

**MORRIS STATE BANCSHARES, INC
AND SUBSIDIARIES**

CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2017

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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, 2017 and 2016, and the related consolidated statements of changes in shareholders' equity, income, comprehensive income, and cash flows for the years ended 2017, 2016, and 2015, 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, 2017 and 2016, and the results of their operations and their cash flows for the year ended 2017, 2016, and 2015 in accordance with accounting principles generally accepted in the United States of America.

Nichols, Cauley + Associates, LLC

Dublin, Georgia
April 16, 2018

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

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	<i>As of December 31,</i>	
	2017	2016
Assets		
Cash and due from banks	\$ 38,087,123	\$ 14,146,018
Federal funds sold	6,624,488	14,206,683
Total cash and cash equivalents	44,711,611	28,352,701
Interest-bearing time deposits in other banks	2,248,000	3,598,000
Securities available for sale, at fair value	51,364,420	50,672,553
Securities held to maturity, at cost	5,934,900	5,824,834
Federal Home Loan Bank stock, restricted, at cost	1,143,600	1,054,200
Loans, net of unearned income	559,493,733	505,363,354
Less - allowance for loan losses	(9,417,617)	(8,950,372)
Loans, net	550,076,116	496,412,982
Bank premises and equipment, net	9,612,661	9,977,184
Goodwill	2,237,890	2,237,890
Intangible assets, net	338,830	389,900
Other real estate and foreclosed assets	1,157,992	2,425,186
Accrued interest receivable	2,816,199	2,464,103
Cash surrender value of life insurance	6,851,182	6,656,656
Other assets	1,082,844	727,562
Total Assets	\$ 679,576,245	\$ 610,793,751
Liabilities and Shareholders' Equity		
Deposits:		
Non-interest bearing	\$ 116,922,117	\$ 107,596,675
Interest bearing	475,869,831	424,200,799
Total deposits	592,791,948	531,797,474
Other borrowed funds	13,142,856	14,428,572
Accrued interest payable	339,920	257,176
Accrued expenses and other liabilities	2,275,841	1,471,377
Total liabilities	608,550,565	547,954,599
Shareholders' Equity:		
Common stock, \$1 par value, authorized 10,000,000 shares, 1,855,548 issued and 1,811,624 outstanding in 2017 and 1,836,241 issued and 1,792,317 outstanding in 2016	1,855,548	1,836,241
Paid-in capital surplus	22,837,933	22,172,933
Less note receivable for the sale of common stock (Note M)	-	(714,801)
Retained earnings	47,332,599	41,076,479
Accumulated other comprehensive income (loss)	210,699	(320,601)
Treasury stock, at cost 43,924 shares in 2017 and 2016	(1,211,099)	(1,211,099)
Total shareholders' equity	71,025,680	62,839,152
Total Liabilities and Shareholders' Equity	\$ 679,576,245	\$ 610,793,751

See Accompanying Notes to Consolidated Financial Statements

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

	<i>Years ended December 31,</i>		
	2017	2016	2015
Interest and Dividend Income:			
Interest and fees on loans	\$ 31,397,586	\$ 27,710,305	\$ 24,559,775
Interest income on securities	1,265,068	1,244,362	1,212,187
Income on federal funds sold	159,657	75,892	25,182
Income on time deposits held in other banks	59,049	73,428	55,502
Other interest and dividend income	<u>216,326</u>	<u>110,523</u>	<u>114,549</u>
Total interest and dividend income	<u>33,097,686</u>	<u>29,214,510</u>	<u>25,967,195</u>
Interest Expense:			
Deposits	3,256,799	2,336,830	2,259,453
Interest on other borrowed funds	448,687	479,879	515,061
Interest on federal funds purchased	<u>1,154</u>	<u>346</u>	<u>4,263</u>
Total interest expense	<u>3,706,640</u>	<u>2,817,055</u>	<u>2,778,777</u>
Net interest income before provision for loan losses	29,391,046	26,397,455	23,188,418
Less - provision for loan losses	<u>975,000</u>	<u>1,735,000</u>	<u>945,000</u>
Net interest income after provision for loan losses	<u>28,416,046</u>	<u>24,662,455</u>	<u>22,243,418</u>
Noninterest Income:			
Service charges on deposit accounts	2,080,312	1,738,086	1,507,090
Other service charges, commissions and fees	208,156	317,788	347,232
Gain on sales of loans	28,141	25,217	596,278
Gain (loss) on sales and calls of securities	(37,263)	37,794	2,921
Increase in CSV of life insurance	194,527	203,327	206,500
Other income	<u>358,570</u>	<u>559,538</u>	<u>306,081</u>
Total noninterest income	<u>2,832,443</u>	<u>2,881,750</u>	<u>2,966,102</u>
Noninterest Expense:			
Salaries	8,081,342	7,151,332	6,108,169
Employee benefits	1,924,808	1,558,466	1,329,376
Net occupancy expense	1,674,658	1,488,370	1,380,353
Equipment rental and depreciation of equipment	69,813	39,734	67,283
Impairment recognized on other real estate held for sale	91,224	730,111	437,596
Loss (gain) on sales of foreclosed assets and other real estate	278,659	(44,065)	60,591
Loss (gain) on sales of premises and equipment	213,957	(1,205)	43,881
Other expenses	<u>5,537,014</u>	<u>5,534,137</u>	<u>4,856,262</u>
Total noninterest expense	<u>17,871,475</u>	<u>16,456,880</u>	<u>14,283,511</u>
Net Income	<u>\$ 13,377,014</u>	<u>\$ 11,087,325</u>	<u>\$ 10,926,009</u>
Earnings per common share:			
Basic	<u>\$ 7.41</u>	<u>\$ 6.20</u>	<u>\$ 6.18</u>
Diluted	<u>\$ 7.41</u>	<u>\$ 6.20</u>	<u>\$ 6.18</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>2017</u>	<u>2016</u>	<u>2015</u>
Net Income	<u>\$ 13,377,014</u>	<u>\$ 11,087,325</u>	<u>\$ 10,926,009</u>
Other comprehensive income (loss):			
Unrealized holding gains (losses) on securities available for sale	494,037	(711,769)	9,659
Reclassification adjustments for (gains) losses realized in income	<u>37,263</u>	<u>(37,794)</u>	<u>(2,921)</u>
Total other comprehensive income (loss)	<u>531,300</u>	<u>(749,563)</u>	<u>6,738</u>
Total comprehensive income	<u>\$ 13,908,314</u>	<u>\$ 10,337,762</u>	<u>\$ 10,932,747</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, 2014	\$ 1,788,153	\$ 20,624,423	\$ (1,999,988)	\$ 30,102,206	\$ 422,224	\$ (999,995)	\$ 49,937,023
Issuance of common stock	38,707	1,141,403	-	-	-	-	1,180,110
Purchase of treasury stock	-	-	-	-	-	(211,104)	(211,104)
Repayment of note receivable	-	60,102	653,516	-	-	-	713,618
Net income	-	-	-	10,926,009	-	-	10,926,009
Other comprehensive income	-	-	-	-	6,738	-	6,738
Cash dividends	-	-	-	(5,854,377)	-	-	(5,854,377)
Balance, December 31, 2015	1,826,860	21,825,928	(1,346,472)	35,173,838	428,962	(1,211,099)	56,698,017
Issuance of common stock	9,381	314,785	-	-	-	-	324,166
Repayment of note receivable	-	32,220	631,671	-	-	-	663,891
Net income	-	-	-	11,087,325	-	-	11,087,325
Other comprehensive loss	-	-	-	-	(749,563)	-	(749,563)
Cash dividends	-	-	-	(5,184,684)	-	-	(5,184,684)
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	<u>\$ 1,855,548</u>	<u>\$ 22,837,933</u>	<u>\$ -</u>	<u>\$ 47,332,599</u>	<u>\$ 210,699</u>	<u>\$ (1,211,099)</u>	<u>\$ 71,025,680</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>		
	2017	2016	2015
Cash Flows from Operating Activities:			
Net income	\$ 13,377,014	\$ 11,087,325	\$ 10,926,009
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	975,000	1,735,000	945,000
Depreciation	588,093	556,801	529,040
Impairment recognized on other real estate held for sale	91,224	730,111	437,596
Loss (gain) on sales of foreclosed assets, other real estate and property, net	492,616	(45,270)	104,472
Gain on sales of loans	(28,141)	(25,217)	(596,278)
Net amortization on securities	547,453	684,090	546,613
Loss (gain) on sales / calls of investment securities	37,263	(37,794)	(2,921)
Increase in CSV life insurance	(194,526)	(203,328)	(206,500)
Amortization of intangible assets	51,070	52,001	13,881
Changes in accrued income and other assets	(764,125)	(260,951)	(304,882)
Changes in accrued expenses and other liabilities	887,208	54,957	30,773
Net cash provided by operating activities	<u>16,060,149</u>	<u>14,327,725</u>	<u>12,422,803</u>
Cash Flows from Investing Activities:			
Net change in loans to customers	(55,899,507)	(78,465,795)	(47,918,671)
Proceeds from sales of loans	541,205	284,117	6,499,064
Net change in interest-bearing time deposits in other banks	1,350,000	1,100,000	(1,380,000)
Purchase of available for sale securities	(8,354,765)	(7,603,902)	(12,903,379)
Proceeds from sales of available for sale securities	4,209,229	3,144,942	273,218
Proceeds from maturities/calls/paydowns of available for sale securities	3,425,803	7,208,654	10,665,972
Purchase of held to maturity securities	(1,247,167)	-	(1,520,089)
Proceeds from maturities/calls/paydowns of held to maturity securities	1,111,551	-	4,986
Proceeds from redemption of Federal Home Loan Bank stock	-	-	224,600
Purchase of Federal Home Loan Bank stock	(89,400)	(48,200)	-
Payment for acquisition of branch location	-	-	(2,304,856)
Property and equipment expenditures	(705,304)	(1,377,750)	(1,532,943)
Proceeds from sales of property and equipment	267,777	-	-
Capital expenditures on other real estate and repossessed assets	-	-	14,802
Proceeds from sales of other real estate and repossessed assets	<u>1,702,367</u>	<u>2,370,545</u>	<u>875,977</u>
Net cash used in investing activities	<u>(53,688,211)</u>	<u>(73,387,389)</u>	<u>(49,001,319)</u>
Cash Flows from Financing Activities:			
Net change in deposits	60,994,474	46,998,691	52,219,758
Proceeds from other borrowed funds	6,000,000	-	-
Repayment of other borrowed funds	(7,285,716)	(285,714)	(5,301,854)
Purchase of treasury stock	-	-	(211,104)
Proceeds from issuance of common stock	674,775	324,166	1,180,110
Proceeds from stock note receivable	724,333	663,891	713,618
Cash dividends paid	<u>(7,120,894)</u>	<u>(5,184,684)</u>	<u>(5,854,377)</u>
Net cash provided by financing activities	<u>53,986,972</u>	<u>42,516,350</u>	<u>42,746,151</u>
Net Increase (decrease) in Cash and Cash Equivalents	16,358,910	(16,543,314)	6,167,635
Cash and Cash Equivalents, Beginning of Year	<u>28,352,701</u>	<u>44,896,015</u>	<u>38,728,380</u>
Cash and Cash Equivalents, End of Year	<u>\$ 44,711,611</u>	<u>\$ 28,352,701</u>	<u>\$ 44,896,015</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>		
	2017	2016	2015
Cash paid for interest:			
Interest on deposits	\$ 3,158,248	\$ 2,329,465	\$ 2,259,245
Interest on borrowings	\$ 465,648	\$ 480,584	\$ 516,234
Noncash items:			
Changes in unrealized gain/loss on securities available for sale	\$ 531,300	\$ (749,563)	\$ 6,738
Transfer of loans to other real estate and other assets	\$ 1,171,519	\$ 6,292,732	\$ 2,732,203
Transfer of other real estate and other assets to loans	\$ 423,210	\$ 3,136,259	\$ 313,254
Transfer of foreclosed assets to bank premises and equipment	\$ -	\$ -	\$ 249,711

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 2017

A. 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, 2017 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 acquired 100% ownership of IMOR Properties LLC. At December 31, 2017 the Company owned 100% of IMOR Properties LLC. IMOR Properties LLC was established by the Company as a subsidiary for holding real property.

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.

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.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2017

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 (net of tax effect) 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.

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.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2017

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, 2017, neither of the Company's assets had identified 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 five to seven 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.
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** – The Company does not reflect a provision for federal and state income taxes inasmuch as there was a Small Business Corporation election in force. This Small Business Corporation election, under Section 1372(a) of the Internal Revenue Code of 1954, provided for the income or loss of the Company to pass through to the shareholders as personal taxable income or loss.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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The Company adopted the Financial Accounting Standards Board (FASB) Accounting Standard Codification (ASC) 740, *Accounting for Uncertainty in Income Taxes*, as of January 1, 2009. A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50 percent likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. The adoption had no effect on the Company’s financial statements for the year ending December 31, 2017.

The Company recognizes penalties related to income tax matters in income tax expense. The Company is subject to U.S. federal and Georgia state income tax audit for returns for the tax periods ending December 31, 2017, 2016, and 2015.

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, 2017 or 2016.
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.

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, 2017, 2016, and 2015 were \$340,592, \$218,747, and \$258,173, 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.

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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,		
	2017	2016	2015
Net income applicable to common shares	\$ 13,377,014	\$ 11,087,325	\$ 10,926,009
Average number of common shares outstanding	1,804,830	1,788,490	1,767,461
Effect of dilutive options, warrants, etc.	-	-	-
Average number of common shares outstanding used to calculate diluted earnings per common share	1,804,830	1,788,490	1,767,461

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**

Staff Accounting Bulletin No. 118 (“SAB 118”). SAB 118 provides guidance on accounting for the tax effects of H.R. 1, commonly known as the Tax Cuts and Jobs Act of 2017 (the “Tax Act”), which was signed into law on December 22, 2017. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under Accounting Standards Codification Topic 740, Income Taxes. The Company continues to analyze the Tax Act, including the impact on deductibility of certain executive compensation and alternative minimum tax credits, and any refinements to the provisional accounting will be completed within one year of the tax enactment date.

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

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ASU 2016-13 - Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (“ASU 2016-13”). 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. 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, 2018, and interim periods within those annual periods with early adoption permitted. The Company is currently evaluating the impact this standard will have on the Company’s results of operations, financial position or disclosures.

ASU 2014-09 – Revenue from Contracts with Customers (“ASU 2014-09”). ASU 2014-09 provides guidance that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective prospectively, for annual and interim periods, beginning after December 15, 2017. The Company is currently evaluating the impact this standard will have on the Company’s results of operations, financial position or disclosures.

B. BUSINESS COMBINATIONS

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.

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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 CertusBank</u>	<u>Initial Fair Value Adjustment</u>	<u>As Recorded by 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
Intangible assets	-	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.

C. 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, 2017 and 2016. In addition, gross unrealized gains and gross unrealized losses are disclosed as of December 31, 2017 and 2016.

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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, 2017				
Non-mortgage backed debt securities of:				
U.S. Government agencies	\$ 4,246,011	\$ 3,047	\$ 23,035	\$ 4,226,023
State, county, and municipal securities	26,597,606	429,044	175,717	26,850,933
Other debt securities	-	-	-	-
Total non-mortgage backed debt securities	<u>30,843,617</u>	<u>432,091</u>	<u>198,752</u>	<u>31,076,956</u>
Mortgage backed securities:				
Residential mortgage backed securities	14,330,721	157,949	149,543	14,339,127
Commercial mortgage backed securities	<u>5,979,383</u>	-	<u>31,046</u>	<u>5,948,337</u>
Total mortgage backed securities	<u>20,310,104</u>	<u>157,949</u>	<u>180,589</u>	<u>20,287,464</u>
Total	<u>\$ 51,153,721</u>	<u>\$ 590,040</u>	<u>\$ 379,341</u>	<u>\$ 51,364,420</u>
December 31, 2016				
Non-mortgage backed debt securities of:				
U.S. Government agencies	\$ 4,244,242	\$ 21,738	\$ 21,212	\$ 4,244,768
State, county, and municipal securities	24,502,795	280,130	468,584	24,314,341
Other debt securities	<u>702,146</u>	<u>19,141</u>	-	<u>721,287</u>
Total non-mortgage backed debt securities	<u>29,449,183</u>	<u>321,009</u>	<u>489,796</u>	<u>29,280,396</u>
Mortgage backed securities:				
Residential mortgage backed securities	13,091,999	172,474	174,509	13,089,964
Commercial mortgage backed securities	<u>8,451,972</u>	<u>11,534</u>	<u>161,313</u>	<u>8,302,193</u>
Total mortgage backed securities	<u>21,543,971</u>	<u>184,008</u>	<u>335,822</u>	<u>21,392,157</u>
Total	<u>\$ 50,993,154</u>	<u>\$ 505,017</u>	<u>\$ 825,618</u>	<u>\$ 50,672,553</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, 2017				
Non-mortgage backed debt securities of:				
State, county, and municipal securities	\$ 3,835,466	\$ 131,581	\$ 195	\$ 3,966,852
Total non-mortgage backed debt securities	3,835,466	131,581	195	3,966,852
Residential Mortgage backed securities	<u>2,099,434</u>	-	<u>35,693</u>	<u>2,063,741</u>
Total	<u>\$ 5,934,900</u>	<u>\$ 131,581</u>	<u>\$ 35,888</u>	<u>\$ 6,030,593</u>
December 31, 2016				
Non-mortgage backed debt securities of:				
State, county, and municipal securities	\$ 4,147,163	\$ 63,172	\$ 30,138	\$ 4,180,197
Total non-mortgage backed debt securities	4,147,163	63,172	30,138	4,180,197
Residential Mortgage backed securities	<u>1,677,671</u>	-	<u>7,385</u>	<u>1,670,286</u>
Total	<u>\$ 5,824,834</u>	<u>\$ 63,172</u>	<u>\$ 37,523</u>	<u>\$ 5,850,483</u>

The book and market values of pledged securities were \$45,007,745 and \$45,184,157 at December 31, 2017, respectively and \$43,800,237 and \$43,696,381 at December 31, 2016, respectively.

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The amortized cost and estimated market value of debt securities held to maturity and available for sale at December 31, 2017 and 2016, 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.

	Available for Sale	
	Amortized Cost	Estimated Market Value
December 31, 2017		
Non-mortgage backed securities:		
Due in one year or less	\$ 1,596,117	\$ 1,598,004
Due after one year through five years	18,701,932	18,807,574
Due after five years through ten years	8,571,152	8,579,610
Due after ten years	<u>1,974,436</u>	<u>2,091,768</u>
Total non-mortgage backed securities	<u>30,843,637</u>	<u>31,076,956</u>
Mortgage backed securities:		
Residential mortgage backed securities	14,330,721	14,339,127
Commercial mortgage backed securities	<u>5,979,383</u>	<u>5,948,337</u>
Total mortgage backed securities	<u>20,310,104</u>	<u>20,287,464</u>
Total	<u>\$ 51,153,741</u>	<u>\$ 51,364,420</u>

	Available for Sale	
	Amortized Cost	Estimated Market Value
December 31, 2016		
Non-mortgage backed securities:		
Due in one year or less	\$ 1,203,862	\$ 1,231,217
Due after one year through five years	17,088,200	17,214,051
Due after five years through ten years	9,192,594	8,908,242
Due after ten years	<u>1,964,527</u>	<u>1,926,886</u>
Total non-mortgage backed securities	<u>29,449,183</u>	<u>29,280,396</u>
Mortgage backed securities:		
Residential mortgage backed securities	13,091,999	13,089,964
Commercial mortgage backed securities	<u>8,451,972</u>	<u>8,302,193</u>
Total mortgage backed securities	<u>21,543,971</u>	<u>21,392,157</u>
Total	<u>\$ 50,993,154</u>	<u>\$ 50,672,553</u>

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	Held to Maturity	
	<u>Amortized Cost</u>	<u>Estimated Market Value</u>
December 31, 2017		
Non-mortgage backed securities:		
Due in one year or less	\$ 245,000	\$ 245,377
Due after one year through five years	952,598	963,764
Due after five years through ten years	1,994,870	2,036,875
Due after ten years	<u>642,998</u>	<u>720,836</u>
Total non-mortgage backed securities	3,835,466	3,966,852
Residential mortgage backed securities	<u>2,099,434</u>	<u>2,063,741</u>
Total	<u>\$ 5,934,900</u>	<u>\$ 6,030,593</u>
December 31, 2016		
Non-mortgage backed securities:		
Due in one year or less	\$ 300,000	\$ 301,314
Due after one year through five years	803,406	797,745
Due after five years through ten years	2,412,990	2,409,129
Due after ten years	<u>630,767</u>	<u>672,009</u>
Total non-mortgage backed securities	4,147,163	4,180,197
Residential mortgage backed securities	<u>1,677,671</u>	<u>1,670,286</u>
Total	<u>\$ 5,824,834</u>	<u>\$ 5,850,483</u>

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, 2017 and 2016, 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.

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Information pertaining to securities with gross unrealized losses at December 31, 2017 and 2016, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	December 31, 2017			
	<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	\$ 17,657	\$ 1,982,344	\$ 5,378	\$ 494,621
State, county, and municipal securities	18,117	2,753,893	157,600	5,794,031
Other debt securities	-	-	-	-
Total non-mortgage backed debt securities	<u>35,774</u>	<u>4,736,237</u>	<u>162,978</u>	<u>6,288,652</u>
Mortgage backed securities:				
Residential mortgage backed securities	27,949	3,667,568	121,594	4,037,791
Commercial mortgage backed securities	<u>16,057</u>	<u>4,924,067</u>	<u>14,989</u>	<u>1,024,270</u>
Total mortgage backed securities	<u>44,006</u>	<u>8,591,635</u>	<u>136,583</u>	<u>5,062,061</u>
Total	<u>\$ 79,780</u>	<u>\$ 13,327,872</u>	<u>\$ 299,561</u>	<u>\$ 11,350,713</u>
<u>Securities Held to Maturity</u>				
Non-mortgage backed debt securities of:				
State, county, and municipal securities	\$ 195	\$ 549,944	\$ -	\$ -
Total non-mortgage backed debt securities	195	549,944	-	-
Residential mortgage backed securities	<u>22,468</u>	<u>1,218,620</u>	<u>13,225</u>	<u>845,121</u>
Total	<u>\$ 22,663</u>	<u>\$ 1,768,564</u>	<u>\$ 13,225</u>	<u>\$ 845,121</u>
<u>December 31, 2016</u>				
	<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	\$ 21,212	\$ 2,478,788	\$ -	\$ -
State, county, and municipal securities	468,584	12,358,916	-	-
Other debt securities	-	-	-	-
Total non-mortgage backed debt securities	489,796	14,837,704	-	-
Mortgage backed securities:				
Residential mortgage backed securities	161,313	6,330,071	91,470	1,220,047
Commercial mortgage backed securities	<u>1,002</u>	<u>405,861</u>	<u>82,037</u>	<u>4,163,273</u>
Total mortgage backed securities	<u>162,315</u>	<u>6,735,932</u>	<u>173,507</u>	<u>5,383,320</u>
Total	<u>\$ 652,111</u>	<u>\$ 21,573,636</u>	<u>\$ 173,507</u>	<u>\$ 5,383,320</u>
<u>Securities Held to Maturity</u>				
Non-mortgage backed debt securities of-				
State, county, and municipal securities	\$ 30,138	\$ 1,831,827	\$ -	\$ -
Total non-mortgage backed debt securities	30,138	1,831,827	-	-
Residential mortgage backed securities	<u>7,385</u>	<u>1,025,173</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 37,523</u>	<u>\$ 2,857,000</u>	<u>\$ -</u>	<u>\$ -</u>

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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, 2017, 40 debt securities had unrealized losses with aggregate depreciation of 1.50% from the Company's amortized cost basis.

As of December 31, 2017, the company held 3 U.S. Government agency 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, 2017.

As of December 31, 2017, the Company held 4 commercial mortgage backed securities and 9 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, 2017.

As of December 31, 2017, the Company held 24 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, 2017.

D. 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.

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Loans are stated at unpaid balances, net of unearned income and deferred loan fees. Balances within the major loans receivable categories at December 31, 2017 and 2016 are presented in the following table:

	<u>2017</u>	<u>2016</u>
Commercial	\$ 72,059,139	\$ 60,244,368
Commercial Real Estate	305,891,933	287,341,352
Consumer	31,459,126	30,911,788
Residential Real Estate	120,027,996	91,949,145
Agriculture	27,209,521	25,372,032
Other	<u>702,284</u>	<u>736,210</u>
Total Loans	557,349,999	496,554,895
Other:		
Overdraft, in-process, and suspense accounts	<u>2,143,734</u>	<u>8,808,459</u>
Gross Loans	559,493,733	505,363,354
Allowance for loan losses	<u>(9,417,617)</u>	<u>(8,950,372)</u>
Loans, net	<u>\$ 550,076,116</u>	<u>\$ 496,412,982</u>

Overdrafts included in loans were \$431,629 and \$525,867 at December 31, 2017 and 2016, 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, 2017 and 2016:

	<u>As of December 31, 2017</u>							
	Current and < 30 Days Past Due	<u>Past Due and Still Accruing</u>				Total Accruing Past Due	Non-accrual	Total Loans
		30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due				
Commercial	\$ 68,417,196	\$ 618,261	\$ 54,120	\$ 406,615	\$ 1,078,996	\$ 2,562,947	\$ 72,059,139	
Commercial Real Estate	303,158,300	131,517	135,863	-	267,380	2,466,253	305,891,933	
Consumer	30,302,205	664,842	147,726	-	812,568	344,353	31,459,126	
Residential Real Estate	117,403,908	869,466	304,471	-	1,173,937	1,450,151	120,027,996	
Agriculture	26,496,525	39,147	662,209	-	701,356	11,640	27,209,521	
Other	<u>702,284</u>	-	-	-	-	-	<u>702,284</u>	
Total	<u>\$ 546,480,418</u>	<u>\$ 2,323,233</u>	<u>\$ 1,304,389</u>	<u>\$ 406,615</u>	<u>\$ 4,034,237</u>	<u>\$ 6,835,344</u>	<u>\$ 557,349,999</u>	
Overdraft, in-process, and suspense accounts						<u>2,143,734</u>		
							<u>\$ 559,493,733</u>	

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As of December 31, 2016							
	Past Due and Still Accruing				Total Accruing	Non-accrual	Total Loans
	Current and <	90 Days or					
	30 Days	30-59 Days	60-89 Days	More			
	Past Due	Past Due	Past Due	Past Due	Past Due		
Commercial	\$ 57,263,727	\$ 745,402	\$ 293,994	\$ 12,924	\$ 1,052,320	\$ 1,928,321	\$ 60,244,368
Commercial Real Estate	282,687,811	2,175,178	763,870	-	2,939,048	1,714,493	287,341,352
Consumer	30,004,598	471,064	176,530	-	647,594	259,596	30,911,788
Residential Real Estate	89,766,849	1,023,898	107,303	11,950	1,143,151	1,039,145	91,949,145
Agriculture	25,056,214	13,236	-	-	13,236	302,582	25,372,032
Other	736,210	-	-	-	-	-	736,210
Total	\$ 485,515,409	\$ 4,428,778	\$ 1,341,697	\$ 24,874	\$ 5,795,349	\$ 5,244,137	\$ 496,554,895
Overdraft, in-process, and suspense accounts						8,808,459	
							<u>\$ 505,363,354</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, 2017			
	Average Investment	Interest Income	
		Interest Income	Interest Income
		Recognized on	Recognized on Cash
	in Impaired Loans	Impaired Loans	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	\$ 674,288	\$ 360,019

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As of December 31, 2016			
	Average Investment in Impaired Loans	Interest Income Recognized on Impaired Loans	Interest Income Recognized on Cash Basis on Impaired Loans
Commercial	\$ 2,851,808	\$ 348,884	\$ 149,825
Commercial Real Estate	5,922,797	175,019	131,295
Consumer	2,283	-	-
Residential Real Estate	2,172,275	93,506	86,310
Agriculture	1,116,318	100,100	85,348
Other	-	-	-
Total	\$ 12,065,481	\$ 717,509	\$ 452,778

As of December 31, 2015			
	Average Investment in Impaired Loans	Interest Income Recognized on Impaired Loans	Interest Income Recognized on Cash Basis on Impaired Loans
Commercial	\$ 2,160,650	\$ 88,899	\$ 82,297
Commercial Real Estate	8,900,531	210,133	194,099
Consumer	7,446	99	99
Residential Real Estate	3,059,471	71,326	66,255
Agriculture	1,348,454	52,554	42,926
Other	-	-	-
Total	\$ 15,476,552	\$ 423,011	\$ 385,676

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

As of December 31, 2017					
	Unpaid Total Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Total Related Allowance
Commercial	\$ 3,746,929	\$ 784,341	\$ 2,858,245	\$ 3,642,586	\$ 1,503,151
Commercial real estate	3,763,562	186,681	3,576,881	3,763,562	1,306,093
Consumer	205,310	205,310	-	205,310	-
Residential real estate	1,531,852	405,846	1,126,006	1,531,852	354,146
Agriculture	655,195	344,637	310,558	655,195	16,258
Other	-	-	-	-	-
Total	\$ 9,902,848	\$ 1,926,815	\$ 7,871,690	\$ 9,798,505	\$ 3,179,648

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	As of December 31, 2016				
	Unpaid Total	Recorded		Total	Related
		Principal	Investment		
	Balance	With No	With	Recorded	Allowance
Balance	Allowance	Allowance	Investment	Allowance	
Commercial	\$ 3,610,467	\$ 2,293,834	\$ 1,191,071	\$ 3,484,905	\$ 401,091
Commercial real estate	3,257,060	616,995	2,640,065	3,257,060	464,450
Consumer	-	-	-	-	-
Residential real estate	1,650,746	720,044	930,702	1,650,746	163,096
Agriculture	633,050	633,050	-	633,050	-
Other	-	-	-	-	-
Total	\$ 9,151,323	\$ 4,263,923	\$ 4,761,838	\$ 9,025,761	\$ 1,028,637

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.

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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.

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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.

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The following tables present the loan portfolio by risk grade as of December 31, 2017 and 2016:

	As of December 31, 2017						
	Commercial Real			Residential Real			
	Commercial	Estate	Consumer	Estate	Agriculture	Other	Total
Grade 1 (Excellent Risk)	\$ 925,849	\$ 10,721	\$ 1,167,378	\$ 156,275	\$ -	\$ -	\$ 2,260,223
Grade 2 (High Quality)	58,515	-	171,995	26,941	-	-	257,451
Grade 3 (Average Risk)	699,203	9,268,335	536,442	5,772,026	1,456,414	702,284	18,434,704
Grade 4 (Acceptable)	64,212,885	288,353,205	28,480,760	105,159,649	23,369,348	-	509,575,847
Grade 5 (Watch)	1,000,139	4,325,204	254,857	6,201,483	1,712,151	-	13,493,834
Grade 6 (Substandard)	1,519,962	170,906	597,405	1,179,770	16,413	-	3,484,456
Grade 7 (Impaired)	3,642,586	3,763,562	205,310	1,531,852	655,195	-	9,798,505
Grade 8 (Doubtful)	-	-	44,979	-	-	-	44,979
Grade 9 (Loss)	-	-	-	-	-	-	-
Total	\$ 72,059,139	\$ 305,891,933	\$ 31,459,126	\$ 120,027,996	\$ 27,209,521	\$ 702,284	557,349,999

Overdraft, in-process, and suspense accounts	2,143,734
Total Loans	\$ 559,493,733

	As of December 31, 2016						
	Commercial Real			Residential Real			
	Commercial	Estate	Consumer	Estate	Agriculture	Other	Total
Grade 1 (Excellent Risk)	\$ 665,110	\$ -	\$ 849,144	\$ -	\$ -	\$ -	\$ 1,514,254
Grade 2 (High Quality)	80,387	-	205,323	31,056	-	-	316,766
Grade 3 (Average Risk)	754,519	10,651,864	402,591	7,182,621	2,642,546	736,210	22,370,351
Grade 4 (Acceptable)	52,586,364	269,465,713	27,685,530	78,950,580	20,949,369	-	449,637,556
Grade 5 (Watch)	1,644,370	3,434,222	640,478	3,075,397	793,107	-	9,587,574
Grade 6 (Substandard)	1,028,713	532,493	1,015,021	1,058,745	353,960	-	3,988,932
Grade 7 (Impaired)	3,484,905	3,257,060	-	1,650,746	633,050	-	9,025,761
Grade 8 (Doubtful)	-	-	113,701	-	-	-	113,701
Grade 9 (Loss)	-	-	-	-	-	-	-
Total	\$ 60,244,368	\$ 287,341,352	\$ 30,911,788	\$ 91,949,145	\$ 25,372,032	\$ 736,210	496,554,895

Overdraft, in-process, and suspense accounts	8,808,459
Total Loans	\$ 505,363,354

Troubled Debt Restructurings ("TDRs")

Loans are considered to have been modified in a TDR when due to a borrower's financial difficulty, the Company makes certain concessions to the borrower that it would not otherwise consider for new debt with similar risk characteristics. Modifications may include interest rate reductions, principal or interest forgiveness, 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 non-accrual loan that has been modified in a TDR remains on non-accrual status for a period of 6 months 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 non-accrual 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.

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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. Generally, the types of concessions granted to borrowers that are evaluated in determining whether the loan is classified as a TDR include:

- Interest rate reductions – Occur when the stated interest rate is reduced to a nonmarket rate or a rate the borrower would not be able to obtain elsewhere under similar circumstances.
- Amortization or maturity date changes – Result when the amortization period of the loan is extended beyond what is considered a normal amortization period for loans of similar type with similar collateral.
- Principal reductions – These are often the result of commercial real estate loan workouts where two new notes are created. The primary note is underwritten based upon the Bank's normal underwriting standards and is structured so that the projected cash flows are sufficient to repay the contractual principal and interest of the newly restructured note. The terms of the secondary note vary by situation and often involve that note being charged-off, or the principal and interest payments being deferred until after the primary note has been repaid. In situations where a portion of the note is charged-off during modification there is often no specific reserve allocated to those loans. This is due to the fact that the amount of the charge-off usually represents the excess of the original loan balance over the collateral value and the Company has determined there is no additional exposure on those loans.

The following table presents the amount of troubled debt restructurings by loan class, classified separately as accrual and non-accrual at December 31, 2017 and 2016.

	As of December 31, 2017		
	Accruing	Non-Accrual	Total
Commercial	\$ 126,966	\$ -	\$ 126,966
Commercial real estate	-	1,088,189	1,088,189
Consumer	16,984	-	16,984
Residential real estate	171,867	-	171,867
Agriculture	-	-	-
Other	-	-	-
Total TDR's	\$ 315,817	\$ 1,088,189	\$ 1,404,006

	As of December 31, 2016		
	Accruing	Non-Accrual	Total
Commercial	\$ 47,537	\$ -	\$ 47,537
Commercial real estate	469,421	-	469,421
Consumer	3,737	4,600	8,337
Residential real estate	267,823	-	267,823
Agriculture	-	-	-
Other	-	-	-
Total TDR's	\$ 788,518	\$ 4,600	\$ 793,118

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The following table presents the amount of troubled debt restructurings by loan class, classified separately as those currently paying under restructured terms and those that have defaulted under restructures terms as of December 31, 2017 and 2016. Loan modified in a troubled debt restructuring are considered to be in default once the loan becomes 90 days past due.

		As of December 31, 2017			
		Loans Currently Paying Under Restructured Terms		Loans that have Defaulted Under Restructured Terms	
		#	Balance	#	Balance
Commercial	2	\$	126,966	-	\$ -
Commercial real estate	1		138,189	1	950,000
Consumer	4		16,984	-	-
Residential real estate	3		171,867	-	-
Agriculture	-		-	-	-
Other	-		-	-	-
Total	<u>10</u>	<u>\$</u>	<u>454,006</u>	<u>1</u>	<u>\$ 950,000</u>

		As of December 31, 2016			
		Loans Currently Paying Under Restructured Terms		Loans that have Defaulted Under Restructured Terms	
		#	Balance	#	Balance
Commercial	1	\$	47,537	-	\$ -
Commercial real estate	1		469,421	-	-
Consumer	3		8,162	1	175
Residential real estate	4		267,823	-	-
Agriculture	-		-	-	-
Other	-		-	-	-
Total	<u>9</u>	<u>\$</u>	<u>792,943</u>	<u>1</u>	<u>\$ 175</u>

The following table presents the amount of troubled debt restructurings by types of concessions made, classified separately as accrual and non-accrual at December 31, 2017 and 2016.

		As of December 31, 2017			
		Accruing Loans		Non-Accruing Loans	
Type of Concession:		#	Balance	#	Balance
Forbearance of Interest		-	\$ -	-	\$ -
Forgiveness of Principal		2	156,945	-	-
Payment Modification Only		3	12,908	2	1,088,189
Rate Reduction Only		-	-	-	-
Rate Reduction, Forbearance of Interest		2	84,946	-	-
Rate Reduction, Forbearance of Principal		1	56,942	-	-
Rate Reduction, Payment Modification		1	4,076	-	-
Total		<u>9</u>	<u>\$ 315,817</u>	<u>2</u>	<u>\$ 1,088,189</u>

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Type of Concession:	As of December 31, 2016			
	Accruing Loans		Non-Accruing Loans	
	#	Balance	#	Balance
Forbearance of Interest	1	\$ 47,537	-	\$ -
Forgiveness of Principal	2	167,296	-	-
Payment Modification Only	2	473,158	1	3,449
Rate Reduction Only	-	-	-	-
Rate Reduction, Forbearance of Interest	1	41,610	-	-
Rate Reduction, Forbearance of Principal	1	58,917	1	175
Rate Reduction, Payment Modification	-	-	1	976
Total	7	\$ 788,518	3	\$ 4,600

As of December 31, 2017 and 2016, the Company had a balance of \$1,404,006 and \$793,118, respectively, in troubled debt restructurings. The Company had a balance of \$1,906 and \$19,771 in previous charge-offs on such loans as of December 31, 2017 and 2016, respectively. The Company's balance in the allowance for loan losses allocated to such troubled debt restructurings was \$475,000 and \$140,342 at December 31, 2017 and 2016, respectively. The Company had no unfunded commitments on troubled debt restructured loans as of December 31, 2017.

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.

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The following tables detail activity in the allowance for loan losses by portfolio segment for the year ended December 31, 2017 and 2016. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

	2017						
	Commercial			Residential			
Allowance for credit losses:	Commercial	Real Estate	Consumer	Real Estate	Agriculture	Other	Total
Beginning Balance	\$ 2,268,534	\$ 3,453,399	\$ 1,264,929	\$ 1,191,548	\$ 48,843	\$ 723,119	\$ 8,950,372
Chargeoffs	(282,178)	(452)	(504,888)	-	-	-	(787,518)
Recoveries	126,184	16,144	121,627	15,808	-	-	279,763
Provision	949,337	735,716	2,332	(87,322)	6,079	(631,142)	975,000
Ending Balance	<u>\$ 3,061,877</u>	<u>\$ 4,204,807</u>	<u>\$ 884,000</u>	<u>\$ 1,120,034</u>	<u>\$ 54,922</u>	<u>\$ 91,977</u>	<u>\$ 9,417,617</u>
Period-end amount allocated to:							
Loans individually evaluated for impairment	\$ 1,503,151	\$ 1,306,093	\$ -	\$ 354,146	\$ 16,258	\$ -	\$ 3,179,648
Loans collectively evaluated for impairment	<u>\$ 1,558,726</u>	<u>\$ 2,898,714</u>	<u>\$ 884,000</u>	<u>\$ 765,888</u>	<u>\$ 38,664</u>	<u>\$ 91,977</u>	<u>\$ 6,237,969</u>
Ending balance	<u>\$ 3,061,877</u>	<u>\$ 4,204,807</u>	<u>\$ 884,000</u>	<u>\$ 1,120,034</u>	<u>\$ 54,922</u>	<u>\$ 91,977</u>	<u>\$ 9,417,617</u>
Loans:							
Individually evaluated for impairment	\$ 3,642,586	\$ 3,763,562	\$ 205,310	\$ 1,531,852	\$ 655,195	\$ -	\$ 9,798,505
Collectively evaluated for impairment	<u>68,416,553</u>	<u>302,128,371</u>	<u>31,253,816</u>	<u>118,496,144</u>	<u>26,554,326</u>	<u>702,284</u>	<u>547,551,494</u>
Ending balance	<u>\$ 72,059,139</u>	<u>\$ 305,891,933</u>	<u>\$ 31,459,126</u>	<u>\$ 120,027,996</u>	<u>\$ 27,209,521</u>	<u>\$ 702,284</u>	<u>\$ 559,493,733</u>
Overdraft, in-process, and suspense accounts							2,143,734
Total loans							<u>\$ 559,493,733</u>
	2016						
	Commercial			Residential			
Allowance for credit losses:	Commercial	Real Estate	Consumer	Real Estate	Agriculture	Other	Total
Beginning Balance	\$ 2,276,410	\$ 3,093,284	\$ 739,526	\$ 1,274,299	\$ 111,945	\$ 723,119	\$ 8,218,583
Chargeoffs	(534,495)	(15,726)	(538,666)	(23,810)	-	-	(1,112,697)
Recoveries	44,551	28,823	22,440	13,672	-	-	109,486
Provision	482,068	347,018	1,041,629	(72,613)	(63,102)	-	1,735,000
Ending Balance	<u>\$ 2,268,534</u>	<u>\$ 3,453,399</u>	<u>\$ 1,264,929</u>	<u>\$ 1,191,548</u>	<u>\$ 48,843</u>	<u>\$ 723,119</u>	<u>\$ 8,950,372</u>
Period-end amount allocated to:							
Loans individually evaluated for impairment	\$ 401,091	\$ 464,450	\$ -	\$ 163,096	\$ -	\$ -	\$ 1,028,637
Loans collectively evaluated for impairment	<u>1,867,443</u>	<u>2,988,949</u>	<u>1,264,929</u>	<u>1,028,452</u>	<u>48,843</u>	<u>723,119</u>	<u>7,921,735</u>
Ending balance	<u>\$ 2,268,534</u>	<u>\$ 3,453,399</u>	<u>\$ 1,264,929</u>	<u>\$ 1,191,548</u>	<u>\$ 48,843</u>	<u>\$ 723,119</u>	<u>\$ 8,950,372</u>
Loans:							
Individually evaluated for impairment	\$ 3,484,905	\$ 3,257,060	\$ -	\$ 1,650,746	\$ 633,050	\$ -	\$ 9,025,761
Collectively evaluated for impairment	<u>56,759,463</u>	<u>284,084,292</u>	<u>30,911,788</u>	<u>90,298,399</u>	<u>24,738,982</u>	<u>736,210</u>	<u>487,529,134</u>
Ending balance	<u>\$ 60,244,368</u>	<u>\$ 287,341,352</u>	<u>\$ 30,911,788</u>	<u>\$ 91,949,145</u>	<u>\$ 25,372,032</u>	<u>\$ 736,210</u>	<u>496,554,895</u>
Overdraft, in-process, and suspense accounts							8,808,459
Total loans							<u>\$ 505,363,354</u>

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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.

E. BANK PREMISES AND EQUIPMENT

Premises and equipment as of December 31, 2017 and 2016 are summarized as follows:

	<u>2017</u>	<u>2016</u>
Land	\$ 1,621,936	\$ 1,621,936
Buildings and improvements	9,157,950	9,232,742
Leasehold improvements	451,994	391,089
Equipment, furniture and fixtures	3,142,362	2,980,681
Vehicles	<u>100,058</u>	<u>72,120</u>
Total	14,474,300	14,298,568
Less - accumulated depreciation	<u>(4,861,639)</u>	<u>(4,321,384)</u>
Bank premises and equipment, net	<u>\$ 9,612,661</u>	<u>\$ 9,977,184</u>

Depreciation included in operating expenses amounted to \$588,093, \$556,801, and \$529,040 for the years ended December 31, 2017, 2016 and 2015, respectively.

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F. GOODWILL AND INTANGIBLE ASSETS

The Bank recorded \$1,849,075 of goodwill on the branch purchase from CertusBank during 2015. Previously, the Company reported goodwill in the amount of \$388,815 which resulted in total reported goodwill of \$2,237,890 for the years ended December 31, 2017 and 2016. Impairment exists when a reporting unit's carrying value of goodwill exceeds its fair value. At December 31, 2017, 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 \$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, 2017 and the five succeeding fiscal years are as follows:

	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</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>(116,952)</u>	<u>(166,862)</u>	<u>(215,385)</u>	<u>(262,293)</u>	<u>(307,358)</u>	<u>(350,352)</u>
Net carrying value	<u>\$ 338,830</u>	<u>\$ 288,920</u>	<u>\$ 240,397</u>	<u>\$ 193,489</u>	<u>\$ 148,424</u>	<u>\$ 105,430</u>
Amortization expense	<u>\$ 51,070</u>	<u>\$ 49,910</u>	<u>\$ 48,523</u>	<u>\$ 46,908</u>	<u>\$ 45,065</u>	<u>\$ 42,994</u>

G. OTHER REAL ESTATE AND FORECLOSED ASSETS

At December 31, 2017 and 2016 the Bank reported \$1,157,992 and \$2,425,186, respectively, as other real estate and foreclosed assets. At December 31, 2017, the balance of foreclosed real estate included \$136,778 of foreclosed residential real estate properties recorded as a result of obtaining physical possession of the property. At December 31, 2017, the Bank has no consumer mortgage loans secured by residential real estate for which formal foreclosure procedures are in process.

H. 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 \$6,851,182 and \$6,656,656 at December 31, 2017 and 2016, respectively. Income earned on the cash surrender value of these policies was \$194,527, \$203,327 and \$206,500 for the years ended December 31, 2017, 2016, and 2015, respectively.

I. DEPOSITS

The aggregate amount of time deposits that meet or exceed \$250,000 at December 31, 2017 and 2016 was \$56,261,055 and \$43,958,906, respectively, and the Bank had deposit liabilities in NOW accounts of \$107,684,767 and \$102,864,993 at December 31, 2017 and 2016, respectively.

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At December 31, 2017, the scheduled maturities of time deposits are as follows:

2018	\$ 127,686,779
2019	35,625,821
2020	14,413,865
2021	2,034,965
2022 and thereafter	<u>8,162,721</u>
Total time deposits	<u>\$ 187,924,151</u>

J. 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, 2017. At December 31, 2017 and 2016, there were no outstanding balances on these lines of credit.

K. 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. The Bank was advanced \$12,000,000 and \$13,000,000 against this line of credit at December 31, 2017 and 2016, respectively. In the event the Bank requests future advances, the Bank had pledged first liens on 1 to 4 family real estate loans with a carrying value of \$104,404,000 and \$66,995,000 at December 31, 2017 and 2016, respectively.

A detail of the individual FHLB advances and related maturities and interest rates held as of December 31, 2017 are as follows:

As of December 31, 2017				
	Principal Balance	Maturity Date	Interest Rate	
\$	3,000,000	8/20/2018	3.67%	Fixed
	3,000,000	6/12/2019	3.34%	Fixed
	6,000,000	4/24/2024	1.53%	Fixed
Total	\$ 12,000,000			

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 \$1,142,856 and \$1,428,572 as of December 31, 2017 and 2016, 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, 2017 and 2016 the Company reported an outstanding balance with the lending institution of \$254,882 and \$254,882, 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:

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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, 2017, the scheduled payments of outstanding debt are as follows:

2018		\$	3,285,714
2019			3,285,714
2020			571,428
2021			-
2022			-
Thereafter			<u>6,000,000</u>
Total			<u><u>\$ 13,142,856</u></u>

L. EMPLOYEE BENEFIT PLANS

The Company adopted a 401(k) plan in 1996 and made contributions to the plan totaling \$219,590, \$190,981, and \$168,434 for the years ended December 31, 2017, 2016, and 2015, 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 discretions 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, 2017, the Plan owned 127,783 shares of stock. The amount of pension expense charged to operations for the years ended December 31, 2017, 2016, and 2015 were \$320,485, \$184,931, and \$160,798, respectively.

The Company initiated a Stock Grant Plan on February 1, 2017 in which granted stock has a 3 year vesting period. The fair value of each grant under the Stock Grant Plan 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 the Stock Grant Plan was 2.1 years as of December 31, 2017. Under the Stock Grant Plan, there were 6,000 stock grants outstanding as of December 31, 2017. Dividend income is accrued on the ex-dividend date and allocated based on the individual ownership percentage of the participants. The Company recognized \$61,911 in expense for the portion of the stock value vested in 2017. As of December 31, 2017, there was \$140,708 of total unrecognized cost related to nonvested shares granted under the Stock Grant Plan; that cost is expected to be recognized over a period of 2.1 years.

M. NOTES RECEIVABLE ARISING FROM THE SALE OF COMMON STOCK

The Company issued a note receivable to facilitate the sale of common stock to Benefit Trust Company on behalf of the Morris Bank 401(k) and Employee Stock Ownership Plan. The related note receivable was for the sale of 73,421 shares at \$27.24 per share, bears interest at 3%, and was collateralized by the common stock sold. The note was due in quarterly payments beginning February 2015 totaling \$71,429 plus interest through July 2021. The note issued was full recourse and carried an unpaid principal balance of \$714,801 as of December 31, 2016. As of December 31, 2016, accrued interest outstanding was \$2,820. Interest on the note was credited to additional paid-in capital as it was earned. During the years ended December 31, 2017 and 2016, interest earned and included in additional paid-in capital was \$9,532 and \$32,220 respectively. The note was paid in full on August 11, 2017.

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N. 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, 2017, the amount available for distribution as dividends in the subsequent year without regulatory consent was \$9,583,030.

O. 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>	
	2017	2016
Financial instruments whose contract amount represent credit risk:		
Commitments to extend credit	\$ 74,063,000	\$ 62,572,000
Standby letters of credit	3,883,000	623,000
Total	\$ 77,946,000	\$ 63,195,000

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.

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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.

P. COMMITMENTS AND CONTINGENCIES

In the ordinary course of business, the Company has various outstanding commitments and contingent liabilities that are not reflected in the accompanying consolidated financial statements.

Q. 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, 2017 with respect to such loans to these individuals:

Balances at December 31, 2016	\$	7,751,628
New loans		4,760,354
Repayments		<u>(3,530,003)</u>
Balances at December 31, 2017	\$	<u><u>8,981,979</u></u>

The Bank also had deposits from these related parties of approximately \$2,558,125 and \$6,762,646 at December 31, 2017 and 2016, 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 T for further detail.

R. 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 certain financial instruments 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.

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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.

Cash and Cash Equivalents

For disclosure purposes for cash, due from banks and federal funds sold, the carrying amount is a reasonable estimate of 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.

Federal Home Loan Bank Stock

The fair value of Federal Home Loan Bank stock approximates carrying value, as there is no ready market for such investments.

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.

Intangible Assets and Goodwill

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 three to ten years. Goodwill represents the excess of the purchase price over the fair value of the net identifiable assets acquired in a business combination. Goodwill and other intangible assets deemed to have an indefinite useful life are not amortized but instead are subject to an annual review for impairment.

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Other Real Estate and Foreclosed Assets

Foreclosed assets are adjusted to fair value, less cost to sell, upon transfer of the loans to 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 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 foreclosed asset as nonrecurring Level 3.

Cash Surrender Value of Life Insurance

For disclosure purposes, for cash surrender value of life insurance, the carrying value is a reasonable estimate of fair value.

Deposits

For disclosure purposes, the fair value of demand deposits, savings accounts, NOW accounts and money market deposits is the amount payable on demand at the reporting date, while the fair value of fixed maturity certificates of deposit is estimated by discounting the future cash flows using current rates at which comparable certificates would be issued.

Securities Sold under Agreements to Repurchase and Other Borrowings

The carrying amount of variable rate borrowings and securities sold under repurchase agreements approximates fair value. The fair value of fixed rate other borrowings is estimated based on discounted contractual cash flows using the current incremental borrowing rates for similar borrowing arrangements.

Other Borrowed Funds

For disclosure purposes, for short-term borrowings at a fixed rate, the fair value of the borrowing is estimated using discounted cash flows, based on the current incremental borrowing rates for similar types of borrowing arrangements. For short-term borrowings at a variable rate, the carrying value is a reasonable estimate of fair value.

Commitments to Extend Credit and Standby Letters of Credit

Because commitments to extend credit and standby letters of credit are made using variable rates and have short maturities, the carrying value and the fair value are immaterial for disclosure.

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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, 2017 and 2016, aggregated by the level in the fair value hierarchy within which those measurements fall.

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
ASSETS:				
Investment securities available for sale:				
U.S. Government agencies	\$ -	\$ 4,226,023	\$ -	\$ 4,226,023
State, county, and municipal securities	546,055	26,304,878	-	26,850,933
Other debt securities	-	-	-	-
Residential mortgage backed securities	2,996,250	11,342,877	-	14,339,127
Commercial mortgage backed securities	-	5,948,337	-	5,948,337
Total investment securities	<u>\$ 3,542,305</u>	<u>\$ 47,822,115</u>	<u>\$ -</u>	<u>\$ 51,364,420</u>

	December 31, 2016			
	Level 1	Level 2	Level 3	Total
ASSETS:				
Investment securities available for sale:				
U.S. Government agencies	\$ -	\$ 4,244,768	\$ -	\$ 4,244,768
State, county, and municipal securities	-	24,314,341	-	24,314,341
Other debt securities	-	721,287	-	721,287
Residential mortgage backed securities	-	10,267,671	2,822,293	13,089,964
Commercial mortgage backed securities	-	8,302,193	-	8,302,193
Total investment securities	<u>\$ -</u>	<u>\$ 47,850,260</u>	<u>\$ 2,822,293</u>	<u>\$ 50,672,553</u>

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, 2017 and 2016, aggregated by the level in the fair value hierarchy within which those measurements fall.

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
Impaired loans	\$ -	\$ -	\$ 6,618,857	\$ 6,618,857
Other real estate and foreclosed assets	-	-	1,157,992	1,157,992
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 7,776,849</u>	<u>\$ 7,776,849</u>

	December 31, 2016			
	Level 1	Level 2	Level 3	Total
Impaired loans	\$ -	\$ -	\$ 7,997,124	\$ 7,997,124
Other real estate and foreclosed assets	-	-	2,425,186	2,425,186
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 10,422,310</u>	<u>\$ 10,422,310</u>

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The following table presents a reconciliation of assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3).

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
	<u>Total</u>	<u>Residential mortgage backed securities</u>
Balance, December 31,2016	\$ 2,822,293	\$ 2,822,293
Transfers into Level 3	-	-
Transfers out of Level 3	(2,822,293)	(2,822,293)
Total net gains (losses) included in:		
Net income	-	-
Other comprehensive income	-	-
Transactions during the period:		
Purchases	-	-
Sales	-	-
Settlements	-	-
Balance, December 31,2017	<u>\$ -</u>	<u>\$ -</u>
Change in unrealized gains (losses) included in net income for the year for assets held as of December 31,2017	<u>\$ -</u>	<u>\$ -</u>
	<u>Total</u>	<u>Residential mortgage backed securities</u>
Balance, December 31,2015	\$ 5,781,001	\$ 5,781,001
Transfers into Level 3	-	-
Transfers out of Level 3	(2,626,201)	(2,626,201)
Total net losses included in:		
Net income	(86,822)	(86,822)
Other comprehensive income	-	-
Transactions during the period:		
Purchases	-	-
Sales	-	-
Settlements	(245,685)	(245,685)
Balance, December 31,2016	<u>\$ 2,822,293</u>	<u>\$ 2,822,293</u>
Change in unrealized gains (losses) included in net income for the year for assets held as of December 31,2016	<u>\$ -</u>	<u>\$ -</u>

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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, 2017				
Recurring:					
Residential mortgage backed securities	\$	-	Third party book price	Credit quality of issuer	-
Nonrecurring:					
Impaired loans	\$	6,618,857	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	\$	1,157,992	Third party appraisals	Collateral discounts and estimated selling costs	0.00% - 16.44%

Measurements:	Fair Value at		Valuation Technique	Unobservable Inputs	Range
	December 31, 2016				
Recurring:					
Residential mortgage backed securities	\$	2,822,293	Third party book price	Credit quality of issuer	-
Nonrecurring:					
Impaired loans	\$	7,997,124	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	\$	2,425,186	Third party appraisals	Collateral discounts and estimated selling costs	0.00% - 61.17%

The carrying amount and estimated fair value of the Company's financial instruments, not shown elsewhere in these financial statements, were as follows:

	2017		2016	
	Amount	Fair Value	Amount	Fair Value
Assets:				
Cash and short-term investments	\$ 44,711,611	\$ 44,711,611	\$ 28,352,701	\$ 28,352,701
Interest-bearing time deposits in other banks	2,248,000	2,248,000	3,598,000	3,598,000
Loans	559,493,733	560,385,407	505,363,354	505,839,630
Liabilities:				
Deposits	592,791,948	592,580,089	531,797,474	531,813,247
Other borrowed funds	13,142,856	12,714,204	14,428,572	14,384,040
Unrecognized financial instruments:				
Commitments to extend credit	74,063,000	74,063,000	62,572,000	62,572,000
Standby letters of credit	3,883,000	3,883,000	623,000	623,000

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S. 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 \$21,583,992 as of December 31, 2017.

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, 2017 the Company had an outstanding balance of \$809,944 with the FHLB, which is entirely uninsured.

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, 2017, the Company had an outstanding balance of \$2,698,330 with the Federal Reserve Bank, which is backed by the full faith and credit of the United States Government.

T. LEASE EXPENSES

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 \$8,668.33, after which time, monthly lease payments may increase by no more than 10% of the price of the previous lease term.

Estimated minimum lease payments as of December 31, 2017, for each of the next five years are as follows:

2018	\$ 202,840
2019	202,840
2020	202,840
2021	202,840
2022	202,840
	<u>\$ 1,014,200</u>

The Company recognized lease expenses of \$221,978, \$130,190 and \$127,605 for the years ended December 31, 2017, 2016, and 2015, respectively.

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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U. 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, 2017, 2016, and 2015 are as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Data processing	\$ 1,660,334	\$ 1,647,994	\$ 1,379,232
FDIC insurance assessments	357,611	373,304	383,264
Legal and accounting fees	383,086	358,968	703,876

There were no components of other operating income greater than 1% of total interest income and other income for the periods ended December 31, 2017, 2016, and 2015.

V. 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 with full phase in effective as of January 1, 2019. 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. Capital amounts and ratios for December 31, 2017 are calculated using Basel I rules.

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, 2017, the Bank meets all capital adequacy requirements to which it is subject. As of December 31, 2017, 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
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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, 2017</i>						
Total Risk-Based Capital To (Risk-Weighted Assets)	\$ 75,390,000	13.39%	\$ 45,037,440	≥ 8.0%	\$ 56,296,800	≥ 10.0%
Tier I Capital To (Risk-Weighted Assets)	68,324,000	12.14%	33,778,080	≥ 6.0%	45,037,440	≥ 8.0%
Common Equity Tier I Capital To (Risk-Weighted Assets)	68,324,000	12.14%	25,333,560	≥ 4.5%	36,592,920	≥ 6.5%
Tier I Capital To (Average Assets)	68,324,000	10.32%	26,482,440	≥ 4.0%	33,103,050	≥ 5.0%
<i>As of December 31, 2016</i>						
Total Risk-Based Capital To (Risk-Weighted Assets)	\$ 66,861,000	13.14%	\$ 40,709,200	≥ 8.0%	\$ 50,886,500	≥ 10.0%
Tier I Capital To (Risk-Weighted Assets)	60,468,000	11.88%	30,531,900	≥ 6.0%	40,709,200	≥ 8.0%
Common Equity Tier I Capital To (Risk-Weighted Assets)	60,468,000	11.88%	22,898,925	≥ 4.5%	33,076,225	≥ 6.5%
Tier I Capital To (Average Assets)	60,468,000	10.18%	23,755,720	≥ 4.0%	29,694,650	≥ 5.0%

W. 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, 2017

X. SUBSEQUENT EVENTS

The Company performed an evaluation of subsequent events through April 16, 2018, the date upon which the Company's financial statements were available for issue. The Company has not evaluated subsequent events after this date. No subsequent events were identified that would have required a change to the financial statements or disclosure in the notes to the financial statements.

Y. CONDENSED FINANCIAL STATEMENTS (PARENT COMPANY ONLY)

Condensed parent company financial information on Morris State Bancshares, Inc. at December 31, 2017 and 2016, is as follows:

BALANCE SHEETS

	<i>As of December 31,</i>	
	<u>2017</u>	<u>2016</u>
Assets		
Cash in subsidiary	\$ 301,633	\$ 522,444
Deposits in other banks	15,017	14,846
Premises and equipment net	-	168,251
Investment in subsidiaries, at equity in underlying net assets	71,342,492	63,180,537
Goodwill	388,816	388,816
Other assets	140,708	-
Total Assets	<u>\$ 72,188,666</u>	<u>\$ 64,274,894</u>
Liabilities		
Notes payable	\$ 1,142,856	\$ 1,428,572
Accrued expenses	20,130	7,170
Total liabilities	<u>1,162,986</u>	<u>1,435,742</u>
Shareholders' Equity		
Common stock, \$1 par value, authorized 10,000,000 shares, 1,855,548 issued and 1,811,624 outstanding in 2017 and 1,836,241 issued and 1,792,317 outstanding in 2016	1,855,548	1,836,241
Paid-in capital surplus	22,837,933	22,172,933
Less: note receivable for the sale of common stock	-	(714,801)
Retained earnings	47,332,599	41,076,479
Accumulated other comprehensive income (loss)	210,699	(320,601)
Treasury stock, at cost 43,924 shares in 2017 and 2016	<u>(1,211,099)</u>	<u>(1,211,099)</u>
Total shareholders' equity	<u>71,025,680</u>	<u>62,839,152</u>
Total Liabilities and Shareholders' Equity	<u>\$ 72,188,666</u>	<u>\$ 64,274,894</u>

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2017

STATEMENTS OF INCOME AND RETAINED EARNINGS

	<i>Years ended December 31,</i>		
	2017	2016	2015
Revenues			
Dividend Income	\$ 5,900,000	\$ 5,950,000	\$ 3,960,000
Interest income	170	90	433
Gain on sale of premises and equipment	5,540	-	-
Total income	<u>5,905,710</u>	<u>5,950,090</u>	<u>3,960,433</u>
Expenses			
Interest expense	42,385	51,471	56,179
Occupancy expense	1,837	3,545	-
Other	65,129	39,000	22,516
Total expenses	<u>109,351</u>	<u>94,016</u>	<u>78,695</u>
Income Before Equity Income of Subsidiary	5,796,359	5,856,074	3,881,738
Equity in undistributed income of subsidiaries	<u>7,580,655</u>	<u>5,231,251</u>	<u>7,044,271</u>
Net Income	13,377,014	11,087,325	10,926,009
Retained Earnings, Beginning	41,076,479	35,173,838	30,102,206
Stock and cash dividends	<u>(7,120,894)</u>	<u>(5,184,684)</u>	<u>(5,854,377)</u>
Retained Earnings, Ending	<u>\$ 47,332,599</u>	<u>\$ 41,076,479</u>	<u>\$ 35,173,838</u>

MORRIS STATE BANCSHARES, INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2017

STATEMENTS OF CASH FLOWS

	<i>Years ended December 31,</i>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:			
Net income	\$ 13,377,014	\$ 11,087,325	\$ 10,926,009
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation expense	1,385	1,385	-
Equity in undistributed income of subsidiary	(7,580,655)	(5,231,251)	(7,044,271)
Net change in operating assets and liabilities:			
Accrued income and other assets	(140,708)	-	-
Changes in accrued expenses and other liabilities	12,960	(1,130)	7,839
Net cash provided by operating activities	<u>5,669,996</u>	<u>5,856,329</u>	<u>3,889,577</u>
Cash flows from investing activities:			
Capital injection to subsidiaries	(50,000)	(785,000)	(260,000)
Proceeds from sale of property and equipment	166,866	-	-
Property and equipment expenditures	-	(169,636)	-
Net cash provided by (used in) investing activities	<u>116,866</u>	<u>(954,636)</u>	<u>(260,000)</u>
Cash flows from financing activities:			
Repayment of other borrowed funds	(285,716)	(285,714)	(214,285)
Purchase of treasury stock	-	-	(211,104)
Proceeds from stock note receivable	724,333	663,891	713,618
Proceeds from issuance of common stock	674,775	324,166	1,180,110
Cash dividends paid	(7,120,894)	(5,184,684)	(5,854,377)
Net cash used in financing activities	<u>(6,007,502)</u>	<u>(4,482,341)</u>	<u>(4,386,038)</u>
Net increase (decrease) in cash and cash equivalents	<u>(220,640)</u>	<u>419,352</u>	<u>(756,461)</u>
Cash and cash equivalents at beginning of year	<u>537,290</u>	<u>117,938</u>	<u>874,399</u>
Cash and cash equivalents at end of year	<u>\$ 316,650</u>	<u>\$ 537,290</u>	<u>\$ 117,938</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>2017</u>	<u>2016</u>	<u>2015</u>
Cash paid for interest:			
Interest on borrowings	<u>\$ 49,825</u>	<u>\$ 52,622</u>	<u>\$ 47,858</u>
Noncash items:			
Changes in unrealized gain/loss on investments	<u>\$ 531,300</u>	<u>\$ (749,563)</u>	<u>\$ 6,738</u>