



MORRIS STATE BANCSHARES, INC.

SHAREHOLDER REPORT

DECEMBER 31, 2019

Dear Shareholder,

2019 was a transformational year for your company marked by strong underlying financial and operational performance. Morris State Bancshares eclipsed the \$1 billion asset mark for the first time in its 66-year history as we grew organically and completed the purchase and integration of FMB Equibanc, Inc. in Bulloch, County, Georgia. With our conversion from S-Corp tax status to C-Corp status during the year, it is important to evaluate our earnings on a pre-tax basis to better gauge our overall performance. Pretax earnings in 2019 were \$15.7 million, up 3.24% from 2018 pretax earnings of \$15.2 million. This increase in earnings was solid when considering we had one-time merger related costs of over \$924,000. Core earnings were supplemented by a one-time gain on the sale of government-guaranteed loans of \$263M and a gain on sale of other real estate of \$409M. Tangible book value per share was \$47.18 as of year-end, which represented an increase of 8.83% or \$3.83 per share from the prior year. With the issuance of additional shares to complete our purchase of FMB Equibanc our earnings per share decreased from \$8.34 as of 12/31/18 to \$6.87 as of 12/31/19.

Attached are our audited financial statements. At the bank level, our balance sheet grew 33.3% with loan growth of 20.6% and deposit growth of 33.5%. Our strong core deposit growth of over \$236.7 million or 53% allowed for continued reduction in brokered deposits and FHLB borrowings. We held the highest level of liquidity we've seen in years with significant funds invested in Fed funds sold, interest-bearing deposits with other banks, and investment securities. The net interest margin was 4.37% for 12/31/2019, which was down from 4.59% a year ago. The bank's credit quality reflected adversely graded assets of \$15,640M, which was up \$3,281M from 12/31/2018. When you look at these assets in relation to our Tier 1 Capital and the Allowance for Loan and Lease Losses (ALLL), our adversely classified items ratio was flat at 14.49% as of 12/31/2019 as compared with 14.97% as of 12/31/2018 and remains at a solid level. Our reserve for loan losses totaled \$9.7 million as of 12/31/2019, or 1.32% of gross loans.

As I write this letter, I and the rest of our team are laser-focused on navigating the unprecedented times we are in with the corona virus global pandemic and the seismic shift it is creating in our economy. We are by the government's definition, an "essential" business

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and we will remain open. Our team went to work immediately implementing our business continuity plan to make sure that our bank would be in continual operation serving our communities and customers. As a community bank, that is and will always be our mission. Our team is currently meeting daily, sometimes hourly, to ensure we have the latest information and are making the best decisions to again, support our team, our communities and our customers. As we help our customers, please know that we are simultaneously focused on mitigating risk and protecting your investment as well.

In times like these that test our mettle, we have only one option and that is to keep pushing forward. I've had a front row seat to witnessing our 200 bankers dig deep and commit to one another that we will indeed persevere and help each and every individual we possibly can in any way that we can. I continue prayers for our country and appreciate your continued trust and support as a shareholder.

Best Regards,

A handwritten signature in black ink, appearing to read "Spence Mullis".

Spence Mullis
President & CEO
Morris Bank

**MORRIS STATE BANCSHARES, INC
AND SUBSIDIARIES**

CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2019

TABLE OF CONTENTS

	<u>Page</u>
Independent Auditor's Report	1
Consolidated Financial Statements	
Consolidated Balance Sheets	2
Consolidated Statements of Income	3
Consolidated Statements of Comprehensive Income	4
Consolidated Statements of Changes in Shareholders' Equity	5
Consolidated Statements of Cash Flows	6
Supplemental Information to Consolidated Statements of Cash Flows	7
Notes to Consolidated Financial Statements	8



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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Morris State Bancshares, Inc.
Dublin, GA

We have audited the accompanying consolidated financial statements of Morris State Bancshares, Inc. and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of changes in shareholders' equity, income, comprehensive income, and cash flows for the years ended 2019, 2018, and 2017, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Morris State Bancshares, Inc. and its subsidiary as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the year ended 2019, 2018, and 2017 in accordance with accounting principles generally accepted in the United States of America.

Nichols, Cauley + Associates, LLC

Dublin, Georgia
March 25, 2020

Atlanta | Calhoun | Canton | Dalton | Dublin
Fayetteville | Kennesaw | Rome | Warner Robins

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	<i>As of December 31,</i>	
	2019	2018
Assets		
Cash and due from banks	\$ 77,696,887	\$ 29,257,366
Federal funds sold	16,293,628	14,044,014
Total cash and cash equivalents	93,990,515	43,301,380
Interest-bearing time deposits in other banks	1,350,000	2,098,000
Securities available for sale, at fair value	124,315,098	70,845,928
Securities held to maturity, at cost	4,752,384	5,716,318
Federal Home Loan Bank stock, restricted, at cost	842,900	993,300
Loans, net of unearned income	738,886,405	613,029,720
Less - allowance for loan losses	(9,716,060)	(9,480,989)
Loans, net	729,170,345	603,548,731
Bank premises and equipment, net	15,618,198	8,884,433
ROU asset for operating lease, net	519,601	-
Goodwill	9,361,704	2,237,890
Intangible assets, net	3,067,075	288,920
Other real estate and foreclosed assets	396,486	835,921
Accrued interest receivable	3,962,808	3,064,254
Cash surrender value of life insurance	13,248,384	7,035,138
Other assets	6,352,473	1,215,978
Total Assets	\$ 1,006,947,971	\$ 750,066,191
Liabilities and Shareholders' Equity		
Deposits:		
Non-interest bearing	\$ 195,016,772	\$ 122,899,907
Interest bearing	682,509,497	532,608,585
Total deposits	877,526,269	655,508,492
Other borrowed funds	14,483,605	9,857,143
Lease liability for operating lease	519,601	-
Accrued interest payable	537,598	401,934
Accrued expenses and other liabilities	2,455,266	2,066,457
Total liabilities	895,522,339	667,834,026
Shareholders' Equity:		
Common stock, \$1 par value, authorized 10,000,000 shares, 2,144,766 issued and 2,098,249 outstanding in 2019 and 1,882,740 issued and 1,838,816 outstanding in 2018	2,144,766	1,882,740
Paid-in capital surplus	39,292,064	24,225,182
Retained earnings	69,537,950	57,792,589
Accumulated other comprehensive income (loss)	1,830,484	(457,247)
Treasury stock, at cost 46,517 in 2019 and 43,924 shares in 2018	(1,379,632)	(1,211,099)
Total shareholders' equity	111,425,632	82,232,165
Total Liabilities and Shareholders' Equity	\$ 1,006,947,971	\$ 750,066,191

See Accompanying Notes to Consolidated Financial Statements

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

	<i>Years ended December 31,</i>		
	2019	2018	2017
Interest and Dividend Income:			
Interest and fees on loans	\$ 42,519,788	\$ 35,472,471	\$ 31,397,586
Interest income on securities	2,885,822	1,755,255	1,265,068
Income on federal funds sold	513,422	312,613	159,657
Income on time deposits held in other banks	36,218	42,579	59,049
Other interest and dividend income	<u>1,712,547</u>	<u>396,993</u>	<u>216,326</u>
Total interest and dividend income	<u>47,667,797</u>	<u>37,979,911</u>	<u>33,097,686</u>
Interest Expense:			
Deposits	7,963,852	5,408,394	3,256,799
Interest on other borrowed funds	733,330	319,560	448,687
Interest on federal funds purchased	<u>151</u>	<u>946</u>	<u>1,154</u>
Total interest expense	<u>8,697,333</u>	<u>5,728,900</u>	<u>3,706,640</u>
Net interest income before provision for loan losses	38,970,464	32,251,011	29,391,046
Less - provision for loan losses	<u>1,650,000</u>	<u>1,425,000</u>	<u>975,000</u>
Net interest income after provision for loan losses	<u>37,320,464</u>	<u>30,826,011</u>	<u>28,416,046</u>
Noninterest Income:			
Service charges on deposit accounts	3,076,557	2,384,911	2,080,312
Other service charges, commissions and fees	55,326	155,083	208,156
Gain on sales of loans	263,029	47,493	28,141
Increase in CSV of life insurance	213,246	183,956	194,527
Other income	<u>401,952</u>	<u>394,494</u>	<u>358,570</u>
Total noninterest income	<u>4,010,110</u>	<u>3,165,937</u>	<u>2,869,706</u>
Noninterest Expense:			
Salaries	11,378,897	8,840,754	8,081,342
Employee benefits	2,677,574	2,165,479	1,924,808
Net occupancy expense	2,269,686	1,666,663	1,674,658
Equipment rental and depreciation of equipment	102,862	105,290	69,813
Impairment recognized on other real estate held for sale	236,064	124,101	91,224
Loss on sales and calls of securities	24,471	3,351	37,263
Loss (gain) on sales of foreclosed assets and other real estate	(270,572)	141,799	278,659
Loss (gain) on sales of premises and equipment	(1,000)	435	213,957
Other expenses	<u>9,182,933</u>	<u>5,707,932</u>	<u>5,537,014</u>
Total noninterest expense	<u>25,600,915</u>	<u>18,755,804</u>	<u>17,908,738</u>
Income Before Income Taxes	15,729,659	15,236,144	13,377,014
Provision for income taxes	<u>2,108,705</u>	-	-
Net Income	<u>\$ 13,620,954</u>	<u>\$ 15,236,144</u>	<u>\$ 13,377,014</u>
Earnings per common share:			
Basic	<u>\$ 6.87</u>	<u>\$ 8.34</u>	<u>\$ 7.41</u>
Diluted	<u>\$ 6.87</u>	<u>\$ 8.34</u>	<u>\$ 7.41</u>

See Accompanying Notes to Consolidated Financial Statements

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	<i>Years ended December 31,</i>		
	<u>2019</u>	<u>2018</u>	<u>2017</u>
Net Income	<u>\$ 13,620,954</u>	<u>\$ 15,236,144</u>	<u>\$ 13,377,014</u>
Other comprehensive income (loss):			
Unrealized holding gains (losses) on available for sale debt securities	2,749,874	(671,297)	494,037
Reclassification adjustments for losses realized in income	<u>24,471</u>	<u>3,351</u>	<u>37,263</u>
Net unrealized gains (losses)	2,774,345	(667,946)	531,300
Tax effect	<u>(486,614)</u>	<u>-</u>	<u>-</u>
Total other comprehensive income (loss)	<u>2,287,731</u>	<u>(667,946)</u>	<u>531,300</u>
Total comprehensive income	<u>\$ 15,908,685</u>	<u>\$ 14,568,198</u>	<u>\$ 13,908,314</u>

See Accompanying Notes to Consolidated Financial Statements

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	Common Stock	Paid-in Capital Surplus	Note Receivable from Sale of Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance, December 31, 2016	\$ 1,836,241	\$ 22,172,933	\$ (714,801)	\$ 41,076,479	\$ (320,601)	\$ (1,211,099)	\$ 62,839,152
Issuance of common stock	19,307	655,468	-	-	-	-	674,775
Repayment of note receivable	-	9,532	714,801	-	-	-	724,333
Net income	-	-	-	13,377,014	-	-	13,377,014
Other comprehensive income	-	-	-	-	531,300	-	531,300
Cash dividends	-	-	-	(7,120,894)	-	-	(7,120,894)
Balance, December 31, 2017	1,855,548	22,837,933	-	47,332,599	210,699	(1,211,099)	71,025,680
Issuance of common stock	27,192	1,387,249	-	-	-	-	1,414,441
Net income	-	-	-	15,236,144	-	-	15,236,144
Other comprehensive loss	-	-	-	-	(667,946)	-	(667,946)
Cash dividends	-	-	-	(4,776,154)	-	-	(4,776,154)
Balance, December 31, 2018	1,882,740	24,225,182	-	57,792,589	(457,247)	(1,211,099)	82,232,165
Issuance of common stock	262,026	15,066,882	-	-	-	-	15,328,908
Purchase of treasury stock	-	-	-	-	-	(168,533)	(168,533)
Net income	-	-	-	13,620,954	-	-	13,620,954
Other comprehensive income	-	-	-	-	2,287,731	-	2,287,731
Cash dividends	-	-	-	(1,875,593)	-	-	(1,875,593)
Balance, December 31, 2019	<u>\$ 2,144,766</u>	<u>\$ 39,292,064</u>	<u>\$ -</u>	<u>\$ 69,537,950</u>	<u>\$ 1,830,484</u>	<u>\$ (1,379,632)</u>	<u>\$ 111,425,632</u>

See Accompanying Notes to Consolidated Financial Statements

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	<i>Years ended December 31,</i>		
	2019	2018	2017
Cash Flows from Operating Activities:			
Net income	\$ 13,620,954	\$ 15,236,144	\$ 13,377,014
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	1,650,000	1,425,000	975,000
Depreciation	815,912	585,214	588,093
Impairment recognized on other real estate held for sale	236,064	124,101	91,224
Loss (gain) on sales of foreclosed assets, other real estate and property, net	(271,572)	142,234	492,616
Gain on sales of loans	(263,029)	(47,493)	(28,141)
Net amortization on securities	272,731	428,753	547,453
Loss on sales / calls of investment securities	24,471	3,351	37,263
Increase in CSV life insurance	(213,246)	(183,956)	(194,526)
Amortization of intangible assets	250,427	49,910	51,070
Amortization of operating lease right-of-use assets	166,865	-	-
Amortization of operating lease liabilities	(166,865)	-	-
Changes in accrued income and other assets	(2,347,547)	(418,201)	(764,125)
Changes in accrued expenses and other liabilities	(192,184)	(147,370)	887,208
Net cash provided by operating activities	<u>13,582,981</u>	<u>17,197,687</u>	<u>16,060,149</u>
Cash Flows from Investing Activities:			
Net change in loans to customers	(27,102,688)	(57,664,779)	(55,899,507)
Proceeds from sales of loans	10,279,854	1,126,545	541,205
Net change in interest-bearing time deposits in other banks	748,000	150,000	1,350,000
Purchase of available for sale securities	(47,964,278)	(27,827,884)	(8,354,765)
Proceeds from sales of available for sale securities	4,476,588	507,207	4,209,229
Proceeds from maturities/calls/paydowns of available for sale securities	22,886,781	6,766,359	3,425,803
Purchase of held to maturity securities	-	-	(1,247,167)
Proceeds from maturities/calls/paydowns of held to maturity securities	933,066	191,342	1,111,551
Proceeds from redemption of Federal Home Loan Bank stock	150,400	150,300	-
Purchase of Federal Home Loan Bank stock	-	-	(89,400)
Acquisition of FMB, net of cash and cash equivalents acquired	10,830,569	-	-
Purchase of bank-owned life insurance	(6,000,000)	-	-
Property and equipment expenditures	(2,064,619)	(430,894)	(705,304)
Proceeds from sales of property and equipment	1,000	573,473	267,777
Proceeds from sales of other real estate and repossessed assets	1,628,044	1,781,295	1,702,367
Net cash used in investing activities	<u>(31,197,283)</u>	<u>(74,677,036)</u>	<u>(53,688,211)</u>
Cash Flows from Financing Activities:			
Net change in deposits	54,516,193	62,716,544	60,994,474
Proceeds from other borrowed funds	13,912,176	-	6,000,000
Repayment of other borrowed funds	(13,409,714)	(3,285,713)	(7,285,716)
Purchase of treasury stock	(168,533)	-	-
Proceeds from issuance of common stock	15,328,908	1,414,441	674,775
Proceeds from stock note receivable	-	-	724,333
Cash dividends paid	(1,875,593)	(4,776,154)	(7,120,894)
Net cash provided by financing activities	<u>68,303,437</u>	<u>56,069,118</u>	<u>53,986,972</u>
Net Increase (decrease) in Cash and Cash Equivalents	50,689,135	(1,410,231)	16,358,910
Cash and Cash Equivalents, Beginning of Year	<u>43,301,380</u>	<u>44,711,611</u>	<u>28,352,701</u>
Cash and Cash Equivalents, End of Year	<u>\$ 93,990,515</u>	<u>\$ 43,301,380</u>	<u>\$ 44,711,611</u>

See Accompanying Notes to Consolidated Financial Statements

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
SUPPLEMENTAL INFORMATION TO CONSOLIDATED STATEMENTS OF CASH FLOWS

	<i>Years ended December 31,</i>		
	2019	2018	2017
Cash paid for interest:			
Interest on deposits	\$ 7,840,680	\$ 5,340,507	\$ 3,158,248
Interest on borrowings	\$ 720,989	\$ 326,379	\$ 465,648
Noncash items:			
Changes in unrealized gain/loss on securities available for sale	\$ 2,287,731	\$ (667,946)	\$ 531,300
Transfer of loans to other real estate and foreclosed assets	\$ 1,181,121	\$ 1,702,912	\$ 1,171,519
Transfer of other real estate and foreclosed assets to loans	\$ 27,025	\$ 14,800	\$ 423,210
Initial recognition of operating lease right-of-use assets	\$ 679,386	\$ -	\$ -
Initial recognition of operating lease liabilities	\$ (679,386)	\$ -	\$ -
Right-of-use assets obtained in exchange for new operating lease liabilities	\$ 7,080	\$ -	\$ -

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of Morris State Bancshares, Inc. (the "Company") and subsidiaries conform with generally accepted accounting principles in the United States of America ("GAAP") and with general practices within the banking industry. The following is a description of the more significant of those policies the Company follows in preparing and presenting its financial statements.

1. **Principles of Consolidation** – The consolidated financial statements include the accounts of Morris State Bancshares, Inc. and its wholly-owned subsidiaries, Morris Bank (the "Bank") and IMOR Properties LLC. All significant intercompany balances and transactions have been eliminated in consolidation.
2. **Reporting Entity** - The Company was formed on July 1, 1989, as Morris State Bancshares, Inc., and operates as a bank holding company with one bank subsidiary. At December 31, 2019 the Company owned 100% of Morris Bank, Dublin, Georgia. The Bank provides a variety of financial services to individuals and small businesses through its offices in Middle Georgia. The Bank offers a full range of commercial and personal loan products. The Bank makes loans to individuals for purposes such as home mortgage financing, personal vehicles and various consumer purchases and other personal and family needs. The Bank makes commercial loans to businesses for purposes such as providing equipment and machinery purchases, commercial real estate purchases and working capital. The Bank offers a full range of deposit services that are typically available from financial institutions, including NOW accounts, demand, savings and other time deposits. In addition, retirement accounts such as Individual Retirement Accounts are available. All deposit accounts are insured by the FDIC up to the maximum amount currently permitted by law.

During 2015, the Company established IMOR Properties LLC with 100% ownership. At December 31, 2019, the Company owned 100% of IMOR Properties LLC. IMOR Properties LLC was established by the Company as a subsidiary for holding real property.

On April 30, 2019, the Company acquired 100% ownership of FMB Equibanc, Inc. ("FMB"). Upon consummation of the acquisition, FMB was merged with and into the Company, with Morris State Bancshares, Inc. as the surviving entity in the merger. At that time, FMB's wholly-owned banking subsidiary, Farmers & Merchants Bank, was also merged with and into the Bank. The acquisition expanded the Company's existing market presence, as Farmers & Merchants Bank had 3 full-service branches located in Statesboro, Georgia and the surrounding area.

3. **Acquisition Accounting** - Acquisitions are accounted for under the purchase method of accounting. Purchased assets and assumed liabilities are recorded at their estimated fair values as of the purchase date. Any identifiable intangible assets are also recorded at fair value. When the fair value of the assets purchased exceeds the fair value of liabilities assumed, it results in a "bargain purchase gain." If the consideration given exceeds the fair value of the net assets received, goodwill is recognized. Fair values are subject to refinement for up to one year after the closing date of an acquisition as information relative to closing date fair values becomes available.

All identifiable intangible assets that are acquired in a business combination are recognized at fair value on the acquisition date. Identifiable intangible assets are recognized separately if they arise from contractual or other legal rights or if they are separable (i.e., capable of being sold, transferred, licensed, rented, or exchanged separately from the entity). Because deposit liabilities and the related customer relationship intangible assets may be exchanged in a sale or exchange transaction, the intangible asset associated with the depositor relationship is considered identifiable.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

Purchased loans acquired in a business combination are recorded at estimated fair value on their purchase date and prohibit the carryover of the related allowance for loan losses. When the loans have evidence of credit deterioration since origination and it is probable at the date of acquisition that the Company will not collect all contractually required principal and interest payments, the difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the non-accretable discount. The Company must estimate expected cash flows at each reporting date. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent increases in cash flows result in a reversal of the provision for loan losses to the extent of prior provisions and adjust accretable discount if no prior provisions have been made. This increase in accretable discount will have a positive impact on interest income. In addition, purchased loans without evidence of credit deterioration are also handled under this method.

4. **Securities** – The classification of securities is determined at the date of purchase. Gains or losses on the sale of securities are recognized on a specific identification basis.

Securities available for sale, primarily debt securities, are recorded at fair value with unrealized gains or losses excluded from earnings and reported as a component of shareholders' equity. Securities available for sale will be used as a part of the Company's interest rate risk management strategy and may be sold in response to changes in interest rates, changes in prepayment risk, and other factors.

Held to maturity securities, primarily debt securities, are stated at cost, net of the amortization of premium and the accretion of discount. The Company intends and has the ability to hold such securities on a long-term basis or until maturity.

Mortgage-backed securities represent participating interests in pools of long-term first mortgage loans originated and serviced by issuers of the securities. Mortgage-backed securities are carried at unpaid principal balances, adjusted for unamortized premiums and unearned discounts.

The market value of securities is generally based on quoted market prices. If a quoted market price is not available, market value is estimated using quoted market prices for similar securities.

Premiums and discounts are recognized in interest income using the interest method over the period to maturity.

5. **Loans and Interest Income** – Loans are stated at the amount of unpaid principal, reduced by net deferred loan fees, unearned discounts and a valuation allowance for possible loan losses. Interest on simple interest installment loans and other loans is calculated by using the simple interest method on daily balances of the principal amount outstanding. Loans are generally placed on non-accrual status when full payment of principal or interest is in doubt, or when they are past due 90 days as to either principal or interest. Senior management may grant a waiver from non-accrual status if a past due loan is well secured and in process of collection. A non-accrual loan may be restored to accrual status when all principal and interest amounts contractually due, including payments in arrears, are reasonably assured of repayment within a reasonable period, and there is a sustained period of performance by the borrower in accordance with the contractual terms of the loan. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received.
6. **Allowance for Loan Losses** - The allowance for loan losses is available to absorb losses inherent in the credit extension process. The entire allowance is available to absorb losses related to the loan and lease portfolio and other extensions of credit, including off-balance sheet credit exposures. Credit exposures deemed to be uncollectible are charged against the allowance for loan losses. Recoveries of previously charged-off amounts are credited to the allowance for loan losses. Additions to the allowance for loan losses are made by charges to the provision for loan losses.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

The allowance for loan losses is maintained at a level, which, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio. The amount of the allowance is based on management's evaluation of the collectability of the loan portfolio, including the nature of the portfolio, credit concentrations, trends in historical loss experience, specific impaired loans, economic conditions and other risks inherent in the portfolio. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated cash flows. Although management uses available information to recognize losses on loans, because of uncertainties associated with local economic conditions, collateral values and future cash flows on impaired loans, it is reasonably possible that a material change could occur in the allowance for loan losses in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

A loan is considered impaired when, based on current information and events, it is probable that a creditor will not be able to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Substantially all of the Bank's loans, which have been identified as impaired, have been measured by the fair value of existing collateral.

Large groups of smaller balance homogenous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer loans for impairment disclosures.

7. **Premises and Equipment** – Land is carried at cost. Other premises and equipment are stated at cost, less accumulated depreciation. Depreciation is charged to operating expenses over the estimated useful lives of the assets and is computed on the straight-line method. In general, estimated lives for buildings are up to 40 years, furniture and equipment (including vehicles) useful lives range from five to 20 years, and the lives of software and computer related equipment range from three to five years. Leasehold improvements are amortized over the life of the related lease, or the related assets, whichever is shorter. Expenditures for major improvements of the Company's premises and equipment are capitalized and depreciated over their estimated useful lives. Minor repairs, maintenance and improvements are charged to operations as incurred. When assets are sold or disposed of, their cost and related accumulated depreciation are removed from the accounts and any gain or loss is reflected in earnings.
8. **Goodwill and Intangible Assets** – Goodwill represents the excess of cost over the fair value of the net assets purchased in business combinations. Goodwill is required to be tested annually for impairment or whenever events occur that may indicate that the recoverability of the carrying amount is not probable. In the event of an impairment, the amount by which the carrying amount exceeds the fair value is charged to earnings. At December 31, 2019, the Company's intangible assets had identified no impairment and still had an indefinite life; accordingly, no impairment was recorded for the year.

Intangible assets consist of core deposit premiums acquired in connection with business combinations and are based on the established value of acquired customer deposits. The core deposit premium is initially recognized based on a valuation performed as of the consummation date and is amortized over an estimated useful life of ten years. Amortization periods are reviewed annually in connection with the annual impairment testing of goodwill.

9. **Other Real Estate** - Other real estate, acquired principally through foreclosure, is stated at fair value less cost to sell. Loan losses incurred in the acquisition of these properties are charged against the allowance for possible loan losses at the time of foreclosure. Subsequent write-downs of other real estate owned are charged against the current period's expense.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

10. **Cash Surrender Value of Life Insurance (“BOLI”)** – The Bank has purchased life insurance on the lives of certain Bank officers. The beneficial aspects of these life insurance policies are tax-free earnings and a tax free death benefit, which are realized by the Bank as the owner of the policies. The cash surrender value of these policies is included as an asset on the balance sheets, and any increases in cash surrender value are recorded as noninterest income in the statements of income
11. **Income Taxes and Change in Tax Status** – For the year ended December 31, 2018 and prior years, the Company with the consent of its stockholders elected to be taxed under sections of federal and Georgia income tax law which provide that, in lieu of corporate income taxes, the stockholders separately account for their pro rata shares of the Company’s income, deductions, losses, and credits. On March 19, 2019, the Company’s stockholders terminated this election effective with the year beginning on January 1, 2019.

As a result of the January 1, 2019 termination, on that date, the company recorded a net deferred tax asset of \$1,965,947, by a credit to income tax expense, for temporary differences between the financial reporting and the income tax basis of property and equipment, reserve for bad debts, and deferred compensation. The deferred tax asset related to deferred compensation is \$76,177.

Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, 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.

Investment tax credits are accounted for by the flow-through method whereby they reduce income taxes currently payable and the provision for income taxes in the period the assets giving rise to such credits are placed in service. To the extent such credits are not currently utilized on the Company's tax return, deferred tax assets, subject to considerations about the need for a valuation allowance, are recognized for the carryforward amount.

The Company recognizes the tax benefit from an uncertain tax position only if it is more-likely-than-not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The amount of unrecognized tax benefits is adjusted as appropriate for changes in facts and circumstances, such as significant amendments to existing tax law, new regulations or interpretations by the taxing authorities, new information obtained during a tax examination, or resolution of an examination.

The Company recognizes interest and penalties related to income tax matters in income tax expense.

12. **Cash and Cash Equivalents** - For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, highly liquid debt instruments purchased with an original maturity of three months or less, and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.
13. **Securities Sold Under Agreement to Repurchase** - Securities sold under agreement to repurchase are secured borrowings from customers and are treated as financing activities which are carried at the amounts at which the securities will be subsequently reacquired as specified in the respective agreements. The Bank had no such items outstanding as of December 31, 2019 or 2018.
14. **Use of Estimates** - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral.

The Bank's loans are generally secured by specific items of collateral including real property, consumer assets and business assets. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent on local economic conditions.

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

15. **Advertising Costs** – It is the policy of the Company to expense advertising costs as they are incurred. The Company does not engage in any direct-response advertising and accordingly has no advertising costs reported as assets on its balance sheet. Amounts charged to advertising expense for the years ended December 31, 2019, 2018, and 2017 were \$505,494, \$283,726, and \$340,592, respectively.
16. **Stock Compensation Plans** – The Bank has an employee stock ownership plan covering substantially all of its employees meeting age and length of service requirements. Contributions to the plan are made at the discretion of the Board of Directors. The Bank also adopted a 401K Plan during 1996 covering those employees qualifying for coverage under the employee stock ownership plan. Contributions to the plan are made at the discretion of the Board of Directors. The employee stock ownership plan and 401k Plan have merged into a single plan known as 401kSOP. The Bank also has a stock ownership plan which grants stocks to selected executives and other key employees. Stock grants under this plan vest over a period of three years.
17. **Earnings per Common Share** – Basic earnings per share represents income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed conversion. Potentially dilutive common shares are limited to preferred shares outstanding that would be converted to common shares upon change in control of the Company. As such, the average number of common shares outstanding used to calculate diluted earnings per share equals the total number of common and preferred shares outstanding less any shares held in treasury.

Earnings per common share have been computed based on the following:

	Years ended December 31,		
	2019	2018	2017
Net income applicable to common shares	\$ 13,620,954	\$ 15,236,144	\$ 13,377,014
Average number of common shares outstanding	1,983,180	1,826,422	1,804,830
Effect of dilutive options, warrants, etc.	-	-	-
Average number of common shares outstanding used to calculate diluted earnings per common share	1,983,180	1,826,422	1,804,830

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

18. **Comprehensive Income** – GAAP generally requires that recognized revenues, expenses, gains and losses be included in net earnings. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the consolidated balance sheets, such items along with net earnings, are components of comprehensive income. The adoption of FASB Accounting Standards Codification Topic 220, *Comprehensive Income*, had no effect on the Company's net income or shareholders' equity. The Company presents comprehensive income in a separate consolidated statement of comprehensive income.
19. **Reclassifications** – Certain accounts in the prior-year financial statements have been reclassified to conform to the presentation of current-year financial statements.
20. **Changes in Accounting Principles and Effects of New Accounting Pronouncements**

ASU 2018-13 — Fair Value Measurement (Topic 820) ("ASU-2018-13"). The amendments in this update affect fair value measurement disclosure requirements by removing certain requirements, modifying certain requirements and adding certain new requirements. Disclosure requirements removed include the following: transfers between Level 1 and Level 2 of the fair value hierarchy; the policy for determining when transfers between any of the three levels have occurred; the valuation processes for Level 3 measurements; and the changes in unrealized gains or losses presented in earnings for Level 3 instruments held at end of the reporting period. Disclosure requirements that have been modified include the following: for investments in certain entities that calculate net asset value, an entity is required to disclose the timing of liquidation of an investee's assets and the date when restrictions from redemption might lapse only if the investee has communicated the timing to the entity or announced the timing publicly; and clarification that the Level 3 measurement uncertainty disclosure should communicate information about the uncertainty at the balance sheet date. New disclosure requirements include the following: the changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 instruments held at the end of the reporting period; and the range and weighted average of significant unobservable inputs used for Level 3 measurements or disclosure of other quantitative information in place of the weighted average to the extent that it would be a more reasonable and rational method to reflect the distribution of unobservable inputs. ASU 2018-13 is effective for interim and annual periods beginning after December 15, 2019. Early adoption is permitted. The Company is currently evaluating the impact this standard will have on the Company's fair value measurement disclosures, but it is not expected to have a material impact.

ASU 2018-03 – Technical Corrections and Improvements to Financial Instruments – Overall (Subtopic 825-10). This Update clarifies certain aspects of the guidance issued in ASU 2016-01 including (i) an entity measuring an equity security using the measurement alternative may make an irrevocable election to change its measurement approach to a fair value method under Topic 820 for that security and any identical or similar investments of the same issuer, (ii) fair value adjustments under the measurement alternative should be as of the date the observable transaction for a similar security occurred, (iii) requiring the re-measurement of the entire value of forward contracts and purchased options when observable transactions occur on the underlying equity securities, (iv) financial liabilities for which the fair value option is elected should follow the guidance in paragraph 825-10-45-5, (v) changes in the fair value of financial liabilities for which the fair value option is elected relating to the instrument-specific credit risk should first be measured in the currency of denomination and then both components of the change in fair value should be re-measured into the reporting entity's functional currency using end-of-period spot rates, and (vi) the prospective transition approach should only be applied for instances in which the measurement alternative is applied. The guidance was effective for interim periods beginning after June 15, 2018 and may be early adopted provided ASU 2016-01 was adopted. The Company adopted the amendments in this ASU effective January 1, 2018. The adoption of ASU 2018-03 had no material impact on the Company's consolidated financial statements.

ASU 2017-08 – Premium Amortization on Purchased Callable Debt Securities (Subtopic 310-20). This update shortens the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. For securities held at a discount, the discount will continue to be amortized to maturity. For private entities, this update is effective for fiscal years beginning after December 15, 2019, with modified retrospective application. The adoption of this update is not expected to have a material impact on the Company's consolidated financial statements.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

ASU 2016-13 – Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. ASU 2016-13 significantly changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. The standard will replace the current incurred loss approach with an expected loss model, referred to as the current expected credit loss (“CECL”) model. The new standard will apply to financial assets subject to credit losses and measured at amortized cost and certain off-balance sheet credit exposures, which include, but are not limited to, loans, leases, held-to-maturity securities, loan commitments and financial guarantees. ASU 2016-13 simplifies the accounting for purchased credit-impaired debt securities and loans and expands the disclosure requirements regarding an entity’s assumptions, models and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. ASU 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019. Early adoption is permitted for interim and annual reporting periods beginning after December 15, 2018. Upon adoption, ASU 2016-13 provides for a modified retrospective transition by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is effective. While the Company is currently evaluating the impact this standard will have on the results of operations, financial position and disclosures, the Company expects to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective. On November 15, 2018, the FASB issued ASU 2018-19. The amendments in this Update mitigate transition complexity by requiring that for nonpublic business entities the amendments in Update 2016-13 are effective for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. In November 2019, the FASB issued ASU 2019-10. The amendment in this update changed the effective implementation date of ASU 2016-13 to fiscal years beginning after December 15, 2022, including interim periods within those fiscal years, for all non-public reporting entities. The Company is currently evaluating the impact this standard will have on the Company’s results of operations, financial position, or disclosures.

ASU 2016-02 – Leases (Topic 842) (“ASU 2016-02”). ASU 2016-02 amends the existing standards for lease accounting effectively requiring most leases be carried on the balance sheets of the related lessees by requiring them to recognize a right-of-use asset and a corresponding lease liability. ASU 2016-02 includes qualitative and quantitative disclosure requirements intended to provide greater insight into the nature of an entity’s leasing activities. The standard must be adopted using a modified retrospective transition with a cumulative-effect adjustment to equity as of the beginning of the period in which it is adopted. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020, with early adoption permitted. The Company adopted this ASU effective April 1, 2019. The adoption of ASU 2016-02 had no material impact on the Company’s consolidated financial statements..

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

NOTE 2. BUSINESS COMBINATIONS

FMB Equibanc, Inc.

On April 30, 2019, the Company completed its acquisition of Equibanc, Inc. ("FMB"). Upon consummation of the acquisition, FMB was merged with and into the Company, with Morris State Bancshares, Inc. as the surviving entity in the merger. At that time, FMB's wholly-owned banking subsidiary, Farmers & Merchants Bank, was also merged with and into the Bank. The acquisition expanded the Company's existing market presence, as Farmers & Merchants Bank had three full-service branches located in Statesboro, Georgia and the surrounding area. Under the terms of the merger agreement, FMB's shareholders received 0.1423 shares of Company common stock or \$9.25 in cash for each share of FMB common stock or preferred stock they previously held. As a result, the Company issued 206,720 common shares at a fair value of \$12,403,200 and paid \$9,916,392 in cash to the former shareholders of FMB as merger consideration, resulting in an aggregate purchase price of \$23,353,192.

The following table presents the assets acquired and liabilities assumed as of April 30, 2019 and their fair value estimates. The fair value adjustments shown in the following table continue to be evaluated by management and may be subject to further adjustment:

	<u>As Recorded by</u>	<u>Initial Fair Value</u>	<u>As Recorded by</u>
	<u>FMB</u>	<u>Adjustment</u>	<u>Morris Bank</u>
Assets			
Cash & Due From Banks	\$ 21,742,399	\$ -	\$ 21,742,399
Interest Bearing Deposits in other Banks	8,412,067	-	8,412,067
Fed Funds Sold	4,100,000	-	4,100,000
AFS Securities	30,360,250	-	30,360,250
Restricted Investments	253,200	-	253,200
Loans, net	113,480,243	(2,472,296)	111,007,947
Interest Receivable	603,077	-	603,077
Premises and Equipment	3,296,135	2,188,923	5,485,058
ORE	331,900	-	331,900
Deferred Taxes	3,804,635	(1,287,881)	2,516,754
Other Assets	427,292	(112,816)	314,476
Core Deposit Intangible	-	<u>3,028,582</u>	<u>3,028,582</u>
Total Assets	<u>186,811,198</u>	<u>1,344,512</u>	<u>188,155,710</u>
Liabilities			
Deposits:			
Non-interest Bearing	57,218,320	-	57,218,320
Interest Bearing	110,216,875	66,389	110,283,264
Note Payable	4,124,000	-	4,124,000
Accrued Interest Payable	82,408	-	82,408
Other Liabilities	<u>147,635</u>	<u>-</u>	<u>147,635</u>
Total Liabilities	<u>171,789,238</u>	<u>66,389</u>	<u>171,855,627</u>
Net identifiable assets acquired over (under) liabilities assumed	15,021,960	1,278,123	16,300,083
Goodwill	-	<u>7,123,814</u>	<u>7,123,814</u>
Net assets acquired over (under) liabilities assumed	<u>\$ 15,021,960</u>	<u>\$ 8,401,937</u>	<u>\$ 23,423,897</u>
Consideration:			
Cash paid as deposit premium	<u>\$ 23,423,897</u>		
Fair value of total consideration transferred	<u>\$ 23,423,897</u>		

Goodwill in the amount of \$7,123,814 which is the excess of the purchase consideration over the fair value of the net assets acquired, was recorded in the branch acquisitions and is the result of expected operational synergies and other factors.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

Additionally, a core deposit intangible on the acquired core deposits in the amount of \$3,028,582 was recognized to be amortized over a 10 year period. All other fair value adjustments presented were management's estimates of the values of the loans, premises, and deposits acquired from FMB.

CertusBank

On September 28, 2015, the Company completed its acquisition of the Warner Robins, Georgia branch from CertusBank. The acquisition of the branch was accounted for using the acquisition method of accounting in accordance with FASB ASC 805, *Business Combinations*. Assets acquired, liabilities assumed and consideration exchanged were recorded at their respective acquisition date fair values. Determining the fair value of assets and liabilities is a complicated process involving significant judgment regarding methods and assumptions used to calculate estimated fair values. Fair values are preliminary and subject to refinement for up to one year after the closing date of the acquisition as additional information regarding the closing date fair values becomes available. Management continues to evaluate its initial estimates regarding the valuation of loans, premises and intangible assets acquired.

The following table presents the assets acquired and liabilities assumed as of September 28, 2015 and their fair value estimates. The fair value adjustments shown in the following table continue to be evaluated by management and may be subject to further adjustment:

	<u>As Recorded by</u> <u>CertusBank</u>	<u>Initial Fair Value</u> <u>Adjustment</u>	<u>As Recorded by</u> <u>Morris Bank</u>
Assets			
Cash and cash equivalents	\$ 47,981,741	\$ -	\$ 47,981,741
Loans	1,985,497	(11,059)	1,974,438
Premises and equipment	642,461	626,311	1,268,772
Core deposit intangible	-	455,782	455,782
Accrued interest receivable	4,437	-	4,437
Total assets	<u>50,614,136</u>	<u>1,071,034</u>	<u>51,685,170</u>
Liabilities			
Deposits:			
Demand deposits	27,192,878	-	27,192,878
Time deposits	26,290,469	41,461	26,331,930
Other liabilities	9,437	-	9,437
Total liabilities	<u>53,492,784</u>	<u>41,461</u>	<u>53,534,245</u>
Net identifiable assets acquired over (under) liabilities assumed	(2,878,648)	1,029,573	(1,849,075)
Goodwill	-	1,849,075	1,849,075
Net assets acquired over (under) liabilities assumed	<u>\$ (2,878,648)</u>	<u>\$ 2,878,648</u>	<u>\$ -</u>
Consideration:			
Cash paid as deposit premium	<u>\$ 2,878,648</u>		
Fair value of total consideration transferred	<u>\$ 2,878,648</u>		

Goodwill in the amount of \$1,849,075 which is the excess of the purchase consideration over the fair value of the net assets acquired, was recorded in the branch acquisitions and is the result of expected operational synergies and other factors. Additionally, a core deposit intangible on the acquired core deposits in the amount of \$455,782 was recognized to be amortized over a 10 year period. All other fair value adjustments presented were management's estimates of the values of the loans, premises, and deposits acquired from CertusBank.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

NOTE 3. INVESTMENT SECURITIES

Debt and equity securities have been classified in the balance sheet according to management's intent. The following table reflects the amortized cost and estimated market values of investments in debt and equity securities held at December 31, 2019 and 2018. In addition, gross unrealized gains and gross unrealized losses are disclosed as of December 31, 2019 and 2018.

The book and market values of securities **available for sale** were:

	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Estimated Market Value</u>
December 31, 2019				
Non-mortgage backed debt securities of:				
U.S. Government agencies	\$ 6,703,427	\$ 37,011	\$ 27	\$ 6,740,411
U.S. Treasury securities	7,501,842	267,950	14,994	7,754,798
State, county, and municipal securities	24,438,299	853,890	32,203	25,259,986
Other debt securities	<u>4,904,408</u>	<u>61,749</u>	<u>30,770</u>	<u>4,935,387</u>
Total non-mortgage backed debt securities	<u>43,547,976</u>	<u>1,220,600</u>	<u>77,994</u>	<u>44,690,582</u>
Mortgage backed securities:				
Residential mortgage backed securities	31,023,294	503,111	46,572	31,479,833
Commercial mortgage backed securities	<u>47,426,748</u>	<u>744,784</u>	<u>26,849</u>	<u>48,144,683</u>
Total mortgage backed securities	<u>78,450,042</u>	<u>1,247,895</u>	<u>73,421</u>	<u>79,624,516</u>
Total	<u>\$ 121,998,018</u>	<u>\$ 2,468,495</u>	<u>\$ 151,415</u>	<u>\$ 124,315,098</u>
December 31, 2018				
Non-mortgage backed debt securities of:				
U.S. Government agencies	\$ 4,247,816	\$ -	\$ 61,716	\$ 4,186,100
U.S. Treasury securities	5,477,302	37,152	-	5,514,454
State, county, and municipal securities	<u>28,500,318</u>	<u>185,082</u>	<u>314,040</u>	<u>28,371,360</u>
Total non-mortgage backed debt securities	<u>38,225,436</u>	<u>222,234</u>	<u>375,756</u>	<u>38,071,914</u>
Mortgage backed securities:				
Residential mortgage backed securities	11,034,972	89,077	197,966	10,926,083
Commercial mortgage backed securities	<u>22,042,767</u>	<u>72,474</u>	<u>267,310</u>	<u>21,847,931</u>
Total mortgage backed securities	<u>33,077,739</u>	<u>161,551</u>	<u>465,276</u>	<u>32,774,014</u>
Total	<u>\$ 71,303,175</u>	<u>\$ 383,785</u>	<u>\$ 841,032</u>	<u>\$ 70,845,928</u>

The book and market values of securities **held to maturity** were:

	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Estimated Market Value</u>
December 31, 2019				
Non-mortgage backed debt securities of:				
State, county, and municipal securities	\$ 3,323,985	\$ 200,904	\$ -	\$ 3,524,889
Residential Mortgage backed securities	<u>1,428,399</u>	<u>-</u>	<u>14,588</u>	<u>1,413,811</u>
Total	<u>\$ 4,752,384</u>	<u>\$ 200,904</u>	<u>\$ 14,588</u>	<u>\$ 4,938,700</u>
December 31, 2018				
Non-mortgage backed debt securities of:				
State, county, and municipal securities	\$ 3,823,771	\$ 76,020	\$ 5,583	\$ 3,894,208
Residential Mortgage backed securities	<u>1,892,547</u>	<u>-</u>	<u>84,109</u>	<u>1,808,438</u>
Total	<u>\$ 5,716,318</u>	<u>\$ 76,020</u>	<u>\$ 89,692</u>	<u>\$ 5,702,646</u>

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

The book and market values of pledged securities were \$24,401,983 and \$24,830,013 at December 31, 2019, respectively and \$12,533,501 and \$12,416,924 at December 31, 2018, respectively.

The proceeds from sales of securities and the associated gains and losses are as follows:

	<u>December 31, 2019</u>	<u>December 31, 2018</u>	<u>December 31, 2017</u>
Proceeds	\$ 4,453,903	\$ 7,464,908	\$ 8,746,583
Gross gains	2,020	-	-
Gross losses	24,705	3,351	37,263

The amortized cost and estimated market value of debt securities held to maturity and available for sale at December 31, 2019 and 2018, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or repay obligations with or without call or prepayment penalties.

December 31, 2019	<u>Available for Sale</u>	
	<u>Amortized Cost</u>	<u>Estimated Market Value</u>
Non-mortgage backed securities:		
Due in one year or less	\$ 9,013,944	\$ 9,065,303
Due after one year through five years	10,265,328	10,445,518
Due after five years through ten years	21,136,723	21,836,116
Due after ten years	3,131,981	3,343,645
Total non-mortgage backed securities	<u>43,547,976</u>	<u>44,690,582</u>
Mortgage backed securities:		
Residential mortgage backed securities	31,023,294	31,479,833
Commercial mortgage backed securities	47,426,748	48,144,683
Total mortgage backed securities	<u>78,450,042</u>	<u>79,624,516</u>
Total	<u>\$ 121,998,018</u>	<u>\$ 124,315,098</u>

December 31, 2018	<u>Available for Sale</u>	
	<u>Amortized Cost</u>	<u>Estimated Market Value</u>
Non-mortgage backed securities:		
Due in one year or less	\$ 6,588,886	\$ 6,597,544
Due after one year through five years	14,730,998	14,670,101
Due after five years through ten years	14,454,506	14,320,835
Due after ten years	2,451,046	2,483,434
Total non-mortgage backed securities	<u>38,225,436</u>	<u>38,071,914</u>
Mortgage backed securities:		
Residential mortgage backed securities	11,034,972	10,926,083
Commercial mortgage backed securities	22,042,767	21,847,931
Total mortgage backed securities	<u>33,077,739</u>	<u>32,774,014</u>
Total	<u>\$ 71,303,175</u>	<u>\$ 70,845,928</u>

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

	Held to Maturity	
	Amortized Cost	Estimated Market Value
December 31, 2019		
Non-mortgage backed securities:		
Due in one year or less	\$ 290,000	\$ 290,200
Due after one year through five years	1,165,193	1,214,031
Due after five years through ten years	1,541,719	1,678,756
Due after ten years	327,073	341,902
Total non-mortgage backed securities	3,323,985	3,524,889
Residential mortgage backed securities	1,428,399	1,413,811
Total	\$ 4,752,384	\$ 4,938,700
December 31, 2018		
Non-mortgage backed securities:		
Due in one year or less	\$ 786,706	\$ 786,188
Due after one year through five years	397,490	404,894
Due after five years through ten years	2,311,098	2,369,746
Due after ten years	328,477	333,380
Total non-mortgage backed securities	3,823,771	3,894,208
Residential mortgage backed securities	1,892,547	1,808,438
Total	\$ 5,716,318	\$ 5,702,646

The market value is established by an independent pricing service as of the approximate dates indicated. The differences between the book value and market value reflect current interest rates and represent the potential loss (or gain) had the portfolio been liquidated on that date. Security losses (or gains) are realized only in the event of dispositions prior to maturity.

At December 31, 2019 and 2018, the Company did not hold investment securities of any single issuer, other than obligations of the U. S. Treasury and other U. S. Government agencies, whose aggregate book value exceeded ten percent of shareholders' equity.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

Information pertaining to securities with gross unrealized losses at December 31, 2019 and 2018, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	December 31, 2019			
	<u>Less Than Twelve Months</u>		<u>Twelve Months or More</u>	
	<u>Unrealized Losses</u>	<u>Estimated Market Value</u>	<u>Unrealized Losses</u>	<u>Estimated Market Value</u>
<u>Securities Available for Sale</u>				
Non-mortgage backed debt securities of:				
U.S. Government agencies	\$ 27	\$ 1,499,973	\$ -	\$ -
U.S. Treasury securities	14,994	1,510,664	-	-
State, county, and municipal securities	30,818	1,620,869	1,385	613,220
Other debt securities	<u>30,770</u>	<u>2,385,521</u>	-	-
Total non-mortgage backed debt securities	<u>76,609</u>	<u>7,017,027</u>	<u>1,385</u>	<u>613,220</u>
Mortgage backed securities:				
Residential mortgage backed securities	32,505	4,975,837	14,067	823,607
Commercial mortgage backed securities	<u>21,266</u>	<u>6,795,730</u>	<u>5,583</u>	<u>403,475</u>
Total mortgage backed securities	<u>53,771</u>	<u>11,771,567</u>	<u>19,650</u>	<u>1,227,082</u>
Total	<u>\$ 130,380</u>	<u>\$ 18,788,594</u>	<u>\$ 21,035</u>	<u>\$ 1,840,302</u>

Securities Held to Maturity

Non-mortgage backed debt securities of:				
State, county, and municipal securities	\$ -	\$ -	\$ -	\$ -
Residential mortgage backed securities	<u>1,324</u>	<u>702,914</u>	<u>13,264</u>	<u>710,897</u>
Total	<u>\$ 1,324</u>	<u>\$ 702,914</u>	<u>\$ 13,264</u>	<u>\$ 710,897</u>

	December 31, 2018			
	<u>Less Than Twelve Months</u>		<u>Twelve Months or More</u>	
	<u>Unrealized Losses</u>	<u>Estimated Market Value</u>	<u>Unrealized Losses</u>	<u>Estimated Market Value</u>
<u>Securities Available for Sale</u>				
Non-mortgage backed debt securities of:				
U.S. Government agencies	\$ -	\$ -	\$ 61,716	\$ 4,186,100
State, county, and municipal securities	<u>8,160</u>	<u>3,164,204</u>	<u>305,880</u>	<u>10,520,042</u>
Total non-mortgage backed debt securities	<u>8,160</u>	<u>3,164,204</u>	<u>367,596</u>	<u>14,706,142</u>
Mortgage backed securities:				
Residential mortgage backed securities	69,777	4,663,268	128,189	3,188,405
Commercial mortgage backed securities	<u>91,054</u>	<u>8,314,141</u>	<u>176,256</u>	<u>7,611,001</u>
Total mortgage backed securities	<u>160,831</u>	<u>12,977,409</u>	<u>304,445</u>	<u>10,799,406</u>
Total	<u>\$ 168,991</u>	<u>\$ 16,141,613</u>	<u>\$ 672,041</u>	<u>\$ 25,505,548</u>

Securities Held to Maturity

Non-mortgage backed debt securities of-				
State, county, and municipal securities	\$ -	\$ -	\$ 5,583	\$ 922,967
Residential mortgage backed securities	-	-	<u>84,109</u>	<u>1,808,438</u>
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 89,692</u>	<u>\$ 2,731,405</u>

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2019

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

As of December 31, 2019, 19 debt securities had unrealized losses with aggregate depreciation of 0.72% from the Company's amortized cost basis.

As of December 31, 2019, the company held 1 U.S. Government agency security that was in an unrealized loss position. Because the decline in fair value is attributable to changes in interest rates, and not credit quality, and because the Company does not have the intent to sell this security and it is likely that it will not be required to sell the security before its anticipated recovery, management does not consider this security to be other-than-temporarily impaired at December 31, 2019.

As of December 31, 2019, the Company held 5 commercial mortgage backed securities and 5 residential mortgage backed securities that were in an unrealized loss position, all of which were issued by U.S. government sponsored entities and agencies. Because the decline in fair value is attributable to changes in interest rates and illiquidity, and not credit quality, and because the Company does not have the intent to sell these mortgage-backed securities and it is likely that it will not be required to sell the securities before their anticipated recovery, management does not consider these securities to be other-than-temporarily impaired at December 31, 2019.

As of December 31, 2019, the Company held 4 state, county, and municipal securities that were in an unrealized loss position. Because the decline in fair value is attributable to changes in interest rates, and not credit quality, and because the Company does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery, management does not consider these securities to be other-than-temporarily impaired at December 31, 2019.

As of December 31, 2019, the Company held 2 U.S. Treasury notes and bonds that were in an unrealized loss position. Because the decline in fair value is attributable to changes in interest rates, and not credit quality, and because the Company does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery, management does not consider these securities to be other-than-temporarily impaired at December 31, 2019.

As of December 31, 2019, the Company held 2 corporate bonds that were in an unrealized loss position. Because the decline in fair value is attributable to changes in interest rates, and not credit quality, and because the Company does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery, management does not consider these securities to be other-than-temporarily impaired at December 31, 2019.

NOTE 4. LOANS

The Company engages in a full complement of lending activities, including real estate-related loans, commercial and industrial loans and consumer installment loans. The majority of its lending activities are concentrated in real estate loans. While risk of loss in the Company's portfolio is primarily tied to the credit quality of the various borrowers, risk of loss may increase due to factors beyond the Company's control, such as local, regional and/or national economic downturns. General conditions in the real estate market may also impact the relative risk in the real estate portfolio.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

Loans are stated at unpaid balances, net of unearned income and deferred loan fees. Balances within the major loans receivable categories at December 31, 2019 and 2018 are presented in the following table:

	<u>2019</u>	<u>2018</u>
Commercial	\$ 77,589,719	\$ 79,399,720
Commercial Real Estate	427,329,447	345,787,812
Consumer	28,766,767	27,368,309
Residential Real Estate	162,729,056	131,971,906
Agriculture	41,485,918	24,913,306
Other	<u>2,054,796</u>	<u>672,593</u>
Total Loans	739,955,703	610,113,646
Other:		
Overdraft, in-process, and suspense accounts	<u>(1,069,298)</u>	<u>2,916,074</u>
Gross Loans	738,886,405	613,029,720
Allowance for loan losses	<u>(9,716,060)</u>	<u>(9,480,989)</u>
Loans, net	<u>\$ 729,170,345</u>	<u>\$ 603,548,731</u>

Overdrafts included in loans were \$233,299 and \$179,978 at December 31, 2019 and 2018, respectively.

Nonaccrual and Past Due Loans

A loan is placed on nonaccrual status when, in management's judgment, the collection of the interest income appears doubtful. Interest receivable that has been accrued and is subsequently determined to have doubtful collectability is charged to interest income. Interest on loans that are classified as non-accrual is recognized when received. Past due loans are loans whose principal or interest is 30 days or more past due. In some cases, where borrowers are experiencing financial difficulties, loans may be restructured to provide terms significantly different from the original contractual terms.

The following tables present an analysis of past due loans and loans accounted for on a nonaccrual basis as of December 31, 2019 and 2018:

	<u>As of December 31, 2019</u>						
	Current and < 30 Days Past Due	<u>Past Due and Still Accruing</u>				Non-accrual	Total Loans
		90 Days or					
		30-59 Days Past Due	60-89 Days Past Due	More Past Due	Total Accruing Past Due		
Commercial	\$ 75,901,451	\$ 894,667	\$ 218,603	\$ -	\$ 1,113,270	\$ 574,998	\$ 77,589,719
Commercial Real Estate	416,738,982	723,768	373,466	-	1,097,234	9,493,231	427,329,447
Consumer	27,798,036	461,920	273,142	-	735,062	233,669	28,766,767
Residential Real Estate	159,933,732	999,948	362,860	-	1,362,808	1,432,516	162,729,056
Agriculture	41,232,113	-	-	-	-	253,805	41,485,918
Other	<u>2,054,796</u>	-	-	-	-	-	<u>2,054,796</u>
Total	<u>\$ 723,659,110</u>	<u>\$ 3,080,303</u>	<u>\$ 1,228,071</u>	<u>\$ -</u>	<u>\$ 4,308,374</u>	<u>\$ 11,988,219</u>	739,955,703
Overdraft, in-process, and suspense accounts						<u>(1,069,298)</u>	
							<u>\$ 738,886,405</u>

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

As of December 31, 2018							
	<u>Past Due and Still Accruing</u>					<u>Non-accrual</u>	<u>Total Loans</u>
	Current and <	90 Days or					
	30 Days	30-59 Days	60-89 Days	More	Total Accruing		
	<u>Past Due</u>	<u>Past Due</u>	<u>Past Due</u>	<u>Past Due</u>	<u>Past Due</u>		
Commercial	\$ 72,430,193	\$ 429,224	\$ 2,357,180	\$ -	\$ 2,786,404	\$ 4,183,123	\$ 79,399,720
Commercial Real Estate	343,219,939	541,818	117,545	-	659,363	1,908,510	345,787,812
Consumer	26,423,880	647,441	61,967	-	709,408	235,021	27,368,309
Residential Real Estate	129,445,497	1,044,764	269,296	-	1,314,060	1,212,349	131,971,906
Agriculture	24,332,395	297,053	-	-	297,053	283,858	24,913,306
Other	672,593	-	-	-	-	-	672,593
Total	<u>\$ 596,524,497</u>	<u>\$ 2,960,300</u>	<u>\$ 2,805,988</u>	<u>\$ -</u>	<u>\$ 5,766,288</u>	<u>\$ 7,822,861</u>	610,113,646
Overdraft, in-process, and suspense accounts							<u>2,916,074</u>
							<u>\$ 613,029,720</u>

Impaired Loans

Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreements. Impaired loans include loans on nonaccrual status and troubled debt restructurings. If a loan is deemed impaired, a specific valuation allowance is allocated, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest is recognized on a cash basis.

The following is a summary of information pertaining to interest income on impaired loans:

As of December 31, 2019			
	Average Investment in Impaired Loans	Interest Income	
		Interest Income Recognized on Impaired Loans	Interest Income Recognized on Cash Basis on Impaired Loans
Commercial	\$ 3,064,502	\$ 150,756	\$ 1,556
Commercial Real Estate	6,394,517	542,956	309,117
Consumer	16,527	-	-
Residential Real Estate	898,446	47,674	12,977
Agriculture	533,320	53,405	43,922
Other	-	-	-
Total	<u>\$ 10,907,312</u>	<u>\$ 794,791</u>	<u>\$ 367,572</u>

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

As of December 31, 2018			
	Average Investment in Impaired Loans	Interest Income Recognized on Impaired Loans	Interest Income Recognized on Cash Basis on Impaired Loans
Commercial	\$ 4,853,121	\$ 483,197	\$ 249,745
Commercial Real Estate	3,085,305	124,645	69,280
Consumer	119,182	2,043	1,760
Residential Real Estate	1,264,031	69,714	64,550
Agriculture	469,527	26,079	19,800
Other	-	-	-
Total	\$ 9,791,166	\$ 705,678	\$ 405,135

As of December 31, 2017			
	Average Investment in Impaired Loans	Interest Income Recognized on Impaired Loans	Interest Income Recognized on Cash Basis on Impaired Loans
Commercial	\$ 3,563,746	\$ 351,584	\$ 143,621
Commercial Real Estate	3,510,311	179,238	110,610
Consumer	102,655	10,787	7,897
Residential Real Estate	1,591,299	70,845	45,363
Agriculture	644,123	61,833	52,528
Other	-	-	-
Total	\$ 9,412,134	\$ 674,287	\$ 360,019

The following is an analysis of information pertaining to impaired loans:

As of December 31, 2019					
	Unpaid Total Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Total Related Allowance
Commercial	\$ 65,349	\$ 44,467	\$ 20,882	\$ 65,349	\$ 20,882
Commercial real estate	10,381,986	10,381,986	-	10,381,986	-
Consumer	-	-	-	-	-
Residential real estate	800,682	378,789	421,893	800,682	197,420
Agriculture	782,781	253,806	528,975	782,781	10,328
Other	-	-	-	-	-
Total	\$ 12,030,798	\$ 11,059,048	\$ 971,750	\$ 12,030,798	\$ 228,630

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

	As of December 31, 2018				
	Unpaid Total Principal Balance	Recorded	Recorded	Total Recorded Investment	Related Allowance
		Investment	Investment		
		With No Allowance	With Allowance		
Commercial	\$ 6,063,655	\$ 4,924,719	\$ 1,138,936	\$ 6,063,655	\$ 877,408
Commercial real estate	2,407,047	449,894	1,957,153	2,407,047	1,017,474
Consumer	33,053	33,053	-	33,053	-
Residential real estate	996,209	220,033	776,176	996,209	206,494
Agriculture	283,858	-	283,858	283,858	20,881
Other	-	-	-	-	-
Total	\$ 9,783,822	\$ 5,627,699	\$ 4,156,123	\$ 9,783,822	\$ 2,122,257

The recorded investment in loans excludes accrued interest receivable and loan origination fees, net, due to immateriality.

Credit Quality Indicators

The Company uses a nine category risk grading system to assign a risk grade to each loan in the portfolio. The following is a description of the general characteristics of the grades:

Grade 1 – Excellent Risk

Loans in this category are considered to have very little, if any, credit risk. The following characteristics are common for loans in this category:

- Loan is fully secured by cash or cash equivalents.
- Loan is secured by marketable securities with no less than a 25% margin.
- There are no material exceptions to the Bank's loan policy.
- Alternative sources of cash exist, such as commercial paper market, capital market, internal liquidity, or other bank lines.
- Borrower is a national or regional company with excellent cash flow which covers all debt service requirements and a significant portion of capital expenditures.
- Balance sheet strength and liquidity are excellent and exceed industry norms.
- Financial trends are positive.
- Borrower is a market leader within the industry, and industry performance is excellent.
- Borrower is of unquestioned strength. Financial wherewithal is known.
- Borrower exhibits excellent liquidity, net worth, cash flow, and leverage.

Grade 2 – High Quality

Loans in this category are considered to be an excellent credit risk with minimal risk of loss. The following characteristics are common for loans in this category:

- Loan is secured by marketable securities with margin below 25%.
- There are no material exceptions to the Bank's loan policy.
- Borrower has stable and reliable cash flow and above-average liquidity.
- Borrower exhibits moderate risk from exposure to contingent liabilities.
- Borrower has strong, stable financial trends.
- Borrower has strong cash flow which covers all debt service requirements and some portion of capital expenditures.
- Alternative sources of repayment are evident and financial ratios are comparable to or exceed the industry norms.
- Borrower holds a prominent position in the industry or local economy.
- Borrower's industry's performance is above average.
- Management is strong in most areas and with good back-up depth.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2019

Grade 3 – Average Risk

Loans in this category are considered to be of normal risk and of average quality. The following characteristics are common for loans in this category:

- Borrower has reliable cash flow but alternative sources of repayment would require sale of assets that may be considered illiquid.
- Borrower's financial position has been leveraged to an average degree or individual has an average net worth position considering income and debt.
- Cash flow is adequate to cover all debt service requirements but not capital expenditures.
- Balance sheet may be leveraged but still comparable to the industry.
- Financial trends are stable to mixed over long-term but no significant concerns exist at this time.
- Borrower's industry has a generally stable outlook and may have some cyclical characteristics.
- Borrower holds an average position in the industry or local economy.
- Management is considered capable and stable.
- Start-up venture with experienced management, adequate capitalization, and favorable performance versus projections.

Grade 4 – Acceptable

Loans in this category are considered to be of above-average risk or of below-average quality. The following characteristics are common for loans in this category:

- Borrower's sources of income or cash flow have become unstable or limited.
- Borrower's income has declined due to current business or economic conditions.
- Borrower has a somewhat highly-leveraged condition and limited capital.
- Moderate history of some degree of slow payment.
- Loan conditions require more frequent monitoring than the higher-graded loans.
- Stability is lacking in the primary repayment source, cash flow, credit history, or liquidity, however, the instability is manageable and considered temporary.
- Overall trends are not yet adverse.
- Loan involves speculative activity where the primary source for repayment is the activity itself and the borrower has limited ability to support the debt outside the successful completion of the activity.

Grade 5 – Watch

Loans in this category have potential financial weaknesses, the loan officer may not have properly supervised the credit, or material collateral exceptions exist. This category includes loans which do not presently expose the bank to a sufficient degree of risk to warrant adverse classification but do possess credit deficiencies deserving of management's close attention. Failure to correct deficiencies could result in greater credit risk in the future. The following characteristics are common for loans in this category:

- There is a material exception to the bank's loan policy.
- Management has potential weakness and back-up depth is weak.
- Principal and interest are currently protected through sufficient cash flows, collateral values, or secondary repayment sources, but downward trends in profitability and cash flow are evident.
- Financial leverage is excessive, and margins and financial ratios fall below industry averages.
- Adequate financial statements are not produced and/or provided timely, or the borrower exhibits an uncooperative attitude.
- Moderate delinquency may exist from time to time.
- A loss may not be readily apparent, but sufficient problems have arisen to cause the lender to go to abnormal lengths to protect its position.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2019

Grade 6 – Substandard

Loans in this category display a well-defined weakness or weaknesses that may jeopardize collection of the debt. Assets do not appear to possess any loss, but exhibit more than a normal degree of risk. Lack of continued close attention on the part of the bank could result in deterioration and potential loss. The following characteristics are common for loans in this category:

- Cash flows are not sufficient to meet scheduled obligations and/or the financial strengths of the guarantors are questionable.
- Losses have eroded the net worth so that survivability of the business is in question.
- Primary and secondary sources of repayment are believed to offer marginal protection to the credit.
- Repayment of debt is likely to come from the liquidation of collateral or payments from guarantors.
- Past due problems are apparent.
- The loan has been placed on non-accrual status and/or is in bankruptcy with current repayment history for less than three months.
- The value of the collateral is questionable or has declined significantly.

Grade 7 – Impaired

Loans in this category have been classified as Impaired. The classification of Impaired is based upon the likelihood that the bank will not be able to collect all principal and interest under the original terms of the note. The following characteristics are common for loans in this category:

- Loan has been placed on non-accrual.
- Repayment of the debt is dependent upon the sale of collateral.
- The value of the collateral has declined such that its liquidation would not be sufficient to retire the debt.
- Repayment is dependent upon cash flows, and the cash flows are no longer sufficient to cover principal and interest payments under the terms of the debt.

Grade 8 – Doubtful

Loans in this category have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions, and values, highly questionable and improbable. The following characteristics are common for loans in this category:

- Borrower is having financial difficulties, and the collateral does not cover the loan balance.
- Loan is unsecured and repayment is highly questionable.
- Bank's access or rights to the collateral is unclear (e.g. because the lender's lien is subordinate to substantial other liens or there is a dispute over title to the collateral).
- Business is on the verge of closing, being sold, or liquidated.

Grade 9 – Loss

Loans in this category are considered not collectible and of such little value that their continuance as active assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

The following tables present the loan portfolio by risk grade as of December 31, 2019 and 2018:

	As of December 31, 2019						
	Commercial Real			Residential Real			
	Commercial	Estate	Consumer	Estate	Agriculture	Other	Total
Grade 1 (Excellent Risk)	\$ 4,516,764	\$ -	\$ 1,177,467	\$ 15,618	\$ -	\$ -	\$ 5,709,849
Grade 2 (High Quality)	120,639	15,554	214,613	342,111	1,761,198	-	2,454,115
Grade 3 (Average Risk)	4,471,883	15,472,649	238,509	5,838,468	7,963,087	635,607	34,620,203
Grade 4 (Acceptable)	63,755,715	390,593,078	26,380,629	149,430,992	29,732,921	1,419,189	661,312,524
Grade 5 (Watch)	3,458,560	10,445,781	312,597	5,005,136	996,926	-	20,219,000
Grade 6 (Substandard)	1,200,809	420,399	427,789	1,296,049	249,005	-	3,594,051
Grade 7 (Impaired)	65,349	10,381,986	-	800,682	782,781	-	12,030,798
Grade 8 (Doubtful)	-	-	15,163	-	-	-	15,163
Grade 9 (Loss)	-	-	-	-	-	-	-
Total	<u>\$ 77,589,719</u>	<u>\$ 427,329,447</u>	<u>\$ 28,766,767</u>	<u>\$ 162,729,056</u>	<u>\$ 41,485,918</u>	<u>\$ 2,054,796</u>	739,955,703
Overdraft, in-process, and suspense accounts							(1,069,298)
Total Loans							<u>\$ 738,886,405</u>

	As of December 31, 2018						
	Commercial Real			Residential Real			
	Commercial	Estate	Consumer	Estate	Agriculture	Other	Total
Grade 1 (Excellent Risk)	\$ 1,305,209	\$ -	\$ 1,007,414	\$ 154,680	\$ -	\$ -	\$ 2,467,303
Grade 2 (High Quality)	10,206	-	37,678	22,676	-	-	70,560
Grade 3 (Average Risk)	1,247,496	10,103,956	240,115	5,964,409	1,282,159	672,593	19,510,728
Grade 4 (Acceptable)	66,103,783	327,886,993	25,290,053	119,657,022	22,111,386	-	561,049,237
Grade 5 (Watch)	3,664,706	5,374,188	250,061	4,132,424	1,235,903	-	14,657,282
Grade 6 (Substandard)	969,944	15,628	489,025	1,044,486	-	-	2,519,083
Grade 7 (Impaired)	6,063,655	2,407,047	33,053	996,209	283,858	-	9,783,822
Grade 8 (Doubtful)	34,721	-	20,910	-	-	-	55,631
Grade 9 (Loss)	-	-	-	-	-	-	-
Total	<u>\$ 79,399,720</u>	<u>\$ 345,787,812</u>	<u>\$ 27,368,309</u>	<u>\$ 131,971,906</u>	<u>\$ 24,913,306</u>	<u>\$ 672,593</u>	610,113,646
Overdraft, in-process, and suspense accounts							2,916,074
Total Loans							<u>\$ 613,029,720</u>

Troubled Debt Restructurings ("TDRs")

The restructuring of a loan is deemed to be a troubled debt restructuring (TDR) if the borrower is experiencing financial difficulties and the Company grants certain concessions to the borrower that it would not otherwise consider for new debt with similar risk characteristics. Loan modifications are reviewed and approved by the Company's senior lending staff, who then determine whether the loan meets the criteria for a TDR. In order to determine whether a borrower is experiencing financial difficulties, 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 conducted under the Company's internal underwriting process. Concessions that may be granted include interest rate reductions, principal or interest forgiveness, restructuring of amortization schedules or maturity date, forbearance, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of the collateral. Each potential loan modification is reviewed individually and the terms of the loan are modified to meet the borrower's specific circumstances at a point in time. Not all loan modifications are TDRs. Generally, a nonaccrual loan that has been modified in a TDR remains on nonaccrual status for a period subsequent of modification to demonstrate that the borrower is able to meet the terms of the modified loan. However, performance prior to the modification, or significant events that coincide with the modification, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of loan modification or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains on nonaccrual status. Once a loan is modified in a troubled debt restructuring it is accounted for as an impaired loan, regardless of its accrual status, until the loan is paid in full, sold or charged off.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

As of December 31, 2019 and 2018, the Company had a recorded investment in TDRs of \$3,134,838 and \$2,295,044, respectively. The Company had previous charge offs of \$-0- on such loans as of December 31, 2019 and 2018. The Company's allowance for loan losses included an allocation of \$10,328 and \$954,147 of specific allowance for those loans as of December 31, 2019 and 2018, respectively. The Company had no unfunded commitments to lend to customers with loans modified as TDRs as of December 31, 2019.

The following table presents loans modified as TDRs by class of loan and type of modification that occurred during the years ended December 31, 2019 and 2018.

December 31, 2019			
		Recorded	Recorded
		Investment Prior to	Investment After
	Number of Loans	Modification	Modification
Commercial			
Commercial real estate			
Payment Modification Only	3	1,755,341	1,755,341
Rate Reduction, Payment Modification	1	48,176	48,176
Consumer			
Payment Modification Only	1	1,332	1,332
Rate Reduction, Payment Modification	9	41,133	41,133
Residential real estate			
Rate Reduction, Payment Modification	1	85,408	85,408
Agriculture			
Payment Modification Only	1	528,976	528,976
Other	-	-	-
Total TDR's	<u>16</u>	<u>\$ 2,460,366</u>	<u>\$ 2,460,366</u>
December 31, 2018			
		Recorded	Recorded
		Investment Prior to	Investment After
	Number of Loans	Modification	Modification
Commercial			
Rate Reduction, Payment Modification	1	\$ 285,000	\$ 285,000
Commercial real estate			
	-	-	-
Consumer			
Payment Modification Only	1	6,238	6,238
Rate Reduction, Payment Modification	3	26,248	26,248
Forgiveness of Principal	1	13,584	2,912
Residential real estate			
Payment Modification Only	3	150,240	150,240
Rate Reduction, Payment Modification	2	144,771	144,771
Forbearance of Interest	1	298,926	298,926
Forgiveness of Principal	1	48,678	44,849
Agriculture			
Rate Reduction, Payment Modification	1	8,306	8,306
Other	-	-	-
Total TDR's	<u>14</u>	<u>\$ 981,991</u>	<u>\$ 967,490</u>

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2019

The TDRs described above increased the allowance for loan losses \$10,328 and \$221 during the years ended December 31, 2019 and 2018, respectively. The above TDRs resulted in charge offs of \$-0- and \$14,501 during the years ended December 31, 2019 and 2018.

During the years ended December 31, 2019 and 2018, the Company reported no new loans modified as TDRs that subsequently defaulted.

Allowance for Loan Losses

The allowance for loan losses represents a reserve for inherent losses in the loan portfolio. The adequacy of the allowance for loan losses is evaluated periodically based on a review of all significant loans, with a particular emphasis on non-accruing, past due and other loans that management believes might be potentially impaired or warrant additional attention. The Company segregates the loan portfolio by type of loan and utilizes this segregation in evaluating exposure to risks within the portfolio. In addition, based on internal reviews and external reviews performed by independent auditors and regulatory authorities, the Company further segregates the loan portfolio by loan grades based on an assessment of risk for a particular loan or group of loans. Certain reviewed loans are assigned specific allowances when a review of relevant data determines that a general allocation is not sufficient or when the review affords management the opportunity to fine tune the amount of exposure in a given credit. In establishing allowances, management considers historical loan loss experience but adjusts this data with a significant emphasis on data such as current loan quality trends, current economic conditions and other factors in the markets where the Company operates. Factors considered include, among others, current valuations of real estate in their markets, unemployment rates, the effect of weather conditions on agricultural related entities and other significant local economic events.

The Company has developed a methodology for determining the adequacy of the allowance for loan losses which is monitored by the Company's Senior Credit Officer. Loans are segregated by loan type and historical loss rates for each type are used to estimate a general reserve percentage for loans that are not considered impaired and assigned specific reserves. Procedures provide for the assignment of a risk rating for every loan included in the total loan portfolio. The risk rating schedule provides seven ratings of which four ratings are classified as pass ratings and three ratings are classified as criticized ratings. Loans classified as substandard or below are reviewed on a quarterly basis by management for potential impairment. As a result of these evaluations, loans deemed impaired may be assigned specific reserve allocations and excluded from general reserve pools. Past due loans are assigned risk ratings based on the number of days past due. The calculation of the allowance for loan losses, including underlying data and assumptions, is reviewed regularly by executive management and the Board of Directors.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

The following tables detail activity in the allowance for loan losses by portfolio segment for the year ended December 31, 2019 and 2018. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

	2019						
	Commercial			Residential			
	Commercial	Real Estate	Consumer	Real Estate	Agriculture	Other	Total
Allowance for credit losses:							
Beginning Balance	\$ 2,994,524	\$ 4,174,000	\$ 766,843	\$ 1,460,511	\$ 74,948	\$ 10,163	\$ 9,480,989
Chargeoffs	(965,136)	-	(445,719)	(175,756)	-	-	(1,586,611)
Recoveries	71,304	5,500	67,597	27,281	-	-	171,682
Provision	1,197,927	(2,661,274)	1,034,015	2,042,895	38,557	(2,120)	1,650,000
Ending Balance	<u>\$ 3,298,619</u>	<u>\$ 1,518,226</u>	<u>\$ 1,422,736</u>	<u>\$ 3,354,931</u>	<u>\$ 113,505</u>	<u>\$ 8,043</u>	<u>\$ 9,716,060</u>

Period-end amount allocated to:

Loans individually evaluated for impairment	\$ 20,882	\$ -	\$ -	\$ 197,420	\$ 10,328	\$ -	\$ 228,630
Loans collectively evaluated for impairment	<u>3,277,737</u>	<u>1,518,226</u>	<u>1,422,736</u>	<u>3,157,511</u>	<u>103,177</u>	<u>8,043</u>	<u>9,487,430</u>
Ending balance	<u>\$ 3,298,619</u>	<u>\$ 1,518,226</u>	<u>\$ 1,422,736</u>	<u>\$ 3,354,931</u>	<u>\$ 113,505</u>	<u>\$ 8,043</u>	<u>\$ 9,716,060</u>

Loans:

Individually evaluated for impairment	\$ 65,349	\$ 10,381,986	\$ -	\$ 800,682	\$ 782,781	\$ -	\$ 12,030,798
Collectively evaluated for impairment	<u>77,524,370</u>	<u>416,947,461</u>	<u>28,766,767</u>	<u>161,928,374</u>	<u>40,703,137</u>	<u>2,054,796</u>	<u>727,924,905</u>
Ending balance	<u>\$ 77,589,719</u>	<u>\$ 427,329,447</u>	<u>\$ 28,766,767</u>	<u>\$ 162,729,056</u>	<u>\$ 41,485,918</u>	<u>\$ 2,054,796</u>	<u>739,955,703</u>
Overdraft, in-process, and suspense accounts							<u>(1,069,298)</u>
Total loans							<u>\$ 738,886,405</u>

	2018						
	Commercial			Residential			
	Commercial	Real Estate	Consumer	Real Estate	Agriculture	Other	Total
Allowance for credit losses:							
Beginning Balance	\$ 3,061,877	\$ 4,204,807	\$ 884,000	\$ 1,120,034	\$ 54,922	\$ 91,977	\$ 9,417,617
Chargeoffs	(934,869)	-	(392,272)	(418,859)	-	-	(1,746,000)
Recoveries	46,168	247,466	58,840	31,898	-	-	384,372
Provision	821,348	(278,273)	216,275	727,438	20,026	(81,814)	1,425,000
Ending Balance	<u>\$ 2,994,524</u>	<u>\$ 4,174,000</u>	<u>\$ 766,843</u>	<u>\$ 1,460,511</u>	<u>\$ 74,948</u>	<u>\$ 10,163</u>	<u>\$ 9,480,989</u>

Period-end amount allocated to:

Loans individually evaluated for impairment	\$ 877,408	\$ 1,017,474	\$ -	\$ 206,494	\$ 20,881	\$ -	\$ 2,122,257
Loans collectively evaluated for impairment	<u>2,117,116</u>	<u>3,156,526</u>	<u>766,843</u>	<u>1,254,017</u>	<u>54,067</u>	<u>10,163</u>	<u>7,358,732</u>
Ending balance	<u>\$ 2,994,524</u>	<u>\$ 4,174,000</u>	<u>\$ 766,843</u>	<u>\$ 1,460,511</u>	<u>\$ 74,948</u>	<u>\$ 10,163</u>	<u>\$ 9,480,989</u>

Loans:

Individually evaluated for impairment	\$ 6,063,655	\$ 2,407,047	\$ 33,053	\$ 996,209	\$ 283,858	\$ -	\$ 9,783,822
Collectively evaluated for impairment	<u>73,336,065</u>	<u>343,380,765</u>	<u>27,335,256</u>	<u>130,975,697</u>	<u>24,629,448</u>	<u>672,593</u>	<u>600,329,824</u>
Ending balance	<u>\$ 79,399,720</u>	<u>\$ 345,787,812</u>	<u>\$ 27,368,309</u>	<u>\$ 131,971,906</u>	<u>\$ 24,913,306</u>	<u>\$ 672,593</u>	<u>610,113,646</u>
Overdraft, in-process, and suspense accounts							<u>2,916,074</u>
Total loans							<u>\$ 613,029,720</u>

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

Risk characteristics relevant to each portfolio segment are as follows:

Commercial loans – Loans in this segment are generally made to businesses and are typically secured by business assets, equipment, inventory and accounts receivable. Repayment is expected from the cash flows of the business entity. A weakened economy and decreased consumer spending will have a negative impact on the credit quality in this portfolio segment.

Commercial real estate loans – Loans in this segment include all mortgages and other liens on commercial real estate. The underlying cash flows generated by the properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates, which in turn will have an effect on the credit quality in this portfolio segment.

Consumer loans – Loans in this segment include unsecured loans, cash value loans and auto loans. Loans in these categories are primarily dependent on the credit quality of the borrower. The overall health of the economy, including unemployment rates in the Bank’s market area will have an effect on the credit quality of this portfolio segment.

Residential real estate loans – Loans in this segment include all mortgages and other liens on residential real estate, as well as vacant land designated as residential real estate. Loans in this segment are dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates will have an effect on the credit quality of this portfolio segment.

Agriculture loans – Loans in this segment include loans to finance agricultural production and other loans to farmers. The overall health of the economy will have an effect on the credit quality of this portfolio segment.

Other loans – Loans in this segment do not belong in the other categories previously described. Loans in this segment are dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates will have an effect on the credit quality of the segment.

NOTE 5. BANK PREMISES AND EQUIPMENT

Premises and equipment as of December 31, 2019 and 2018 are summarized as follows:

	<u>2019</u>	<u>2018</u>
Land	\$ 3,556,936	\$ 1,621,936
Buildings and improvements	12,891,552	8,659,936
Leasehold improvements	487,026	487,026
Equipment, furniture and fixtures	4,804,253	3,436,061
Vehicles	140,985	100,058
Construction in progress	-	26,058
Total	<u>21,880,752</u>	<u>14,331,075</u>
Less - accumulated depreciation	<u>(6,262,554)</u>	<u>(5,446,642)</u>
Bank premises and equipment, net	<u>\$ 15,618,198</u>	<u>\$ 8,884,433</u>

Depreciation included in operating expenses amounted to \$815,912, \$585,214, and \$588,093 for the years ended December 31, 2019, 2018 and 2017, respectively.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

NOTE 6. LEASES

The Company has entered into operating leases for branch locations, storage, and equipment with terms extending through October 2022. These leases have initial terms of one to five years. The exercise of lease renewal options are at the sole discretion of the Company, which does not consider exercise of any lease renewal options reasonably certain. The lease agreements do not contain early termination options. No renewal options or early termination options have been included in the calculation of the operating right-of-use asset or operating lease liability. At the commencement date of the lease, the Company recognizes a lease liability of the lease payments not yet paid. At the commencement date, the Company also recognizes a right-of-use asset measured at the initial measurement of the lease liability. Lease expense is recognized on a straight-line basis over the lease term. At December 31, 2019, the Company had no leases classified as finance leases.

NOTE 7. GOODWILL AND INTANGIBLE ASSETS

The Company recorded \$7,123,814 of goodwill on the acquisition of FMB during 2019. Previously, the Company reported goodwill in the amount of \$2,237,890 which resulted in total reported goodwill of \$9,361,704 and \$2,237,890 for the years ended December 31, 2019 and 2018, respectively. Impairment exists when a reporting unit's carrying value of goodwill exceeds its fair value. At December 31, 2019, the Company's management determined reporting unit had positive equity and the Company elected to perform a qualitative assessment to determine if it was more likely than not that the fair value of the reporting unit exceeded its carrying value, including goodwill. The qualitative assessment indicated that it was more likely than not that the fair value of the reporting unit exceeded its carrying value, resulting in no impairment.

The Bank recorded a core deposit intangible asset of \$3,028,582 associated with the acquisition of FMB during 2019. The amortization period used for the core deposit intangible is 10 years. The intangible asset's carrying amount, accumulated amortization and amortization expense for December 31, 2019 and the five succeeding fiscal years are as follows:

	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>
Amortizing intangible assets						
Core deposit premium						
Gross carrying amount	\$ 3,028,582	\$ 3,028,582	\$ 3,028,582	\$ 3,028,582	\$ 3,028,582	\$ 3,028,582
Accumulated amortization	<u>(201,904)</u>	<u>(504,760)</u>	<u>(807,616)</u>	<u>(1,110,472)</u>	<u>(1,413,328)</u>	<u>(1,716,184)</u>
Net carrying value	<u>\$ 2,826,678</u>	<u>\$ 2,523,822</u>	<u>\$ 2,220,966</u>	<u>\$ 1,918,110</u>	<u>\$ 1,615,254</u>	<u>\$ 1,312,398</u>
Amortization expense	<u>\$ 201,904</u>	<u>\$ 302,856</u>				

The Bank recorded a core deposit intangible asset of \$455,782 associated with the branch purchase from CertusBank during 2015. The amortization period used for the core deposit intangible is 10 years. The intangible asset's carrying amount, accumulated amortization and amortization expense for December 31, 2019 and the five succeeding fiscal years are as follows:

	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>
Amortizing intangible assets						
Core deposit premium						
Gross carrying amount	\$ 455,782	\$ 455,782	\$ 455,782	\$ 455,782	\$ 455,782	\$ 455,782
Accumulated amortization	<u>(215,385)</u>	<u>(262,293)</u>	<u>(307,358)</u>	<u>(350,352)</u>	<u>(391,047)</u>	<u>(429,216)</u>
Net carrying value	<u>\$ 240,397</u>	<u>\$ 193,489</u>	<u>\$ 148,424</u>	<u>\$ 105,430</u>	<u>\$ 64,735</u>	<u>\$ 26,566</u>
Amortization expense	<u>\$ 48,523</u>	<u>\$ 46,908</u>	<u>\$ 45,065</u>	<u>\$ 42,994</u>	<u>\$ 40,695</u>	<u>\$ 38,169</u>

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

NOTE 8. OTHER REAL ESTATE AND FORECLOSED ASSETS

At December 31, 2019 and 2018 the Bank reported \$396,486 and \$835,921, respectively, as other real estate and foreclosed assets. At December 31, 2019 and 2018, the balance of foreclosed real estate included \$384,310 and \$414,300, respectively of foreclosed residential real estate properties recorded as a result of obtaining physical possession of the property. At December 31, 2019, the Bank had no consumer mortgage loans secured by residential real estate for which formal foreclosure procedures were in process.

NOTE 9. CASH SURRENDER VALUE OF LIFE INSURANCE

The Bank has established a BOLI program under which single-premium, split-dollar, whole-life insurance contracts are purchased on certain eligible officers. Initial investments in the policies are non-deductible for income tax purposes and the related investment income and death benefits are non-taxable when received. Death benefits are divided among the Bank and beneficiaries designated by the insured officer. The cash surrender value of these policies was \$13,248,384 and \$7,035,138 at December 31, 2019 and 2018, respectively. Income earned on the cash surrender value of these policies was \$213,246, \$183,956 and \$194,527 for the years ended December 31, 2019, 2018, and 2017, respectively.

NOTE 10. DEPOSITS

The aggregate amount of time deposits that meet or exceed \$250,000 at December 31, 2019 and 2018 was \$61,358,756 and \$64,579,269, respectively.

At December 31, 2019, the scheduled maturities of time deposits are as follows:

2020	\$ 158,423,701
2021	23,949,234
2022	16,042,028
2023	5,447,145
2024	3,709,807
2025 and thereafter	<u>5,000</u>
Total time deposits	<u>\$ 207,576,915</u>

NOTE 11. SHORT-TERM BORROWINGS

The Bank had six lines of credit for federal funds purchased totaling \$36,500,000 and one line of credit for repurchase transactions and reverse repurchase transactions in the amount of \$10,000,000 with correspondent institutions as of December 31, 2019. At December 31, 2019 and 2018, there were no outstanding balances on these lines of credit.

NOTE 12. SUBORDINATED DEBENTURES

On April 30, 2019, the Company acquired FMB Equibanc, Inc. ("FMB") by merger. In connection with such transaction, the Company assumed the obligations of FMB related to its prior issuance of trust preferred securities. In 2005, FMB's statutory trust subsidiary, FMB 2005 Capital Trust I, issued \$4,000,000 in principal amount of trust preferred securities at a rate per annum equal to the 3-month LIBOR plus 1.57% through a pool sponsored by a national brokerage firm. These trust preferred securities have a maturity of 30 years and are redeemable at the Company's option on any quarterly interest payment date.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

On April 15, 2019, the Company completed the sale of \$10,000,000 in aggregate principal amount of its 6.25% Fixed-To-Floating Rate Subordinated Notes due 2029 (the "2029 subordinated notes"). The 2029 subordinated notes will mature on April 15, 2029 and through April 14, 2024 will bear a fixed rate of interest of 6.25% per annum, payable quarterly in arrears on March 31, June 30, September 30, and December 31 of each year. Beginning December 15, 2024, the interest rate on the 2029 subordinated notes resets quarterly to a floating rate per annum equal to the then-current 3-month LIBOR plus 4.08%, payable quarterly in arrears on March 31, June 30, September 30, and December 31 of each year to the maturity date or earlier redemption. On any scheduled interest payment date beginning April 15, 2024, the Company may, at its option, redeem the 2029 subordinated notes, in whole or in part, at a redemption price equal to 100% of the principal amount plus accrued and unpaid interest.

NOTE 13. LONG-TERM BORROWINGS

The Bank became a member of the Federal Home Loan Bank ("FHLB") of Atlanta during 1998 establishing a Credit Availability of \$15,000,000. This agreement was modified in 2008 to increase credit availability to 20% of total assets. Amounts advanced against this line of credit were \$0 and \$9,000,000 at December 31, 2019 and 2018, respectively. In the event the Bank requests future advances, the Bank has pledged first liens on 1 to 4 family real estate loans with a carrying value of \$24,130,699 and \$20,105,706 at December 31, 2019 and 2018, respectively.

Investment in stock of a Federal Home Loan Bank (FHLB) is required for every federally insured institution that utilizes its services. FHLB stock is considered restricted, as defined in FASB Accounting Standards Codification Topic 320, *Investments – Debt and Equity Securities*; accordingly, the provisions of ASC Topic 320 are not applicable to this investment. The FHLB stock is reported in the consolidated financial statements at cost. Dividend income is recognized when earned.

On September 24, 2014 the Company executed a promissory agreement in the amount of \$2,000,000 with a variable interest rate of Prime minus .25%, with a minimum rate of 3%. Principal and interest payments are due quarterly beginning February 2015 through maturity of the note in August 2021. The outstanding principal balance due was \$571,429 and \$857,143 as of December 31, 2019 and 2018, respectively. The Company has pledged, as collateral, its interest in Morris Bank shares consisting of 33,000 shares of common stock with a par value of \$10.00 per share. In addition during the life of the borrowing agreement the Company is required to maintain a deposit account with the lender with a minimum deposit of \$100,000 at all times. As of December 31, 2019 and 2018 the Company reported an outstanding balance with the lending institution of \$254,725 and \$254,736, respectively. Additional financial covenants in place as part of the lending agreement state that the Company and its Bank subsidiary are to maintain the following performance measures:

1. Both the Company and its Bank subsidiary are required to be classified as "well capitalized" with the rules and regulations of its primary federal regulator. Additionally the Company shall cause its Bank subsidiary to maintain a Tier 1 leverage capital ratio of not less than nine percent.
2. The Company shall cause its Bank subsidiary to maintain an annual return on assets greater than 0.5%.
3. The Company shall cause its Bank subsidiary's ratio of non-performing assets to stockholders equity, including the allowance for loan and lease losses, to be less than forty (40) percent.

At December 31, 2019, the scheduled payments of outstanding debt are as follows:

2020	\$	285,714
2021		285,715
2022		-
2023		-
2024		-
Thereafter		-
Total	\$	<u>571,429</u>

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

NOTE 14. INCOME TAXES AND CHANGE IN TAX STATUS

For the year ended December 31, 2018 and prior years, the Company, with the consent of its stockholders, elected to be taxed under sections of federal and Georgia income tax law which provide that, in lieu of corporate income taxes, the stockholders separately account for their pro rata shares of the Company's income, deductions, losses, and credits. On March 19, 2019, the Company's stockholders terminated this election effective with the year beginning on January 1, 2019.

As a result of the January 1, 2019 termination, on that date, the Company recorded a net deferred tax asset of \$1,965,947, by a credit to income tax expense, for temporary differences between the financial reporting and the income tax basis of property and equipment, reserve for bad debts, and deferred compensation. The deferred tax asset related to deferred compensation was \$76,177.

The provision for income taxes for the year ended December 31, 2019 is as follows:

	2019
Current tax expense (benefit)	\$ 3,302,198
Deferred tax expense (benefit)	(2,135,051)
Change in valuation allowance	941,558
Net provision for (benefit of) income taxes	\$ 2,108,705

Deferred income taxes are reflected for certain timing differences between book and taxable income and will be reduced in future years as these timing differences reverse. The reasons for the difference between the actual tax expense and tax computed at the federal income tax rate are as follows:

	2019
Tax on pretax income at statutory rate	\$ 3,303,228
Change resulting from:	
Tax-exempt interest income	(130,842)
State income taxes, net of federal tax benefit	(87,422)
Life insurance income	(44,782)
Other	(931,478)
Total	\$ 2,108,705
Net effective tax rate	13.4%

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

The sources and tax effects of temporary differences that give rise to significant portions of deferred income tax assets and liabilities are as follows:

	2019
Deferred Income Tax Assets:	
Net operating loss carryover	\$ 3,222,389
Provision for loan losses	2,599,046
Deferred compensation	107,456
Deferred loan fees	65,138
Core deposit	41,075
Other real estate	19,418
AMT tax credit carryover	17,179
Other	63,349
Total deferred tax assets	6,135,050
Less: valuation allowance	(2,229,439)
Net deferred tax assets	\$ 3,905,611
Deferred Income Tax Liabilities:	
Unrealized gains on securities available for sale	\$ (342,984)
Depreciation	(861,352)
Total deferred tax liabilities	(1,204,336)
Net deferred tax asset (liability)	\$ 2,701,275

Realization of deferred tax assets associated with net operating loss carryforwards is dependent upon generating sufficient taxable income prior to their expiration. A valuation allowance to reflect management's estimate of the temporary deductible differences that may expire prior to their utilization has been recorded at year-end 2019.

At year-end 2019, the Company had federal net operating loss carryforwards of approximately \$11,000,000 which expire at various dates from 2031 to 2039. The Company also had state operating loss carryforwards of approximately \$15,000,000 which expire at various dates from 2030 to 2039. Deferred tax assets are recognized for net operating losses because the benefit is more likely than not to be realized.

The Company and its subsidiary are subject to U.S. federal income tax as well as tax of the state of Georgia. The Company is subject to examination by taxing authorities for years ended December 31, 2017 and thereafter.

NOTE 15. EMPLOYEE BENEFIT PLANS

The Company adopted a 401(k) plan in 1996 and made contributions to the plan totaling \$329,650, \$259,374, and \$219,590 for the years ended December 31, 2019, 2018, and 2017, respectively.

The Bank established Morris Bank Employee Stock Ownership Plan and Trust ("the Plan") effective as of January 1, 2012. The Plan covers substantially all of its full-time employees meeting length of service requirements. Under the Plan, shares of stock in the Company are purchased on behalf of eligible employees. Contributions are made to the plan at management's discretion based on a percentage of salary, not to exceed 16% or \$17,000. Dividend income is accrued on the ex-dividend date and allocated based on the individual ownership percentage of the participants. As of December 31, 2019, the Plan owned 145,908 shares of stock. The amount of pension expense charged to operations for the years ended December 31, 2019, 2018, and 2017 were \$309,616, \$325,318, and \$320,485, respectively.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

	<i>As of December 31,</i>	
	2019	2018
Shares held by the Plan were as follows:		
Allocated to participants	155,801	145,908
Unearned	-	-
Total KSOP shares	155,801	145,908
Fair value of unearned shares	\$ -	\$ -

The Company initiated a Stock Grant Plan (“Plan 1”) on February 1, 2017 in which granted stock has a 3 year vesting period. The fair value of each grant under Plan 1 was estimated on the date of grant using the same valuation model used for shares granted under the Plan. The term for shares granted under Plan 1 was 0.1 years as of December 31, 2019. Under Plan 1, there were 2,000 stock grants outstanding as of December 31, 2019. Dividend income is accrued on the ex-dividend date and allocated based on the individual ownership percentage of the participants. The Company recognized \$67,540 in expense for the portion of the stock value vested in the years ended December 31, 2019 and 2018. As of December 31, 2019 there was \$5,628 of total unrecognized cost related to nonvested shares granted under Plan 1; that cost is expected to be recognized over a period of 0.1 years.

The Company initiated a Stock Grant Plan (“Plan 2”) on September 25, 2019 in which granted stock has a 3.22 year vesting period. The fair value of each grant under Plan 2 was estimated on the date of grant using the same valuation model used for shares granted under the Plan. The term for shares granted under Plan 2 was 3 years as of December 31, 2019. Under Plan 2, there were 20,253 stock grants outstanding as of December 31, 2019. Dividend income is accrued on the ex-dividend date and allocated based on the individual ownership percentage of the participants. The Company recognized \$292,656 in expense for the portion of the stock value vested in 2019. As of December 31, 2019, there was \$877,968 of total unrecognized cost related to nonvested shares granted under Plan 2; that cost is expected to be recognized over a period of 3 years.

The Company initiated a Stock Grant Plan (“Plan 3”) on September 25, 2019 in which granted stock has a 5.22 year vesting period. The fair value of each grant under Plan 3 was estimated on the date of grant using the same valuation model used for shares granted under the Plan. The term for shares granted under Plan 3 was 5 years as of December 31, 2019. Under Plan 3, there were 13,685 stock grants outstanding as of December 31, 2019. Dividend income is accrued on the ex-dividend date and allocated based on the individual ownership percentage of the participants. The Company recognized \$118,594 in expense for the portion of the stock value vested in 2019. As of December 31, 2019, there was \$593,256 of total unrecognized cost related to nonvested shares granted under Plan 3; that cost is expected to be recognized over a period of 5 years.

NOTE 16. LIMITATION ON DIVIDENDS

The Board of Directors of any state-chartered bank in Georgia with a Subchapter S election in force may declare and pay cash dividends on its outstanding capital stock without any request for approval of the Bank’s regulatory agency if the following conditions are met:

1. Total classified assets at the most recent examination of the bank do not exceed eighty (80) percent of equity capital.
2. The aggregate amount of dividends declared in the calendar year does not exceed fifty (50) percent of the prior year's net income plus an additional fifty (50) percent of the calculated income taxes “as if” the corporation was still a taxable corporation.
3. The ratio of equity capital to adjusted total assets shall not be less than six (6) percent.

As of December 31, 2019, the amount available for distribution as dividends in the subsequent year without regulatory consent was \$9,698,688.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

NOTE 17. FINANCIAL INSTRUMENTS

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Bank has in those particular financial instruments.

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

The Bank does require collateral or other security to support financial instruments with credit risk.

	<i>As of December 31,</i>	
	2019	2018
Financial instruments whose contract amount represent credit risk:		
Commitments to extend credit	\$ 98,369,000	\$ 78,958,000
Standby letters of credit	3,823,000	3,998,000
Total	\$ 102,192,000	\$ 82,956,000

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. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. 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 Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank upon extension of credit is based on management's credit evaluation. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing and similar transactions. All letters of credit are due within one year of the original commitment date. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

NOTE 18. RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Company, through the Bank, has direct and indirect loans outstanding to or for the benefit of certain executive officers and directors. These loans were made on substantially the same terms as those prevailing, at the time made, for comparable loans to other persons and did not involve more than the normal risk of collectability or present other unfavorable features. The following is a summary of activity during the year ended December 31, 2019 with respect to such loans to these individuals:

Balances at December 31, 2018	\$ 11,096,196
New loans	4,968,614
Repayments	(1,785,388)
Balances at December 31, 2019	\$ 14,279,422

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

The Bank also had deposits from these related parties of approximately \$13,943,768 and \$3,448,862 at December 31, 2019 and 2018, respectively.

The Bank leases office space for its Warner Robins branch from Red Thunder Properties, LLC, of which a member of the Bank's Board of Directors is the managing member. See Note 20 for further detail.

NOTE 19. FAIR VALUES OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the company's various financial instruments. In cases where quoted market prices are not available, fair value is based on discounted cash flows or other valuation techniques. These techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. The accounting standard for disclosures about the fair value of financial instruments excludes financial instruments not recorded at fair value and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

The fair value hierarchy describes three levels of inputs that may be used to measure fair value:

Level 1 – Valuation is based upon quoted prices for identical instruments traded in active markets.

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

Level 3 – Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of assets or liabilities.

Following is a description of valuation methodologies used for assets and liabilities which are either recorded or disclosed at fair value.

Investment Securities Available for Sale

The fair value of securities available for sale is determined by various valuation methodologies. Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. Level 2 securities include mortgage-backed securities issued by government sponsored enterprises and municipal bonds. The level 2 fair value pricing is provided by an independent third-party and is based upon similar securities in an active market. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy and include certain residual municipal securities and other less liquid securities.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

Loans

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, a creditor may measure impairment based on a loan's observable market price, or the fair value of the collateral if repayment of the loan is dependent upon the sale of the underlying collateral. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. In accordance with ASC 820, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3.

Other Real Estate and Foreclosed Assets

Other real estate and foreclosed assets are adjusted to fair value, less cost to sell, upon transfer of the loans to other real estate and foreclosed assets. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the other real estate and foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the other real estate and foreclosed asset as nonrecurring Level 3.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis as of December 31, 2019 and 2018, aggregated by the level in the fair value hierarchy within which those measurements fall.

	December 31, 2019			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
ASSETS:				
Investment debt securities available for sale:				
U.S. Government agencies	\$ -	\$ 6,740,411	\$ -	\$ 6,740,411
U.S. Treasury securities	-	7,754,798	-	7,754,798
State, county, and municipal securities	1,467,942	23,792,044	-	25,259,986
Corporate bonds	-	4,435,387	500,000	4,935,387
Residential mortgage backed securities	3,071,818	26,396,596	2,011,419	31,479,833
Commercial mortgage backed securities	-	43,147,643	4,997,040	48,144,683
Total investment securities	<u>\$ 4,539,760</u>	<u>\$ 112,266,879</u>	<u>\$ 7,508,459</u>	<u>\$ 124,315,098</u>
	December 31, 2018			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
ASSETS:				
Investment debt securities available for sale:				
U.S. Government agencies	\$ -	\$ 4,186,100	\$ -	\$ 4,186,100
U.S. Treasury securities	-	5,514,454	-	5,514,454
State, county, and municipal securities	507,207	27,864,153	-	28,371,360
Residential mortgage backed securities	-	10,926,083	-	10,926,083
Commercial mortgage backed securities	-	21,847,931	-	21,847,931
Total investment securities	<u>\$ 507,207</u>	<u>\$ 70,338,721</u>	<u>\$ -</u>	<u>\$ 70,845,928</u>

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

Assets Recorded at Fair Value on a Nonrecurring Basis

The Company may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. The table below presents the Company's assets and liabilities measured at fair value on a nonrecurring basis as of December 31, 2019 and 2018, aggregated by the level in the fair value hierarchy within which those measurements fall.

	December 31, 2019			
	Level 1	Level 2	Level 3	Total
Impaired loans	\$ -	\$ -	\$ 11,802,168	\$ 11,802,168
Other real estate and foreclosed assets	-	-	396,486	396,486
	\$ -	\$ -	\$ 12,198,654	\$ 12,198,654

	December 31, 2018			
	Level 1	Level 2	Level 3	Total
Impaired loans	\$ -	\$ -	\$ 7,661,565	\$ 7,661,565
Other real estate and foreclosed assets	-	-	835,921	835,921
	\$ -	\$ -	\$ 8,497,486	\$ 8,497,486

The Company did not have assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of December 31, 2018. The following table presents a reconciliation of assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31, 2019.

	Total	Residential mortgage backed securities	Commercial mortgage backed securities	Corporate Bonds
Balance, December 31, 2018	\$ -	\$ -	\$ -	\$ -
Transfers into Level 3	-	-	-	-
Transfers out of Level 3	-	-	-	-
Total net gains (losses) included in:				
Net income	-	-	-	-
Other comprehensive income	-	-	-	-
Transactions during the period:				
Purchases	7,508,459	2,011,419	4,997,040	500,000
Sales	-	-	-	-
Settlements	-	-	-	-
Balance, December 31, 2019	\$ 7,508,459	\$ 2,011,419	\$ 4,997,040	\$ 500,000
Change in unrealized gains (losses) included in net income for the year for assets held as of December 31, 2019	\$ -	\$ -	\$ -	\$ -

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

The following table shows significant unobservable inputs used in the fair value measurement of level 3 assets and liabilities.

Measurements:	Fair Value at		Valuation Technique	Unobservable Inputs	Range
	December 31, 2019				
Recurring:					
Residential mortgage backed securities	\$	2,011,419	Third party book price	Credit quality of issuer	0.00%
Commercial mortgage backed securities	\$	4,997,040	Third party book price	Credit quality of issuer	0.00%
Corporate bonds	\$	500,000	Third party book price	Credit quality of issuer	0.00%
Nonrecurring:					
Impaired loans	\$	11,802,168	Third party appraisals, discounted cash flows, and loan pricing	Collateral discounts, estimated selling expenses, and discount rates	0.00% - 100.00%
Other real estate and foreclosed assets	\$	396,486	Third party appraisals	Collateral discounts and estimated selling costs	10.00% - 39.09%

Measurements:	Fair Value at		Valuation Technique	Unobservable Inputs	Range
	December 31, 2018				
Nonrecurring:					
Impaired loans	\$	7,661,565	Third party appraisals, discounted cash flows, and loan pricing	Collateral discounts, estimated selling expenses, and discount rates	0.00% - 100.00%
Other real estate and foreclosed assets	\$	835,921	Third party appraisals	Collateral discounts and estimated selling costs	2.27% - 15.00%

NOTE 20. CREDIT RISK CONCENTRATION

The Bank grants agribusiness, commercial and residential loans to customers. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent on the area's economic stability. The primary trade area for the Bank is generally that area within fifty miles in each direction.

The distribution of commitments to extend credit approximates the distribution of loans outstanding. Commercial and standby letters of credit were granted primarily to commercial borrowers. The Bank, as a matter of policy, does not extend credit in excess of the legal lending limit to any single borrower or group of related borrowers.

The Company's bank subsidiary maintains its cash at several financial institutions located in the Southeast. On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law and permanently raised the FDIC coverage limit to \$250,000. The Company had uninsured balances of \$62,969,051 as of December 31, 2019.

The Company maintains a cash balance in an account held with the Federal Home Loan Bank (FHLB). The FHLB is not a financial institution, and as a result, funds held are not subject to FDIC coverage. As of December 31, 2019 the Company had an outstanding balance of \$102,383 with the FHLB, which is entirely uninsured.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

The Company also maintains an account with the Federal Reserve Bank of Atlanta. Although funds held by this institution are not insured with the FDIC, funds are backed by the full faith and credit of the United States Government. As of December 31, 2019, the Company had an outstanding balance of \$1,348,554 with the Federal Reserve Bank, which is backed by the full faith and credit of the United States Government.

Pandemics, natural disasters such as extreme weather conditions, hurricanes, floods, and other acts of nature, and geopolitical events involving civil unrest, changes in government regimes, terrorism, or military conflict could adversely affect our business operations and those of our customers and have significant negative impacts upon economic conditions and cause substantial damage and loss to real and personal property. These pandemics, natural disasters and geopolitical events could impair our borrowers' ability to service their loans, decrease the level and duration of deposits by customers, erode the value of loan collateral, and result in an increase in the amount of our non-performing loans and a higher level of non-performing assets (including real estate owned), net charge-offs, and provision for loan losses, and could materially and adversely affect our business, financial condition, results of operations, and the value of our common stock.

NOTE 21. LEASES EXPENSE

On August 15, 2012, the organizers of Morris Bank entered into a lease agreement for office space located in Gray, Georgia. This lease agreement includes a period of five years beginning September 1, 2012 and ending August 31, 2017. The lease agreement states that at the end of the lease term, the Bank may renew the lease for an additional term of five years. The Bank renewed the initial lease with no rate increase for five years ending August 31, 2022. The Bank has two remaining five year options to extend the original lease term for an aggregate term of twenty years. Monthly lease payments for the first five year period were established at \$8,235, after which time, monthly lease payments may increase by no more than 10% of the original rent price.

On December 19, 2016, the organizers of Morris Bank entered into a lease agreement for office space located in Warner Robins, Georgia. This lease agreement includes a period of five years beginning December 16, 2016 and ending December 31, 2021. The lease agreement states that at the end of the lease term, the Bank may renew the lease for an additional term of five years. The Bank will have a total of three, five year options to extend the original lease term for an aggregate term of twenty years. Monthly lease payments for the first five year period were established at \$8,668, after which time, monthly lease payments may increase by no more than 10% of the price of the previous lease term.

The Company's right-of-use lease asset and lease liability also include leases for storage space and small equipment.

Estimated minimum lease payments as of December 31, 2019, for each of the next five years are as follows:

2020	\$ 220,127
2021	215,407
2022	84,067
2023	-
2024	-
	<u>\$ 519,601</u>

The weighted average remaining lease term was 29 months as of December 31, 2019. The Company recognized lease expenses of \$247,216, \$224,939 and \$221,978 for the years ended December 31, 2019, 2018, and 2017, respectively.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

NOTE 22. OPERATING INCOME AND EXPENSES

Components of other operating expenses greater than 1% of total interest income and other income for the periods ended December 31, 2019, 2018, and 2017 are as follows:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Data processing	\$ 2,526,627	\$ 1,880,949	\$ 1,660,334
Legal and accounting fees	885,926	291,433	383,086
Miscellaneous expenses	512,362	22,300	5,383

There were no components of other operating income greater than 1% of total interest income and other income for the periods ended December 31, 2019, 2018, and 2017.

NOTE 23. REGULATORY MATTERS

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

The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in as of January 1, 2019. Under the Basel III rules, the Bank must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer was phased in at a rate of 0.625% per year from 0.0% in 2015 to 2.50% on January 1, 2019. The capital conservation buffer for 2018 was 1.875%. The Company and its bank subsidiary have elected to exclude the net unrealized gain or loss on available for sale securities, if any, in computing regulatory capital.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total risk-based, Tier I capital and Common Equity Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2019, the Bank meets all capital adequacy requirements to which it is subject. As of December 31, 2019, the most recent notification from regulatory agencies categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier I risk-based, Common Equity Tier I risk-based, and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

The Bank's actual capital amounts and ratios are presented in the following table.

	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<i>As of December 31, 2019</i>						
Total Risk-Based Capital To (Risk-Weighted Assets)	\$ 112,291,000	13.53%	\$ 66,393,680	≥ 8.0%	\$ 82,992,100	≥ 10.0%
Tier I Capital To (Risk-Weighted Assets)	102,575,000	12.36%	49,795,260	≥ 6.0%	66,393,680	≥ 8.0%
Common Equity Tier I Capital To (Risk-Weighted Assets)	102,575,000	12.36%	37,346,445	≥ 4.5%	53,944,865	≥ 6.5%
Tier I Capital To (Average Assets)	102,575,000	10.38%	39,515,840	≥ 4.0%	49,394,800	≥ 5.0%
<i>As of December 31, 2018</i>						
Total Risk-Based Capital To (Risk-Weighted Assets)	\$ 86,308,000	13.35%	\$ 51,730,320	≥ 8.0%	\$ 64,662,900	≥ 10.0%
Tier I Capital To (Risk-Weighted Assets)	78,208,000	12.09%	38,797,740	≥ 6.0%	51,730,320	≥ 8.0%
Common Equity Tier I Capital To (Risk-Weighted Assets)	78,208,000	12.09%	29,098,305	≥ 4.5%	42,030,885	≥ 6.5%
Tier I Capital To (Average Assets)	78,208,000	10.68%	29,291,800	≥ 4.0%	36,614,750	≥ 5.0%

NOTE 24. SEGMENT REPORTING

Reportable segments are strategic business units that offer different products and services. Reportable segments are managed separately because each segment appeals to different markets and, accordingly, requires different technology and marketing strategies.

The Company and its subsidiaries do not have any separately reportable operating segments. The entire operations of the Company are managed as one operation.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

NOTE 25. SUBSEQUENT EVENTS

The Company performed an evaluation of subsequent events through March 25, 2020, the date upon which the Company's financial statements were available to issue.

In early 2020, an outbreak of a novel strain of coronavirus (COVID-19) emerged globally. As a result, events have occurred domestically in United States and globally, including mandates from federal, state and local authorities, leading to an overall decline in economic activity. The ultimate impact of COVID-19 on the financial performance of the Company cannot be reasonably estimated at this time.

Additionally, it is reasonably possible that estimates made in the financial statements have been, or will be, materially and adversely impacted in the near term as a result of these conditions, including the allowance for loan losses, impairment losses related to goodwill, valuation allowances on deferred tax assets, and market values of securities and other real estate properties held.

NOTE 26. CONDENSED FINANCIAL STATEMENTS (PARENT COMPANY ONLY)

Condensed parent company financial information on Morris State Bancshares, Inc. at December 31, 2019 and 2018, is as follows:

BALANCE SHEETS

	<i>As of December 31,</i>	
	2019	2018
Assets		
Cash in subsidiary	\$ -	\$ 1,780,233
Deposits in other banks	6,780,510	15,317
Investment in subsidiaries, at equity in underlying net assets	117,141,358	80,582,948
Goodwill	388,816	388,816
Other assets	1,768,646	364,816
Total Assets	\$ 126,079,330	\$ 83,132,130
Liabilities		
Due to subsidiary	\$ 117,144	\$ -
Notes payable	14,483,605	857,143
Accrued expenses	52,949	42,822
Total liabilities	14,653,698	899,965
Shareholders' Equity		
Common stock, \$1 par value, authorized 10,000,000 shares, 2,144,766 issued and 2,098,249 outstanding in 2019 and 1,882,740 issued and 1,838,816 outstanding in 2018	2,144,766	1,882,740
Paid-in capital surplus	39,292,064	24,225,182
Retained earnings	69,537,950	57,792,589
Accumulated other comprehensive income (loss)	1,830,484	(457,247)
Treasury stock, at cost 46,517 in 2019 and 43,924 shares in 2018	(1,379,632)	(1,211,099)
Total shareholders' equity	111,425,632	82,232,165
Total Liabilities and Shareholders' Equity	\$ 126,079,330	\$ 83,132,130

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

STATEMENTS OF INCOME AND RETAINED EARNINGS

	<i>Years ended December 31,</i>		
	2019	2018	2017
Revenues			
Dividend Income	\$ 7,750,000	\$ 5,450,000	\$ 5,900,000
Interest income	65,870	301	170
Gain on sale of premises and equipment	-	-	5,540
Other	500	-	-
Total income	<u>7,816,370</u>	<u>5,450,301</u>	<u>5,905,710</u>
Expenses			
Interest expense	657,054	54,018	42,385
Occupancy expense	-	-	1,837
Other	613,579	68,540	65,129
Total expenses	<u>1,270,633</u>	<u>122,558</u>	<u>109,351</u>
Income Before Equity Income of Subsidiary	6,545,737	5,327,743	5,796,359
Equity in undistributed income of subsidiaries	<u>7,075,217</u>	<u>9,908,401</u>	<u>7,580,655</u>
Net Income	13,620,954	15,236,144	13,377,014
Retained Earnings, Beginning	57,792,589	47,332,599	41,076,479
Stock and cash dividends	<u>(1,875,593)</u>	<u>(4,776,154)</u>	<u>(7,120,894)</u>
Retained Earnings, Ending	<u>\$ 69,537,950</u>	<u>\$ 57,792,589</u>	<u>\$ 47,332,599</u>

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2019

STATEMENTS OF CASH FLOWS

	<i>Years ended December 31,</i>		
	<u>2019</u>	<u>2018</u>	<u>2017</u>
Cash flows from operating activities:			
Net income	\$ 13,620,954	\$ 15,236,144	\$ 13,377,014
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation expense	-	-	1,385
Equity in undistributed income of subsidiary	(7,075,217)	(9,908,401)	(7,580,655)
Net change in operating assets and liabilities:			
Accrued income and other assets	(1,403,830)	(224,109)	(140,708)
Changes in accrued expenses and other liabilities	<u>127,271</u>	<u>22,692</u>	<u>12,960</u>
Net cash provided by operating activities	<u>5,269,178</u>	<u>5,126,326</u>	<u>5,669,996</u>
Cash flows from investing activities:			
Capital injection to subsidiaries	(27,195,462)	-	(50,000)
Proceeds from sale of property and equipment	<u>-</u>	<u>-</u>	<u>166,866</u>
Net cash provided by (used in) investing activities	<u>(27,195,462)</u>	<u>-</u>	<u>116,866</u>
Cash flows from financing activities:			
Proceeds from borrowed funds	13,912,176	-	-
Repayment of other borrowed funds	(285,714)	(285,713)	(285,716)
Purchase of treasury stock	(168,533)	-	-
Proceeds from stock note receivable	-	-	724,333
Proceeds from issuance of common stock	15,328,908	1,414,441	674,775
Cash dividends paid	<u>(1,875,593)</u>	<u>(4,776,154)</u>	<u>(7,120,894)</u>
Net cash provided by (used in) financing activities	<u>26,911,244</u>	<u>(3,647,426)</u>	<u>(6,007,502)</u>
Net increase (decrease) in cash and cash equivalents	4,984,960	1,478,900	(220,640)
Cash and cash equivalents at beginning of year	<u>1,795,550</u>	<u>316,650</u>	<u>537,290</u>
Cash and cash equivalents at end of year	<u>\$ 6,780,510</u>	<u>\$ 1,795,550</u>	<u>\$ 316,650</u>

The following additional information is related to the Holding Company's cash flows during the periods reported.

	<i>Years ended December 31,</i>		
	<u>2019</u>	<u>2018</u>	<u>2017</u>
Cash paid for interest:			
Interest on borrowings	<u>\$ 621,357</u>	<u>\$ 47,046</u>	<u>\$ 49,825</u>
Noncash items:			
Changes in unrealized gain/loss on investments	<u>\$ 2,287,731</u>	<u>\$ (667,946)</u>	<u>\$ 531,300</u>