued)

The Company estimates the allowance for credit losses based on the underlying assets' amortized cost basis, which is the amount at which the financing receivable is originated or acquired, adjusted for collection of cash and charge-offs, as well as applicable accretion or amortization of premium, discount, and net deferred fees or costs. In the event that collection of principal becomes uncertain, the Company has policies in place to reverse accrued interest in a timely manner. Therefore, the Company has made a policy election to exclude accrued interest from the measurement of allowance for credit losses.

Financial instruments include off-balance sheet credit losses, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for off-balance sheet loan commitments is represented by the contractual amount of those instruments. Such financial instruments are recorded when they are funded.

The Company recognizes a liability for off-balance sheet credit losses through a charge to credit loss expense for off-balance sheet credit losses, which is included in credit loss expense in the Company's consolidated statements of income, unless the commitments to extend credit are unconditionally cancellable, such as credit cards. The liability for off-balance sheet credit losses is estimated by loan segment at each balance sheet date under the current expected credit loss model using the same methodologies as portfolio loans, taking into consideration the likelihood that funding will occur. This liability is included in other liabilities on the balance sheet for the year ended December 31, 2024 and was included in net loans on the balance sheet for the year ended December 31, 2023. The balance of this liability as of December 31, 2024 and 2023 was \$1,864 and \$3,115, respectively.

While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for credit losses and may require the Company to make additions to the allowance based on their judgment about information available to them at the time of their examination.

Loans that do not share risk characteristics are evaluated on an individual basis. Loans evaluated individually are not also included in the collective evaluation. When management determines that foreclosure is probable expected credit losses are based on the fair value of the collateral at the reporting date, adjusted for selling costs as appropriate.

Loans are categorized into pools of loans with similar risk and loss characteristics and assessed for expected losses. These loan pools include commercial; commercial real estate; agricultural, including real estate; residential real estate; consumer; and direct financing leases.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation (Continued)

The following table illustrates the impact of ASC 326:
January 1, 2023

	As Reported Under ASC 326	Pre-ASC 326 Adoption	Impact of ASC 326 Adoption
Assets:			
Loans			
Commercial	\$ 3,117	\$ 2,741	\$ 376
Commercial real estate	16,137	16,090	47
Agricultural, including real estate	1,669	1,347	322
Residential real estate	3,350	2,515	835
Consumer	1,190	850	340
Direct financing leases	1,874	2,566	(692)
Total	<u>27,337</u>	<u>26,109</u>	<u>1,228</u>
Less off balance sheet allowance	3,520	-	3,520
Allowance for credit losses recorded on loans	<u>\$ 23,817</u>	<u>\$ 26,109</u>	<u>\$ (2,292)</u>
Total impact of adoption			\$ 1,228
Less deferred tax liability			<u>344</u>
Change in accounting principle (Note 1)			<u>\$ 884</u>

As allowed by ASC 326, the Company elected to maintain pools of loans accounted for under ASC 310-30. The Company segments the loan portfolio into pools based on the following risk characteristics: financial asset type, collateral type, loan characteristics, credit characteristics, industry of borrower and concentrations, and historical or expected credit loss. In accordance with the standard, management did not reassess whether modifications to individual acquired financial assets accounted for in pools were modifications to borrowers experiencing financial difficulty as of the date of adoption.

Operating leases: For operating leases in which the Company is the lessor, the cost of the equipment is recorded as an asset and is depreciated over its estimated useful life and the rental income is recognized ratably as the lease rental payments are earned. Rental income is included in the caption, other noninterest income, in the consolidated statements of income.

Investment in restricted stock: The Company is a member of the Federal Home Loan Bank of Des Moines (FHLB) and, as such, is required to maintain a minimum investment in capital stock of the Federal Home Loan Bank that varies with the level of advances outstanding. The stock is bought from and sold to the FHLB based upon its \$100 par value. The stock does not have a readily determinable fair value and, as such, is classified as restricted stock, carried at cost, and evaluated for impairment in accordance with guidance for depository and lending institutions. In accordance with this guidance, the stock's value is determined by the ultimate recoverability of the par value rather than by recognizing temporary declines. The determination of whether the par value will ultimately be recovered is influenced by criteria such as the following: (a) the significance of the decline in net assets of the FHLB as compared to the capital stock amount and the length of time this situation has persisted, (b) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance, (c) the impact of legislative and regulatory changes on the customer base of the FHLB and (d) the liquidity position of the FHLB.

Management has determined that the FHLB stock and Federal Reserve Bank stock were not impaired at December 31, 2024 and 2023.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation (Continued)

Premises and equipment: Premises and equipment are stated at cost less accumulated depreciation. Depreciation is provided principally on a straight-line basis over the estimated useful lives of the assets.

Gain on sale of loans: Mortgage banking activity revenue recognition begins when the Company is committed to originate a loan with a borrower at an agreed-upon interest rate (interest rate loan commitment, IRLC). The revenue recognition ends when the Company sells the loan to an investor (Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 815). The IRLC is considered a derivative and is recorded as an asset at its estimated fair value. The fair value of the IRLC is determined after considering the contractual loan origination-related fees, estimated sales premium, direct loan origination costs and the estimated fair value of the expected net future cash flows associated with servicing the loan. Also included in gain on sale of loans are the unrealized gains and losses from the various derivative instruments utilized by the Company to hedge the interest rate risk associated with its mortgage banking activities. These derivatives include the fair value of loan sales commitments and forward sale commitments. Further, the gain also includes the unrealized gains and losses on loans held for sale that occur during the period from the date of its funding through the date of its sale to an end investor.

Loans are accounted for as sold when control of the mortgage loans is surrendered. Control over mortgage loans is deemed to be surrendered when (1) the mortgage loans have been isolated from the Company, (2) the buyer has the right (free of conditions that constrain the buyer from taking advantage of that right) to pledge or exchange the mortgage loans, and (3) the Company does not maintain effective control of the mortgage loans through either (a) an agreement that entitles and obligates the Company to repurchase or redeem the mortgage loans before maturity or (b) the ability to unilaterally cause the buyer to return specific mortgage loans.

Loan servicing: The Company sells loans to investors in the secondary market and generally retains the right to service mortgage loans originated or purchased from unaffiliated correspondent banks. Mortgage servicing rights retained are initially measured at fair value and have been recognized as a separate asset and are being amortized in proportion to and over the period of estimated net servicing income.

Mortgage servicing rights are periodically evaluated for impairment based on the fair value of those rights. Fair values are estimated using discounted cash flows based on current market rates of interest. For purposes of measuring impairment, the rights must be stratified by one or more predominant risk characteristics of the underlying loans. The Company stratifies its capitalized mortgage servicing rights based on the interest rates of the underlying loans. The amount of impairment recognized is the amount, if any, by which the amortized cost of the rights for each stratum exceeds their fair value.

The Company recognizes it could experience some make-whole costs for loans serviced that are sold on the secondary market. If those mortgages go through foreclosure and there is a loss, the government sponsored entity may require the Company to cover any losses if it is proven that the Company failed to follow underwriting requirements at the time. In order to estimate the necessary reserve for this loss, management analyzed the historical claims rate and the loss severity for the origination years from 2000 through 2024 and applied that to the outstanding balances. As the government sponsored entities are no longer reviewing loans they acquired prior to 2009, a discount was applied to those remaining balances. Finally, management analyzed the improvement in the economy from 2009 to 2024 and applied an adjustment factor to recognize the improvement. The secondary market buyback reserve at December 31, 2024 and 2023 was \$100 and \$100, respectively.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation (Continued)

Derivative assets and liabilities: All derivatives are recognized as either assets or liabilities in the consolidated balance sheets, measured at fair value, and are reported in accrued interest receivable and other assets and accrued interest payable and other liabilities on the balance sheet.

Goodwill: Represents the excess of the purchase price over the fair value of net assets acquired in business combinations. Goodwill is subject to an impairment test at least on an annual basis. The Company's goodwill impairment assessments in 2024 and 2023 concluded no impairment existed. Any future impairment will be recorded as noninterest expense in the period of assessment.

Intangibles: The core deposit intangible represents the capacity of the deposit accounts acquired in an acquisition to generate future income. The core deposit intangible is being amortized over the estimated three to eight year lives attributed to the deposits acquired. The amortization of the core deposit intangible was \$263 and \$479 in 2024 and 2023, respectively. Future amortization of the core deposit intangible is \$54 in 2025.

Bank-owned life insurance: The Company owns life insurance policies on certain key employees. Bank-owned life insurance is recorded at its cash surrender value, or the amount that can be realized if lower.

Interest rate swap on trust preferred securities: The Company uses derivative instruments to primarily protect against the risk of adverse interest rate movements on the cash flows of certain liabilities. Derivative instruments represent contracts between parties that usually require little or no initial net investment and result in one party delivering cash or another type of asset to the other party based upon a notional amount and an underlying asset as specified in the contract. A notional amount represents the number of units of a specific item, such as currency units. An underlying represents a variable, such as an interest rate or price index.

The amount of cash or other asset delivered from one party to the other is determined based upon the interaction of the notional amount of the contract with the underlying. Derivatives can also be implicit in certain contracts and commitments and are reported in accrued interest receivable and other assets on the balance sheet.

Other real estate and other personal property owned: Other real estate owned (OREO) and other personal property owned represent properties acquired through foreclosure or other proceedings. OREO and other personal property owned are initially recorded at fair value of the properties less estimated costs of disposal. Any write-down to fair value less estimated costs of disposal at the time of transfer to OREO and other personal property owned is charged to the allowance for loan and lease losses. Property is evaluated regularly to ensure that the recorded amount is supported by its current fair value less estimated costs of disposal. Subsequent write-downs are charged to other noninterest expenses.

Deferred taxes: Deferred taxes are provided on an asset and liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss or tax credit carryforwards, and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the amounts of assets and liabilities recorded for income tax and financial reporting purposes. Deferred tax assets are reduced by a valuation allowance when management determines that it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation (Continued)

Employee stock ownership plan: The Company provides a noncontributory employee stock ownership plan covering substantially all employees eligible as to age and length of service. The amount of the contribution to the plan is determined annually at the discretion of the Board of Directors. Contributions are allocated to participants based on the ratio of each participant's compensation to total compensation of all participants.

Salary 401(k) plan: The Company provides a 401(k) plan, which covers substantially all of the Company's employees who are eligible as to age and length of service. A participant may elect to make contributions of up to the maximum allowed by law of the participant's annual compensation. The Company makes matching contributions up to three hundred dollars for each participant. Matching contributions of \$123 and \$126 were made in 2024 and 2023, respectively.

Earnings per common share: Basic earnings per share is calculated by dividing net income by the weighted-average common shares outstanding during the year. ESOP shares allocated to participants and shares released for allocation are treated as outstanding for purposes of computing weighted-average common shares outstanding. The weighted-average number of shares of common stock used to compute basic earnings per share was 7,926,015 and 7,907,292 in 2024 and 2023, respectively.

Comprehensive income: Accounting principles generally accepted in the United States of America require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities and interest rate swaps, are reported on the consolidated statement of comprehensive income. Such items, along with net income, are components of comprehensive income.

Gains and losses on available-for-sale securities are reclassified to net income as the gains or losses are realized upon sale of the securities. Credit losses, of which there have been \$0 in 2024 and 2023, would be recognized in net income at the time of the charge.

Reclassification: Certain amounts in the 2023 consolidated financial statements have been reclassified to conform to the 2024 presentation.

Subsequent events: In preparing these consolidated financial statements, the Company has evaluated events and transactions for potential recognition or disclosure through February 13, 2025, the date the consolidated financial statements were available to be issued.

Note 2. Restrictions on Cash and Cash Equivalents

The subsidiary banks may be required to maintain reserve balances, in cash on premises or on deposit with the Federal Reserve Bank, based upon a percentage of deposits. There was no required reserve balance for the Company as of December 31, 2024 and 2023.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 3. Securities

The amortized cost and fair value of securities, with gross unrealized gains and losses, follows:

	December 31, 2024				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Credit Loss Recognized	Fair Value
Securities available for sale:					
GSE residential mortgage-backed securities	\$ 160,509	\$ 167	\$ (5,157)	\$ -	\$ 155,519
GSE collateralized residential mortgage obligations	103,557	212	(12,173)	-	91,596
Obligations of states and political subdivisions	54	-	-	-	54
US government corporations and agencies	6,828	-	(88)	-	6,740
GSE commercial mortgage-backed securities	30,578	4	(1,342)	-	29,240
Total securities available for sale	<u>\$ 301,526</u>	<u>\$ 383</u>	<u>\$ (18,760)</u>	<u>\$ -</u>	<u>\$ 283,149</u>
Securities held to maturity:					
GSE residential mortgage-backed securities	\$ 21,681	\$ 13	\$ (1,906)	\$ -	\$ 19,788
GSE collateralized residential mortgage obligations	10,010	-	(1,483)	-	8,527
Obligations of states and political subdivisions	293	4	-	-	297
GSE commercial mortgage-backed securities	4,073	-	(104)	-	3,969
Total securities held to maturity	<u>\$ 36,057</u>	<u>\$ 17</u>	<u>\$ (3,493)</u>	<u>\$ -</u>	<u>\$ 32,581</u>
	December 31, 2023				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Credit Loss Recognized	Fair Value
Securities available for sale:					
GSE residential mortgage-backed securities	\$ 48,521	\$ 311	\$ (3,213)	\$ -	\$ 45,619
GSE collateralized residential mortgage obligations	112,704	65	(13,696)	-	99,073
Obligations of states and political subdivisions	90	-	-	-	90
US government corporations and agencies	7,616	61	(109)	-	7,568
GSE commercial mortgage-backed securities	51,994	-	(2,129)	-	49,865
Total securities available for sale	<u>\$ 220,925</u>	<u>\$ 437</u>	<u>\$ (19,147)</u>	<u>\$ -</u>	<u>\$ 202,215</u>
Securities held to maturity:					
GSE residential mortgage-backed securities	\$ 24,798	\$ 31	\$ (2,097)	\$ -	\$ 22,732
GSE collateralized residential mortgage obligations	11,419	-	(1,510)	-	9,909
Obligations of states and political subdivisions	405	11	-	-	416
GSE commercial mortgage-backed securities	1,099	-	(66)	-	1,033
Total securities held to maturity	<u>\$ 37,721</u>	<u>\$ 42</u>	<u>\$ (3,673)</u>	<u>\$ -</u>	<u>\$ 34,090</u>

GSE indicates government-sponsored enterprises, such as Federal National Mortgage Association (FNMA) or Federal Home Loan Mortgage Corporation (FHLMC).

Merchants Financial Group, Inc. and Subsidiary

**Notes to Consolidated Financial Statements
(In Thousands, Except Share Information)**

Note 3. Securities (Continued)

Contractual maturities at December 31, 2024:

	Securities Held to Maturity		Securities Available for Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within one year	\$ -	\$ -	\$ -	\$ -
Due after one year through five years	114	113	54	54
Due after five years through ten years	179	184	-	-
Due after ten years	-	-	-	-
	<u>293</u>	<u>297</u>	<u>54</u>	<u>54</u>
GSE residential mortgage-backed securities	21,681	19,788	163,321	158,392
US government corporations and agencies	-	-	6,828	6,740
GSE collateralized residential mortgage obligations	10,010	8,527	100,745	88,723
GSE commercial mortgage-backed securities	4,073	3,969	30,578	29,240
	<u>\$ 36,057</u>	<u>\$ 32,581</u>	<u>\$ 301,526</u>	<u>\$ 283,149</u>

Maturities of residential mortgage-backed securities, US government corporations and agencies, collateralized residential mortgage obligations, and commercial mortgage-backed securities are not readily determinable, since they may be prepaid without penalty.

Net loss on the sale of securities was \$1,175 and \$134 in 2024 and 2023, respectively. Realized gains were \$0 and \$188 and realized losses were \$1,175 and \$322 on sales proceeds of \$26,734 and \$59,926 in 2024 and 2023, respectively. The Company sold its VISA B shares in 2024, resulting in Other Income reported of \$1,706.

Changes in accumulated other comprehensive income related to the unrealized gain (loss) on available-for-sale securities, net of the related deferred tax effects:

	Years Ended December 31	
	2024	2023
Balance, beginning	\$ (13,481)	\$ (15,945)
Unrealized holding gain during the year	332	3,421
Deferred tax effect of unrealized gain	(92)	(957)
Balance, ending	<u>\$ (13,241)</u>	<u>\$ (13,481)</u>

Changes in accumulated other comprehensive income related to the unrealized gain (loss) on interest rate swap on trust preferred securities, net of the related deferred tax effects:

	Years Ended December 31	
	2024	2023
Balance, beginning	\$ 883	\$ 1,046
Unrealized loss during the year	(412)	(226)
Deferred tax effect of unrealized loss	115	63
Balance, ending	<u>\$ 586</u>	<u>\$ 883</u>

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 3. Securities (Continued)

There were 105 and 92 securities in unrealized loss positions at December 31, 2024 and 2023, respectively. The Company believes the unrealized loss position in GSE residential and commercial mortgage-backed securities is temporary, as based on current estimated prepayment speeds the Company intends to hold these securities until paid-off, at which time the investments will pay face value. The Company does not believe there to be any deterioration in the credit quality of the bonds, but rather, the unrealized loss is the result of either an increase in the general level of interest rates or other external economic factors.

Pledged securities: Securities with a carrying value of \$118,909 and \$147,422 at December 31, 2024 and 2023, respectively, were pledged to secure public deposits, FHLB repurchase agreements, and for other purposes as required or permitted by law.

Note 4. Loans Held for Sale and Loan Servicing

Loans held for sale consist of the following:

	December 31	
	2024	2023
Loans held for sale, unpaid principal balance	\$ 1,022	\$ 1,892
Fair value adjustment	27	37
Total loans held for sale	<u>\$ 1,049</u>	<u>\$ 1,929</u>

Mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of these loans are as follows:

	December 31	
	2024	2023
Mortgage loan portfolios serviced for:		
FNMA	\$ 1,836,728	\$ 1,938,089
FHLMC	650,733	600,027
	<u>\$ 2,487,461</u>	<u>\$ 2,538,116</u>
Outstanding commitments at year-end:		
Commitments to fund loans	\$ 10,357	\$ 7,659
Commitments to sell loans	1,862	8,717

Merchants Financial Group, Inc. and Subsidiary

**Notes to Consolidated Financial Statements
(In Thousands, Except Share Information)**

Note 4. Loans Held for Sale and Loan Servicing (Continued)

Mortgage servicing rights, net of valuation allowance, are summarized as follows:

	Years Ended December 31	
	2024	2023
Balance at beginning of year, net	\$ 15,339	\$ 16,638
Mortgage servicing rights capitalized:		
Loans originated	1,569	1,267
Loans purchased	551	487
Amortization expense	(2,658)	(3,053)
Balance at end of year, net	<u>\$ 14,801</u>	<u>\$ 15,339</u>

The valuation allowance at December 31, 2024 and 2023, was \$1 and \$210, respectively, with the impairment loss recognized in mortgage servicing rights on the consolidated statements of income. The estimated fair value of the servicing assets aggregated \$33,620 and \$31,939 at December 31, 2024 and 2023, respectively. Fair value is estimated by discounting estimated future cash flows from the servicing assets using discount rates that approximate current market rates and using current expected future prepayment rates.

Note 5. Loans and Direct Financing Leases

Composition of loans and direct financing leases receivable:

	December 31	
	2024	2023
Commercial	\$ 406,584	\$ 450,184
Commercial real estate	1,208,065	1,188,407
Agricultural, including real estate	143,847	152,175
Residential real estate	274,468	275,421
Consumer	55,883	60,529
Direct financing leases	29,127	36,712
Total loans	<u>2,117,974</u>	<u>2,163,428</u>
Less unearned income on loans and leases	3,199	3,618
Less allowance for credit losses	28,490	28,145
Loans receivable, net	<u>\$ 2,086,285</u>	<u>\$ 2,131,665</u>

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

Loans pledged to the Federal Home Bank of Des Moines for notes payable are discussed at Note 11.

Loans are made to individuals as well as commercial and tax-exempt entities. Specific loan terms vary as to interest rate, repayment and collateral requirements based on the type of loan requested and the creditworthiness of the prospective borrower. Credit risk tends to be geographically concentrated in that a majority of the loan customers are located in the markets serviced by the Company.

The Company's extension of credit is governed by the individual loan policies that were established to control the quality of the Company's loans. These policies and procedures are reviewed and approved by the Board of Directors on a regular basis.

Commercial loans: Commercial operating and term loans are originated in the Company's primary service area. These loans are made to individuals, partnerships, corporations, limited liability partnerships and limited liability companies for the purpose of assisting in the development of a business enterprise. Loans to closely held businesses will generally be guaranteed in full or for a meaningful amount by the business' major owners. Commercial loans are made based primarily on the historical and projected cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not perform as forecasted, and collateral securing loans may fluctuate in value due to economic or individual performance factors. Minimum standards and underwriting guidelines have been established for all commercial loan types.

Commercial real estate loans: The Company's goal is to create and maintain a high-quality portfolio of commercial real estate loans with customers who meet the quality and relationship profitability objectives of the Company. Commercial real estate loans are subject to underwriting standards and processes similar to commercial operating and term loans. These loans are analyzed using projected cash flows, and the repayment of these loans is largely dependent on the successful operation of the property. Loan performance may be adversely affected by factors impacting the general economy or conditions specific to the real estate market, such as geographic location and property type.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

Agricultural, including real estate: Agricultural operating and term loans are originated in the Company's primary service area and are generally used to purchase agricultural equipment or crop inputs. These loans are primarily secured by agricultural real estate and agricultural equipment or crops. Agricultural term and operating loans are made based primarily on the historical and projected cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not behave as forecasted, and collateral securing loans may fluctuate in value due to economic or individual performance factors. Minimum standards and underwriting guidelines have been established for all agricultural loan types.

The Company originates loans secured by agricultural real estate in its service area. Agricultural land in the Company's service area is considered to be prime agricultural land. These loans are underwritten using both a cash flow analysis and appraised values.

Residential real estate loans: The Company originates residential real estate loans in its service area. The underwriting process consists of a credit analysis, employment history, and an analysis of the secured real estate property. A significant portion of the residential real estate loans originated is sold in the secondary market and is required to meet the underwriting standards of the purchaser.

Consumer loans: The Company originates direct consumer loans, including personal, credit cards, recreational and vehicle loans, using a credit analysis as part of the underwriting process. Each loan type has a separate specified scoring that consists of several factors, including debt to income, type of collateral, loan to collateral value, credit history and the Company's relationship with the borrower.

Direct financing leases: Direct financing leases are originated in the Company's primary service area, and the equipment leased consists primarily of trucks, construction and agricultural equipment. Direct financing leases are made based primarily on the historical and projected cash flow of the lessee and secondarily on the underlying equipment leased to the lessee. The cash flows of lessees, however, may not perform as forecasted, and collateral securing these leases may fluctuate in value due to economic or individual performance factors. Minimum standards and underwriting guidelines have been established for all direct financing leases.

Minimum lease payments: At December 31, 2024, the minimum future lease payments, including guaranteed residual values, unearned initial direct costs and unearned amounts, due under the direct financing leases are as follows:

Years Ending December 31,

2025	\$	12,717
2026		7,046
2027		4,902
2028		2,898
2029		1,059
Thereafter		505
Total lease payments receivable		<u>29,127</u>
Unearned lease residual income		<u>(2,691)</u>
Net investment in direct financing leases	\$	<u>26,436</u>

Merchants Financial Group, Inc. and Subsidiary

**Notes to Consolidated Financial Statements
(In Thousands, Except Share Information)**

Note 5. Loans and Direct Financing Leases (Continued)

Loans receivable aging by class:

	December 31, 2024					
	Current	30–59 Days Past Due	60–89 Days Past Due	Loans Past Due 90 Days or More	Total Past Due	Total
Commercial	\$ 403,705	\$ 1,500	\$ 1,006	\$ 373	\$ 2,879	\$ 406,584
Commercial real estate	1,206,721	699	-	645	1,344	1,208,065
Agricultural, including real estate	143,625	202	20	-	222	143,847
Residential real estate	270,065	3,329	221	853	4,403	274,468
Consumer	54,863	768	187	65	1,020	55,883
Direct financing leases	29,127	-	-	-	-	29,127
Total loans	\$ 2,108,106	\$ 6,498	\$ 1,434	\$ 1,936	\$ 9,868	\$ 2,117,974
Nonperforming loans	\$ 4,030	\$ 675	\$ 364	\$ 1,936	\$ 2,975	\$ 7,005

	December 31, 2023					
	Current	30–59 Days Past Due	60–89 Days Past Due	Loans Past Due 90 Days or More	Total Past Due	Total
Commercial	\$ 448,113	\$ 1,527	\$ 210	\$ 334	\$ 2,071	\$ 450,184
Commercial real estate	1,187,041	873	493	-	1,366	1,188,407
Agricultural, including real estate	149,963	374	57	1,781	2,212	152,175
Residential real estate	270,125	1,407	1,043	2,846	5,296	275,421
Consumer	59,944	504	7	74	585	60,529
Direct financing leases	36,396	163	-	153	316	36,712
Total loans	\$ 2,151,582	\$ 4,848	\$ 1,810	\$ 5,188	\$ 11,846	\$ 2,163,428
Nonperforming loans	\$ 3,784	\$ 480	\$ 131	\$ 5,187	\$ 5,798	\$ 9,582

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

The amount of interest income recognized on non accrual loans was \$218 and \$682 as of December 31, 2024 and 2023, respectively.

Recorded investment in nonaccrual loans and loans past due 90 days or more and still accruing by class of loans as of December 31, 2024 and 2023, were as follows:

	Nonaccrual With No Credit Loss	Nonaccrual With Credit Loss	Loans Past Due 90 Days or More and Still Accruing
2024			
Commercial	\$ 392	\$ 1,407	\$ 210
Commercial real estate	1,298	913	-
Agricultural, including real estate	170	-	-
Residential real estate	925	1,003	-
Consumer	283	80	50
Direct financing leases	16	257	-
Total	\$ 3,084	\$ 3,660	\$ 260
2023			
Commercial	\$ 881	\$ 57	\$ 106
Commercial real estate	1,408	778	-
Agricultural, including real estate	-	612	1,697
Residential real estate	-	612	1,697
Consumer	1,347	1,270	1,025
Direct financing leases	48	119	48
Total	\$ 3,717	\$ 2,836	\$ 3,029

The Company utilizes an internal asset classification system as a means of reporting problem and potential problem loans. Under the Company's risk rating system, the Company classifies problem and potential problem loans as "special mention," "substandard" and "doubtful." Substandard loans include those characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Loans that do not currently expose the Company to sufficient risk to warrant classification in one of the aforementioned categories, but possess weaknesses that deserve management's close attention, are deemed to be special mention. Risk ratings are updated any time the situation warrants.

Merchants Financial Group, Inc. and Subsidiary

**Notes to Consolidated Financial Statements
(In Thousands, Except Share Information)**

Note 5. Loans and Direct Financing Leases (Continued)

Loans not meeting the criteria above that are analyzed individually as part of the above-described process are considered to be pass-rated loans. Residential real estate and consumer loans are included in groups of homogeneous loans with similar risk and loss characteristics that are not rated. The following tables present the risk category of loans by class of loans based on the most recent analysis performed and the contractual aging:

	December 31, 2024				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	\$ 356,866	\$ 21,958	\$ 27,760	\$ -	\$ 406,584
Commercial real estate	1,137,868	16,349	53,848	-	1,208,065
Agricultural, including real estate	125,716	1,099	17,032	-	143,847
Residential real estate	263,191	499	10,778	-	274,468
Consumer	55,074	65	744	-	55,883
Direct financing leases	28,234	-	893	-	29,127
Total	\$ 1,966,949	\$ 39,970	\$ 111,055	\$ -	\$ 2,117,974

	December 31, 2023				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	\$ 428,699	\$ 13,375	\$ 8,110	\$ -	\$ 450,184
Commercial real estate	1,142,380	12,983	33,044	-	1,188,407
Agricultural, including real estate	146,139	1,773	4,263	-	152,175
Residential real estate	265,300	4,502	5,619	-	275,421
Consumer	59,842	1	686	-	60,529
Direct financing leases	35,742	-	970	-	36,712
Total	\$ 2,078,102	\$ 32,634	\$ 52,692	\$ -	\$ 2,163,428

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

The following tables present total loans by risk categories and year of origination:

	December 31, 2024							
	Amortized Cost Basis by Origination Year					Revolving	Revolving to Term	Total
	2024	2023	2022	2021	Prior			
Commercial								
Pass	\$ 87,644	\$ 106,224	\$ 55,618	\$ 20,669	\$ 13,585	\$ 73,123	\$ -	\$ 356,863
Special Mention	3,670	8,791	4,137	1,292	721	3,347	-	21,958
Substandard	2,049	6,958	6,462	1,299	3,800	7,195	-	27,763
Doubtful	-	-	-	-	-	-	-	-
Total	93,363	121,973	66,217	23,260	18,106	83,665	-	406,584
Commercial real estate								
Pass	47,849	186,755	376,536	164,912	360,044	1,772	-	1,137,868
Special Mention	49	1,453	3,812	10,651	383	-	-	16,348
Substandard	1,813	8,292	11,706	8,241	23,797	-	-	53,849
Doubtful	-	-	-	-	-	-	-	-
Total	49,711	196,500	392,054	183,804	384,224	1,772	-	1,208,065
Agricultural, including real estate								
Pass	8,046	13,870	21,122	11,499	47,767	23,412	-	125,716
Special Mention	-	-	-	-	1,099	-	-	1,099
Substandard	1,120	2,140	875	1,091	8,553	3,253	-	17,032
Doubtful	-	-	-	-	-	-	-	-
Total	9,166	16,010	21,997	12,590	57,419	26,665	-	143,847
Real estate								
Pass	34,165	53,201	35,764	13,612	33,055	93,394	-	263,191
Special Mention	-	-	234	196	-	69	-	499
Substandard	88	1,152	1,736	552	3,717	3,533	-	10,778
Doubtful	-	-	-	-	-	-	-	-
Total	34,253	54,353	37,734	14,360	36,772	96,996	-	274,468
Consumer								
Pass	9,108	10,873	6,609	2,299	1,387	24,297	-	54,573
Special Mention	-	20	46	-	-	451	-	517
Substandard	92	241	65	29	291	75	-	793
Doubtful	-	-	-	-	-	-	-	-
Total	9,200	11,134	6,720	2,328	1,678	24,823	-	55,883
Direct financing leases								
Pass	7,988	8,905	3,967	3,364	3,820	-	-	28,044
Special Mention	-	-	-	-	-	-	-	-
Substandard	474	248	166	138	57	-	-	1,083
Doubtful	-	-	-	-	-	-	-	-
Total	8,462	9,153	4,133	3,502	3,877	-	-	29,127
Total loans	\$ 204,155	\$ 409,123	\$ 528,855	\$ 239,844	\$ 502,076	\$ 233,921	\$ -	\$ 2,117,974

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

	December 31, 2023						
	Amortized Cost Basis by Origination Year				Revolving	Revolving to Term	Total
	2023	2022	2021	Prior			
Commercial							
Pass	\$ 165,853	\$ 93,910	\$ 43,842	\$ 39,039	\$ 86,054	\$ -	\$ 428,698
Special Mention	3,188	3,694	1,052	1,977	3,464	-	13,375
Substandard	1,132	2,400	731	3,356	492	-	8,111
Doubtful	-	-	-	-	-	-	-
Total	170,173	100,004	45,625	44,372	90,010	-	450,184
Commercial real estate							
Pass	148,408	383,102	192,946	416,721	1,204	-	1,142,381
Special Mention	-	3,056	2,354	7,574	-	-	12,984
Substandard	596	828	1,095	30,523	-	-	33,042
Doubtful	-	-	-	-	-	-	-
Total	149,004	386,986	196,395	454,818	1,204	-	1,188,407
Agricultural, including real estate							
Pass	21,050	23,796	14,174	62,134	24,986	-	146,140
Special Mention	-	138	10	1,625	-	-	1,773
Substandard	714	32	252	3,085	179	-	4,262
Doubtful	-	-	-	-	-	-	-
Total	21,764	23,966	14,436	66,844	25,165	-	152,175
Real estate							
Pass	75,774	45,246	17,363	41,665	85,252	-	265,300
Special Mention	2,964	1,342	-	159	37	-	4,502
Substandard	2	1,496	86	1,847	2,188	-	5,619
Doubtful	-	-	-	-	-	-	-
Total	78,740	48,084	17,449	43,671	87,477	-	275,421
Consumer							
Pass	17,244	10,646	3,809	3,443	24,253	-	59,395
Special Mention	-	-	-	-	448	-	448
Substandard	164	29	44	380	69	-	686
Doubtful	-	-	-	-	-	-	-
Total	17,408	10,675	3,853	3,823	24,770	-	60,529
Direct financing leases							
Pass	12,118	5,920	5,796	11,861	-	-	35,695
Special Mention	-	-	-	-	-	-	-
Substandard	416	86	317	198	-	-	1,017
Doubtful	-	-	-	-	-	-	-
Total	12,534	6,006	6,113	12,059	-	-	36,712
Total loans	\$ 449,623	\$ 575,721	\$ 283,871	\$ 625,587	\$ 228,626	\$ -	\$ 2,163,428

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

The terms of certain loans were modified during the years ended December 31, 2024 and December 31, 2023 with a total recorded investment of \$2,402 and \$4,350, respectively. The modification of these loans involved a modification of the terms of a loan to borrowers who were not experiencing financial difficulties.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without modification. This evaluation is performed under the Company's internal underwriting policy.

The change in the allowance for credit losses on loans and off balance sheet credit exposures for the years ended December 31, 2024 and 2023, was as follows:

	Commercial	Commercial Real Estate	Agricultural	Residential Real Estate	Consumer	Direct Financing Leases	Allowance on loans	Allowance on off balance sheet credit exposures
Allowance for loan and lease losses:								
December 31, 2022	\$ 2,741	\$ 16,090	\$ 1,347	\$ 2,515	\$ 850	\$ 2,566	\$ 26,109	\$ -
Impact of adopting ASC 326	376	47	322	836	340	(693)	1,228	-
Charge-offs	(65)	(28)	-	(26)	(898)	(1)	(1,018)	-
Recoveries	119	-	-	3	323	1	446	-
Provision for credit losses	163	762	77	198	59	121	1,380	-
December 31, 2023	3,334	16,871	1,746	3,526	674	1,994	28,145	-
Reclassification of off balance sheet allowance	(856)	(1,345)	(172)	(713)	(29)	-	(3,115)	3,115
Charge-offs	(1,323)	(6,220)	-	(205)	(641)	(23)	(8,412)	-
Recoveries	330	-	-	4	186	-	520	-
Provision for credit losses	1,740	6,831	309	1,175	902	395	11,352	(1,251)
December 31, 2024	\$ 3,225	\$ 16,137	\$ 1,883	\$ 3,787	\$ 1,092	\$ 2,366	\$ 28,490	\$ 1,864

Merchants Financial Group, Inc. and Subsidiary

**Notes to Consolidated Financial Statements
(In Thousands, Except Share Information)**

Note 5. Loans and Direct Financing Leases (Continued)

The following tables present the amortized cost basis of collateral dependent loans, by the primary collateral type, which are individually evaluated to determine expected credit losses, and the related credit loss allocated to these loans:

	December 31, 2024				
	Primary Type of Collateral				Credit Loss
	Real Estate	Consumer	Other	Total	
Commercial	\$ -	\$ -	\$ 1,715	\$ 1,715	\$ 344
Commercial real estate	6,947	-	714	7,661	884
Agricultural, including real estate	170	-	-	170	-
Residential real estate	2,323	-	-	2,323	1,020
Consumer	114	261	-	375	89
Direct Financing Leases	-	-	279	279	66
Total	\$ 9,554	\$ 261	\$ 2,708	\$ 12,523	\$ 2,403

	December 31, 2023				
	Primary Type of Collateral				Credit Loss
	Real Estate	Consumer	Other	Total	
Commercial	\$ -	\$ -	\$ 207	\$ 207	\$ 82
Commercial real estate	1,808	-	-	1,808	446
Agricultural, including real estate	1,195	-	25	1,220	-
Residential real estate	233	-	-	233	125
Consumer	3,697	14	437	4,148	910
Direct Financing Leases	-	-	227	227	83
Total	\$ 6,933	\$ 14	\$ 896	\$ 7,843	\$ 1,646

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 6. Operating Leases

Investment in operating lease assets includes the following as of December 31, 2024 and 2023:

	Years Ended December 31	
	2024	2023
Operating lease assets	\$ 31,649	\$ 32,007
Less accumulated depreciation	14,753	11,642
Net investment in operating leases	<u>\$ 16,896</u>	<u>\$ 20,365</u>

Future minimum lease payments receivable under operating leases as of December 31, 2024, are as follows:

<u>Years Ending December 31,</u>	
2025	\$ 11,182
2026	3,250
2027	1,553
Thereafter	911
Total lease payments receivable	<u>\$ 16,896</u>

At December 31, 2024 and 2023, none of these operating leases were classified as non accrual.

Note 7. Premises and Equipment

	Useful Lives (Years)	December 31	
		2024	2023
Land and improvements	15–40	\$ 7,138	\$ 7,138
Buildings and improvements	10–40	36,306	36,262
Furniture and equipment	3–7	13,225	12,738
		<u>56,669</u>	<u>56,138</u>
Less accumulated depreciation		31,834	30,410
		<u>\$ 24,835</u>	<u>\$ 25,728</u>

Merchants Financial Group, Inc. and Subsidiary**Notes to Consolidated Financial Statements
(In Thousands, Except Share Information)****Note 8. Other Real Estate and Other Personal Property Owned**

An analysis of activity for other real estate and other personal property owned is as follows:

	Years Ended December 31	
	2024	2023
Balance at beginning of year	\$ 1,005	\$ 806
Transfers from loans	6,039	347
Proceeds from sales	(554)	(140)
Net charge-offs/impairments	(105)	(23)
Net gain on sales	72	15
Balance at end of year	<u>\$ 6,457</u>	<u>\$ 1,005</u>

Expenses applicable to other real estate and other personal property owned assets include the following amounts reported in other noninterest expense:

	Years Ended December 31	
	2024	2023
Net gain on sales	\$ (72)	\$ (15)
Net charge-offs/impairments	105	23
Operating expenses, net of rental income	195	59
	<u>\$ 228</u>	<u>\$ 67</u>

Note 9. Deposits

	December 31	
	2024	2023
Demand deposits	\$ 463,169	\$ 482,293
Savings and NOW accounts	1,457,252	1,325,823
Time deposits	503,337	366,293
	<u>\$ 2,423,758</u>	<u>\$ 2,174,409</u>

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 9. Deposits (Continued)

The aggregate amount of time deposit accounts that exceed the FDIC insurance limit were \$153,204 and \$99,944 at December 31, 2024 and 2023, respectively.

At December 31, 2024, the scheduled maturities of time deposits are as follows:

Years Ending December 31,

2025	\$	450,970
2026		45,115
2027		3,590
2028		3,088
2029		574
	\$	<u>503,337</u>

The Company participates and is a member of the Certificate of Deposit Account Registry Service (CDARS) deposit product program. Through CDARS, the Company may accept deposits in excess of the FDIC insured maximum from a depositor and place the deposits through a network to other CDARS member banks in increments of less than the FDIC insured maximum to provide the depositor full FDIC insurance coverage. Where the Company receives an equal dollar amount of deposits from other CDARS member banks in exchange for the deposits the Company places into the network, the Company records these as CDARS reciprocal deposits. At December 31, 2024 and 2023, CDARS reciprocal deposits totaled \$3,518 and \$0, respectively.

Note 10. Repurchase Agreements

	<u>December 31</u>	
	<u>2024</u>	<u>2023</u>
Customer repurchase agreements	<u>\$ 15,060</u>	<u>\$ 15,064</u>

Securities sold under agreements to repurchase are held by the Company. Customer repurchase agreements are due on demand with interest at 4.70 percent at December 31, 2024.

The Company has an option to borrow from the FHLB under agreements to repurchase securities sold. The Company has pledged to the FHLB its FHLB stock, certain loans with a carrying value of \$893,468 and \$978,369 at December 31, 2024 and 2023, respectively, to secure any borrowings. These loans also collateralize the fixed-rate advances outstanding to the FHLB (see Note 11).

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 11. Notes Payable

Federal Home Loan Bank (FHLB) advances consist of fixed-rate advances with interest rates ranging from 5.17 percent to 5.43 percent, due quarterly. Advances are subject to various prepayment, call and conversion provisions. Advances are secured by securities and loans.

The Company has an ESOP loan with US Bank that bears interest at the three-month CME TERM SOFR plus 2.25 (at December 31, 2024, the interest rate is approximately 6.56 percent).

Future annual maturities are as follows:

Years Ending December 31,

2025	\$ 10,000
Thereafter	<u>1,900</u>
	<u>\$ 11,900</u>

Note 12. Subordinated Debentures

Subordinated debentures of \$12,903 were redeemed by Merchants Capital Trust I as of December 31, 2023.

Subordinated debentures of \$23,196 are owed to Merchants Capital Trust II and bear interest at the three-month CME TERM SOFR plus 1.30 percent (at December 31, 2024, the interest rate is approximately 5.61 percent). They mature October 31, 2037. Early redemptions are permitted. The debentures are unsecured and are subordinate to all other indebtedness of the Company.

Subordinated debentures of \$5,155 are owed to Merchants Capital Trust—Jerema, Inc. Capital Trust I and mature July 23, 2034. The interest rate is equal to the three-month CME TERM SOFR plus 2.70 percent (at December 31, 2024, the interest rate is approximately 7.01 percent). Early redemptions are permitted. The debentures are unsecured and are subordinate to all other indebtedness of the Company.

The underlying capital securities of the trusts qualify under risk-based capital guidelines as Tier 1 capital for regulatory purposes to the extent they do not exceed 33 percent of Tier I capital, with the remainder allowed as Tier II capital.

Merchants Financial Group, Inc. and Subsidiary

**Notes to Consolidated Financial Statements
(In Thousands, Except Share Information)**

Note 13. Income Taxes

The cumulative tax effects of the temporary differences are shown in the following table:

	December 31	
	2024	2023
Deferred tax assets:		
Allowance for loan and lease losses	\$ 8,549	\$ 7,254
Deferred compensation	546	499
Other	297	372
Unrealized loss on available-for-sale securities	5,137	5,231
Total deferred tax assets	<u>14,529</u>	<u>13,356</u>
Deferred tax liabilities:		
Direct financing leases	(5,538)	(5,613)
Mortgage servicing rights	(3,571)	(3,142)
Premises and equipment	(1,794)	(1,488)
Intangibles	(5,491)	(4,730)
Total deferred tax liabilities	<u>(16,394)</u>	<u>(14,973)</u>
Net deferred tax liabilities	<u>\$ (1,865)</u>	<u>\$ (1,617)</u>

At December 31, 2024 and 2023, there was no valuation allowance for deferred tax assets. The provision for income taxes charged to operations consists of the following:

	Years Ended December 31	
	2024	2023
Current tax expense	\$ 5,625	\$ 11,042
Deferred tax expense (benefit)	248	(2,572)
	<u>\$ 5,873</u>	<u>\$ 8,470</u>

The income tax provision differs from the amount of income tax determined by applying the U.S. federal income tax rate to pretax income as follows:

	Years Ended December 31	
	2024	2023
Computed "expected" tax expense	\$ 5,127	\$ 7,134
Increase (decrease) in income taxes resulting from:		
State income taxes, net of federal tax benefit	1,533	2,007
Tax-exempt interest income (net of disallowed expenses)	(671)	(279)
Tax credit amortization	556	
Other	(672)	(392)
	<u>\$ 5,873</u>	<u>\$ 8,470</u>

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 13: Income Taxes (continued)

In March 2023, the FASB issued ASU 2023-02, Investments – Equity Method and Joint Ventures – Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method. Allowing reporting entities to consistently account for equity investments made primarily for the purpose of receiving income tax credits and other income tax benefits. In December 2023, the FASB issued ASU 2023-09, Income Taxes (Topic 740) – Improvements to Income Tax Disclosures. Additional transparency about income tax information through improvements to income tax disclosures, primarily related to the rate reconciliation and income taxes paid information, is now required.

The Company has investments that generate income tax credits and other income tax benefits from a tax credit program for which it has elected on a tax-credit-program-by-tax-credit-program basis to apply the proportional amortization method. The Company currently has \$14,681 of tax credit investments and they are recognized in Accrued interest receivable and other assets on the Consolidated Balance Sheet. The amount of amortization recognized as a component of income tax expense for 2024 was \$556 and the income tax benefit recognized during the period was \$193. Due to the implementation of ASU 2023-02, the Company amortized \$163 of an equity investment that was made in 2022 and benefits recognized in 2022 and 2023. In addition, an equity investment made in 2023 and 2024 had amortization of \$118 and no benefit will be recognized until 2025. The Company also committed to an energy tax credit purchase for 2024 that created a net tax benefit of \$112.

The amortization and benefits are recognized in the Provision for income taxes line on the Consolidated Statements of Income and as a net in the Cash Flows From Investing Activities in the Consolidated Statements of Cash Flows. There were no significant modifications or events that resulted in a change in the nature of the investments or a change in the relationship with the underlying projects in 2024.

Note 14: Commitments, Contingencies and Credit Risk

Financial instruments with off-balance-sheet risk: The Company is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, credit card commitments and standby letters of credit. They involve, to varying degrees, elements of credit risk in excess of amounts recognized on the consolidated balance sheets.

The Company's exposure to credit loss in the event of nonperformance by the other parties to the financial instruments for these commitments is represented by the contractual amounts of the instruments. The Company uses the same credit policies in making commitments as it does for on-balance-sheet instruments. These commitments were as follows:

	December 31	
	2024	2023
Commitments to extend credit	\$ 545,875	\$ 608,174
Credit card commitments	100,686	97,011
Standby letters of credit	7,170	8,243
	<u>\$ 653,731</u>	<u>\$ 713,428</u>

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 14: Commitments, Contingencies and Credit Risk (continued)

Financial instruments with concentrations of credit risk:

Commitments to extend credit and credit card commitments: Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. If deemed necessary upon extension of credit, the amount of collateral obtained is based on management's credit evaluation of the party. Collateral held varies, but may include accounts receivable, crops, livestock, inventory, property and equipment, residential real estate and income-producing commercial properties. Credit card commitments are unsecured.

Standby letters of credit: Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required in instances which the Company deems necessary.

Concentration by institution: The nature of the Company's business requires that it maintain amounts due from banks that, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 15. Employee Stock Ownership Plan

The Company has a leveraged employee stock ownership plan (ESOP). There were no shares purchased by the ESOP in 2023. The details of leveraged shares is as follows:

Year Leveraged	Shares Purchased	Price Paid	Shares Released as of December 31, 2024	Shares Released as of December 31, 2023
2017	148,206	\$ 20.07	148,206	136,641
2018	72,729	\$ 25.15	72,729	65,517
2019	13,950	\$ 27.20	13,950	11,520
2020	201,189	\$ 30.00	97,298	76,820
2021	27,180	\$ 31.33	10,872	8,154
2022	68,850	\$ 35.00	20,655	13,770
2024	90,435	\$ 29.65	9,113	n/a

The ESOP shares were pledged as collateral for its debt. As the debt is repaid, shares are released from collateral and allocated to employees based on the proportion of loan principal paid during the year. The Company intends to make annual contributions to the ESOP sufficient for the ESOP to repay its loan, including interest. The shares pledged as collateral are deducted from stockholders' equity as unearned ESOP shares in the accompanying consolidated balance sheets. As shares are released from collateral, the Company reports compensation expense equal to the fair value of the shares, and the shares become outstanding for earnings per share computations.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 15. Employee Stock Ownership Plan (Continued)

The Company obtains an annual independent appraisal of fair value of its common shares. The appraised fair value as of December 31, 2024 and 2023, was \$29.65 per share and \$32.11 per share, respectively.

Dividends on allocated ESOP shares are recorded as a reduction of retained earnings; dividends on unallocated ESOP shares are recorded as compensation expense and may be used by the ESOP for debt service. Total ESOP compensation expense was \$2,343 and \$1,981 for the years ended December 31, 2024 and 2023, respectively.

Participants who receive shares of stock under the plan have a put option requiring the Company to repurchase the shares at fair value for a 60-day period after distribution of the shares and during the first 60 days of the next plan year. In addition, if a participant receives an offer from a third party to purchase the shares, the participant must first give the Company the option of purchasing the shares. In 2024, 117,545 shares were purchased from participants and retained by the ESOP, and in 2023, 92,300 shares were purchased and retained by the ESOP. In the event a terminated ESOP participant desires to sell his/her shares of the Company's stock, or for certain employees who elect to diversify their account balances, the Company may be required to purchase the shares from the participant at their fair market value. As permitted, the ESOP elected to purchase the shares in lieu of the Company. In addition, at December 31, 2024, 123,760 shares of the Company's stock, with an aggregate fair market value of approximately \$3,669 are held by ESOP participants who will be eligible to elect their diversification privileges under the ESOP during the year ending December 31, 2025.

Shares of the Company held by the ESOP at December 31, 2024 and 2023 are as follows:

	December 31	
	2024	2023
Allocated shares	1,192,730	1,231,398
Shares released for allocation	60,401	51,767
Unreleased (unearned) shares	249,716	219,682
Total shares held	<u>1,502,847</u>	<u>1,502,847</u>
Fair value of unreleased (unearned) shares	<u>\$ 7,725</u>	<u>\$ 6,734</u>

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 16. Loans and Other Transactions With Related Parties

Shareholders, officers and directors of the Company, including their families and companies of which they are principal owners, are considered to be related parties. These related parties were loan customers of, and had other transactions with, the Company in the ordinary course of business. In management's opinion, these loans and transactions were on the same terms as those for comparable loans and transactions with nonrelated parties. Total loans to related parties were approximately \$7,507 and \$8,612 at December 31, 2024 and 2023, respectively. Total deposits with related parties were approximately \$11,318 and \$11,702 at December 31, 2024 and 2023, respectively.

Note 17. Regulatory Capital Requirements

The Company (on a consolidated basis) and the subsidiary banks are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated 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 assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and Bank to maintain minimum ratios (set forth in the following table) of total and Tier I capital to risk-weighted assets, of Tier I capital to average assets, and common equity Tier 1 capital (all as defined in the regulations). Management believes, as of December 31, 2024, that the Company and Bank meet all capital adequacy requirements to which they are subject.

Merchants Financial Group, Inc. and Subsidiary

**Notes to Consolidated Financial Statements
(In Thousands, Except Share Information)**

Note 17. Regulatory Capital Requirements (Continued)

The following table presents regulatory capital information for the Company.

	Actual		Minimum Capital Requirements		Well Capitalized Standard	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2024:						
Total capital (to risk-weighted assets):						
Consolidated	\$ 318,628	12.88%	\$ 259,751	>10.50	N/A	N/A
Merchants Bank	320,728	12.98%	259,549	>10.50	\$ 247,189	>10.0%
Common equity Tier 1 capital (to risk-weighted assets):						
Consolidated	262,639	10.61%	173,277	>7.0%	160,900	>6.5%
Merchants Bank	290,374	11.75%	173,033	>7.0%	160,673	>6.5%
Tier I capital (to risk-weighted assets):						
Consolidated	290,138	11.73%	210,246	>8.50%	N/A	N/A
Merchants Bank	290,374	11.75%	210,111	>8.50%	197,752	>8.0%
Leverage ratio:						
Consolidated	290,138	10.81%	103,069	>4.0%	N/A	N/A
Merchants Bank	290,374	10.58%	109,793	>4.0%	137,241	>5.0%
As of December 31, 2023:						
Total capital (to risk-weighted assets):						
Consolidated	\$ 303,141	12.31%	\$ 258,569	>10.50	N/A	N/A
Merchants Bank	307,365	12.49%	258,393	>10.50	\$ 246,089	>10.0%
Common equity Tier 1 capital (to risk-weighted assets):						
Consolidated	250,611	10.17%	172,495	>7.0%	160,174	>6.5%
Merchants Bank	279,220	11.35%	172,206	>7.0%	159,906	>6.5%
Tier I capital (to risk-weighted assets):						
Consolidated	278,111	11.29%	209,384	>8.50%	N/A	N/A
Merchants Bank	279,220	11.35%	209,107	>8.50%	196,807	>8.0%
Leverage ratio:						
Consolidated	278,111	11.35%	98,013	>4.0%	N/A	N/A
Merchants Bank	279,220	11.15%	100,169	>4.0%	125,211	>5.0%

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 17. Regulatory Capital Requirements (Continued)

In order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold a capital conservation buffer, as described in the previous paragraph, composed of common equity Tier 1 capital above its minimum risk-based capital requirements. The buffer is measured relative to risk-weighted assets.

Note 18. Additional Cash Flow Information

Cash flows from securities:

	Years Ended December 31	
	2024	2023
Available-for-sale securities:		
Maturities and sales	\$ 71,499	\$ 92,251
Purchases	(153,407)	(16,110)
Held-to-maturity securities:		
Maturities	4,694	5,488
Purchases	(2,997)	(6,120)
	<u>\$ (80,211)</u>	<u>\$ 75,509</u>
Supplemental disclosures of cash flow information:		
Cash payments for interest	\$ 47,480	\$ 28,783
Cash payments for income taxes	8,532	16,796
Supplemental schedule of noncash investing and financing activities:		
Other real estate and other personal property owned acquired in settlement of loans	<u>\$ 6,039</u>	<u>\$ 347</u>

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 19. Interest Rate Swaps

The Company entered into an interest rate swap agreement in 2023 with a notional amount of \$22,000. The interest rate swap contract was designated as a fair value hedging instrument with the objective of protecting against the risk of adverse interest rate movements on the cash flows of a fixed rate customer loan throughout a fifteen year period with a three year forward start date. The trade date was June 27, 2023, the effective date is June 1, 2026 and the maturity date is June 30, 2041. Under the swap, the Company will receive interest at a rate of CME TERM SOFR plus a margin of 1.555 percent and pay a fixed rate of 4.75 percent which agrees to the customer loan rate. The rate received by the Company as of December 31, 2024 was 5.86 percent.

The Company entered into an interest rate swap agreement in 2016 with a notional amount of \$13,000. The interest rate swap contract was designated as a cash flow hedging instrument with the objective of protecting against the risk of adverse interest rate movements on the cash flows of Merchants Trust II preferred securities throughout the ten year period beginning January 30, 2017 and ending January 30, 2027 from the risk of variability of those payments resulting from changes in the three-month CME TERM SOFR. Under the swap, the Company will pay a fixed interest rate of 3.463 percent and receive a variable interest rate of three-month CME TERM SOFR plus a margin of 1.30 percent on the notional amount, with quarterly settlements. The rate received by the Company as of December 31, 2024 was 5.61 percent.

The Company entered into an interest rate swap agreement in 2020 with an original notional amount of \$3,800 and current notional amount of \$3,000. The interest rate swap contract was designated as a cash flow hedging instrument with the objective of protecting against the risk of adverse interest rate movements on the cash flows of Merchants ESOP loan throughout the nine year period beginning July 22, 2020 and ending December 31, 2029 from the risk of variability of those payments resulting from changes in the three-month CME TERM SOFR. Under the swap, the Company will pay a fixed interest rate of 2.50% and receive a variable interest rate of one-month CME TERM SOFR plus a margin of 2.25% on the notional amount, with semi-annual settlements. The rate received by the Company as of December 31, 2024 was 6.58%.

The estimated fair value of the interest rate derivative contracts outstanding was a gain of \$814 and \$1,225 as of December 31, 2024 and 2023, respectively, and was included in other assets in the consolidated balance sheets.

The effective portion of the gain due to changes in the fair value of the derivative hedging instrument, a loss of \$296 and a loss of \$163 for the years ended December 31, 2024 and 2023, respectively, is included in other comprehensive income, while the ineffective portion (indicated by the excess of the cumulative change in the fair value of the derivative over that which is necessary to offset the cumulative change in expected future cash flows on the hedge transaction) is included in other noninterest income or other noninterest expense. No ineffectiveness related to the interest rate derivative was recognized during the reporting period. Therefore, changes in the fair value of the interest rate swap have had no impact on net income.

There were no net cash flows as a result of the interest rate swap agreements for the years ended December 31, 2024 and 2023. Cash is only disbursed or received upon exceeding contractual thresholds.

The Company was in receipt of \$2,230 and \$1,020 cash as collateral related to the derivative contracts at December 31, 2024 and 2023, respectively, due to fluctuations in the market.

There are no credit-risk-related contingent features associated with our derivative contracts.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 20. Fair Value Measurements

ASC Topic 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

ASC Topic 820 requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert expected future amounts, such as cash flows or earnings, to a single present value amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, ASC Topic 820 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 20. Fair Value Measurements (Continued)

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, or other inputs that are observable or can be corroborated by observable market data

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Investment securities available for sale: The fair value of residential mortgage-backed securities and collateralized residential mortgage obligations is generally determined based on matrix pricing. Matrix pricing is a mathematical technique that utilizes observable market inputs including, for example, yield curves, credit ratings and prepayment speeds. Fair values determined using matrix pricing are categorized as Level 2 in the fair value hierarchy.

The fair value of investments in obligations of states and political subdivisions is generally based on a discounted cash flow model that uses significant inputs, such as credit rating, coupon rate, maturity date and call features, some of which are unobservable in the markets. Fair values determined using a discounted cash flow analysis with significant unobservable inputs are categorized as Level 3 in the fair value hierarchy. The activity of investments in obligations of states and political subdivisions for the years ended December 31, 2024 and 2023 are as follows:

	Years Ended December 31	
	2024	2023
Balance, beginning	\$ 90	\$ 184
Maturities	(35)	(94)
Change in unrealized gain/loss	(1)	-
Balance, ending	<u>\$ 54</u>	<u>\$ 90</u>

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 20. Fair Value Measurements (Continued)

Interest rate lock commitments and forward sale commitments: Interest rate lock commitments related to the origination of mortgage loans that will be sold are considered derivative instruments. The Company estimates the fair value of these derivatives using the difference between the guaranteed interest rate in the commitment and the current market interest rate plus the present value of estimated cash flow from servicing and marketing gains. To reduce the net interest rate exposure arising from its loan sale activity, the Company enters into a commitment to sell these loans at essentially the same time that the interest rate lock commitment on the loan is quoted. The commitments to sell loans are also considered derivative instruments, with estimated fair values based on changes in current market rates. These commitments are not designated as hedging instruments and, therefore, changes in fair value are recognized immediately into income. The fair values of the Company's derivative instruments are deemed to be Level 2 measurements and are included in the caption, accrued interest receivable and other assets, in the consolidated balance sheets. The volume of derivative activity is disclosed in Note 4. The gain on the derivative instruments was \$76 in 2024 and the loss was \$40 in 2023 and is included in the caption, gain on sale of loans, in the consolidated statements of income.

Loans held for sale: Fair value of loans held for sale is based on commitments on hand from investors or prevailing market prices and the fair value of expected future servicing. The fair values of the Company's loans held for sale are deemed to be Level 2 measurements, and the change in fair value is included in the caption, gain on sale of loans, in the consolidated statements of income.

Interest rate swap on trust preferred securities: The Company utilizes an interest rate swap agreement to convert one of our variable rate trust preferred securities to a fixed rate. This has been designated as a cash flow hedge. This interest rate swap is recorded at fair value based on third party vendors who compile prices from various sources and may determine fair value of identical or similar instruments by using pricing models that consider observable market data. The fair value of the Company's interest rate swap is deemed to be a Level 2 measurement and is included in other assets in the consolidated statements of financial condition.

Deposits: The fair value of deposits with no stated maturity (such as demand deposits, savings, interest and noninterest checking, and money market accounts) is equal to the amount payable on demand at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the marketplace on certificates of similar remaining maturities. Use of internal discounted cash flows provides a Level 3 fair value measurement.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 20. Fair Value Measurements (Continued)

The following tables summarize financial assets and financial liabilities measured at fair value on a recurring basis segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	Fair Value Measurements at December 31, 2024			
	Total	Level 1	Level 2	Level 3
Financial assets:				
Investment securities available for sale:				
GSE residential mortgaged-backed securities	\$ 155,519	\$ -	\$ 155,519	\$ -
GSE collateralized residential mortgage obligations	91,596	-	91,596	-
Obligations of states and political subdivisions	54	-	-	54
US government corporations and agencies	6,740	-	6,740	-
GSE commercial mortgage-backed securities	29,240	-	29,240	-
Loans held for sale	1,049	-	1,049	-
Interest rate lock commitments	35	-	35	-
Forward sale commitments	95	-	95	-
Interest rate swaps	814	-	814	-
	<u>\$ 285,142</u>	<u>\$ -</u>	<u>\$ 285,088</u>	<u>\$ 54</u>

	Fair Value Measurements at December 31, 2023			
	Total	Level 1	Level 2	Level 3
Financial assets:				
Investment securities available for sale:				
GSE residential mortgaged-backed securities	\$ 45,619	\$ -	\$ 45,619	\$ -
GSE collateralized residential mortgage obligations	99,073	-	99,073	-
Obligations of states and political subdivisions	90	-	-	90
US government corporations and agencies	7,568	-	7,568	-
GSE commercial mortgage-backed securities	49,865	-	49,865	-
Loans held for sale	1,929	-	1,929	-
Interest rate lock commitments	77	-	77	-
Forward sale commitments	(67)	-	(67)	-
Interest rate swaps	1,225	-	1,225	-
	<u>\$ 205,379</u>	<u>\$ -</u>	<u>\$ 205,289</u>	<u>\$ 90</u>

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 20. Fair Value Measurements (Continued)

Financial instruments recorded at fair value on a nonrecurring basis: The Company is required, on a nonrecurring basis, to adjust the carrying value of certain assets or provide valuation allowances related to certain assets using fair value measurements in accordance with generally accepted accounting principles.

Impaired loans and leases: The specific reserves for collateral-dependent impaired loans and leases are determined based on the fair value of collateral method in accordance with ASC Topic 310. Under the fair value of collateral method, the specific reserve is equal to the difference between the carrying value of the loan or lease and the fair value of the collateral less estimated selling costs. When a specific reserve is required for an impaired loan or lease, the impaired loan is essentially measured at fair value. The fair value of collateral for impaired loans was determined based on appraisals with further adjustments made to the appraised values due to various factors, including the age of the appraisal, age of comparables included in the appraisal, and known changes in the market and in the collateral. The fair value of collateral for leases was determined based on comparable equipment values with further adjustments made due to various factors, including the age of comparables, and known changes in the market and on the collateral. The resulting fair value measurement is disclosed in the nonrecurring hierarchy table. Where estimates of fair value used for other collateral supporting commercial loans or leases are based on assumptions not observable in the marketplace, such valuations have been classified as Level 3.

Other real estate and other personal property owned: Other real estate and other personal property owned, upon initial recognition, is measured and reported at fair value less estimated costs of disposal through a charge-off to the allowance for possible loan losses based upon the fair value of the other real estate and other personal property acquired. The fair value of other real estate and other personal property owned is estimated based on assumptions not observable in the marketplace, and such valuations have been classified as Level 3.

Assets measured at fair value on a nonrecurring basis are included in the tables below:

	Fair Value at December 31, 2024			
	Total	Level 1	Level 2	Level 3
Collateral-dependent loans and leases	\$ 2,924	\$ -	\$ -	\$ 2,924
Other real estate owned and other personal property owned	6,457	-	-	6,457
	<u>\$ 9,381</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 9,381</u>
	Fair Value at December 31, 2023			
	Total	Level 1	Level 2	Level 3
Collateral-dependent loans and leases	\$ 1,436	\$ -	\$ -	\$ 1,436
Other real estate owned and other personal property owned	1,005	-	-	1,005
	<u>\$ 2,441</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,441</u>

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 20. Fair Value Measurements (Continued)

ASC Topic 825 requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring or nonrecurring basis. The methodologies for estimating the fair value of financial assets and financial liabilities that are measured at fair value on a recurring or nonrecurring basis are discussed above. The methodologies for other financial assets and financial liabilities are discussed below.

	December 31, 2024		December 31, 2023	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	\$ 177,566	\$ 177,566	\$ 39,056	\$ 39,056
Federal funds sold	228	-	-	-
Available-for-sale securities	283,149	283,149	202,215	202,215
Held-to-maturity securities	36,057	32,581	37,721	34,090
Loans held for sale	1,049	1,049	1,929	1,929
Loans and direct financing leases, net	2,086,285	1,936,417	2,131,665	1,939,532
Investment in restricted stock	5,397	5,397	9,430	9,430
Accrued interest receivable and other assets	5,114	5,114	4,754	4,754
Cash value of life insurance	32,933	32,933	20,165	20,165
Mortgage servicing rights	14,801	33,619	15,339	31,939
Interest rate swap	586	586	883	883
Financial liabilities:				
Deposits	2,423,758	2,426,418	2,174,409	2,174,512
Federal funds purchased	-	-	94,690	94,690
Repurchase agreements	15,060	15,060	15,064	15,064
Notes payable	11,900	11,917	7,262	7,192
Subordinated debentures	28,351	28,351	28,351	28,351
Accrued interest payable and other liabilities	25,453	25,453	15,024	15,024

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 20. Fair Value Measurements (Continued)

Interest rate risk: The Company assumes interest rate risk (the risk that general rate levels will change) as a result of its normal operations. As a result, fair values of the Company's financial instruments will change when interest rate levels change, and that change may be either favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed-rate obligations are more likely to prepay in a falling-rate environment and less likely to prepay in a rising-rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising-rate environment and less likely to do so in a falling-rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company's overall interest rate risk.

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, investment in restricted stock, accrued interest receivable, cash value of life insurance, accrued interest payable, federal funds purchased, short-term borrowings and variable-rate long-term borrowings approximate their fair values. The fair value of commitments to extend credit is based on fees currently charged to enter into similar agreements with comparable credit risks and the current creditworthiness of the parties. Commitments are generally short-term in nature and, if drawn upon, are advanced under current market terms and conditions for credits with comparable risks. Therefore, the fair values of these financial instruments are not significant.

Investment securities: The fair values of investment securities were generally determined based on matrix pricing. Matrix pricing is a mathematical technique that utilizes observable market inputs including, for example, yield curves, credit ratings and prepayment speeds.

Loans and direct financing leases, net: The fair values for loans and direct financing leases are determined using estimated future cash flows, discounted at rates commensurate with the risks involved, and calculated using a pricing model.

Deposits: The estimated fair values of demand deposits and savings and NOW accounts are assumed to equal their carrying amounts, which represent the amounts payable on demand. Fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies current adjusted risk-free rates to a schedule of aggregated expected periodic maturities on certificates of deposit.

Notes payable and subordinated debentures: The fair values of notes payable with fixed interest rates are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements. Due to the inactive market for subordinated debentures, it was not practical for management to estimate the fair value using a discounted cash flow model, and therefore, management concluded the carrying amount reported approximates its fair value.



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