

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period **September 30, 2021**

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ____ to
Commission File Number 001-38084

FARMERS & MERCHANTS BANCORP, INC.

(Exact name of registrant as specified in its charter)

OHIO

(State or other jurisdiction of
incorporation or organization)

307 North Defiance Street, Archbold, Ohio
(Address of principal executive offices)

34-1469491

(IRS Employer
Identification No.)

43502

(Zip Code)

(419) 446-2501

Registrant's telephone number, including area code
(Former name, former address and former fiscal year, if changed since last report.)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of Each Exchange
Common Stock, No Par Value	FMAO	NASDAQ Capital Market

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or Section 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input checked="" type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
Emerging growth company	<input type="checkbox"/>		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares of each of the issuers' classes of common stock, as of the latest practicable date:

Common Stock, No Par Value
Class

13,066,233
Outstanding as of October 22, 2021

		Page
<u>Form 10-Q Items</u>		
PART I.	<u>FINANCIAL INFORMATION</u>	
Item 1.	<u>Financial Statements (Unaudited)</u>	
	<u>Condensed Consolidated Balance Sheets - September 30, 2021 and December 31, 2020</u>	3
	<u>Condensed Consolidated Statements of Income - Three and Nine Months Ended September 30, 2021 and September 30, 2020</u>	4
	<u>Condensed Consolidated Statements of Comprehensive Income - Three and Nine Months Ended September 30, 2021 and September 30, 2020</u>	5
	<u>Condensed Consolidated Statements of Changes to Stockholders' Equity - Three and Nine Months Ended September 30, 2021 and September 30, 2020</u>	6-7
	<u>Condensed Consolidated Statements of Cash Flows - Nine Months Ended September 30, 2021 and September 30, 2020</u>	8-9
	<u>Notes to Condensed Consolidated Financial Statements</u>	10
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	48-67
Item 3.	<u>Qualitative and Quantitative Disclosures About Market Risk</u>	68
Item 4.	<u>Controls and Procedures</u>	69
PART II.	<u>OTHER INFORMATION</u>	69
Item 1.	<u>Legal Proceedings</u>	69
Item 1A.	<u>Risk Factors</u>	69
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	69
Item 3.	<u>Defaults Upon Senior Securities</u>	69
Item 4.	<u>Mine Safety Disclosures</u>	69
Item 5.	<u>Other Information</u>	69
Item 6.	<u>Exhibits</u>	70
	<u>Signatures</u>	71
101.INS	Inline XBRL Instance Document - The instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document. (1)	
101.SCH	Inline XBRL Taxonomy Extension Schema Document (1)	
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document (1)	
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document (1)	
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document (1)	
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document (1)	

(1) Pursuant to Rule 406T of Regulation S-T, the interactive Data Files in Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

PART 1 - FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

FARMERS & MERCHANTS BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	(in thousands of dollars)	
	September 30, 2021	December 31, 2020
	(Unaudited)	
Assets		
Cash and due from banks	\$ 112,875	\$ 98,279
Federal funds sold	45,203	77,427
Total cash and cash equivalents	158,078	175,706
Interest-bearing time deposits	14,622	4,653
Securities - available-for-sale	426,717	307,812
Other securities, at cost	4,905	5,939
Loans held for sale	3,735	7,740
Loans, net	1,479,864	1,289,318
Premises and equipment	26,476	27,063
Goodwill	55,214	47,340
Mortgage servicing rights	3,097	3,320
Other real estate owned	167	71
Bank owned life insurance	27,397	25,208
Other assets	18,711	15,374
Total Assets	\$ 2,218,983	\$ 1,909,544
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Noninterest-bearing	\$ 438,076	\$ 351,147
Interest-bearing		
NOW accounts	646,237	542,317
Savings	529,532	455,145
Time	252,383	247,553
Total deposits	1,866,228	1,596,162
Federal funds purchased and securities sold under agreements to repurchase	29,601	30,239
Federal Home Loan Bank (FHLB) advances	17,868	17,861
Subordinated notes, net of unamortized issuance costs	34,441	-
Dividend payable	2,002	1,889
Accrued expenses and other liabilities	14,097	14,233
Total liabilities	1,964,237	1,660,384
Commitments and Contingencies		
Stockholders' Equity		
Common stock - No par value 20,000,000 shares authorized; issued and outstanding 12,230,000 shares 9/30/21 and 12/31/20	81,382	81,804
Treasury stock - 997,680 shares 9/30/21, 1,032,456 shares 12/31/20	(11,718)	(11,932)
Retained earnings	184,181	173,591
Accumulated other comprehensive income	901	5,697
Total stockholders' equity	254,746	249,160
Total Liabilities and Stockholders' Equity	\$ 2,218,983	\$ 1,909,544

See Notes to Condensed Consolidated Unaudited Financial Statements.

Note: The December 31, 2020, Condensed Consolidated Balance Sheet has been derived from the audited Consolidated Balance Sheet as of that date.

FARMERS & MERCHANTS BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	(in thousands of dollars, except per share data)		(in thousands of dollars, except per share data)	
	Three Months Ended		Nine Months Ended	
	September 30, 2021	September 30, 2020	September 30, 2021	September 30, 2020
Interest Income				
Loans, including fees	\$ 18,766	\$ 16,181	\$ 50,637	\$ 48,256
Debt securities:				
U.S. Treasury and government agencies	924	761	2,532	2,674
Municipalities	284	279	881	784
Dividends	44	36	125	107
Federal funds sold	10	4	21	15
Other	94	32	221	194
Total interest income	20,122	17,293	54,417	52,030
Interest Expense				
Deposits	1,221	1,864	3,837	7,019
Federal funds purchased and securities sold under agreements to repurchase	165	174	494	605
Borrowed funds	87	231	424	754
Subordinated notes	199	-	199	-
Total interest expense	1,672	2,269	4,954	8,378
Net Interest Income - Before Provision for Loan Losses	18,450	15,024	49,463	43,652
Provision for Loan Losses	659	1,987	3,000	4,986
Net Interest Income After Provision for Loan Losses	17,791	13,037	46,463	38,666
Noninterest Income				
Customer service fees	2,242	2,299	7,254	6,143
Other service charges and fees	1,010	879	2,722	2,622
Net gain on sale of loans	822	1,537	2,823	2,128
Net gain on sale of available-for-sale securities	-	-	293	270
Total noninterest income	4,074	4,715	13,092	11,163
Noninterest Expense				
Salaries and wages	5,442	5,102	14,423	13,420
Employee benefits	1,621	1,566	5,530	4,461
Net occupancy expense	529	558	1,652	1,686
Furniture and equipment	903	875	2,542	2,383
Data processing	1,548	490	2,481	1,340
Franchise taxes	372	368	1,112	1,105
ATM expense	460	444	1,368	1,234
Advertising	439	411	1,005	979
Net (gain) loss on sale of other assets owned	219	(7)	421	(13)
FDIC assessment	296	194	808	410
Mortgage servicing rights amortization	285	296	1,314	784
Consulting fees	256	205	873	561
Other general and administrative	1,951	1,553	6,211	4,740
Total noninterest expense	14,321	12,055	39,740	33,090
Income Before Income Taxes	7,544	5,697	19,815	16,739
Income Taxes	1,624	1,287	4,003	3,420
Net Income	\$ 5,920	\$ 4,410	\$ 15,812	\$ 13,319
Basic and Diluted Earnings Per Share	\$ 0.53	\$ 0.40	\$ 1.41	\$ 1.20
Dividends Declared	\$ 0.18	\$ 0.17	\$ 0.52	\$ 0.49

See Notes to Condensed Consolidated Unaudited Financial Statements

FARMERS & MERCHANTS BANCORP, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (Unaudited)

	(in thousands of dollars)		(in thousands of dollars)	
	Three Months Ended		Nine Months Ended	
	September 30, 2021	September 30, 2020	September 30, 2021	September 30, 2020
Net Income	\$ 5,920	\$ 4,410	\$ 15,812	\$ 13,319
Other Comprehensive Income (Net of Tax):				
Net unrealized gain (loss) on available-for-sale securities	173	639	(5,778)	6,298
Reclassification adjustment for realized gain on sale of available-for-sale securities	-	-	(293)	(270)
Net unrealized gain (loss) on available-for-sale securities	173	639	(6,071)	6,028
Tax expense (benefit)	36	134	(1,275)	1,266
Other comprehensive income (loss)	137	505	(4,796)	4,762
Comprehensive Income	<u>\$ 6,057</u>	<u>\$ 4,915</u>	<u>\$ 11,016</u>	<u>\$ 18,081</u>

See Notes to Condensed Consolidated Unaudited Financial Statements

[Remainder of this page intentionally left blank]

FARMERS & MERCHANTS BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES TO STOCKHOLDERS' EQUITY
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2021
(000'S OMITTED, EXCEPT PER SHARE DATA)
(Unaudited)

	Shares of Common Stock	Common Stock	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance - January 1, 2021	11,197,544	\$ 81,804	\$ (11,932)	\$ 173,591	\$ 5,697	\$ 249,160
Net income				4,909		4,909
Other comprehensive loss					(5,554)	(5,554)
Purchase of treasury stock	(950)		(23)			(23)
Issuance of 750 shares of restricted stock (Net of forfeitures - 600)	150	1	(7)	6		-
Stock-based compensation expense		225				225
Cash dividends declared - \$0.17 per share				(1,889)		(1,889)
Balance - March 31, 2021	11,196,744	82,030	(11,962)	176,617	143	246,828
Net income				4,983		4,983
Other comprehensive income					621	621
Purchase of treasury stock	(8,929)		(201)			(201)
Forfeiture of 1,975 shares of restricted stock	(1,975)	58	(47)	(11)		-
Stock-based compensation expense		171				171
Director stock award	3,212		38	33		71
Cash dividends declared - \$0.17 per share				(1,888)		(1,888)
Balance - June 30, 2021	11,189,052	\$ 82,259	\$ (12,172)	\$ 179,734	\$ 764	\$ 250,585
Net income				5,920		5,920
Other comprehensive income					137	137
Purchase of treasury stock	(4,732)		(107)			(107)
Issuance of 48,000 shares of restricted stock	48,000	(1,090)	561	529		-
Stock-based compensation expense		213				213
Cash dividends declared - \$0.18 per share				(2,002)		(2,002)
Balance - September 30, 2021	<u>11,232,320</u>	<u>\$ 81,382</u>	<u>\$ (11,718)</u>	<u>\$ 184,181</u>	<u>\$ 901</u>	<u>\$ 254,746</u>

See Notes to Condensed Consolidated Unaudited Financial Statements

FARMERS & MERCHANTS BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES TO STOCKHOLDERS' EQUITY
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2020
(000'S OMITTED, EXCEPT PER SHARE DATA)
(Unaudited)

	Shares of Common Stock	Common Stock	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance - January 1, 2020	11,136,935	\$ 81,535	\$ (12,456)	\$ 160,081	\$ 1,098	\$ 230,258
Net income				4,105		4,105
Other comprehensive income					3,735	3,735
Purchase of treasury stock	(7,064)		(170)			(170)
Forfeiture of 450 shares of restricted stock	(450)	11	(10)	(2)		(1)
Stock-based compensation expense		298				298
Cash dividends declared - \$0.16 per share				(1,768)		(1,768)
Balance - March 31, 2020	11,129,421	81,844	(12,636)	162,416	4,833	236,457
Net income				4,804		4,804
Other comprehensive income					522	522
Purchase of treasury stock	(2,508)		(56)			(56)
Stock-based compensation expense		290				290
Director stock award	2,112		24	24		48
Cash dividends declared - \$0.16 per share				(1,768)		(1,768)
Balance - June 30, 2020	11,129,025	\$ 82,134	\$ (12,668)	\$ 165,476	\$ 5,355	\$ 240,297
Net income				4,410		4,410
Other comprehensive income					505	505
Purchase of treasury stock	(6,875)		(150)			(150)
Issuance of 36,551 shares of restricted stock	36,551	(796)	421	377		2
Stock-based compensation expense		239				239
Cash dividends declared - \$0.17 per share				(1,882)		(1,882)
Balance - September 30, 2020	11,158,701	\$ 81,577	\$ (12,397)	\$ 168,381	\$ 5,860	\$ 243,421

See Notes to Condensed Consolidated Unaudited Financial Statements

FARMERS & MERCHANTS BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	(in thousands of dollars)	
	Nine Months Ended	
	September 30, 2021	September 30, 2020
Cash Flows from Operating Activities		
Net income	\$ 15,812	\$ 13,319
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation	2,073	1,993
Amortization of premiums on available-for-sale securities, net	1,598	900
Amortization of servicing rights	1,314	784
Amortization of core deposit intangible	478	546
Amortization of customer list intangible	92	-
Net amortization (accretion) of fair value adjustments	(170)	382
Amortization of subordinated note issuance costs	20	-
Stock-based compensation expense	609	827
Director stock award	71	48
Deferred income taxes	-	(3)
Provision for loan loss	3,000	4,986
Gain on sale of loans held for sale	(2,823)	(2,128)
Originations of loans held for sale	(86,720)	(151,477)
Proceeds from sale of loans held for sale	93,548	150,130
(Gain) loss on sale of other assets owned	421	(13)
Gain on sales of securities available-for-sale	(293)	(270)
Increase in cash surrender value of bank owned life insurance	(475)	(266)
Change in other assets and other liabilities, net	(1,278)	(3,265)
Net cash provided by operating activities	27,277	16,493
Cash Flows from Investing Activities		
Activity in available-for-sale securities:		
Maturities, prepayments and calls	41,305	67,137
Sales	9,291	11,843
Purchases	(146,634)	(110,330)
Activity in other securities, at cost:		
Purchases	(207)	(17)
Proceeds from redemption of FHLB stock	1,522	-
Change in interest-bearing time deposits	10,257	(348)
Proceeds from sale of other assets owned	196	92
Additions to premises and equipment	(1,418)	(2,407)
Loan originations and principal collections, net	(141,116)	(144,978)
Acquisition of Ossian Financial Services, Inc., net of cash received	228	-
Net cash used in investing activities	(226,576)	(179,008)
Cash Flows from Financing Activities		
Net change in deposits	154,042	230,359
Net change in federal funds purchased and securities sold under agreements to repurchase	(638)	(18,214)
Repayment of FHLB advances	(157)	(7,493)
Purchase of treasury stock	(331)	(376)
Proceeds from issuance of subordinated notes	34,421	-
Cash dividends paid on common stock	(5,666)	(5,304)
Net cash provided by financing activities	181,671	198,972
Net Increase (Decrease) in Cash and Cash Equivalents	(17,628)	36,457
Cash and Cash Equivalents - Beginning of year	175,706	51,296
Cash and Cash Equivalents - End of period	\$ 158,078	\$ 87,753

(continued)

FARMERS & MERCHANTS BANCORP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited) (Continued)

	(in thousands of dollars)	
	Nine Months Ended	
	September 30, 2021	September 30, 2020
Supplemental Information		
Supplemental cash flow information:		
Interest paid	\$ 4,559	\$ 7,970
Income taxes paid	5,100	5,016
Supplemental noncash disclosures:		
Transfer of loans to other real estate owned	209	71
Cash dividends declared not paid	2,002	1,882
The Company purchased the assets of Ossian Financial Services, Inc. for \$20,001 on April 30, 2021.		
Fair value of assets acquired	\$ 137,058	\$ -
Cash paid for the capital stock	20,001	-
Liabilities assumed	<u>\$ 117,057</u>	<u>\$ -</u>

See Notes to Condensed Consolidated Unaudited Financial Statements.

[Remainder of this page intentionally left blank]

NOTE 1 BASIS OF PRESENTATION AND OTHER

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions for Form 10Q and Rule 10-01 of Regulation S-X; accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included. Operating results for the nine months ended September 30, 2021 are not necessarily indicative of the results that are expected for the year ended December 31, 2021. The condensed consolidated balance sheet of the Company as of December 31, 2020, has been derived from the audited consolidated balance sheet of the Company as of that date. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2020.

The Company recognizes revenues as they are earned based on contractual terms, as transactions occur, or as services are provided and collectability is reasonably assured. The Company's principal source of revenue is interest income from loans and investment securities. The Company also earns noninterest income from various banking and financial services offered primarily through Farmers & Merchants State Bank. Interest income is primarily recognized on an accrual basis according to nondiscretionary formulas written in contracts, such as loan agreements or investment security contracts. The Company also earns noninterest income from various banking and financial services provided to business and consumer clients such as deposit account, debit card, and mortgage banking services. Revenue is recorded for noninterest income based on the contractual terms for the service or transaction performed.

NOTE 2 BUSINESS COMBINATION AND ASSET PURCHASE

On April 30, 2021, the Company acquired Ossian Financial Services, Inc., (OSFI), the bank holding company for Ossian State Bank, a community bank based in Ossian, Indiana. Ossian State Bank operated two full-service offices in the northeast Indiana communities of Ossian and Bluffton. Shareholders of OSFI received \$67.71 in cash for each share. OSFI had 295,388 shares outstanding on April 30, 2021. Total consideration for the acquisition was approximately \$20.0 million in cash. As a result of the acquisition, the Company has increased its deposit base and is working to reduce transaction costs. The Company also expects to reduce costs through economies of scale.

In 2020, the Company incurred \$42.5 thousand of third-party acquisition-related costs. The expenses recognized in 2020 related to other general and administration expenses of \$30.0 thousand and consulting fees of \$12.5 thousand. These acquisition expenses were included in the Company's 2020 consolidated statement of income.

In 2021, the Company has incurred additional third-party acquisition-related costs of \$2.1 million. These expenses are comprised of employee benefits of \$694.1 thousand, data processing costs of \$938.9 thousand, consulting fees of \$255.2 thousand, ATM expense of \$13.8 thousand and other general and administrative expense of \$241.3 thousand in the Company's consolidated statement of income for the nine months ended September 30, 2021. For the quarter ended September 30, 2021, the Company incurred third-party acquisition related costs of \$1.2 million. These expenses are comprised of employee benefits of \$152.6 thousand, data processing costs of \$938.9 thousand, consulting fees of \$10.3 thousand, ATM expense of \$2.6 thousand and other general and administrative expense of \$61.5 thousand in the Company's consolidated statement of income for the three months ended September 30, 2021.

Under the acquisition method of accounting, the total purchase was allocated to net tangible and intangible assets based on their current estimated fair values on the date of acquisition. Of the total purchase price of \$20.0 million, \$980.2 thousand has been allocated to core deposit intangible included in other assets and will be amortized over seven years on a straight line basis. Goodwill of \$7.9 million which resulted from the acquisition consists largely of the synergies and economies of scale expected from combining the operations of the Company and Ossian State Bank and is deductible for tax purposes over 15 years. The following table summarizes the consideration paid for Ossian State Bank and the amounts of the assets acquired and liabilities assumed recognized at the acquisition date.

Fair Value of Consideration Transferred

	(In Thousands)
Cash	\$ 20,001
Total	<u>\$ 20,001</u>

Recognized amounts of identifiable assets acquired and liabilities assumed

Assets

Cash and cash equivalents	\$ 20,229
Interest-bearing time deposits	20,226
Securities - available-for-sale	30,243
Other securities, at cost	281
Loans, net	52,403
Premises and equipment	494
Goodwill	7,874
Other assets	5,308
Total Assets Purchased	<u>\$ 137,058</u>

Liabilities

Deposits	
Noninterest bearing	\$ 34,509
Interest bearing	81,535
Total deposits	<u>116,044</u>
Accrued expenses and other liabilities	1,013
Total Liabilities Assumed	<u>\$ 117,057</u>

The fair value of the assets acquired includes loans with a fair value of \$52.4 million. The gross principal and contractual interest due under the contracts is \$58.6 million, of which \$1.1 million is expected to be uncollectible. The loans have a weighted average life of 52 months.

The fair value of building and land included in premises and equipment was written down by \$596 thousand with \$244 thousand attributable to buildings and will be accreted over the useful life of 39 years,

The fair value for certificates of deposit incorporates a valuation amount of \$59 thousand which will be accreted over 1.4 years.

Certain transferred loans evidenced deterioration of credit quality since origination and management deemed it probable, at acquisition, that all contractually required payments would not be collected.

Loans purchased with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered to be credit impaired. Evidence of credit quality deterioration as of the purchase date may include information such as past-due and nonaccrual status, borrower credit scores and recent loan to value percentages. Purchased credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality (ASC 310-30) and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for credit losses related to these loans is not carried over and recorded at the acquisition date. Management estimated the cash flows expected to be collected at acquisition using our internal risk models, which incorporate the estimate of current key assumptions, such as default rates, severity and prepayment speeds.

The carrying amount of those loans is included in loans, net on the balance sheet at September 30. The amounts of loans at April 30, 2021 and September 30, 2021 are as follows:

	2021 (In Thousands)	
Balance - April 30, 2021		
Consumer Real Estate	\$	24
Agricultural Real Estate		981
Commercial Real Estate		315
Commercial & Industrial		314
Carrying amount, net of fair value adjustment of \$325	\$	<u>1,309</u>
Balance - September 30, 2021		
Consumer Real Estate	\$	23
Agricultural Real Estate		-
Commercial Real Estate		234
Commercial & Industrial		293
Carrying amount, net of fair value adjustment of \$325	\$	<u>225</u>

Loans acquired during 2021 for which it was probable at acquisition that all contractually required payments would not be collected are as follows:

	(In Thousands)	
Contractually required payments receivable at acquisition		
Consumer Real Estate	\$	28
Agricultural Real Estate		1,142
Commercial Real Estate		527
Commercial & Industrial		360
Total required payments receivable	\$	<u>2,057</u>
Cash flows expected to be collected at acquisition	\$	1,309
Basis in acquired loans at acquisition	\$	1,634

During the third quarter, two agricultural real estate purchased credit impaired loans were paid off in full.

Changes in accretable yield, or income expected to be collected, are as follows:

	Three Months Ended September 30, 2021 (In Thousands)	Nine Months Ended September 30, 2021 (In Thousands)
Beginning Balance	\$ 733	\$ -
Additions	-	762
Accretion	(44)	(73)
Reclassification from nonaccretable difference	-	-
Disposals	-	-
Ending Balance	<u>\$ 689</u>	<u>\$ 689</u>

The results of operations of Ossian State Bank have been included in the Company's consolidated financial statements since the acquisition date of April 30, 2021. The following schedule includes pro-forma results for the three and nine months ended September 30, 2021 and 2020 as if the Ossian State Bank acquisitions had occurred as of the beginning of the comparable prior reporting period.

	(in thousands of dollars, except per share data)		(in thousands of dollars, except per share data)	
	Three Months Ended		Nine Months Ended	
	September 30, 2021	September 30, 2020	September 30, 2021	September 30, 2020
Summary of Operations				
Net Interest Income - Before Provision for Loan Losses	\$ 18,450	\$ 15,909	\$ 50,482	\$ 46,387
Provision for Loan Losses	659	1,988	3,001	4,989
Net Interest Income After Provision for Loan Losses	17,791	13,921	47,481	41,398
Noninterest Income	4,074	4,814	13,302	11,363
Noninterest Expense	12,880	13,062	38,010	35,666
Income Before Income Taxes	8,985	5,673	22,773	17,095
Income Taxes	1,892	1,093	4,566	3,273
Net Income	\$ 7,093	\$ 4,580	\$ 18,207	\$ 13,822
Basic and Diluted Earnings Per Share	\$ 0.63	\$ 0.41	\$ 1.63	\$ 1.24

The pro-forma information includes adjustments for interest income on loans, amortization of intangibles arising from the transaction, interest expense on deposits acquired, premises expense for the branches acquired and the related income tax effects. The pro-forma information for the quarter ended September 30, 2021 includes approximately \$348 thousand, net of tax, of operating revenue from Ossian State Bank since January 1, 2021.

The pro-forma financial information is presented for informational purposes only and is not indicative of the results of operations that actually would have been achieved had the acquisition been consummated as of that time, nor is it intended to be a projection of future results.

On January 1, 2019, the Company acquired Limberlost Bancshares, Inc. ("Limberlost"), the bank holding company for Bank of Geneva, a community bank based in Geneva, Indiana. Bank of Geneva operated six full-service offices in the northeast Indiana communities of Geneva, Berne, Decatur, Monroe, Portland and Monroeville. Shareholders of Limberlost received 1,830 shares of FMAO common stock and \$8,465.00 in cash for each share. Limberlost had 1,000 shares outstanding on January 1, 2019. The share price of Farmers & Merchants Bancorp, Inc. (FMAO) stock on January 1, 2019 was \$38.49. Total consideration for the acquisition was approximately \$78.9 million consisting of \$8.5 million in cash and \$70.4 million in stock. As a result of the acquisition, the Company has had an opportunity to increase its deposit base and reduce transaction costs. The Company has also reduced costs through economies of scale.

Under the acquisition method of accounting, the total purchase was allocated to net tangible and intangible assets based on their current estimated fair values on the date of acquisition. Of the total purchase price of \$78.9 million, \$3.9 million has been allocated to core deposit intangible included in other assets and is being amortized over seven years on a straight line basis. Goodwill of \$43.3 million resulting from the acquisition consists largely of the synergies and economies of scale expected from combining the operations of the Company and Bank of Geneva. Of that total amount, none of the purchase price is deductible for tax purposes.

Changes in accretable yield, or income expected to be collected, for the three and nine months ended are as follows:

	Three Months Ended September 30, 2021	Three Months Ended September 30, 2020	Nine Months Ended September 30, 2021	Nine Months Ended September 30, 2020
	(In Thousands)	(In Thousands)	(In Thousands)	(In Thousands)
Beginning Balance	\$ 1,439	\$ 1,871	\$ 1,653	\$ 2,021
Additions	3	-	8	2
Accretion	(108)	(107)	(323)	(321)
Reclassification from nonaccretable difference	-	-	-	62
Disposals	-	(5)	(4)	(5)
Ending Balance	\$ 1,334	\$ 1,759	\$ 1,334	\$ 1,759

As mentioned previously, the acquisition of Bank of Geneva resulted in the recognition of \$3.9 million in core deposit intangible assets which is being amortized over its remaining life of 7 years on a straight line basis.

The amortization expense for the nine months ended September 30, 2020 was \$546 thousand of which \$84 thousand was related to the purchase of the Custar office in December of 2013. Of the \$653 thousand to be expensed in 2021, \$478 thousand has been expensed for the nine months ended September 30, 2021. Annual amortization of core deposit intangible assets is as follows:

	(In Thousands)	(In Thousands)	(In Thousands)
	Geneva	Ossian	Total
2021	\$ 560	\$ 93	\$ 653
2022	560	140	700
2023	560	140	700
2024	560	140	700
2025	560	140	700
Thereafter	-	327	-
	<u>\$ 2,800</u>	<u>\$ 980</u>	<u>\$ 3,453</u>

On November 16, 2020, FM Investment Services, a division of the Bank, purchased the assets and clients of Adams County Financial Resources (ACFR), a full-service registered investment advisory firm located in Geneva, Indiana.

ACFR was founded in 1994 by R. Lee Flueckiger and provides clients and their families with financial confidence through personalized investment planning and services. As of November 30, 2020, ACFR had approximately \$83 million of assets under management and over 450 clients.

Total consideration for the purchase was \$825 thousand which consisted of 40,049 shares of stock. As a result of this purchase, the Company expects an increase to noninterest income of approximately \$500 thousand in 2021 with the majority of the income to be recognized in the second half of the year.

Under the acquisition method of accounting, the total purchase is allocated to net tangible and intangible assets based on their current estimated fair values on the date of acquisition. Of the total purchase price of \$825 thousand, \$800 thousand has been allocated to customer list intangible, included in other assets, to be amortized over 6.5 years on a straight line basis.

The following table summarizes the consideration paid for ACFR and the amounts of the assets acquired:

Fair Value of Consideration Transferred

	(In Thousands)
Common Shares (40,049 shares)	\$ 825
Total	<u>\$ 825</u>

Recognized amounts of identifiable assets acquired

Assets	
Premises and equipment	\$ 25
Customer list intangible	800
Total Assets Purchased	<u>\$ 825</u>

Of the \$123 thousand to be expensed in 2021, \$92 thousand has been expensed for the nine months ended September 30, 2021. Annual amortization expense of customer list intangible is as follows:

	<u>(In Thousands)</u>	
	<u>Adams County Financial Resources</u>	
2021	\$	123
2022		123
2023		123
2024		123
2025		123
Thereafter		169
	\$	<u>784</u>

[Remainder of this page intentionally left blank]

NOTE 3 SECURITIES

Mortgage-backed securities, as shown in the following tables, are all government sponsored enterprises. The amortized cost and fair value of securities, with gross unrealized gains and losses at September 30, 2021 and December 31, 2020, are as follows:

	(In Thousands)			
	September 30, 2021			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale:				
U.S. Treasury	\$ 74,347	\$ 29	\$ (572)	\$ 73,804
U.S. Government agencies	163,771	1,123	(1,698)	163,196
Mortgage-backed securities	124,658	1,348	(907)	125,099
State and local governments	62,802	2,046	(230)	64,618
Total available-for-sale securities	<u>\$ 425,578</u>	<u>\$ 4,546</u>	<u>\$ (3,407)</u>	<u>\$ 426,717</u>

	(In Thousands)			
	December 31, 2020			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale:				
U.S. Treasury	\$ -	\$ -	\$ -	\$ -
U.S. Government agencies	122,514	1,857	(130)	124,241
Mortgage-backed securities	110,828	2,228	-	113,056
State and local governments	67,260	3,265	(10)	70,515
Total available-for-sale securities	<u>\$ 300,602</u>	<u>\$ 7,350</u>	<u>\$ (140)</u>	<u>\$ 307,812</u>

Investment securities will at times depreciate to an unrealized loss position. The Company utilizes the following criteria to assess whether impairment is other than temporary. No one item by itself will necessarily signal that a security should be recognized as an other than temporary impairment.

1. The fair value of the security has significantly declined from book value.
2. A downgrade has occurred that lowered the credit rating to below investment grade (below Baa3 by Moody and BBB – by Standard and Poors.)
3. Dividends have been reduced or eliminated or scheduled interest payments have not been made.
4. The underwater security has longer than 10 years to maturity and the loss position had existed for more than 3 years.
5. Management does not possess both the intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value.

If the impairment is judged to be other than temporary, the cost basis of the individual security shall be written down to fair value, thereby establishing a new cost basis. The new cost basis shall not be changed for subsequent recoveries in fair value. The amount of the write down shall be included in current earnings as a realized loss. The recovery in fair value, if any, shall be recognized in earnings when the security is sold. The table below is presented by category of security and length of time in a continuous loss position. The Company currently does not hold any securities with other than temporary impairment.

Information pertaining to securities with gross unrealized losses at September 30, 2021 and December 31, 2020, aggregated by investment category and length of time that individual securities have been in a continuous loss position follows:

	(In Thousands)					
	September 30, 2021					
	Less Than Twelve Months		Twelve Months & Over		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. Treasury	\$ (572)	\$ 58,913	\$ -	\$ -	\$ (572)	\$ 58,913
U.S. Government agencies	(1,636)	107,353	(62)	2,443	(1,698)	109,796
Mortgage-backed securities	(907)	57,266	-	-	(907)	57,266
State and local governments	(166)	11,260	(64)	2,503	(230)	13,763
Total available-for-sale securities	\$ (3,281)	\$ 234,792	\$ (126)	\$ 4,946	\$ (3,407)	\$ 239,738

	(In Thousands)					
	December 31, 2020					
	Less Than Twelve Months		Twelve Months & Over		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. Treasury	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
U.S. Government agencies	(130)	48,331	-	-	(130)	48,331
Mortgage-backed securities	-	-	-	-	-	-
State and local governments	(10)	3,562	-	-	(10)	3,562
Total available-for-sale securities	\$ (140)	\$ 51,893	\$ -	\$ -	\$ (140)	\$ 51,893

Unrealized losses on securities have not been recognized into income because the issuers' bonds are of high credit quality, values have only been impacted by changes in interest rates since the securities were purchased, and the Company has the intent and ability to hold the securities for the foreseeable future. The fair value is expected to recover as the bonds approach the maturity date.

Below are the gross realized gains and losses for the three and nine months ended September 30, 2021 and September 30, 2020.

	Three Months (In Thousands)		Nine Months (In Thousands)	
	2021	2020	2021	2020
	Gross realized gains	\$ -	\$ -	\$ 293
Gross realized losses	-	-	-	-
Net realized gains	\$ -	\$ -	\$ 293	\$ 270
Tax expense related to net realized gains	\$ -	\$ -	\$ 62	\$ 57

The net realized gains on sales and related tax expense is a reclassification out of accumulated other comprehensive income (loss). The net realized gains are included in net gains on sale of available-for-sale securities and the related tax expense is included in income taxes in the condensed consolidated statements of income and comprehensive income (loss).

The amortized cost and fair value of debt securities at September 30, 2021, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	(In Thousands)	
	Amortized Cost	Fair Value
One year or less	\$ 8,867	\$ 8,923
After one year through five years	120,220	121,121
After five years through ten years	171,484	171,215
After ten years	349	359
Total	\$ 300,920	\$ 301,618
Mortgage-backed securities	124,658	125,099
Total	\$ 425,578	\$ 426,717

Investments with a carrying value of \$77.1 million and \$83.2 million at September 30, 2021 and December 31, 2020, respectively, were pledged to secure public deposits and securities sold under repurchase agreements.

Other securities include Federal Home Loan Bank of Cincinnati and Indianapolis stock in the amount of \$4.5 million as of September 30, 2021 and \$5.8 million as of December 31, 2020 in addition to Ohio Equity Fund for Housing Limited Partnership of \$357 thousand as of September 30, 2021 and \$151 thousand as of December 31, 2020.

[Remainder of this page intentionally left blank]

NOTE 4 LOANS

Loan balances as of September 30, 2021 and December 31, 2020 are summarized below:

<u>Loans:</u>	(In Thousands)	
	September 30, 2021	December 31, 2020
Consumer Real Estate	\$ 202,454	\$ 175,588
Agricultural Real Estate	179,374	189,159
Agricultural	105,580	94,358
Commercial Real Estate	728,852	588,825
Commercial and Industrial	194,767	189,246
Consumer	55,521	52,540
Other	31,096	15,757
	1,497,644	1,305,473
Less: Net deferred loan fees and costs	(2,082)	(2,483)
	1,495,562	1,302,990
Less: Allowance for loan losses	(15,698)	(13,672)
Loans - Net	<u>\$ 1,479,864</u>	<u>\$ 1,289,318</u>

Other loans primarily fund public improvements in the Bank's service area.

The distribution of fixed rate loans and variable rate loans by major loan category is as follows as of September 30, 2021:

	(In Thousands)	
	Fixed	Variable
Consumer Real Estate	\$ 138,024	\$ 64,430
Agricultural Real Estate	108,102	71,272
Agricultural	89,426	16,154
Commercial Real Estate	594,081	134,771
Commercial and Industrial	161,106	33,661
Consumer	51,469	4,052
Other	21,096	10,000

As of September 30, 2021 and December 31, 2020 one to four family residential mortgage loans amounting to \$36.5 million and \$38.0 million, respectively, have been pledged as security for future loans and existing loans the Bank has received from the Federal Home Loan Bank.

Unless listed separately, Other loans are included in the Commercial and Industrial category for the remainder of the tables in this Note 4.

The following table represents the contractual aging of the recorded investment (in thousands) in past due loans by portfolio classification of loans as of September 30, 2021 and December 31, 2020, net of deferred loan fees and costs:

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
September 30, 2021							
Consumer Real Estate	\$ 175	\$ -	\$ 204	\$ 379	\$ 201,991	\$ 202,370	\$ -
Agricultural Real Estate	120	-	-	120	178,931	179,051	-
Agricultural	-	-	117	117	105,605	105,722	-
Commercial Real Estate	-	-	180	180	727,238	727,418	-
Commercial and Industrial	136	199	366	701	224,681	225,382	-
Consumer	62	45	-	107	55,512	55,619	-
Total	\$ 493	\$ 244	\$ 867	\$ 1,604	\$ 1,493,958	\$ 1,495,562	\$ -

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Financing Receivables	Recorded Investment > 90 Days and Accruing
December 31, 2020							
Consumer Real Estate	\$ 269	\$ 191	\$ 1,032	\$ 1,492	\$ 173,824	\$ 175,316	\$ -
Agricultural Real Estate	-	-	88	88	188,738	188,826	-
Agricultural	-	-	176	176	94,314	94,490	-
Commercial Real Estate	-	-	185	185	587,469	587,654	-
Commercial and Industrial	-	750	983	1,733	202,310	204,043	-
Consumer	53	-	-	53	52,608	52,661	-
Total	\$ 322	\$ 941	\$ 2,464	\$ 3,727	\$ 1,299,263	\$ 1,302,990	\$ -

The following table presents the recorded investment in nonaccrual loans by class of loans as of September 30, 2021 and December 31, 2020:

	(In Thousands)	
	September 30, 2021	December 31, 2020
Consumer Real Estate	\$ 395	\$ 1,546
Agricultural Real Estate	4,568	5,575
Agricultural	117	307
Commercial Real Estate	619	665
Commercial & Industrial	542	1,296
Consumer	7	15
Total	<u>\$ 6,248</u>	<u>\$ 9,404</u>

Following are the characteristics and underwriting criteria for each major type of loan the Bank offers:

Consumer Real Estate: Purchase, refinance, or equity financing of one to four family owner occupied dwelling. Success in repayment is subject to borrower's income, debt level, character in fulfilling payment obligations, employment, and others.

Agricultural Real Estate: Purchase of farm real estate or for permanent improvements to the farm real estate. Cash flow from the farm operation is the repayment source and is therefore subject to the financial success of the farm operation.

Agricultural: Loans for the production and housing of crops, fruits, vegetables, and livestock or to fund the purchase or re-finance of capital assets such as machinery and equipment and livestock. The production of crops and livestock is especially vulnerable to commodity prices and weather. The vulnerability to commodity prices is offset by the farmer's ability to hedge their position by the use of various pricing mechanisms. The risk related to weather is often mitigated by requiring crop insurance.

Commercial Real Estate: Construction, purchase, and refinance of business purpose real estate. Risks include potential construction delays and overruns, vacancies, collateral value subject to market value fluctuations, interest rate, market demands, borrower's ability to repay in orderly fashion, and others. The Bank does employ stress testing on higher balance loans to mitigate risk by ensuring the customer's ability to repay in a changing rate environment before granting loan approval.

Commercial and Industrial: Loans to proprietorships, partnerships, limited liability companies or corporations to provide temporary working capital and seasonal loans as well as long term loans for capital asset acquisition. Risks include adequacy of cash flow, reasonableness of projections, financial leverage, economic trends, management ability and estimated capital expenditures during the fiscal year. The Bank does employ stress testing on higher balance loans to mitigate risk by ensuring the customer's ability to repay in a changing rate environment before granting loan approval. Included in commercial loans for 2021 and 2020 are Paycheck Protection Program (PPP) loans, administered by the Small Business Administration (SBA), in the amounts of \$9.8 million and \$36.2 million, respectively. The PPP provides loans to eligible businesses through financial institutions like the Bank, with loans being eligible for forgiveness of some or all of the principal amount by the SBA if the borrower meets certain requirements. The SBA guarantees repayment of the loans to the Bank if the borrower's loan is not forgiven and is then not repaid by the customer. Therefore, there is no allowance for loan losses related to these loans.

Consumer: Funding for individual and family purposes. Success in repayment is subject to borrower's income, debt level, character in fulfilling payment obligations, employment, and others.

Other: Primarily funds public improvements in the Bank's service area. Repayment ability is based on the continuance of the taxation revenue as the source of repayment.

The Bank uses a nine tier risk rating system to grade its loans. The grade of a loan may change during the life of the loan.

The risk ratings are described as follows.

1. Zero (0) Unclassified. Any loan which has not been assigned a classification.
2. One (1) Excellent. Credit to premier customers having the highest credit rating based on an extremely strong financial condition, which compares favorably with industry standards (upper quartile of RMA)

ratios). Financial statements indicate a sound earnings and financial ratio trend for several years with satisfactory profit margins and excellent liquidity exhibited. Prime credits may also be borrowers with loans fully secured by highly liquid collateral such as traded stocks, bonds, certificates of deposit, savings account, etc. No credit or collateral exceptions exist, and the loan adheres to The Bank's loan policy in every respect. Financing alternatives would be readily available and would qualify for unsecured credit. This rate is summarized by high liquidity, minimum risk, strong ratios, and low handling costs.

3. Two (2) Good. Desirable loans of somewhat less stature than rate 1, but with strong financial statements. Loan supported by financial statements containing strong balance sheets and a history of profitability. Probability of serious financial deterioration is unlikely. Possessing a sound repayment source (and a secondary source), which would allow repayment in a reasonable period of time. Individual loans backed by liquid personal assets, established history and unquestionable character.
4. Three (3) Satisfactory. Satisfactory loans of average or slightly above average risk – having some deficiency or vulnerability to changing economic conditions, but still fully collectible. Projects should normally demonstrate acceptable debt service coverage. There may be some weakness but with offsetting features of other support readily available. Loans that are meeting the terms of repayment.

Loans may be rated 3 when there is no recent information on which to base a current risk evaluation and the following conditions apply:

At inception, the loan was properly underwritten and did not possess an unwarranted level of credit risk;

- a. At inception, the loan was secured with collateral possessing a loan-to-value adequate to protect The Bank from loss;
 - b. The loan exhibited two or more years of satisfactory repayment with a reasonable reduction of the principal balance;
 - c. During the period that the loan has been outstanding, there has been no evidence of any credit weakness. Some examples of weakness include slow payment, lack of cooperation by the borrower, breach of loan covenants, or the business is in an industry which is known to be experiencing problems. If any of these credit weaknesses is observed, a lower risk rating is warranted.
5. Four (4) Satisfactory / Monitored. A “4” (Satisfactory/Monitored) risk rating may be established for a loan considered satisfactory but which is of average credit risk due to financial weakness or uncertainty. The loans warrant a higher than average level of monitoring to ensure that weaknesses do not advance. The level of risk in Satisfactory/Monitored classification is considered acceptable and within normal underwriting guidelines, so long as the loan is given management supervision.
 6. Five (5) Special Mention. Loans that possess some credit deficiency or potential weakness which deserve close attention, but which do not yet warrant substandard classification. Such loans pose unwarranted financial risk that, if not corrected, could weaken the loan and increase risk in the future. The key distinctions of a 5 (Special Mention) classification are that (1) it is indicative of an unwarranted level of risk, and (2) weaknesses are considered “potential” versus “defined” impairments to the primary source of loan repayment and collateral.
 7. Six (6) Substandard. One or more of the following characteristics may be exhibited in loans classified substandard:
 - a. Loans which possess a defined credit weakness and the likelihood that a loan will be paid from the primary source are uncertain. Financial deterioration is underway and very close attention is warranted to ensure that the loan is collected without loss.
 - b. Loans are inadequately protected by the current net worth and paying capacity of the borrower.
 - c. The primary source of repayment is weakened, and The Bank is forced to rely on a secondary source of repayment such as collateral liquidation or guarantees.
 - d. Loans are characterized by the distinct possibility that The Bank will sustain some loss if deficiencies are not corrected.
 - e. Unusual courses of action are needed to maintain a high probability of repayment.
 - f. The borrower is not generating enough cash flow to repay loan principal; however, continues to make interest payments.
 - g. The lender is forced into a subordinate position or unsecured collateral position due to flaws in documentation.
 - h. Loans have been restructured so that payment schedules, terms and collateral represent concessions to the borrower when compared to the normal loan terms.

- i. The lender is seriously contemplating foreclosure or legal action due to the apparent deterioration in the loan.
 - j. There is significant deterioration in the market conditions and the borrower is highly vulnerable to these conditions.
8. Seven (7) Doubtful. One or more of the following characteristics may be exhibited in loans classified Doubtful:
- a. Loans have all of the weaknesses of those classified as Substandard. Additionally, however, these weaknesses make collection or liquidation in full based on existing conditions improbable.
 - b. The primary source of repayment is gone, and there is considerable doubt as to the quality of the secondary source of repayment.
 - c. The possibility of loss is high, but, because of certain important pending factors which may strengthen the loan, loss classification is deferred until its exact status is known. A Doubtful classification is established deferring the realization of the loss.
9. Eight (8) Loss. Loans are considered uncollectable and of such little value that continuing to carry them as assets on the institution's financial statements is not feasible. Loans will be classified Loss when it is neither practical nor desirable to defer writing off or reserving all or a portion of a basically worthless asset, even though partial recovery may be possible at some time in the future.

[Remainder of this page intentionally left blank]

The following table represents the risk category of loans by portfolio class, net of deferred fees and costs, based on the most recent analysis performed as of September 30, 2021 and December 31, 2020:

		(In Thousands)				
		Agricultural Real Estate	Agricultural	Commercial Real Estate	Commercial and Industrial	Other
September 30, 2021						
1-2	\$	9,647	\$ 4,902	\$ 11,306	\$ 11,867	\$ -
3		40,914	25,170	222,396	42,616	10,956
4		110,166	74,802	458,886	134,690	20,140
5		4,638	301	7,872	1,098	-
6		13,686	547	26,958	4,015	-
7		-	-	-	-	-
8		-	-	-	-	-
Total	\$	<u>179,051</u>	<u>\$ 105,722</u>	<u>\$ 727,418</u>	<u>\$ 194,286</u>	<u>\$ 31,096</u>
		Agricultural Real Estate	Agricultural	Commercial Real Estate	Commercial and Industrial	Other
December 31, 2020						
1-2	\$	11,960	\$ 5,093	\$ 11,001	\$ 38,486	\$ -
3		38,306	23,779	165,201	26,515	4,651
4		112,465	63,480	396,076	114,108	11,106
5		7,478	1,577	4,010	3,266	-
6		18,617	561	11,366	4,796	-
7		-	-	-	1,115	-
8		-	-	-	-	-
Total	\$	<u>188,826</u>	<u>\$ 94,490</u>	<u>\$ 587,654</u>	<u>\$ 188,286</u>	<u>\$ 15,757</u>

For consumer residential real estate, and other, the Company also evaluates credit quality based on the aging status of the loan, as was previously stated, and by payment activity. The following tables present the recorded investment in those classes based on payment activity and assigned risk grading as of September 30, 2021 and December 31, 2020.

Grade	(In Thousands)	
	Consumer Real Estate	Consumer Real Estate
	September 30, 2021	December 31, 2020
Pass	\$ 199,470	\$ 171,667
Special Mention (5)	1,687	1,284
Substandard (6)	1,213	2,365
Doubtful (7)	-	-
Total	<u>\$ 202,370</u>	<u>\$ 175,316</u>

	(In Thousands)			
	Consumer - Credit		Consumer - Other	
	September 30, 2021	December 31, 2020	September 30, 2021	December 31, 2020
Performing	\$ 3,630	\$ 3,660	\$ 51,976	\$ 48,855
Nonperforming	-	10	13	136
Total	<u>\$ 3,630</u>	<u>\$ 3,670</u>	<u>\$ 51,989</u>	<u>\$ 48,991</u>

Information about impaired loans as of September 30, 2021, December 31, 2020 and September 30, 2020 are as follows:

	(In Thousands)		
	September 30, 2021	December 31, 2020	September 30, 2020
Impaired loans without a valuation allowance	\$ 2,461	\$ 5,172	\$ 5,134
Impaired loans with a valuation allowance	9,388	9,360	10,125
Total impaired loans	<u>\$ 11,849</u>	<u>\$ 14,532</u>	<u>\$ 15,259</u>
Valuation allowance related to impaired loans	\$ 2,400	\$ 1,657	\$ 1,198
Total non-accrual loans	<u>\$ 6,248</u>	<u>\$ 9,404</u>	<u>\$ 7,870</u>
Total loans past-due ninety days or more and still accruing	\$ -	\$ -	\$ -
Quarter ended average investment in impaired loans	\$ 11,639	\$ 14,868	\$ 13,517
Year to date average investment in impaired loans	\$ 12,360	\$ 10,234	\$ 8,613

There were no additional funds available to be advanced in connection with impaired loans as of September 30, 2021.

The Bank had approximately \$6.0 million of its impaired loans classified as troubled debt restructured (TDR) as of September 30, 2021, \$6.5 million as of December 31, 2020 and \$6.4 million as of September 30, 2020.

Modification programs focused on payment pattern changes and/or modified maturity dates with most receiving a combination of the two concessions. The modifications did not result in the contractual forgiveness of principal. During the third quarter of 2021, one new loan was considered TDR as a result of being in a deficiency balance upon the sale of property. The loan is set for a 3 year term and 10 year amortization. The ALLL includes \$1.0 million for the specific allocation on the principal balance of this loan. Year to date 2021, there were two new loans considered TDR with two previously reported TDR loans paid off in June. In the third quarter of 2020, one new loan was considered TDR and was given a rate concession. During the year to date 2020, there were six new loans considered TDR with one of the loans subsequently paid off in May. Interest was paid current at the time of all modifications.

The following tables represent three and nine months ended September 30, 2021 and 2020:

Three Months September 30, 2021 (in thousands)	Number of Contracts Modified in the	Pre- Modification Outstanding Recorded	Post- Modification Outstanding Recorded	Nine Months September 30, 2021 (in thousands)	Number of Contracts Modified in the	Pre- Modification Outstanding Recorded	Post- Modification Outstanding Recorded
<u>Troubled</u>	<u>Debt</u>			<u>Troubled</u>	<u>Debt</u>		
<u>Restructurings</u>	<u>Last Three</u>	<u>Investment</u>	<u>Investment</u>	<u>Restructurings</u>	<u>Last Nine</u>	<u>Investment</u>	<u>Investment</u>
	<u>Months</u>				<u>Months</u>		
Ag Real Estate	-	\$ -	\$ -	Ag Real Estate	-	\$ -	\$ -
Agricultural	-	-	-	Agricultural	-	-	-
Commercial Real Estate	-	-	-	Commercial Real Estate	1	382	382
Commercial and Industrial	1	1,000	1,000	Commercial and Industrial	1	1,000	1,000

Three Months September 30, 2020 (in thousands)	Number of Contracts Modified in the	Pre- Modification Outstanding Recorded	Post- Modification Outstanding Recorded	Nine Months September 30, 2020 (in thousands)	Number of Contracts Modified in the	Pre- Modification Outstanding Recorded	Post- Modification Outstanding Recorded
<u>Troubled</u>	<u>Debt</u>			<u>Troubled</u>	<u>Debt</u>		
<u>Restructurings</u>	<u>Last Three</u>	<u>Investment</u>	<u>Investment</u>	<u>Restructurings</u>	<u>Last Nine</u>	<u>Investment</u>	<u>Investment</u>
	<u>Months</u>				<u>Months</u>		
Ag Real Estate	-	\$ -	\$ -	Ag Real Estate	2	\$ 5,380	\$ 5,380
Agricultural	-	-	-	Agricultural	1	164	164
Commercial Real Estate	-	-	-	Commercial Real Estate	2	981	981
Commercial and Industrial	1	50	50	Commercial and Industrial	1	50	50

For the three and nine month periods ended September 30, 2021 and 2020, there were no TDRs that subsequently defaulted after modification.

For the nine month period ended September 30, 2021, there was one impaired commercial real estate loan of \$86 thousand and one impaired commercial loan of \$480 thousand that were classified as TDR paid off as well as three impaired commercial loans of \$809 thousand that were classified as TDR charged off. There was one impaired commercial real estate loan of \$481 thousand that was classified as TDR paid off for the nine month period ended September 30, 2020.

For the majority of the Bank's impaired loans, the Bank will apply the fair value of collateral or use a measurement incorporating the present value of expected future cash flows discounted at the loan's effective rate of interest. To determine fair value of collateral, collateral asset values securing an impaired loan are periodically evaluated. Maximum time of re-evaluation is every 12 months for chattels and titled vehicles and every two years for real estate. In this process, third party evaluations are obtained. Until such time that updated appraisals are received, the Bank may discount the collateral value used.

The Bank uses the following guidelines as stated in policy to determine when to realize a charge-off, whether a partial or full loan balance. A charge-off in whole or in part is realized when unsecured consumer loans, credit card credits and overdraft lines of credit reach 90 days delinquency. At 90 days delinquent, secured consumer loans are charged down to the value of the collateral, if repossession of the collateral is assured and/or in the process of repossession. Consumer mortgage loan deficiencies are charged down upon the sale of the collateral or sooner upon the recognition of collateral deficiency. A broker's price opinion or appraisal will be completed on all home loans in litigation and any deficiency will be charged off before reaching 150 days delinquent. Commercial and agricultural credits are charged down at 120 days delinquency, unless an established and approved work-out plan is in place or litigation of the credit will likely result in recovery of the loan balance. Upon notification of bankruptcy, unsecured debt is charged off. Additional charge-off may be realized as further unsecured positions are recognized.

The following tables present loans individually evaluated for impairment by class of loans for the three and nine months ended September 30, 2021 and September 30, 2020 and for the year ended December 31, 2020.

(In Thousands)						
Three Months Ended September 30, 2021	Recorded Investment	Unpaid Principal Balance	Related Allowance	QTD Average Recorded Investment	QTD Interest Income Recognized	QTD Interest Income Recognized Cash Basis
With no related allowance recorded:						
Consumer Real Estate	\$ 714	\$ 714	\$ -	\$ 453	\$ 1	\$ 3
Agricultural Real Estate	1,207	1,207	-	1,047	19	-
Agricultural	130	130	-	130	4	-
Commercial Real Estate	180	180	-	2,519	4	1
Commercial and Industrial	215	215	-	525	-	1
Consumer	15	15	-	16	-	-
With a specific allowance recorded:						
Consumer Real Estate	-	-	-	-	-	-
Agricultural Real Estate	4,844	4,844	636	5,104	4	-
Agricultural	117	117	54	117	-	-
Commercial Real Estate	3,427	3,427	710	1,395	31	-
Commercial and Industrial	1,000	1,000	1,000	333	2	-
Consumer	-	-	-	-	-	-
Totals:						
Consumer Real Estate	<u>\$ 714</u>	<u>\$ 714</u>	<u>\$ -</u>	<u>\$ 453</u>	<u>\$ 1</u>	<u>\$ 3</u>
Agricultural Real Estate	<u>\$ 6,051</u>	<u>\$ 6,051</u>	<u>\$ 636</u>	<u>\$ 6,151</u>	<u>\$ 23</u>	<u>\$ -</u>
Agricultural	<u>\$ 247</u>	<u>\$ 247</u>	<u>\$ 54</u>	<u>\$ 247</u>	<u>\$ 4</u>	<u>\$ -</u>
Commercial Real Estate	<u>\$ 3,607</u>	<u>\$ 3,607</u>	<u>\$ 710</u>	<u>\$ 3,914</u>	<u>\$ 35</u>	<u>\$ 1</u>
Commercial and Industrial	<u>\$ 1,215</u>	<u>\$ 1,215</u>	<u>\$ 1,000</u>	<u>\$ 858</u>	<u>\$ 2</u>	<u>\$ 1</u>
Consumer	<u>\$ 15</u>	<u>\$ 15</u>	<u>\$ -</u>	<u>\$ 16</u>	<u>\$ -</u>	<u>\$ -</u>

(In Thousands)

Year Ended December 31, 2020	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized Cash Basis
With no related allowance recorded:						
Consumer Real Estate	\$ 799	\$ 799	\$ -	\$ 738	\$ 22	\$ 10
Agricultural Real Estate	1,546	1,549	-	729	18	12
Agricultural	291	291	-	392	3	3
Commercial Real Estate	185	185	-	195	13	-
Commercial and Industrial	2,328	2,328	-	1,222	26	5
Consumer	23	23	-	16	-	-
With a specific allowance recorded:						
Consumer Real Estate	202	202	31	126	-	3
Agricultural Real Estate	5,210	5,210	600	3,175	6	102
Agricultural	176	176	116	188	-	-
Commercial Real Estate	2,765	2,765	20	2,524	128	-
Commercial and Industrial	1,007	1,007	890	916	52	-
Consumer	-	-	-	11	1	-
Totals:						
Consumer Real Estate	\$ 1,001	\$ 1,001	\$ 31	\$ 864	\$ 22	\$ 13
Agricultural Real Estate	\$ 6,756	\$ 6,759	\$ 600	\$ 3,904	\$ 24	\$ 114
Agricultural	\$ 467	\$ 467	\$ 116	\$ 580	\$ 3	\$ 3
Commercial Real Estate	\$ 2,950	\$ 2,950	\$ 20	\$ 2,719	\$ 141	\$ -
Commercial and Industrial	\$ 3,335	\$ 3,335	\$ 890	\$ 2,138	\$ 78	\$ 5
Consumer	\$ 23	\$ 23	\$ -	\$ 27	\$ 1	\$ -

(In Thousands)

Three Months Ended September 30, 2020	Recorded Investment	Unpaid Principal Balance	Related Allowance	QTD Average Recorded Investment	QTD Interest Income Recognized	QTD Interest Income Recognized Cash Basis
With no related allowance recorded:						
Consumer Real Estate	\$ 780	\$ 780	\$ -	\$ 791	\$ 41	\$ 5
Agricultural Real Estate	1,589	1,589	-	873	2	-
Agricultural	533	533	-	375	4	1
Commercial Real Estate	186	186	-	186	1	-
Commercial and Industrial	2,021	2,021	-	1,190	5	-
Consumer	25	25	-	26	21	-
With a specific allowance recorded:						
Consumer Real Estate	205	205	43	119	8	-
Agricultural Real Estate	5,425	5,425	432	5,450	2	-
Agricultural	188	188	28	342	3	-
Commercial Real Estate	3,033	3,033	44	3,046	-	-
Commercial and Industrial	1,274	1,274	651	1,119	3	-
Consumer	-	-	-	-	-	-
Totals:						
Consumer Real Estate	<u>\$ 985</u>	<u>\$ 985</u>	<u>\$ 43</u>	<u>\$ 910</u>	<u>\$ 49</u>	<u>\$ 5</u>
Agricultural Real Estate	<u>\$ 7,014</u>	<u>\$ 7,014</u>	<u>\$ 432</u>	<u>\$ 6,323</u>	<u>\$ 4</u>	<u>\$ -</u>
Agricultural	<u>\$ 721</u>	<u>\$ 721</u>	<u>\$ 28</u>	<u>\$ 717</u>	<u>\$ 7</u>	<u>\$ 1</u>
Commercial Real Estate	<u>\$ 3,219</u>	<u>\$ 3,219</u>	<u>\$ 44</u>	<u>\$ 3,232</u>	<u>\$ 1</u>	<u>\$ -</u>
Commercial and Industrial	<u>\$ 3,295</u>	<u>\$ 3,295</u>	<u>\$ 651</u>	<u>\$ 2,309</u>	<u>\$ 8</u>	<u>\$ -</u>
Consumer	<u>\$ 25</u>	<u>\$ 25</u>	<u>\$ -</u>	<u>\$ 26</u>	<u>\$ 21</u>	<u>\$ -</u>

(In Thousands)

Nine Months Ended September 30, 2021

	Recorded Investment	Unpaid Principal Balance	Related Allowance	YTD Average Recorded Investment	YTD Interest Income Recognized	YTD Interest Income Recognized Cash Basis
With no related allowance recorded:						
Consumer Real Estate	\$ 714	\$ 714	\$ -	\$ 485	\$ 4	\$ 10
Agricultural Real Estate	1,207	1,207	-	1,191	53	-
Agricultural	130	130	-	161	8	-
Commercial Real Estate	180	180	-	1,768	38	7
Commercial and Industrial	215	215	-	1,206	24	4
Consumer	15	15	-	19	1	-
With a specific allowance recorded:						
Consumer Real Estate	-	-	-	-	-	-
Agricultural Real Estate	4,844	4,844	636	5,273	15	-
Agricultural	117	117	54	123	4	-
Commercial Real Estate	3,427	3,427	710	1,800	58	3
Commercial and Industrial	1,000	1,000	1,000	334	2	-
Consumer	-	-	-	-	-	-
Totals:						
Consumer Real Estate	<u>\$ 714</u>	<u>\$ 714</u>	<u>\$ -</u>	<u>\$ 485</u>	<u>\$ 4</u>	<u>\$ 10</u>
Agricultural Real Estate	<u>\$ 6,051</u>	<u>\$ 6,051</u>	<u>\$ 636</u>	<u>\$ 6,464</u>	<u>\$ 68</u>	<u>\$ -</u>
Agricultural	<u>\$ 247</u>	<u>\$ 247</u>	<u>\$ 54</u>	<u>\$ 284</u>	<u>\$ 12</u>	<u>\$ -</u>
Commercial Real Estate	<u>\$ 3,607</u>	<u>\$ 3,607</u>	<u>\$ 710</u>	<u>\$ 3,568</u>	<u>\$ 96</u>	<u>\$ 10</u>
Commercial and Industrial	<u>\$ 1,215</u>	<u>\$ 1,215</u>	<u>\$ 1,000</u>	<u>\$ 1,540</u>	<u>\$ 26</u>	<u>\$ 4</u>
Consumer	<u>\$ 15</u>	<u>\$ 15</u>	<u>\$ -</u>	<u>\$ 19</u>	<u>\$ 1</u>	<u>\$ -</u>

(In Thousands)

Nine Months Ended September 30, 2020	Recorded Investment	Unpaid Principal Balance	Related Allowance	YTD Average Recorded Investment	YTD Interest Income Recognized	YTD Interest Income Recognized Cash Basis
With no related allowance recorded:						
Consumer Real Estate	\$ 780	\$ 780	\$ -	\$ 688	\$ 120	\$ 9
Agricultural Real Estate	1,589	1,589	-	451	6	-
Agricultural	533	533	-	367	9	1
Commercial Real Estate	186	186	-	199	3	-
Commercial and Industrial	2,021	2,021	-	819	18	-
Consumer	25	25	-	21	37	-
With a specific allowance recorded:						
Consumer Real Estate	205	205	43	60	10	-
Agricultural Real Estate	5,425	5,425	432	2,475	7	-
Agricultural	188	188	28	208	6	-
Commercial Real Estate	3,033	3,033	44	2,389	-	-
Commercial and Industrial	1,274	1,274	651	929	10	-
Consumer	-	-	-	7	-	-
Totals:						
Consumer Real Estate	<u>\$ 985</u>	<u>\$ 985</u>	<u>\$ 43</u>	<u>\$ 748</u>	<u>\$ 130</u>	<u>\$ 9</u>
Agricultural Real Estate	<u>\$ 7,014</u>	<u>\$ 7,014</u>	<u>\$ 432</u>	<u>\$ 2,926</u>	<u>\$ 13</u>	<u>\$ -</u>
Agricultural	<u>\$ 721</u>	<u>\$ 721</u>	<u>\$ 28</u>	<u>\$ 575</u>	<u>\$ 15</u>	<u>\$ 1</u>
Commercial Real Estate	<u>\$ 3,219</u>	<u>\$ 3,219</u>	<u>\$ 44</u>	<u>\$ 2,588</u>	<u>\$ 3</u>	<u>\$ -</u>
Commercial and Industrial	<u>\$ 3,295</u>	<u>\$ 3,295</u>	<u>\$ 651</u>	<u>\$ 1,748</u>	<u>\$ 28</u>	<u>\$ -</u>
Consumer	<u>\$ 25</u>	<u>\$ 25</u>	<u>\$ -</u>	<u>\$ 28</u>	<u>\$ 37</u>	<u>\$ -</u>

As of September 30, 2021, the Company had \$167 thousand of foreclosed residential real estate property obtained by physical possession and \$129 thousand of consumer mortgage loans secured by residential real estate properties for which foreclosure proceedings are in process according to local jurisdictions. This compares to the Company having \$71 thousand of foreclosed residential real estate property obtained by physical possession and \$910 thousand of consumer mortgage loans secured by residential real estate properties for which foreclosure proceeding are in process according to local jurisdictions as of December 31, 2020. As of September 30, 2020, the Company had \$71 thousand of foreclosed residential real estate property obtained by physical possession and \$849 thousand of consumer mortgage loans secured by residential real estate properties for which foreclosure proceedings were in process according to local jurisdictions.

The Allowance for Loan and Lease Losses (ALLL) has a direct impact on the provision expense. An increase in the ALLL is funded through recoveries and provision expense. The following tables summarize the activities in the allowance for credit losses.

	(In Thousands)	
	Nine Months Ended September 30, 2021	Twelve Months Ended December 31, 2020
Allowance for Loan & Lease Losses		
Balance at beginning of year	\$ 13,672	\$ 7,228
Provision for loan loss	3,000	6,981
Loans charged off	(1,154)	(720)
Recoveries	180	183
Allowance for Loan & Lease Losses	<u>\$ 15,698</u>	<u>\$ 13,672</u>
Allowance for Unfunded Loan Commitments & Letters of Credit	<u>\$ 1,039</u>	<u>\$ 641</u>
Total Allowance for Credit Losses	<u>\$ 16,737</u>	<u>\$ 14,313</u>

The Company segregates its ALLL into two reserves: The ALLL and the Allowance for Unfunded Loan Commitments and Letters of Credit (AULC). When combined, these reserves constitute the total Allowance for Credit Losses (ACL).

The ALLL does not include an accretable yield of \$2.0 million and \$1.7 million as of September 30, 2021 and December 31, 2020, respectively nor a nonaccretable yield of \$325 thousand as of September 30, 2021 related to the acquisitions of Bank of Geneva in 2019 and Ossian State Bank in 2021 as previously discussed in Note 2.

The AULC is reported within other liabilities on the balance sheet while the ALLL is netted within the loans, net asset line. The ACL presented above represents the full amount of reserves available to absorb possible credit losses.

[Remainder of this page intentionally left blank]

The following table breaks down the activity within ACL for each loan portfolio classification and shows the contribution provided by both the recoveries and the provision along with the reduction of the allowance caused by charge-offs.

Additional analysis, presented in thousands, related to the allowance for credit losses for the three and nine months ended September 30, 2021 and September 30, 2020 in addition to the ending balances as of December 31, 2020 is as follows:

	Consumer Real Estate	Agricultural Real Estate	Agricultural	Commercial Real Estate	Commercial and Industrial	Consumer	Unfunded Loan Commitment & Letters of Credit	Unallocated	Total
Three Months Ended September 30, 2021									
ALLOWANCE FOR CREDIT LOSSES:									
Beginning balance	\$ 649	\$ 1,217	\$ 720	\$ 8,831	\$ 2,837	\$ 613	\$ 1,145	\$ 220	16,232
Charge Offs	(2)	-	(1)	-	(5)	(95)	-	-	(103)
Recoveries	3	-	1	3	9	39	-	-	55
Provision (Credit)	146	(291)	(33)	(469)	973	49	-	284	659
Other Non-interest expense related to unfunded	-	-	-	-	-	-	(106)	-	(106)
Ending Balance	\$ 796	\$ 926	\$ 687	\$ 8,365	\$ 3,814	\$ 606	\$ 1,039	\$ 504	\$ 16,737
Ending balance: individually evaluated for impairment	\$ -	\$ 636	\$ 54	\$ 710	\$ 1,000	\$ -	\$ -	\$ -	\$ 2,400
Ending balance: collectively evaluated for impairment	\$ 796	\$ 290	\$ 633	\$ 7,655	\$ 2,814	\$ 606	\$ 1,039	\$ 504	\$ 14,337
Ending balance: loans acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
FINANCING RECEIVABLES:									
Ending balance	\$ 202,370	\$ 179,051	\$ 105,722	\$ 727,418	\$ 225,382	\$ 55,619	\$ -	\$ -	\$ 1,495,562
Ending balance: individually evaluated for impairment	\$ 714	\$ 6,051	\$ 247	\$ 3,607	\$ 1,215	\$ 15	\$ -	\$ -	\$ 11,849
Ending balance: collectively evaluated for impairment	\$ 201,595	\$ 173,000	\$ 105,475	\$ 723,577	\$ 223,803	\$ 55,604	\$ -	\$ -	\$ 1,483,054
Ending balance: loans acquired with deteriorated credit quality	\$ 61	\$ -	\$ -	\$ 234	\$ 364	\$ -	\$ -	\$ -	\$ 659

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
 NOTE 4 LOANS (Continued)

December 31, 2020	Consumer Real Estate	Agricultural Real Estate	Agricultural	Commercial Real Estate	Commercial and Industrial	Consumer	Unfunded Loan Commitment & Letters of Credit	Unallocated	Total
ALLOWANCE FOR CREDIT LOSSES:									
Ending Balance	\$ 633	\$ 958	\$ 701	\$ 7,415	\$ 3,346	\$ 606	\$ 641	\$ 13	\$ 14,313
Ending balance: individually evaluated for impairment	\$ 31	\$ 600	\$ 116	\$ 20	\$ 890	\$ -	\$ -	\$ -	\$ 1,657
Ending balance: collectively evaluated for impairment	\$ 602	\$ 358	\$ 585	\$ 7,395	\$ 2,456	\$ 606	\$ 641	\$ 13	\$ 12,656
Ending balance: loans acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
FINANCING RECEIVABLES:									
Ending balance	\$ 175,316	\$ 188,826	\$ 94,490	\$ 587,654	\$ 204,043	\$ 52,661	\$ -	\$ -	\$ 1,302,990
Ending balance: individually evaluated for impairment	\$ 1,001	\$ 6,756	\$ 467	\$ 2,950	\$ 3,335	\$ 23	\$ -	\$ -	\$ 14,532
Ending balance: collectively evaluated for impairment	\$ 174,273	\$ 182,070	\$ 94,023	\$ 584,704	\$ 200,602	\$ 52,638	\$ -	\$ -	\$ 1,288,310
Ending balance: loans acquired with deteriorated credit quality	\$ 42	\$ -	\$ -	\$ -	\$ 106	\$ -	\$ -	\$ -	\$ 148

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
NOTE 4 LOANS (Continued)

	Consumer Real Estate	Agricultural Real Estate	Agricultural	Commercial Real Estate	Commercial and Industrial	Consumer	Unfunded Loan Commitment & Letters of Credit	Unallocated	Total
Three Months Ended September 30, 2020									
ALLOWANCE FOR CREDIT LOSSES:									
Beginning balance	\$ 570	\$ 813	\$ 1,036	\$ 4,458	\$ 2,423	\$ 561	\$ 605	\$ 72	\$ 10,538
Charge Offs	-	-	-	-	-	(79)	-	-	(79)
Recoveries	2	-	-	2	10	28	-	-	42
Provision (Credit)	(42)	(51)	(367)	1,275	839	94	-	239	1,987
Other Non-interest expense related to unfunded	-	-	-	-	-	-	28	-	28
Ending Balance	\$ 530	\$ 762	\$ 669	\$ 5,735	\$ 3,272	\$ 604	\$ 633	\$ 311	\$ 12,516
Ending balance: individually evaluated for impairment	\$ 43	\$ 432	\$ 28	\$ 44	\$ 651	\$ -	\$ -	\$ -	\$ 1,198
Ending balance: collectively evaluated for impairment	\$ 487	\$ 330	\$ 641	\$ 5,691	\$ 2,621	\$ 604	\$ 633	\$ 311	\$ 11,318
Ending balance: loans acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
FINANCING RECEIVABLES:									
Ending balance	\$ 175,595	\$ 192,577	\$ 103,476	\$ 593,936	\$ 244,823	\$ 53,455	\$ -	\$ -	\$ 1,363,862
Ending balance: individually evaluated for impairment	\$ 985	\$ 7,014	\$ 721	\$ 3,219	\$ 3,295	\$ 25	\$ -	\$ -	\$ 15,259
Ending balance: collectively evaluated for impairment	\$ 174,567	\$ 185,563	\$ 102,755	\$ 590,717	\$ 241,528	\$ 53,339	\$ -	\$ -	\$ 1,348,469
Ending balance: loans acquired with deteriorated credit quality	\$ 43	\$ -	\$ -	\$ -	\$ -	\$ 91	\$ -	\$ -	\$ 134

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
NOTE 4 LOANS (Continued)

	Consumer Real Estate	Agricultural Real Estate	Agricultural	Commercial Real Estate	Commercial and Industrial	Consumer	Unfunded Loan Commitment & Letters of Credit	Unallocated	Total
Nine Months Ended September 30, 2021									
ALLOWANCE FOR CREDIT LOSSES:									
Beginning balance	\$ 633	\$ 958	\$ 701	\$ 7,415	\$ 3,346	\$ 606	\$ 641	\$ 13	\$ 14,313
Charge Offs	(2)	-	(143)	-	(814)	(195)	-	-	(1,154)
Recoveries	9	-	7	8	19	137	-	-	180
Provision (Credit)	156	(32)	122	942	1,263	58	-	491	3,000
Other Non-interest expense related to unfunded	-	-	-	-	-	-	398	-	398
Ending Balance	\$ 796	\$ 926	\$ 687	\$ 8,365	\$ 3,814	\$ 606	\$ 1,039	\$ 504	\$ 16,737
Ending balance: individually evaluated for impairment	\$ -	\$ 636	\$ 54	\$ 710	\$ 1,000	\$ -	\$ -	\$ -	\$ 2,400
Ending balance: collectively evaluated for impairment	\$ 796	\$ 290	\$ 633	\$ 7,655	\$ 2,814	\$ 606	\$ 1,039	\$ 504	\$ 14,337
Ending balance: loans acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
FINANCING RECEIVABLES:									
Ending balance	\$ 202,370	\$ 179,051	\$ 105,722	\$ 727,418	\$ 225,382	\$ 55,619	\$ -	\$ -	\$ 1,495,562
Ending balance: individually evaluated for impairment	\$ 714	\$ 6,051	\$ 247	\$ 3,607	\$ 1,215	\$ 15	\$ -	\$ -	\$ 11,849
Ending balance: collectively evaluated for impairment	\$ 201,595	\$ 173,000	\$ 105,475	\$ 723,577	\$ 223,803	\$ 55,604	\$ -	\$ -	\$ 1,483,054
Ending balance: loans acquired with deteriorated credit quality	\$ 61	\$ -	\$ -	\$ 234	\$ 364	\$ -	\$ -	\$ -	\$ 659

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
NOTE 4 LOANS (Continued)

	Consumer Real Estate	Agricultural Real Estate	Agricultural	Commercial Real Estate	Commercial and Industrial	Consumer	Unfunded Loan Commitment & Letters of Credit	Unallocated	Total
Nine Months Ended September 30, 2020									
ALLOWANCE FOR CREDIT LOSSES:									
Beginning balance	\$ 311	\$ 314	\$ 691	\$ 3,634	\$ 1,727	\$ 551	\$ 479	\$ -	\$ 7,707
Charge Offs	(35)	-	-	(8)	(165)	(272)	-	-	(480)
Recoveries	7	-	-	7	19	116	-	-	149
Provision (Credit)	247	448	(22)	2,102	1,691	209	-	311	4,986
Other Non-interest expense related to unfunded	-	-	-	-	-	-	154	-	154
Ending Balance	\$ 530	\$ 762	\$ 669	\$ 5,735	\$ 3,272	\$ 604	\$ 633	\$ 311	\$ 12,516
Ending balance: individually evaluated for impairment	\$ 43	\$ 432	\$ 28	\$ 44	\$ 651	\$ -	\$ -	\$ -	\$ 1,198
Ending balance: collectively evaluated for impairment	\$ 487	\$ 330	\$ 641	\$ 5,691	\$ 2,621	\$ 604	\$ 633	\$ 311	\$ 11,318
Ending balance: loans acquired with deteriorated credit quality	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
FINANCING RECEIVABLES:									
Ending balance	\$ 175,595	\$ 192,577	\$ 103,476	\$ 593,936	\$ 244,823	\$ 53,455	\$ -	\$ -	\$ 1,363,862
Ending balance: individually evaluated for impairment	\$ 985	\$ 7,014	\$ 721	\$ 3,219	\$ 3,295	\$ 25	\$ -	\$ -	\$ 15,259
Ending balance: collectively evaluated for impairment	\$ 174,567	\$ 185,563	\$ 102,755	\$ 590,717	\$ 241,528	\$ 53,339	\$ -	\$ -	\$ 1,348,469
Ending balance: loans acquired with deteriorated credit quality	\$ 43	\$ -	\$ -	\$ -	\$ -	\$ 91	\$ -	\$ -	\$ 134

NOTE 5 EARNINGS PER SHARE

Basic earnings per share are calculated using the two-class method. The two-class method is an earnings allocation formula under which earnings per share is calculated from common stock and participating securities according to dividends declared and participation rights in undistributed earnings. Under this method, all earnings distributed and undistributed, are allocated to participating securities and common shares based on their respective rights to receive dividends. Unvested share-based payment awards that contain non-forfeitable rights to dividends are considered participating securities (i.e. unvested restricted stock), not subject to performance based measures. Basic earnings per share is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding. Application of the two-class method for participating securities results in a more dilutive basic earnings per share as the participating securities are allocated the same amount of income as if they are outstanding for purposes of basic earnings per share. There is no additional potential dilution in calculating diluted earnings per share, therefore basic and diluted earnings per share are the same amounts. Other than the restricted stock plan, the Company has no other employee stock based compensation plans.

Beginning in 2020, the Compensation Committee of the Company has determined that it is appropriate to award shares of the common stock of the Company to Outside Directors and Employees that are officers of the Company or the Bank who also serve as Directors of the Company and the Bank as a portion of their retainer for services rendered as Directors of the Company and the Bank. The Committee believes that it is appropriate to award the Directors shares equal to a specific dollar amount, rounded to the nearest whole share on an annual basis commencing on June 5, 2020 and thereafter on the first Friday of June in each year. Directors receive a prorated dollar value of shares for a partial year of service. The value for the shares is to be based upon the closing price for shares on June 4, 2020 and thereafter on the first Thursday in June in each year. On June 5, 2020, each Director received approximately \$4,000 which equated to 176 shares. On June 4, 2021, ten Directors received approximately \$6,000 worth of shares which equated to 272 shares while four Directors received a prorated dollar value of shares. The use of stock for Directors' retainer, does not have an effect on diluted earnings per share as it is immediately vested.

	(in thousands of dollars) Three Months Ended		(in thousands of dollars) Nine Months Ended	
	September 30, 2021	September 30, 2020	September 30, 2021	September 30, 2020
Earnings per share				
Net income	\$ 5,920	\$ 4,410	\$ 15,812	\$ 13,319
Less: distributed earnings allocated to participating securities	(20)	(15)	(49)	(41)
Less: undistributed earnings allocated to participating securities	(31)	(19)	(77)	(59)
Net earnings available to common shareholders	<u>\$ 5,869</u>	<u>\$ 4,376</u>	<u>\$ 15,686</u>	<u>\$ 13,219</u>
Weighted average common shares outstanding including participating securities	11,209,732	11,142,797	11,199,309	11,135,695
Less: average unvested restricted shares	(96,197)	(83,257)	(89,075)	(83,445)
Weighted average common shares outstanding	<u>11,113,535</u>	<u>11,059,540</u>	<u>11,110,234</u>	<u>11,052,250</u>
Basic and diluted earnings per share	<u>\$ 0.53</u>	<u>\$ 0.40</u>	<u>\$ 1.41</u>	<u>\$ 1.20</u>

NOTE 6 FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair values of financial instruments are management's estimate of the values at which the instruments could be exchanged in a transaction between willing parties. These estimates are subjective and may vary significantly from amounts that would be realized in actual transactions. In addition, other significant assets are not considered financial assets including deferred tax assets, premises, equipment and intangibles. Further, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on the fair value estimates and have not been considered in any of the estimates.

[Remainder of this page intentionally left blank]

The estimated fair values, and related carrying or notional amounts, for on and off-balance sheet financial instruments as of September 30, 2021 and December 31, 2020 are reflected below.

	(In Thousands)				
	September 30, 2021				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Cash and cash equivalents	\$ 158,078	\$ 158,078	\$ 158,078	\$ -	\$ -
Interest-bearing time deposits	14,622	14,651	-	14,651	-
Securities - available-for-sale	426,717	426,717	73,804	349,146	3,767
Other securities	4,905	4,905	-	-	4,905
Loans held for sale	3,735	3,735	-	-	3,735
Loans, net	1,479,864	1,434,960	-	-	1,434,960
Interest receivable	7,401	7,401	-	-	7,401
Financial Liabilities:					
Interest bearing deposits	\$ 1,175,769	\$ 1,175,816	\$ -	\$ -	\$ 1,175,816
Non-interest bearing deposits	438,076	438,076	-	438,076	-
Time deposits	252,383	248,399	-	-	248,399
Total Deposits	1,866,228	1,862,291	-	438,076	1,424,215
Federal funds purchased and securities sold under agreement to repurchase	29,601	29,601	-	-	29,601
Federal Home Loan Bank advances	17,868	17,869	-	-	17,869
Subordinated notes, net of unamortized issuance costs	34,441	35,000	-	35,000	-
Interest payable	588	588	-	-	588

	(In Thousands)				
	December 31, 2020				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Cash and cash equivalents	\$ 175,706	\$ 175,706	\$ 175,706	\$ -	\$ -
Interest-bearing time deposits	4,653	4,677	-	4,677	-
Securities - available-for-sale	307,812	307,812	-	306,250	1,562
Other securities	5,939	5,939	-	-	5,939
Loans held for sale	7,740	7,740	-	-	7,740
Loans, net	1,289,318	1,261,440	-	-	1,261,440
Interest receivable	6,188	6,188	-	-	6,188
Financial Liabilities:					
Interest bearing deposits	\$ 997,462	\$ 1,004,608	\$ -	\$ -	\$ 1,004,608
Non-interest bearing deposits	351,147	351,147	-	351,147	-
Time deposits	247,553	250,135	-	-	250,135
Total Deposits	1,596,162	1,605,890	-	351,147	1,254,743
Federal funds purchased and securities sold under agreement to repurchase	30,239	30,239	-	-	30,239
Federal Home Loan Bank advances	17,861	17,872	-	-	17,872
Subordinated notes, net of unamortized issuance costs	-	-	-	-	-
Interest payable	338	338	-	-	338

Fair Value Measurements

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities in active markets that the Company has the ability to access.

Available-for-sale securities, when quoted prices are available in an active market, securities are valued using the quoted price and are classified as Level 1.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Available-for-sale securities classified as Level 2 are valued using the prices obtained from an independent pricing service. The prices are not adjusted. Securities of obligations of state and political subdivisions are valued using a type of matrix, or grid, pricing in which securities are benchmarked against the treasury rate based on credit rating. Substantially all assumptions used by the independent pricing service are observable in the marketplace, can be derived from observable data, or are supported by observable levels at which transactions are executed in the marketplace.

Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset or liability. The Bank holds some local municipals that the Bank evaluates based on the credit strength of the underlying project. The fair value is determined by valuing similar credit payment streams at similar rates.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Company's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset.

The following summarizes financial assets measured at fair value on a recurring basis as of September 30, 2021 and December 31, 2020, segregated by level or the valuation inputs within the fair value hierarchy utilized to measure fair value:

Assets and Liabilities Measured at Fair Value on a Recurring Basis (In Thousands)			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2021			
Assets - (Securities Available-for-Sale)			
U.S. Treasury	\$ 73,804	\$ -	\$ -
U.S. Government agencies	-	163,196	-
Mortgage-backed securities	-	125,099	-
State and local governments	-	60,851	3,767
Total Securities Available-for-Sale	<u>\$ 73,804</u>	<u>\$ 349,146</u>	<u>\$ 3,767</u>
December 31, 2020			
Assets - (Securities Available-for-Sale)			
U.S. Treasury	\$ -	\$ -	\$ -
U.S. Government agencies	-	124,241	-
Mortgage-backed securities	-	113,056	-
State and local governments	-	68,953	1,562
Total Securities Available-for-Sale	<u>\$ -</u>	<u>\$ 306,250</u>	<u>\$ 1,562</u>

The following tables represent the changes in the Level 3 fair-value category of which unobservable inputs are relied upon as of the three and nine month periods ended September 30, 2021 and September 30, 2020.

	(In Thousands)		
	Fair Value Measurements Using Significant		
	Unobservable Inputs (Level 3)		
	State and Local Governments Tax-Exempt	State and Local Governments Taxable	State and Local Governments Total
Balance at July 1, 2021	\$ 2,410	\$ 1,538	\$ 3,948
Change in Market Value	(9)	(17)	(26)
Purchases	-	-	-
Payments & Maturities	(155)	-	(155)
Balance at September 30, 2021	<u>\$ 2,246</u>	<u>\$ 1,521</u>	<u>\$ 3,767</u>

	(In Thousands)		
	Fair Value Measurements Using Significant		
	Unobservable Inputs (Level 3)		
	State and Local Governments Tax-Exempt	State and Local Governments Taxable	State and Local Governments Total
Balance at July 1, 2020	\$ -	\$ 1,550	\$ 1,550
Change in Market Value	-	35	35
Payments & Maturities	-	-	-
Balance at September 30, 2020	<u>\$ -</u>	<u>\$ 1,585</u>	<u>\$ 1,585</u>

	(In Thousands)		
	Fair Value Measurements Using Significant		
	Unobservable Inputs (Level 3)		
	State and Local Governments Tax-Exempt	State and Local Governments Taxable	State and Local Governments Total
Balance at January 1, 2021	\$ -	\$ 1,562	\$ 1,562
Change in Market Value	(17)	(41)	(58)
Purchases	2,418	-	2,418
Payments & Maturities	(155)	-	(155)
Balance at September 30, 2021	<u>\$ 2,246</u>	<u>\$ 1,521</u>	<u>\$ 3,767</u>

	(In Thousands)		
	Fair Value Measurements Using Significant		
	Unobservable Inputs (Level 3)		
	State and Local Governments Tax-Exempt	State and Local Governments Taxable	State and Local Governments Total
Balance at January 1, 2020	\$ -	\$ 1,490	\$ 1,490
Change in Market Value	-	95	95
Payments & Maturities	-	-	-
Balance at September 30, 2020	<u>\$ -</u>	<u>\$ 1,585</u>	<u>\$ 1,585</u>

Most of the Company's available-for-sale securities, including any bonds issued by local municipalities, have CUSIP numbers or have similar characteristics of those in the municipal markets, making them marketable and comparable as Level 2.

The Company also has assets that, under certain conditions, are subject to measurement at fair value on a non-recurring basis. At September 30, 2021 and December 31, 2020, such assets consist primarily of collateral dependent impaired loans. Collateral dependent impaired loans categorized as Level 3 assets consist of non-homogeneous loans that are considered impaired. The Company estimates the fair value of the loans based on the present value of expected future cash flows using management's best estimate of key assumptions. These assumptions include future payment ability, timing of payment streams, and estimated realizable values of available collateral (typically based on outside appraisals.)

At September 30, 2021 and December 31, 2020, fair value of collateral dependent impaired loans categorized as Level 3 was \$6.9 million and \$7.7 million, respectively. The specific allocation for impaired loans was \$1.3 million and \$1.7 million as of September 30, 2021 and December 31, 2020, respectively, which are accounted for in the allowance for loan losses (see Note 4).

Other real estate is reported at either the lower of the fair value of the real estate minus the estimated costs to sell the asset or the cost of the asset. The determination of fair value of the real estate relies primarily on appraisals from third parties. If the fair value of the real estate, minus the estimated costs to sell the asset, is less than the asset's cost, the deficiency is recognized as a valuation allowance against the asset through a charge to expense. The valuation allowance is therefore increased or decreased, through charges or credits to expense, for changes in the asset's fair value or estimated selling costs.

The following table presents quantitative information about unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements:

	(In Thousands)		Valuation Technique	Unobservable Inputs	Range (Weighted Average)
	Fair Value at September 30, 2021				
State and local government	\$ 3,767		Discounted Cash Flow	Credit strength of underlying project or entity / Discount rate	0.34- 1.34% (0.86%)
Collateral dependent impaired loans	6,925		Collateral based measurements	Discount to reflect current market conditions and ultimate collectability	34.54- 81.41% (32.44%)
Other real estate owned - residential	30		Appraisals	Discount to reflect current market	0.0- 7.32% (50.99%)

ITEM 1 NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (Continued)
 NOTE 6 FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

	(In Thousands)			Range (Weighted Average)
	Fair Value at December 31, 2020	Valuation Technique	Unobservable Inputs	
State and local government	\$ 1,562	Discounted Cash Flow	Credit strength of underlying project or entity / Discount rate	1.19- 1.19% (1.19%)
Collateral dependent impaired loans	7,703	Collateral based measurements	Discount to reflect current market conditions and ultimate collectability	0.71-100% (17.71%)
Other real estate owned - residential	-	Appraisals	Discount to reflect current market	— % (—)

The following table presents impaired loans as recorded at fair value on September 30, 2021 and December 31, 2020:

Assets Measured at Fair Value on a Nonrecurring Basis at September 30, 2021				
(In Thousands)				
	Balance at September 30, 2021	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Collateral dependent impaired loans	\$ 6,925	\$ -	\$ -	\$ 6,925
Other real estate owned - residential	30	-	-	30

Assets Measured at Fair Value on a Nonrecurring Basis at December 31, 2020				
(In Thousands)				
	Balance at December 31, 2020	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Collateral dependent impaired loans	\$ 7,703	\$ -	\$ -	\$ 7,703
Other real estate owned - residential	-	-	-	-

[Remainder of this page intentionally left blank]

NOTE 7 FEDERAL FUNDS PURCHASED AND SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Company had no federal funds purchased as of September 30, 2021 and December 31, 2020. During the same time periods, the Company had \$29.6 million and \$30.2 million in securities sold under agreement to repurchase.

	September 30, 2021				
	Remaining Contractual Maturity of the Agreements (In Thousands)				
	Overnight & Continuous	Up to 30 days	30-90 days	Greater Than 90 days	Total
Repurchase agreements					
US Treasury & agency securities	\$ 1,240	\$ 2,156	\$ 750	\$ 25,455	\$ 29,601
Total	\$ 1,240	\$ 2,156	\$ 750	\$ 25,455	\$ 29,601

	December 31, 2020				
	Remaining Contractual Maturity of the Agreements (In Thousands)				
	Overnight & Continuous	Up to 30 days	30-90 days	Greater Than 90 days	Total
Repurchase agreements					
US Treasury & agency securities	\$ 1,899	\$ -	\$ 3,900	\$ 24,440	\$ 30,239
Total	\$ 1,899	\$ -	\$ 3,900	\$ 24,440	\$ 30,239

NOTE 8 SUBORDINATED NOTES

On July 30, 2021, the Company announced the completion of a private placement of \$35 million aggregate principal amount of its 3.25% fixed-to-floating rate subordinated notes due July 30, 2031 (the “Notes”) to various accredited investors (the “Offering”). The price for the Notes was 100% of the principal amount of the Notes. The Notes are intended to qualify as Tier 2 capital for regulatory purposes. The Company intends to use the net proceeds from the Offering for general corporate purposes, including financing acquisitions and organic growth.

Interest on the Notes will accrue at a rate equal to (i) 3.25% per annum from the original issue date to, but excluding, the five-year anniversary, payable semi-annually in arrears, and (ii) a floating rate per annum equal to a benchmark rate, which is expected to be the Three-Month Term SOFR (as defined in the Notes), plus a spread of 263 basis points from and including the five-year anniversary until maturity, payable quarterly in arrears. Beginning on or after the fifth anniversary of the issue date through maturity, the Notes may be redeemed, at the Company’s option, on any scheduled interest payment date. Any redemption will be at a redemption price equal to 100% of the principal amount of Notes being redeemed, plus accrued and unpaid interest.

(In Thousands)	September 30, 2021		December 31, 2020	
	Principal	Unamortized Note Issuance Costs	Principal	Unamortized Note Issuance Costs
Subordinated Notes	\$ 35,000	\$ (559)	\$ -	\$ -

NOTE 9 PROPOSED BUSINESS COMBINATION

On May 4, 2021, the Company announced they have signed an agreement and plan of reorganization and merger (the Agreement) whereby F&M will acquire Perpetual Federal Savings Bank, (“PFSB”), in a stock and cash transaction. PFSB operates one full-service office in Urbana, Ohio. At March 31, 2021, PFSB reported \$391 million in total assets, \$326 million in loans, \$305 million in deposits and \$79 million in tangible equity. PFSB is taxed as an S-Corporation. The closing date was October 1, 2021.

Subject to the terms of the Agreement, which has been unanimously approved by the Board of Directors of each company, PFSB shareholders will elect to receive either 1.776 shares of FMAO stock or \$41.20 per share in cash for each PFSB share owned, subject to adjustment based upon 1,833,999 shares of FMAO to be issued in the merger. At March 31, 2021, PFSB reported 2,470,032 shares of common stock outstanding. Based on FMAO's closing share price as of May 3, 2021 of \$24.22, the implied aggregate acquisition value equals \$103.7 million.

In 2021, the Company incurred \$523.5 thousand of third-party acquisition related costs. These expenses are comprised of consulting fees of \$160.8 thousand and other general and administrative expense of \$362.7 thousand in the Company's consolidated statement of income for the nine months ended September 30, 2021. During the most recent quarter, the Company incurred \$275.4 thousand of third-party acquisition related costs. These expenses are comprised of consulting fees of \$69.0 thousand and other general and administrative expense of \$206.3 thousand in the Company's consolidated statement of income for the three months ended September 30, 2021.

NOTE 10 RECENT ACCOUNTING PRONOUNCEMENTS

In June 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-13 "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." This ASU requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. The ASU requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration.

The ASU was effective for SEC filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019 (i.e., January 1, 2020, for calendar year entities). FASB subsequently approved a delay in adoption for Smaller Reporting Companies. The Company has completed an analysis to determine that it qualifies as a Smaller Reporting Company. As such, adoption can be postponed until periods beginning after December 15, 2022 (i.e., January 1, 2023, for calendar year entities). Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.

The Company has contracted with an external advisor and has formed a committee to determine the methodology to be used. Most importantly, the Company is gathering as much data as possible to enable management to review scenarios and determine which calculations will produce the most reliable results. The Company began working with the third-party service provider to review parallel reports starting in June 2019. The Company has not adopted ASU 2016-13 in calendar year 2021 and management is currently evaluating when or if they would elect to early adopt ASU 2016-13.

OVERVIEW

The first nine months of 2021 has been a time of expansion and handling one-time events impacting both revenue and expense. A great deal of the focus for 1st quarter remained with COVID-19 related items. While much of the forgiveness from the Paycheck Protection Program (PPP) was received in 4th quarter 2020, we continued to work with our remaining customers to process the forgiveness requests and payments. At the same time, we began the requests for additional funding under the additional PPP opportunities. Farmers & Merchant's (F&M) Commercial Division saw PPP loan activity begin to slow in the 2nd quarter. F&M shifted to working with our PPP Second Draw clients and the forgiveness process. F&M is very proud of the PPP program and the impact it has had on our clients and their employees. The PPP program at F&M has impacted 18,094 jobs. Most COVID-19 restrictions were lifted in the second quarter and many of the F&M client base returned to full schedules. F&M did assist clients with deferrals or modifications that were negatively impacted by COVID-19. As of the end of the third quarter, only two loans are currently under principal deferrals. One of these loans will resume principal payments in October while the second loan will resume principal payments in July 2022. The Bank received approximately \$2.4 million in accelerated net fee income from the most recent round (2021 originations) of PPP loans during the third quarter. The activities surrounding the originations and forgiveness of PPP loans account for a portion of the one-time events occurring in 2021.

Acquisition costs are categorized as one-time when looking at the individual acquisition. Two actual acquisitions had associated costs with them in the first nine months of 2021. The acquisition of Ossian Financial Services, Inc (Ossian) had expenses of \$2.1 million during the first nine months of 2021 and Perpetual Federal Savings (Perpetual) total \$523.5 thousand so far in 2021. The Company is excited to have expanded its coverage in Indiana with the new offices of Ossian and Bluffton. As of May 1st, Ossian has been included in the Company's financials with system software conversion occurred mid-May. The Company has obtained regulatory approvals for the Perpetual deal and has completed the transaction on October 1st with system software conversion occurring mid-October. Each acquisition involves a different structure. Ossian was an all cash deal. Perpetual was a stock and cash deal. Additional detail can be found in the financial statements presented. These two acquisitions will account for expansion of both our footprint and our assets by over half a billion dollars by year end 2021.

F&M Commercial Banking Division continues to see good loan demand and most of this activity is spread throughout the three state footprint, including the Loan Production Offices (LPO) in Muncie, Indiana; Oxford, Ohio; and West Bloomfield, Michigan. The loan environment remains very competitive and we are seeing both lower rates and longer amortizations than what we have historically seen. Commercial clients continue to remain very challenged in the availability of workforce. Commercial clients have seen some of the supply chain challenges lessen, but some areas of material availability and price remain very concerning for our clients. Credit quality of the portfolio remains solid and we are able to analyze most of the commercial portfolio as CPAs have mostly caught up on FYE 2020 reporting.

The 2021 planting season for our market area was favorable as crops were planted timely. The growing conditions through most of our market area has been favorable with average to above average yields anticipated. Commodity prices have fallen from their earlier highs but remain at a profitable level. The outlook for our grain farmers is optimistic for 2021. The livestock industry in our portfolio has been stable. Agri-business is stable and will benefit as farm profits are positive. Concerns in the supply chain exist as they do in other industries. The agriculture portfolio remains healthy and concerns manageable.

Home loan rates remain low though the volume of refinancing loans has slowed as compared to the same time in 2020. Turn times have become more manageable and the Bank focused on home equity lines as an opportunity for growth. Limited inventory and the demand for homes remain strong. During the quarter, 247 loans including home equity and lines of credit were closed totaling \$30.3 million which compares to 541 loans and \$70.6 million the previous year. The third quarter gain on 1-4 family mortgage sales was down by approximately 67% compared to third quarter 2020. On a year to date basis, the gain on 1-4 family mortgage sales was down \$75 thousand from a year ago. The median home-sale price did increase 14% in the United States during Q3 according to *Housing Wire*. Increased lumber prices have impacted the remodeling and new build; however, we have seen input prices begin to decrease.

Additional expenses that would categorize closely to one-time events, were the divestiture of four offices. Three of the offices were in communities of which two offices were present. The review of our office structure spurred from the Company's strategic plan focusing on improving operating efficiency. Office closure expenses of \$406 thousand have been included in the Company's consolidated statements of income for 2021. During fourth quarter, the last office closure expense should be realized. Total savings is expected to be over \$760 thousand, netting a year one savings overall and

significant savings going forward. This will allow the Company to use the savings to fund expansion and transformation of existing offices. ATM's remain at the locations and all have ceased operations as of the end of the second quarter 2021.

The Company formed a "Pandemic" committee at the beginning of the COVID-19 situation in 2020 in the United States. The committee was tasked with researching, monitoring and implementing best practices as it relates to the protection of our employees, customers, shareholders and communities at large. We continue to rely on the committee and follow the directives issued as it remains in place today. With offices in three states, we adhere to the guidelines provided and continue to follow quarantine protocols as it relates to exposure and positive tests. We currently require masking of employees along with social distancing. The Company has offered an employee incentive for vaccinations of COVID-19 and/or the flu. Our meetings have fluctuated between in person and virtual as we monitor the risks of spread. We have participated in the government programs made available to our customers and ourselves. COVID-19 has become a routine part of our business and is a standard consideration in each decision we make. Therefore, we have determined a separate section as it relates to COVID-19 is no longer necessary in our reporting. Our PPP loan balances are under \$10 million and will no longer have a significant impact on our financials. Our committee remains intact, and we will report on any new programs we may participate in.

Overall, COVID-19 has increased the speed of adoption of our digital strategy and has changed the physical location of our team members. Departments are now separated to reduce the risk of a whole department being exposed and the utilization of remote work has increased. At the same time, the Company recognizes the importance of social interaction and will continue to explore the best way to bring people together in a safe environment. During the summer, the Bank hosted employee outings to two local zoos. The events were well received and attended. As we prepare for the holidays and budget for 2022, remain assured COVID -19 has influenced our actions and it has heightened our awareness of risks that must be considered and lessened in all future decisions.

Net interest earnings increased by \$5.8 million as compared to first nine months of 2020. The improvement was due to growth in the balance sheet as the Company continues to operate in the low rate environment preceded by the national prime rate drop of 150 basis points in the first quarter of 2020. The year to date net interest margin increased 9 basis points to 3.36% as compared to year to date June 30, 2021. The asset yield increased by 9 basis points on a year to date basis and 32 basis points when comparing to prior quarter. Cost of funds decreased 1 basis point on a year to date basis and increased 1 basis point when comparing the third quarter's cost to second quarter 2021. The increase in net interest margin and asset yield is attributable to the accelerated net fee income realized with the payoff or forgiveness of PPP loans. Further discussion of the balance sheet composition movements and the impact on the earnings can be viewed in the Material Results of Operations section that follows.

Net income improved 18.7% in comparing the first nine months 2021 to first nine months 2020 and earnings per share increased 17.5% in the same comparison. The higher net income was mainly driven by two factors: higher interest income and lower interest expense. Interest income on a year to date basis increased 4.5% or \$2.4 million compared to 2020. As mentioned previously, interest expense decreased by 40.9% and \$3.4 million on a year to date basis compared to first nine months 2020 on 23.1% higher average balances in 2021. Noninterest income, which also played a large part in the improved earnings, increased 17.3% and \$1.9 million over the same period 2020. Gain on sales of both 1-4 family mortgage loans and fixed rate agricultural loans along with interchange fees on debit card transactions were the biggest contributors. 1-4 family mortgage activity remains strong though has slowed compared to the last three quarters of 2020. We expect additional slowing the last quarter of the year as refinancing has slowed, housing prices have increased, and inventory of available homes is low throughout most of the Bank's market area.

The Company has worked diligently to manage during volatile times and the increase in our size and footprint has helped establish diversity of revenue streams and insulated our earnings. While we report and recognize the many one-time costs incurred by our strategic focus, we continue to realize the long-term benefits of our strategies. Our historical prudent approach to lending has continued to demonstrate its benefits in our credit quality. Past dues over 30 days as of September 30, 2021 were 0.11% of total loans outstanding. The relationships we have with our customers, employees, shareholders and communities has allowed our belief in our mission to "help people live their best lives" be realized. The light at the end of the tunnel is beginning to widen and the Company remains well capitalized and plans to continue in our strategic vision of expansion. The last two years has shown us the benefits from such growth are real.

NATURE OF ACTIVITIES

Farmers & Merchants Bancorp, Inc. (the "Company") is a financial holding company incorporated under the laws of Ohio in 1985. Our subsidiaries are The Farmers & Merchants State Bank (the "Bank"), a community bank operating in Northwest Ohio since 1897, and Farmers & Merchants Risk Management, Inc., a captive insurance company formed in December 2014

and located in Nevada. We report our financial condition and net income on a consolidated basis and we have only one segment.

Our executive offices are located at 307 North Defiance Street, Archbold, Ohio 43502, and our telephone number is (419) 446-2501. The Bank operates twenty-nine full-service banking offices throughout Northwest Ohio and Northeast Indiana and a drive-up facility in Archbold. The Bank also operates three Loan Production Offices (LPOs), one in each state of Ohio, Indiana and Michigan.

As of June 30, 2021, the Bank discontinued operations in four offices, three in Ohio and one in Indiana. Existing customers of those offices will continue to be serviced by other nearby offices.

The Farmers & Merchants State Bank engages in general commercial banking and savings business including commercial, agricultural and residential mortgage, consumer and credit card lending activities. The largest segment of the lending business relates to commercial, both real estate and non-real estate. The type of commercial business ranges from small business to multi-million dollar companies. The loans are a reflection of business located within the Banks' market area. Because the Bank's offices are located in Northwest Ohio and Northeast Indiana, a substantial amount of the loan portfolio is comprised of loans made to customers in the farming industry for such items as farm land, farm equipment, livestock and operating loans for seed, fertilizer, and feed. Other types of lending activities include loans for home improvements, and loans for the purchase of autos, trucks, recreational vehicles, motorcycles, and other consumer goods.

The Bank also provides checking account services, as well as savings and time deposit services such as certificates of deposits. In addition, Automated Teller Machines (ATMs) or Interactive Teller Machines (ITMs) are provided at most branch locations along with other independent locations in the market area. ITMs operate as an ATM with the addition of remote teller access to assist the user. The Bank has custodial services for Individual Retirement Accounts (IRAs) and Health Savings Accounts (HSAs). The Bank provides on-line banking access for consumer and business customers. For consumers, this includes bill-pay, on-line statement opportunities and mobile banking. For business customers, it provides the option of electronic transaction origination such as wire and Automated Clearing House (ACH) file transmittal. In addition, the Bank offers remote deposit capture or electronic deposit processing and merchant credit card services. Mobile banking was added in 2012 and has been widely accepted and used by consumers. Upgrades to our digital products and services continue to occur in both retail and business lines. The Bank continues to offer new suites of products as customer preferences change and the Bank adapts and adopts new technologies. The Bank continues to offer products that also meet the needs of our more traditional customers.

The Bank has established underwriting policies and procedures which facilitate operating in a safe and sound manner in accordance with supervisory and regulatory guidance. Within this sphere of safety and soundness, the Bank's practice has been to not promote innovative, unproven credit products which may not be in the best interest of the Bank or its customers. The Bank does offer a hybrid mortgage loan. Hybrid loans are loans that start out as a fixed rate mortgage but after a set number of years automatically adjust to an adjustable rate mortgage. The Bank offers a three year fixed rate mortgage after which the interest rate will adjust annually. The majority of the Bank's adjustable rate mortgages are of this type. In order to offer longer term fixed rate mortgages, the Bank does participate in the Freddie Mac, Farmer Mac and Small Business Lending programs. The Bank also normally retains the servicing rights on these partially or 100% sold loans. In order for the customer to participate in these programs they must meet the requirements established by those agencies. In addition, the Bank does sell some of its longer term fixed rate agricultural mortgages into the secondary market with the aid of brokers.

The Bank does not have a program to fund sub-prime loans. Sub-prime loans are characterized as a lending program or strategy that targets borrowers who pose a significantly higher risk of default than traditional retail banking customers.

All loan requests are reviewed as to credit worthiness and are subject to the Bank's underwriting guidelines as to secured versus unsecured credit. Secured loans are in turn subject to loan to value (LTV) requirements based on collateral types as set forth in the Bank's Loan Policy. In addition, credit scores of those seeking consumer credit are reviewed and if they do not meet the Bank's Loan Policy guidelines an additional officer approval is required.

Consumer Loans:

- Maximum loan to value (LTV) for cars, SUVs, and trucks is 110% depending on whether direct or indirect.
- Loans above 100% are generally the result of additional charges for extended warranties and/or insurance coverage for wage or death.
- Boats, campers, motorcycles, RV's and Motor Coaches range from 80%-90% based on age of vehicle.
- 1st or 2nd mortgages on 1-4 family homes range from 75%-90% with "in-house" first real estate mortgages requiring private mortgage insurance (PMI) on those exceeding 80% LTV. Exception for 1st lien home equity loans which do not require PMI or exceeding 80% LTV.
- Raw land LTV maximum ranges from 65%-75% depending on whether or not the property has been improved.

Commercial/Agriculture:

Accounts Receivable:

Up to 80% LTV less retainages and greater than 90 days.

Inventory:

- Agriculture:
 - Livestock and grain up to 80% LTV, crops (insured) up to 75% and Warehouse Receipts up to 87%.
- Commercial:
 - Maximum LTV of 50% on raw and finished goods.
- Floor plan:
 - New/used vehicles to 100% of wholesale.
 - New/Used recreational vehicles and manufactured homes to 80% of wholesale.

Equipment:

- New NTE 80% of invoice, used NTE 50% of listed book or 75% of appraised value.
- Restaurant equipment up to 35% of market value.
- Heavy trucks, titled trailers NTE 75% LTV and aircraft up to 75% of appraised value.

Real Estate:

- Maximum LTVs range from 70%-80% depending on type.
- Maximum LTV on non-traditional loan up to 85%.

F&M Investment Services, the brokerage department of the Bank, opened for business in April 1999. Securities are offered through Raymond James Financial Services, Inc. In November of 2020, FM Investment Services purchased the assets and clients of Adams County Financial Resources (ACFR) which is discussed in further detail in Note 2 to the Company's financial statements. Securities are offered through Raymond James Financial Services, Inc.

In December of 2014, the Company became a financial holding company within the meaning of the Bank Holding Company Act of 1956 as amended (the "Act"), in order to provide the flexibility to take advantage of the expanded powers available to a financial holding company under the Act. Our subsidiary bank is in turn regulated and examined by the Ohio Division of Financial Institutions and the Federal Deposit Insurance Corporation. The activities of our bank subsidiary are also subject to other federal and state laws and regulations. The Company also formed a captive insurance company (the "captive") in December 2014 which is located in Nevada and regulated by the State of Nevada Division of Insurance.

The Bank's primary market includes communities located in the Ohio counties of Defiance, Fulton, Hancock, Henry, Lucas, Williams, Wood and in the Indiana counties of Adams, Allen, DeKalb, Jay, Steuben and Wells. In our banking activities, we compete directly with other commercial banks, credit unions, farm credit services, and savings and loan institutions in each of our operating localities. In a number of our locations, we compete against entities which are much larger than us. The primary factors in competing for loans and deposits are the rates charged as well as location and quality of the services provided.

At September 30, 2021, we had 366 full time equivalent employees. The employees are not represented by a collective bargaining unit. We provide our employees with a comprehensive benefit program, some of which is contributory. We consider our employee relations to be good.

RECENT REGULATORY DEVELOPMENTS

The Bank remains attentive to the current regulatory environment in light of the regulatory agencies' risk-based approach to examinations. Regulatory changes and the complexity of new and amended rules have resulted in challenges and uncertainties which could pose an increased risk of noncompliance. Various significant mortgage rules require monitoring by means of testing, validation of results, additional training, and further research or consultation to assist with ongoing compliance.

The global spread of the Coronavirus (COVID-19) and resulting declaration of a world-wide pandemic have impacted the financial services industry and banking operations in the United States (US) and world-wide. The financial services sector is identified as a Critical Infrastructure Sector by the Department of Homeland Security during the COVID-19 response efforts. How basic business operations can be conducted has undergone a rapid and dramatic change. At the same time continuity of business operations involves promoting safety and security of customers and employees, providing a quality customer experience, and maintaining effective delivery systems and channels of communication. Regulatory guidance has been issued to manage and mitigate the unprecedented impact of the COVID-19 pandemic on business operations. Regulatory agencies promote prudent and practical efforts to assist customers and communities during this national emergency. Such assistance to alleviate the financial impact on affected customers involved modification of loan terms for existing borrowers, waiver of

certain fees and charges, providing small dollar loans, and offering forbearance and payment deferrals on mortgage loan obligations due to financial hardship. Legislation enacted in March 2020 has provided the Families First Coronavirus Response Act (FFCRA) and CARES Act. The FFCRA which was effective through December 31, 2020, provided for a paid leave for employees (of employers with fewer than 500 employees) who had to quarantine due to the coronavirus, were caring for a sick family member, or caring for a child out of school. It significantly expanded existing protections currently available to employees who take leave to care for a sick family member. The CARES Act, among other matters, resulted in expansion of SBA Lending Programs; provided for a financial election to suspend GAAP principles and regulatory determinations for COVID-19 related loan modifications that would otherwise be deemed Trouble Debt Restructuring; gave the FDIC authority to establish a temporary Debt Guarantee Program for bank liabilities; delayed Current Expected Credit Losses (CECL) compliance; reduced the Community Bank Leverage Ratio to 8% to eliminate risk-based capital compliance for banks under \$10 billion; required credit furnishers that agree to deferred loan payments, forbearance on a delinquent account, or any other relief during the national emergency to report accounts as current to Credit Reporting Agencies; and defined forbearance requirements and terms for single family and multi-family loans backed by federal government agencies or government sponsored entities due to COVID-19 financial hardship. Of immediate and significant importance was the rollout of the SBA Paycheck Protection Program (PPP). The PPP authorized lending of up to \$350 billion in 100% guaranteed 7(a) loans to cover payroll costs, interest on mortgage payments, rent obligations, and utilities. The PPP provided a guaranteed loan for which a portion of the loan up to or equal to 8 weeks of covered payroll and specific operating expenses can be forgiven. The maximum loan size was capped at the lessor of 250% of the average monthly payroll costs or \$10 million.

In April 2020, legislation known as the Paycheck Protection Program and Health Care Enhancement Act provided additional funding to replenish and supplement key programs under the CARES Act. Included in this legislation was the extension of the PPP with an additional \$320 billion in funding. At least \$60 billion of this funding was to be set aside for small and midsize banks and community lenders. Since April, the SBA has issued various Interim Final Rules to supplement and clarify matters involving the PPP. The Paycheck Protection Program Flexibility Act of 2020 (PPPFA) was enacted in early June 2020. This provided more flexibility to Borrowers regarding use of PPP loan funds. Certain provisions were retroactive to the date of the CARES Act and all PPP loans. Among these provisions were the extension of the covered period of the loan, extension of the forgiveness period, deferral of payments based on the loan forgiveness period, reduction in the minimum that must be spent for payroll costs, extended date by which employees must be rehired, and removal of restrictions on payroll tax deferral. The term for subsequent PPO loans made after enactment of the PPPFA was extended to five years from two. A primary focus is now directed to aiding PPP borrowers in navigating the loan forgiveness process.

FFCRA requirements to provide paid leave to employees ended on December 31, 2020. Due to the extended duration of the COVID-19 pandemic, employers subject to FFCRA could voluntarily extend the paid leave option until March 31, 2021. If the employer has elected to voluntarily apply the FFCRA extension, employees eligible for leave in 2020 and did not use the leave may take the leave in 2021. Under the American Rescue Plan of 2021 enacted in March 2021, for those employers who voluntarily extend the paid leave option, paid leave was reset starting April 1, 2021. If employees previously exhausted their paid leave under FFCRA, they may be entitled to an additional 10 days/80 hours for use. Additionally, the PPP was reauthorized with passage of the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act. It was originally intended to run through March 31, 2021 and was subsequently extended to May 31, 2021. Under the new legislation, \$284 billion in funding for first and second-time PPP loan borrowers was provided to the SBA. Three categories of businesses are eligible to apply for PPP: 1) qualified business that did not receive a PPP loan during the first funding round; 2) previous PPP loan recipients who need a second loan and meet certain criteria; previous PPP loan recipients who returned all or a portion of their original loans and want to apply to additional funding. To be eligible, any business applying for PPP must have been in operation since at least February 15, 2020. Specific eligibility criteria apply to first-time PPP borrowers and previous PPP loan recipients. For 2021, PPP provides expanded coverage for expenditures in addition to covered payroll and specific operating expenses. For second-time loan recipients, the maximum loan amount was reduced from \$10 million to \$2 million. A loan recipient is eligible for full loan forgiveness if at least 60% of the loan amount is spent on payroll costs. Funds must be spent over a covered period of the loan recipients' choosing between eight and 24 weeks after loan origination to be eligible for forgiveness. Depending on the continued duration of COVID-19 spread, further legislation and regulatory guidance may continue due to the economic impact on customers, businesses, communities, and industry sectors.

The Coronavirus Response and Relief Supplemental Appropriations Act, passed by Congress in December 2020, extended certain provisions of the CARES Act affecting the Company into 2021. Key banking provisions under this legislation include the following:

- Provided an additional \$284.6 billion in Paycheck Protection Program (PPP) funding for loans to small businesses, including for borrowers who have previously received a PPP loan.
- A one-page simplified forgiveness process for PPP loans under \$150,000.

- Clarification to various CARES Act provisions, the tax treatment of PPP expenses, lender responsibilities for agent fees, and lender “hold harmless” protections under the PPP and other laws.
- A further delay in Troubled Debt Restructuring (TDR) accounting until 60 days after the termination of the national emergency, or January 1, 2022. During third quarter 2021, there was one loan modification for \$3.1 million that would have been previously treated as TDR under the guidance in ASC 310-40.
- A further optional delay in Current Expected Credit Loss (CECL) accounting until January 1, 2022.
- A new round of Economic Impact Payments (EIPs) for consumers, with aggressive distribution timelines and new exemptions from garnishments.
- Significant added support for Community Development Financial Institutions (CDFIs) and Minority Depository Institutions (MDIs).
- Funding for agricultural support programs and for renter assistance programs.
- Termination of existing Federal Reserve emergency lending authority under the CARES Act, while preserving the Fed’s general 13(3) emergency authority existing prior to that Act.

In December 2020, new Qualified Mortgage (QM) Definition rules were issued by the Consumer Financial Protection Bureau. One set of rules revised the General QM definition and another set added the definition of a Seasoned QM Loan. Both QM Loan rules had an effective date of March 1, 2021. The revised General QM rule replaced the General QM loans definition of a 43% debt-to-income (DTI) limit with a focus on the loan pricing and whether the Annual Percentage Rate exceeds the average prime offer rate by less than 2.25 percentage points. Compliance with the revised General QM Loan rule had a mandatory compliance date of July 1, 2021. The existing Temporary Government Sponsored Entity (GSE) QM option was set to expire as of the mandatory compliance date for the revised General QM Rule. Subsequently, the CFPB issued a final rule published in the Federal Register on April 30, 2021 which delayed and extended the mandatory compliance date for the revised General QM rule to October 1, 2022. At the present time, the Company has the option to comply with either the original DTI-based General QM Loan definition or the revised price-based new General QM Loan definition. Since the Company sells fixed rate consumer mortgage loans to the Federal Home Loan Mortgage Corporation, it must remain attentive to their current loan underwriting requirements and how they evolve in the extended interim period.

With regard to all regulatory matters, the Bank remains committed in making good faith efforts to comply with technical requirements of the laws, rules, regulations, and guidance from both federal and state agencies which govern its activities.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company’s consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, and the Company follows general practices within the financial services industry in which it operates. At times the application of these principles requires management to make assumptions, estimates and judgments that affect the amounts reported in the financial statements and accompanying notes.

These assumptions, estimates and judgments are based on information available as of the date of the financial statements. As this information changes, the financial statements could reflect different assumptions, estimates and judgments. Certain policies inherently have a greater reliance on assumptions, estimates and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Examples of critical assumptions, estimates and judgments are when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not required to be recorded at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability must be recorded contingent upon a future event. These policies, along with the disclosures presented in the notes to the condensed consolidated financial statements and in the management discussion and analysis of the financial condition and results of operations, provide information on how significant assets and liabilities are valued and how those values are determined for the financial statements. Based on the valuation techniques used and the sensitivity of financial statement amounts to assumptions, estimates, and judgments underlying those amounts, management has identified the determination of the ALLL, the valuation of its Mortgage Servicing Rights and the valuation of real estate acquired through or in lieu of loan foreclosures (“OREO Property”) as the accounting areas that require the most subjective or complex judgments, and as such could be the most subject to revision as new information becomes available.

OREO Property held for sale is initially recorded at fair value at the date of foreclosure. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of cost or fair value minus estimated costs to sell.

Costs of holding foreclosed real estate are charged to expense in the current period, except for significant property improvements, which are capitalized. Valuations are periodically performed by management and a write-down is recorded by a charge to non-interest expense if the carrying value exceeds the fair value minus estimated costs to sell.

The net income from operations of foreclosed real estate held for sale is reported either in noninterest income or noninterest expense depending upon whether the property is in a gain or loss position overall. At September 30, 2021 OREO property holdings were \$167 thousand. OREO totaled \$71 thousand and \$206 thousand as of December 31, 2020 and September 30, 2020 respectively.

The ALLL and ACL represents management's estimate of probable credit losses inherent in the Bank's loan portfolio, unfunded loan commitments, and letters of credit at the report date. The ALLL methodology is regularly reviewed for its appropriateness and is approved annually by the Board of Directors. This written methodology is consistent with Generally Accepted Accounting Principles which provides for a consistently applied analysis.

The Bank's methodology provides an estimate of the probable credit losses either by calculating a specific loss per credit or by applying a composite of historical factors over a relevant period of time with current internal and external factors which may affect credit collectability. Such factors which may influence estimated losses are the conditions of the local and national economy, local unemployment trends, and abilities of lending staff, valuation trends of fixed assets, and trends in credit delinquency, classified credits, and credit losses.

Inherent in most estimates is imprecision. The Bank's ALLL may include a margin for imprecision with an unallocated portion. Bank regulatory agencies and external auditors periodically review the Bank's methodology and adequacy of the ALLL. Any required changes in the ALLL or loan charge-offs by these agencies or auditors may have a material effect on the ALLL. For more information regarding the estimates and calculations used to establish the ALLL please see Note 4 to the consolidated financial statements provided herewith.

The Bank is also required to estimate the value of its mortgage servicing rights. The Bank's mortgage servicing rights relating to fixed rate single-family mortgage loans that it has sold without recourse but services for others for a fee represent an asset on the Bank's balance sheet. The valuation is completed by an independent third party.

The expected and actual rates of mortgage loan prepayments are the most significant factors driving the potential for the impairment of the value of mortgage servicing assets. Increases in mortgage loan prepayments reduce estimated future net servicing cash flows because the life of the underlying loan is reduced.

The Bank's mortgage servicing rights relating to loans serviced for others represent an asset. This asset is initially capitalized and included in other assets on the Company's consolidated balance sheet. The mortgage servicing rights are then amortized as noninterest expense in proportion to, and over the period of the estimated future net servicing income of the underlying mortgage servicing rights. There are a number of factors, however, that can affect the ultimate value of the mortgage servicing rights to the Bank. The expected and actual rates of mortgage loan prepayments are the most significant factors driving the potential for the impairment of the value of mortgage servicing assets. Increases in mortgage loan prepayments reduce estimated future net servicing cash flows because the life of the underlying loan is reduced, meaning that the present value of the mortgage servicing rights is less than the carrying value of those rights on the Bank's balance sheet. Therefore, in an attempt to reflect an accurate expected value to the Bank of the mortgage servicing rights, the Bank receives a valuation of its mortgage servicing rights from an independent third party. The independent third party's valuation of the mortgage servicing rights is based on relevant characteristics of the Bank's loan servicing portfolio, such as loan terms, interest rates and recent national prepayment experience, as well as current national market interest rate levels, market forecasts and other economic conditions. For purposes of determining impairment, the mortgage servicing assets are stratified into like groups based on loan type, term, new versus seasoned and interest rate. Management, with the advice from its third-party valuation firm, reviewed the assumptions related to prepayment speeds, discount rates, and capitalized mortgage servicing income on a quarterly basis. Changes are reflected in the following quarter's analysis related to the mortgage servicing asset. In addition, based upon the independent third party's valuation of the Bank's mortgage servicing rights, management then establishes a valuation allowance by each stratum, if necessary, to quantify the likely impairment of the value of the mortgage servicing rights to the Bank. The estimates of prepayment speeds and discount rates are inherently uncertain, and different estimates could have a material impact on the Bank's net income and results of operations. The valuation allowance is evaluated and adjusted quarterly by management to reflect changes in the fair value of the underlying mortgage servicing rights based on market conditions. The accuracy of these estimates and assumptions by management and its third party valuation specialist can be directly tied back to the fact that management has only been required to record minor valuation allowances through its income statement over time based upon the valuation of each stratum of servicing rights.

MATERIAL CHANGES IN FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

The Company plans to continue in its growth mode in 2021 led by loan growth from within our newer markets. The Bank is focused on funding the loan growth with the least expensive source of deposits, sale of securities or borrowings. Growing deposits will also be a focus especially in our newer markets. The Bank offers the Insured Cash Sweep ("ICS") product

accessed through the Promontory network of financial institutions which helps to reduce the amount of pledged securities. This has provided more availability for runoff of securities by the Bank if warranted to fund loan growth.

Liquidity in terms of cash and cash equivalents ended \$17.6 million lower as of September 30, 2021 than it was at yearend December 31, 2020. An increase in deposits helped to fund the \$190.5 million increase in net loans since yearend 2020. All loan portfolios with the exception of the agricultural real estate portfolio increased compared to December 31, 2020.

In comparing to the same prior year period, the September 30, 2021 (net of deferred fees and cost) loan balances of \$1.5 billion accounted for \$131.7 million or 9.7% increase when compared to 2020's \$1.4 billion. The year over year improvement was made up of a combined increase of 4.9% in commercial and industrial related loans (comprised of 22.5% in commercial real estate loans and a decrease of 17.6% in non-real estate commercial loans). PPP loans of approximately \$9.8 million and \$87.2 million are included in the non-real estate commercial portfolio as of September 30, 2021 and September 30, 2020, respectively. Consumer real estate loans increased by 15.2%, consumer loans by 4.0% and other loans by 244.4%. Agricultural related loans decreased 4.8% year over year (comprised of 7.0% in agricultural real estate and offset by an increase of 2.2% in non-real estate agricultural loans). The Company credits the growth not only to the OFSI acquisition but also to the strong team of lenders focused on providing customers valuable localized services and thereby increasing our market share.

The chart below shows the breakdown of the loan portfolio category as of September 30, for the last three years, net of deferred fees and costs.

	(In Thousands)		
	September 30, 2021	September 30, 2020	September 30, 2019
	Amount	Amount	Amount
Consumer Real Estate	\$ 202,370	\$ 175,595	\$ 158,458
Agricultural Real Estate	179,051	192,577	200,625
Agricultural	105,722	103,476	110,405
Commercial Real Estate	727,418	593,936	501,095
Commercial and Industrial	194,286	235,793	130,228
Consumer	55,619	53,455	49,718
Other	31,096	9,030	8,167
Total Loans, net	\$ 1,495,562	\$ 1,363,862	\$ 1,158,696

The following is a contractual maturity schedule by major category of loans excluding fair value adjustments as of September 30, 2021.

	(In Thousands)		
	Within	After One	After
	One Year	Year Within Five Years	Five Years
Consumer Real Estate	\$ 8,137	\$ 31,278	\$ 163,269
Agricultural Real Estate	5,947	2,730	171,167
Agricultural	61,331	32,014	12,266
Commercial Real Estate	28,764	323,045	377,209
Commercial and Industrial	67,459	94,500	33,473
Consumer	5,078	36,199	14,249
Other	247	1,101	29,746

While the security portfolio has been utilized to fund loan growth for the last three years, additional sources have been cultivated during 2019, 2020, and 2021. The security portfolio increased \$118.9 million in the first nine months of 2021 from yearend 2020 and \$167.7 million from September 2020. The amount of pledged investment securities decreased by \$6.1 million as compared to yearend and \$9.9 million as compared to September 30, 2020. Liquidity is improved with the additional option of selling unpledged investment securities if needed to fund loan growth or other initiatives. As of

September 30, 2021, pledged investment securities totaled \$77.1 million. The current portfolio is in a net unrealized gain position of \$1.1 million.

For the Bank, an additional \$6.7 million is also available from the Federal Home Loan Bank based on current amounts of pledged collateral. At the present time, only 1-4 family and home equity portfolios are pledged. Additional borrowings would be available if additional portfolios (i.e. commercial real estate) were pledged.

On July 30, 2021, the Company announced the completion of a private placement of \$35 million aggregate principal amount of its 3.25% fixed-to-floating rate subordinated notes due July 30, 2031 (the "Notes") to various accredited investors (the "Offering"). The price for the Notes was 100% of the principal amount of the Notes. The Notes are intended to qualify as Tier 2 capital for regulatory purposes. The Company intends to use the net proceeds from the Offering for general corporate purposes, including financing acquisitions and organic growth.

With the exception of FHLB stocks, carried at cost, which is shown as other securities, all of the Company's security portfolio is categorized as "available-for-sale" and as such is recorded at fair value.

Management feels confident that liquidity needs for future growth can be met through additional maturities and/or sales from the security portfolio, increased deposits and additional borrowings. For short term needs, the Bank has \$163.2 million of unsecured borrowing capacity through its correspondent banks.

Overall total assets increased 16.2% since yearend 2020 and grew 21.5% since September 30, 2020. The largest growth in both periods was in the loan portfolios and securities. Cash and cash equivalents also increased significantly compared to September 30, 2020.

Deposits accounted for the largest growth within liabilities, up 16.9% or \$270.1 million since yearend and 26.3% or \$388.9 million over September 30, 2020 balances. The OFSI acquisition contributed \$116.0 million to the overall increase in the deposit balances compared to yearend and September 30, 2020. As stated previously, the growth of deposits correlated to a flight to safety as the stock market continues to experience some volatility. Core deposits continue to drive the increase which provide the opportunity to generate additional noninterest income. This growth aided the increased liquidity position and funded the loan growth for the periods along with usage of excess Federal Funds sold for daily borrowings.

Shareholders' equity increased by \$5.6 million as of the third quarter of 2021 compared to yearend 2020. Earnings exceeded dividend declarations during the nine months ended September 30, 2021. Accumulated other comprehensive income decreased in unrealized gain position by \$4.8 million from December 2020 to an unrealized gain of \$901 thousand on September 30, 2021. Dividends declared increased \$0.01 from the last four quarters to \$0.18 per share. Compared to September 30, 2020, shareholders' equity increased 6.0% or \$14.4 million. Profits were higher year to date September 2021 than year to date September 2020 by \$2.5 million.

Basel III regulatory capital requirements became effective in 2016. The Bank and Company include a capital conservation buffer as a part of the transition provision. For calendar year 2016, the applicable required capital conservation buffer percentage of 0.625% was the base above which institutions avoid limitations on distributions and certain discretionary bonus payments. For the calendar year 2017, the applicable required capital conservation buffer percentage was 1.25%. For 2018, the capital conservation buffer percentage increased to 1.875%. The total buffer requirement increased to 2.5% for calendar year 2019. As of September 30, 2021, the Company and the Bank are both positioned well above the 2019 requirement.

The Holding Company has sufficient liquidity to maintain its dividend policy without relying on the upstreaming of dividends from the Bank.

The Bank continues to be well-capitalized in accordance with Federal regulatory capital requirements as the capital ratios below show:

Tier I Leverage Ratio	8.30%
Risk Based Capital Tier I	11.25%
Total Risk Based Capital	12.31%
Stockholders' Equity/Total Assets	10.81%
Capital Conservation Buffer	4.31%

MATERIAL CHANGES IN RESULTS OF OPERATIONS

Comparison of Results of Interest Earnings and Expenses for three month periods ended September 30, 2021 and 2020

Interest Income

When comparing third quarter 2021 to third quarter 2020, average loan balances with the acquisition of OFSI grew \$131.8 million with PPP loans decreasing \$64.6 million. This represented a 9.7% increase in a one-year time period. Interest income on loan balances experienced an increase of \$2.6 million as compared to the quarter ended September 30, 2020. Net fee income for the PPP loans is recognized on a straight line basis over 24 months for the first draw and 60 months for the second draw and will be accelerated upon payoff. PPP loan income for the quarter included interest income of \$56.7 thousand and net fee income of \$2.5 million compared to \$219.7 thousand of loan interest income and \$416.9 thousand of net fee income for 2020.

The available-for-sale securities portfolio increased in average balances by \$144.0 million when comparing to the previous year while the income increased \$176 thousand over third quarter. Federal funds sold and interest-bearing deposits increased in average balances by \$103.6 million as compared to the same quarter in 2020 with increased income of \$68 thousand for the current quarter. Refer to Note 2 Business Combination and Asset Purchase for information on assets acquired from OFSI.

The overall total average balance of the Bank's earning assets increased and interest income for the quarter comparisons was higher for third quarter 2021 by 16.4% or \$2.8 million as compared to third quarter 2020. A low prime lending rate has contributed to the decrease in rate yield.

Annualized yield, for the quarter ended September 30, 2021, was 3.53% as compared to 4.25% for the quarter ended September 30, 2020. The following charts demonstrate the value of increased loan balances in the balance sheet mix, as well as the impact on the changes in interest rates. The yields on tax-exempt securities and the portion of the tax-exempt IDB loans included in loans have been tax adjusted based on a 21% tax rate in the charts to follow.

	(In Thousands)		Annualized Yield/Rate	
	Quarter to Date Ended September 30, 2021		September 30,	September 30,
	Average Balance	Interest/Dividends	2021	2020
Interest Earning Assets:				
Loans	\$ 1,490,988	\$ 18,766	5.04%	4.76%
Taxable investment securities	398,060	1,177	1.18%	1.58%
Tax-exempt investment securities	17,293	75	2.20%	2.10%
Fed funds sold & other	187,398	104	0.22%	0.17%
Total Interest Earning Assets	\$ 2,093,739	\$ 20,122	3.85%	4.04%

Change in Interest Income Quarter to Date September 30, 2021 Compared to September 30, 2020

	(In Thousands)		
	Total Change	Change Due to Volume	Change Due to Rate
Interest Earning Assets:			
Loans	\$ 2,585	\$ 1,570	\$ 1,015
Taxable investment securities	209	603	(394)
Tax-exempt investment securities	(33)	(46)	13
Fed funds sold & other	68	45	23
Total Interest Earning Assets	\$ 2,829	\$ 2,172	\$ 657

Interest Expense

Adding to the higher interest income for the quarter was the decrease in interest expense in 2021 of \$597 thousand or 26.3% compared to third quarter 2020. Since 2020, average interest-bearing deposit balances have increased \$259.9 million or 22.1% and the Company recognized \$643 thousand less in interest expense for the most recent quarter. The prime rate dropped 150 basis points in March of 2020 and management has adjusted deposit rates accordingly. Interest expense on

FHLB borrowings was down \$144 thousand in the third quarter 2021 over the same time frame in 2020 due to borrowings taken on from the Limberlost acquisition being repaid in addition to the related fair value amortization completed in April 2021. Interest expense on fed funds purchased and securities sold under agreement to repurchase was down \$9 thousand compared to second quarter 2020. Interest expense on subordinated notes was \$199 thousand for the most recent quarter. Refer to Note 8 for additional information on subordinated notes. Liabilities assumed from OFSI can be seen in Note 2.

Interest Bearing Liabilities:	(In Thousands)			
	Quarter to Date Ended September 30, 2021		Annualized Yield/Rate	
	Average Balance	Interest	September 30, 2021	September 30, 2020
Savings deposits	\$ 1,181,103	\$ 560	0.19%	0.35%
Other time deposits	252,966	661	1.05%	1.65%
Other borrowed money	17,868	87	1.95%	4.88%
Fed funds purchased & securities				
sold under agreement to repurchase	29,729	165	2.22%	2.31%
Subordinated notes	23,807	199	3.34%	0.00%
Total Interest Bearing Liabilities	\$ 1,505,473	\$ 1,672	0.45%	0.74%

Change in Interest Expense Quarter to Date September 30, 2021 Compared to September 30, 2020

Interest Bearing Liabilities:	(In Thousands)		
	Total Change	Change Due to Volume	Change Due to Rate
Savings deposits	\$ (238)	\$ 232	\$ (470)
Other time deposits	(405)	(24)	(381)
Other borrowed money	(144)	(13)	(131)
Fed funds purchased & securities			
sold under agreement to repurchase	(9)	(2)	(7)
Subordinated notes	199	199	-
Total Interest Bearing Liabilities	\$ (597)	\$ 392	\$ (989)

Overall, net interest spread for the third quarter 2021 was 10 basis points higher than last year. As the following chart indicates, the decline in yields on interest earning assets was less than the decline in the cost of funds when comparing to the same period a year ago.

	September 30, 2021	September 30, 2020	September 30, 2019
Interest/Dividend income/yield	3.85%	4.04%	4.74%
Interest Expense/cost	0.45%	0.74%	1.55%
Net Interest Spread	3.40%	3.30%	3.19%
Net Interest Margin	3.53%	3.51%	3.60%

Net Interest Income

Net interest income increased \$3.4 million for the third quarter 2021 over the same time frame in 2020 with the increase in interest income of \$2.8 million combined with the lower interest expense of \$597 thousand, as previously mentioned. As the new loans added in 2020 and 2021 generate more income, management expects the benefits of the Company's strategy of repositioning the balance sheet to continue to increase net interest income. In terms of net interest margin rate, the Bank recognizes competition for deposits may again increase and put pressure on the margin which may lead to a tightening.

Comparison of Noninterest Results of Operations for three month periods ended September 30, 2021 and 2020

Provision Expense

The ALLL has a direct impact on the provision expense. The increase in the ALLL is funded through recoveries and provision expense. The following tables both deal with the allowance for credit losses. The first table breaks down the activity within ALLL for each loan portfolio class and shows the contribution provided by both the recoveries and the provision along with the reduction of the allowance caused by charge-offs. The second table discloses how much of the ALLL is attributed to each class of the loan portfolio, as well as the percent that each particular class of the loan portfolio represents to the entire loan portfolio in the aggregate. The consumer loan portfolio accounted for the largest component of charge-offs and recoveries for third quarter of 2021 and 2020. The commercial real estate portfolio is currently creating a large impact on the ALLL due to the loan growth.

Total provision for loan losses was \$1.3 million lower for the third quarter 2021 as compared to the same quarter 2020. Provision for loan loss has stabilized during the third quarter of 2021. There is still some uncertainty related to COVID-19 and its effects on the ability of individuals, businesses and other entities to meet their financial obligation; therefore, it is prudent to incorporate the impact of COVID-19 in the evaluation of the adequacy of Allowance for Loan and Lease Losses (ALLL). The restaurant and hospitality sectors have been hit especially hard. Risk in the Consumer and 1-4 Family Portfolio has increased but the full impact still remains unknown. Increases to the Bank's ALLL for the third quarter of 2021, centered around current customers and businesses that are particularly vulnerable and qualitative factors were adjusted accordingly. Management continues to monitor asset quality, making adjustments to the provision as necessary. Loan charge-offs were \$24 thousand higher in third quarter 2021 than the same quarter 2020. Recoveries were \$13 thousand higher in third quarter 2021 as compared to third quarter 2020. Combined net charge-offs were \$11 thousand higher in third quarter 2021 than the same time period 2020.

Past due loans, which include no deferrals related to COVID-19, increased \$1.3 million at September 30, 2021 as compared to September 30, 2020. Approximately 75% of the change is attributed to the increase of past due balances in the consumer real estate and commercial and industrial portfolios.

The following table breaks down the activity within the ALLL for each loan portfolio class and shows the contribution provided by both recoveries and the provision, along with the reduction of the allowance caused by charge-offs. The time period covered is for three months ended September 30, 2021, 2020, and 2019.

	(In Thousands)		
	Three Months Ended September 30, 2021	Three Months Ended September 30, 2020	Three Months Ended September 30, 2019
Loans, net	\$ 1,495,562	\$ 1,363,862	\$ 1,158,696
Daily average of outstanding loans	\$ 1,490,988	\$ 1,359,156	\$ 1,126,173
Allowance for Loan Losses - July 1,	\$ 15,087	\$ 9,933	\$ 6,683
Loans Charged off:			
Consumer Real Estate	2	-	39
Agriculture Real Estate	-	-	-
Agricultural	1	-	22
Commercial Real Estate	-	-	-
Commercial and Industrial	5	-	55
Consumer	95	79	103
	<u>103</u>	<u>79</u>	<u>219</u>
Loan Recoveries:			
Consumer Real Estate	3	2	-
Agriculture Real Estate	-	-	-
Agricultural	1	-	1
Commercial Real Estate	3	2	2
Commercial and Industrial	9	10	13
Consumer	39	28	32
	<u>55</u>	<u>42</u>	<u>48</u>
Net Charge Offs	48	37	171
Provision for loan loss	659	1,987	247
Acquisition provision for loan loss	-	-	-
Allowance for Loan & Lease Losses - September 30,	15,698	11,883	6,759
Allowance for Unfunded Loan Commitments & Letters of Credit - September 30,	1,039	633	430
Total Allowance for Credit Losses - September 30,	\$ 16,737	\$ 12,516	\$ 7,189
Ratio of net charge-offs to average Loans outstanding	0.00%	0.00%	0.02%
Ratio of the Allowance for Loan Loss to Nonperforming Loans*	251.26%	151.01%	173.25%

* Nonperforming loans are defined as all loans on nonaccrual, plus any loans 90 days past due not on nonaccrual.

The Bank uses the following guidelines as stated in policy to determine when to realize a charge-off of a loan, whether partial loan balance or full loan balance. The Bank is also following the guidelines established under the CARES Act. A charge down in whole or in part is realized when unsecured consumer loans, credit card credits and overdraft lines of credit reach 90 days delinquency. At 120 days delinquent, secured consumer loans are charged down to the value of the collateral, if repossession of the collateral is assured and/or in the process of repossession. Consumer mortgage loan deficiencies are charged down upon the sale of the collateral or sooner upon the recognition of collateral deficiency. Commercial and agricultural credits are charged down at 120 days delinquency, unless an established and approved work-out plan is in place or litigation of the credit will likely result in recovery of the loan balance. Upon notification of bankruptcy, unsecured debt is charged off. Additional charge-offs may be realized as further unsecured positions are recognized.

Loans classified as nonaccrual were lower as of September 30, 2021 at \$6.2 million as compared to \$7.9 million as of September 30, 2020. The consumer real estate portfolio decreased \$1.1 million while the commercial real estate and

commercial and industrial portfolios decreased a combined \$852 thousand. The agricultural real estate and agricultural portfolios increased a combined \$393 thousand as compared to September 30, 2020.

In determining the allocation for impaired loans, the Bank applies the appraised market value of the collateral securing the asset, reduced by applying a discount for estimated costs of collateral liquidation. In some instances where the discounted market value is less than the loan amount, a specific impairment allocation is assigned, which may be reduced or eliminated by the write down of the credit's active principal outstanding balance.

For the majority of the Bank's impaired loans, including all collateral dependent loans, the Bank will apply the appraised market value methodology. However, the Bank may also utilize a measurement incorporating the present value of expected future cash flows discounted at the loan's effective rate of interest. To determine appraised market value, collateral asset values securing an impaired loan are periodically evaluated. Maximum time of re-evaluation is every 12 months for chattels and titled vehicles and every two years for real estate. In this process, third party evaluations are obtained and heavily relied upon. Until such time that updated appraisals are received, the Bank may discount the collateral value used.

The following table presents the balances for allowance for loan losses by loan type for nine months ended September 30, 2021 and September 30, 2020.

	(In Thousands) September 30, 2021		(In Thousands) September 30, 2020	
	Amount	% of Loan Category	Amount	% of Loan Category
Balance at End of Period Applicable To:				
Consumer Real Estate	\$ 796	13.53%	\$ 530	12.87%
Agricultural Real Estate	926	11.97%	762	14.12%
Agricultural	687	7.07%	669	7.59%
Commercial Real Estate	8,365	48.64%	5,735	43.55%
Commercial and Industrial	3,814	15.07%	3,272	17.95%
Consumer	606	3.72%	604	3.92%
Unallocated	504	0.00%	311	0.00%
Allowance for Loan & Lease Losses	15,698		11,883	
Off Balance Sheet Commitments	1,039		633	
Total Allowance for Credit Losses	<u>\$ 16,737</u>		<u>\$ 12,516</u>	

Noninterest Income

Noninterest income was down \$641 thousand for the third quarter 2021 over the same time frame in 2020. The Company has seen a decrease in its mortgage production volume and the gain on the sale of these loans was \$715 thousand lower for the third quarter 2021 over the same period in 2020. Loan originations on loans held for sale for the third quarter 2021 were \$21.7 million with proceeds from sale at \$26.8 million for 2021 compared to 2020's third quarter activity of \$63.5 million in originations and \$68.9 million in sales. Loan originations driven by the refinance activity associated with the reduction in interest rates has slowed. The mortgages sold were both 1-4 family and agricultural real estate loans originated for sale.

Combined service fees increased by \$74 thousand as compared to third quarter 2020. Debit card income increased by \$156 thousand and bank owned life insurance cash surrender value increased \$76 thousand. Also contributing to the increase was service charge income and overdraft and returned check charges which increased \$41 and \$90 thousand respectively compared to third quarter 2020. Service fee income for 1-4 family and agricultural real estate loans increased by \$33 thousand while servicing rights income decreased \$346 thousand.

The impact of mortgage servicing rights, both to income and expense, is shown in the following table which reconciles the value of mortgage servicing rights. The capitalization runs through noninterest income while the amortization thereof is included in non-interest expense. For the third quarter of 2021 and 2020, mortgage servicing rights caused a net \$22 and \$287 thousand in income, respectively. The first nine months of 2021 and 2020, mortgage servicing rights caused a net \$165 and \$398 thousand of income, respectively. The lower capitalized additions for 2021 are attributed to a lower loan origination level of 1-4 families. A low interest rate environment has helped to generate the mortgage refinance activity. For loans of 15 years and less, the value was 1.160% in the third quarter 2021 versus 0.975% in third quarter 2020. For loans over 15 years, the value was 1.355% versus a lower 1.109% for the same periods respectively. The carrying value is greater than the market value of \$3.5 million which created the need to establish a \$388 thousand valuation allowance during 2021.

	Three Months (In Thousands)		Nine Months (In Thousands)	
	2021	2020	2021	2020
Beginning Balance	\$ 3,146	\$ 2,740	\$ 3,320	\$ 2,629
Capitalized Additions	236	583	1,091	1,182
Amortization	(214)	(296)	(926)	(784)
Ending Balance, September 30,	3,168	3,027	3,485	3,027
Valuation Allowance	(71)	-	(388)	-
Mortgage Servicing Rights net, September 30,	<u>\$ 3,097</u>	<u>\$ 3,027</u>	<u>\$ 3,097</u>	<u>\$ 3,027</u>

Noninterest Expense

For the third quarter 2021, noninterest expenses were \$2.0 million higher than for the same quarter in 2020. Salaries, wages, and employee benefits (includes normal merit increases, restricted stock expense, incentive payout and all employee benefits) increased \$395 thousand in total. This was comprised of increased salaries of \$340 thousand and increased benefits of \$55 thousand with \$153 thousand acquisition related. Consulting fees increased \$51 thousand over third quarter 2020 with \$79 thousand related to the acquisition of Ossian and Perpetual. FDIC assessment expenses were up \$102 thousand due to the increased assessment base. During the third quarter 2021, the Bank also recognized a loss of \$189 thousand which is included in the Net (Gain) Loss on Sale of Other Assets Owned line of the consolidated statement of income for the sale of buildings. Data processing increased \$1.1 million over third quarter 2020 with \$893 thousand acquisition related. Other general and administrative expenses increased \$165 thousand as compared to third quarter 2020 with \$267 thousand acquisition related while the remainder was primarily attributable to the Company's overall growth for the year.

Income Taxes

Income tax expense was \$337 thousand higher for the third quarter 2021 compared to the same quarter in 2020. Effective tax rates were 21.53% and 22.59% for third quarter 2021 and 2020 respectively. The lower effective income tax rate for third quarter 2021 accounted for a decrease of \$80 thousand of income tax expense. Increased earnings equaled an increase in income tax expense of \$417 thousand.

Net Income

Results overall, net income in the third quarter of 2021 was up \$1.5 million as compared to the same quarter last year. Third quarter 2021 included a decrease of \$1.3 million of loan loss provision as compared to third quarter 2020. The Company has done an exceptional job of growing loans while keeping past dues low. The Company remains strong, stable, and well capitalized and has the capacity to continue to cover the increased costs of expansion.

Comparison of Results of Interest Earnings and Expenses for nine month periods ended September 30, 2021 and 2020

Interest Income

Higher loan balances of \$107.6 million led to an improvement in the interest income for the first nine months of 2021 as compared to the first nine months of 2020. PPP average loan balances decreased approximately \$12.6 million year over year. Interest income in total rose 4.6% or \$2.4 million with interest income from loans accounting for 99.7% of the increase. Contributing to the overall increase was also a decrease in securities income of \$27 thousand and an increase from Fed Funds sold and interest-bearing deposits of \$33 thousand over 2020. The asset yield decreased by 60 basis points to 3.70% for the first nine months of 2021 compared to the first nine months of 2020's 4.30%.

PPP loan interest income recognized was \$291.4 thousand for the first nine months of 2021 with net fee income of \$3.9 million compared to \$389.6 thousand of loan interest income and \$735.1 thousand of net fee income for 2020. The growth factor contribution is shown in the charts which follow.

The average interest earning asset base was \$350.3 million higher in the first nine months 2021 than the first nine months of 2020, an increase of approximately 21.7%.

The yields on tax-exempt securities and the portion of the tax-exempt IDB loans included in loans have been tax adjusted based on a 21% tax rate in the charts to follow.

	(In Thousands)		Annualized Yield/Rate	
	Year to Date Ended September 30, 2021		September 30, 2021	September 30, 2020
	Average Balance	Interest/Dividends		
Interest Earning Assets:				
Loans	\$ 1,413,625	\$ 50,637	4.78%	4.93%
Taxable investment securities	363,284	3,286	1.21%	2.06%
Tax-exempt investment securities	18,387	252	2.31%	2.28%
Fed funds sold & other	171,015	242	0.19%	0.37%
Total Interest Earning Assets	\$ 1,966,311	\$ 54,417	3.70%	4.30%

Change in Interest Income Year to Date September 30, 2021 Compared to September 30, 2020

	(In Thousands)		
	Total Change	Change Due to Volume	Change Due to Rate
Interest Earning Assets:			
Loans	\$ 2,381	\$ 3,980	\$ (1,599)
Taxable investment securities	66	2,390	(2,324)
Tax-exempt investment securities	(93)	(123)	30
Fed funds sold & other	33	262	(229)
Total Interest Earning Assets	\$ 2,387	\$ 6,509	\$ (4,122)

Interest Expense

Interest expense was lower for the first nine months of 2021 compared to the first nine months of 2020. At \$5.0 million, the first nine months of 2021 was down \$3.4 million as compared to the same time period 2020 or 40.9%.

The average balance of interest-bearing liabilities was higher by \$236.9 million in 2021 than the first nine months of 2020. Interest bearing deposits increased \$236.6 million. The remainder is comprised of an increase in subordinated notes of \$8.0 million offset by a decrease in Fed Funds purchased and securities sold under agreement to repurchase of \$3.2 million and other borrowed money of \$4.5 million. Refer to Note 8 for additional information on subordinated notes. The higher balance coupled with the slight variation of the balance sheet mix and lower interest rates, resulted in a 48 basis points decrease in the cost of funds at 0.47% for the first nine months of 2021 as compared to 2020's 0.95%.

The change chart below shows the decreased cost was driven more by rate than volume.

Interest Bearing Liabilities:	(In Thousands)		Annualized Yield/Rate	
	Year to Date Ended September 30, 2021		September 30, 2021	September 30, 2020
	Average Balance	Interest		
Savings deposits	\$ 1,106,674	\$ 1,700	0.20%	0.51%
Other time deposits	248,426	2,137	1.15%	1.88%
Other borrowed money	17,859	424	3.17%	4.49%
Fed funds purchased & securities				
sold under agreement to repurchase	29,973	494	2.20%	2.44%
Subordinated notes	8,023	199	3.31%	0.00%
Total Interest Bearing Liabilities	\$ 1,410,955	\$ 4,954	0.47%	0.95%

Change in Interest Expense Year to Date September 30, 2021 Compared to September 30, 2020

Interest Bearing Liabilities:	(In Thousands)		
	Total Change	Change Due to Volume	Change Due to Rate
Savings deposits	\$ (1,537)	\$ 979	\$ (2,516)
Other time deposits	(1,645)	(286)	(1,359)
Other borrowed money	(330)	(153)	(177)
Fed funds purchased & securities			
sold under agreement to repurchase	(111)	(57)	(54)
Subordinated notes	199	199	-
Total Interest Bearing Liabilities	\$ (3,424)	\$ 682	\$ (4,106)

Net Interest Income

Overall, net interest spread figures for the first nine months of 2021 were down from 2020 by 12 basis points and down 28 basis points from 2019. Net interest margin for the first nine months of 2021 was lower than the same periods of 2020 and 2019. As the chart below illustrates, lower yields on loan and investment income were only partially offset by lower interest expense resulting in total net interest margin down 25 basis points since the first nine months of 2020 and under the first nine months of 2019 by 52 basis points.

	September 30, 2021	September 30, 2020	September 30, 2019
Interest/Dividend income/yield	3.70%	4.30%	4.93%
Interest Expense/cost	0.47%	0.95%	1.42%
Net Interest Spread	3.23%	3.35%	3.51%
Net Interest Margin	3.36%	3.61%	3.88%

Net interest income was up \$5.8 million in the first nine months of 2021 over the same time frame in 2020 due to the increase in interest income and lower interest expense as previously mentioned. As the new loans added in 2020 and 2021 generate more income, management expects the benefits of the Company's strategy of repositioning the balance sheet to continue to widen this margin as measured in dollars. In terms of net interest margin rate, the Bank recognizes competition for deposits may again increase and put pressure on the margin which may lead to a tightening.

Comparison of Results of Noninterest Earnings and Expenses for nine month periods ended September 30, 2021 and 2020

Provision Expense

Total provision for loan losses was \$2.0 million lower for the first nine months 2021 than for the first nine months 2020 attributable primarily to the lessened uncertainties associated with COVID-19 and its effects on the ability of individuals, businesses and other entities to meet their financial obligations. Therefore, it is prudent to incorporate the impact of COVID-19 in the evaluation of the adequacy of Allowance for Loan and Lease Losses (ALLL). The restaurant and hospitality sectors have been hit especially hard. Risk in the Consumer and 1-4 Family Portfolio has increased but the full impact remains

unknown. Increases to the Bank's ALLL for the first nine months of 2021, centered around current customers and businesses that are particularly vulnerable and qualitative factors were adjusted accordingly. Management continues to monitor asset quality, making adjustments to the provision as necessary. Loan charge-offs were \$674 thousand higher in the first nine months of 2021 compared to the same period 2020. Recoveries were \$31 thousand higher in the first nine months of 2021 as compared to first nine months of 2020. Combined net charge-offs were \$643 thousand higher in the nine months ended September 2021 as compared to the same time period 2020. Management continues to evaluate the potential financial implications resulting from COVID-19 and adjusts ALLL qualitative factors as necessary.

The following table breaks down the activity within the ALLL for each loan portfolio class and shows the contribution provided by both recoveries and the provision, along with the reduction of the allowance caused by charge-offs. The time period covered is for nine months ended September 30, 2021, 2020, and 2019.

	(In Thousands)		
	Nine Months Ended September 30, 2021	Nine Months Ended September 30, 2020	Nine Months Ended September 30, 2019
Loans, net	\$ 1,495,562	\$ 1,363,862	\$ 1,158,696
Daily average of outstanding loans	\$ 1,413,625	\$ 1,305,998	\$ 1,113,892
Allowance for Loan Losses - January 1,	\$ 13,672	\$ 7,228	\$ 6,775
Loans Charged off:			
Consumer Real Estate	2	35	95
Agriculture Real Estate	-	-	-
Agricultural	143	-	22
Commercial Real Estate	-	8	-
Commercial and Industrial	814	165	55
Consumer	195	272	382
	<u>1,154</u>	<u>480</u>	<u>554</u>
Loan Recoveries:			
Consumer Real Estate	9	7	-
Agriculture Real Estate	-	-	-
Agricultural	7	-	3
Commercial Real Estate	8	7	7
Commercial and Industrial	19	19	21
Consumer	137	116	97
	<u>180</u>	<u>149</u>	<u>128</u>
Net Charge Offs	974	331	426
Provision for loan loss	3,000	4,986	410
Acquisition provision for loan loss	-	-	-
Allowance for Loan & Lease Losses - September 30,	15,698	11,883	6,759
Allowance for Unfunded Loan Commitments & Letters of Credit - September 30,	1,039	633	430
Total Allowance for Credit Losses - September 30,	<u>\$ 16,737</u>	<u>\$ 12,516</u>	<u>\$ 7,189</u>
Ratio of net charge-offs to average Loans outstanding	<u>0.07%</u>	<u>0.03%</u>	<u>0.04%</u>
Ratio of the Allowance for Loan Loss to Nonperforming Loans*	<u>251.26%</u>	<u>151.01%</u>	<u>173.25%</u>

* Nonperforming loans are defined as all loans on nonaccrual, plus any loans 90 days past due not on nonaccrual.

In comparing past due balances of loans 30+ days, September 30, 2021 balances were \$1.6 million as compared to September 30, 2020 balances of \$324 thousand. Net charge-offs were higher at \$974 thousand for the first nine months of 2021 compared to the first nine months of 2020's \$331 thousand.

Noninterest Income

Noninterest income for the first nine months of 2021 increased over the first nine months of 2020 by \$1.9 million. Gain on sale of loans showed a \$695 thousand increase over the first nine months of 2020 with the surge in refinance activity due to interest rate reductions. Combined service fees increased by \$1.2 million with increased debit card income of \$778 thousand which included a Mastercard growth credit of \$151 thousand, servicing fee income on 1-4 family and agricultural real estate loans of \$176 thousand and bank owned life insurance cash surrender value increases of \$209 thousand. Service charge income increased by \$146 thousand while overdraft and returned check income decreased by \$46 thousand. Servicing rights income and release fees decreased compared to 2020 by \$91 thousand and \$93 thousand, respectively. The Company did sell some of its available-for-sale securities in first nine months of both years and recognized a gain of \$293 thousand in 2021 and \$270 thousand in 2020.

Noninterest Expense

Through the first nine months of 2021, noninterest expenses were \$6.7 million higher than in the first nine months of 2020. 2021 included \$2.7 million of third party acquisition related costs incurred with the Ossian and Perpetual transactions. The nine months of 2021 included an increase of \$1.0 million in salaries and wages in addition to an increase of \$1.1 million in employee benefits. The addition of the acquired offices, normal merit increases, a one time expense for 2020 employer pension match and increased employer taxes have impacted 2021. The increases were offset by decreased restricted stock expense and medical costs. 2021 included acquisition costs of \$694 thousand in the employee benefits line of the Company's consolidated statement of income.

Data processing fees, which included a credit for product upgrades in the amount of \$100 thousand, were \$1.1 million higher than last year with \$939 thousand attributed to the acquisitions. A seven year contract extension was signed in the third quarter of 2016 which has helped reduce the expense while adding new products and services to better align with our customers' expectations in the coming years. Consulting fees increased \$312 thousand with \$416 thousand acquisition related. The increase in FDIC assessments for 2021 was due to Small Bank Credits being applied in 2020 and an increase in the assessment base. 2021 included a loss on the sale of buildings in the amount of \$406 thousand.

General and administrative expenses were up \$1.5 million over the first nine months of 2020. Acquisition costs of \$604 thousand were included in this line for 2021. One of the largest increases was for provision for unfunded loans for \$244 thousand which was partially related to the decreased balances on lines of credit due to PPP. Loan and collection expense increased \$259 thousand while legal fees increased \$420 thousand over 2020 with \$402 thousand related to the acquisitions. Audit, accounting and exam fees increased \$149 thousand compared to 2020 with \$44 thousand attributed to the acquisitions.

Income Taxes

Income tax expense was \$583 thousand higher for the first nine months of 2021 compared to the first nine months of 2020. Effective tax rates were 20.20% and 20.43% for the first nine months of 2021 and 2020 respectively. The slightly lower effective tax rate for the first nine months of 2021 equaled a decrease in income tax expense of \$45 thousand with an increase of \$628 thousand driven from increased earnings.

Net Income

Overall, net income through the first nine months of 2021 was up \$2.5 million as compared to the first nine months of 2020. Decreased interest expense of \$3.4 million, decreased loan loss provision of \$2.0 million and increased loan interest income of \$2.4 million were the largest contributors to the increased net income for 2021.

FORWARD LOOKING STATEMENTS

Statements contained in this portion of the Company's report may be forward-looking statements, as that term is defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements may be identified by the use of words such as "intend," "believe," "expect," "anticipate," "should," "planned," "estimated," and "potential." Such forward-looking statements are based on current expectations, but actual results may differ materially from those currently anticipated due to a number of factors, which include, but are not limited to, factors discussed in documents filed by the Company with the Securities and Exchange Commission from time to time. Other factors which could have a material adverse effect on the operations of the Company and its subsidiaries include, but are not limited to, changes in interest rates, general economic conditions, legislative and regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality and composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Bank's market area, changes in relevant accounting principles and guidelines and other factors over which management has no control, including, but not limited to, the ongoing impact of the COVID-19 pandemic. The forward-looking statements are made as of the date of this report, and the Company assumes no obligation to update the forward-looking statements or to update the reasons why actual results differ from those projected in the forward-looking statements.

ITEM 3 QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the exposure to loss resulting from changes in interest rates and equity prices. The primary market risk to which the Company is subject is interest rate risk. The majority of our interest rate risk arises from the instruments, positions and transactions entered into for purposes other than trading such as loans, available for sale securities, interest bearing deposits, short term borrowings and long term borrowings. Interest rate risk occurs when interest bearing assets and liabilities re-price at different times as market interest rates change. For example, if fixed rate assets are funded with variable rate debt, the spread between asset and liability rates will decline or turn negative if rates increase.

Interest rate risk is managed within an overall asset/liability framework. The principal objectives of asset/liability management are to manage sensitivity of net interest spreads and net income to potential changes in interest rates.

Funding positions are kept within predetermined limits designed to ensure that risk-taking is not excessive and that liquidity is properly managed. In the event that our asset/liabilities management strategies are unsuccessful, our profitability may be adversely affected. The Company employs a sensitivity analysis utilizing interest rate shocks to help in this analysis.

The shocks presented below assume an immediate change of rate in the percentages and directions shown covering a twelve month period:

<u>Interest Rate Shock</u> <u>on Net Interest Margin</u>			<u>Interest Rate Shock</u> <u>on Net Interest Income</u>		
Net Interest Margin (Ratio)	% Change to Flat Rate	Rate Direction	Rate Changes by	Cumulative Total (\$000)	% Change to Flat Rate
3.97%	14.64%	Rising	3.00%	80,136	14.70%
3.86%	11.66%	Rising	2.00%	77,741	11.27%
3.71%	7.34%	Rising	1.00%	74,643	6.83%
3.46%	0.00%	Flat	0.00%	69,868	0.00%
3.22%	-6.98%	Falling	-1.00%	65,529	-6.21%
3.01%	-12.89%	Falling	-2.00%	61,874	-11.44%
2.79%	-19.39%	Falling	-3.00%	57,873	-17.17%

The net interest margin represents the forecasted twelve month margin. The Company also reviews shocks with a 4.0% fluctuation with a delayed time frame of 10 months and over a 24 month time frame. It also shows the effect rate changes will have on both the margin and net interest income. The goal of the Company is to lengthen the term of some of the Bank's fixed rate liabilities or sources of funds to decrease the exposure to a rising rate environment. Of course, customer desires also impact the Bank's ability to attract longer term deposits.

The shock chart currently shows a widening in net interest margin over the next twelve months in a rising rate environment and a tightening in a falling rate environment. With the rate decreases in the first quarter of 2020, the model predicts an expansion of net interest income at any level in a rising rate environment. The rising rate scenarios are predicted to expand the net interest margin and produce higher levels of net interest income. Cost of funds are at 0.45% for the quarter and 0.47% for the year so the lowest shock of 100 basis points is where the Bank can take partial advantage and reprice some funds to match the level of shock. Once the shocks are falling over 100 basis points, the cost of funds cannot lower to match and the loss on net interest income continues to build. The average duration of the majority of the assets is outside the 12 month shock period. The majority of the newer loans added to the commercial real estate portfolio begin with an initial fixed rate period of three to five years whose variable adjustment is outside of the current shock time frame. The Bank continues to adjust its assumptions by including decay rates and key rate ties on certain deposit accounts and continues to review and modify those rates as the index rates change. All shocks are within risk exposure guidelines at all levels. The effect of the rate shocks may be mitigated to the extent that not all lines of business are directly tied to an external index and actual balance sheet composition may differ from prediction.

Overall, the Company must concentrate on increasing loan spreads on variable loans and extend the duration on cost of funds where possible.

ITEM 4 CONTROLS AND PROCEDURES

As of the end of the period covered by this quarterly report on Form 10-Q, an evaluation was performed under the supervision and with the participation of the Company's management including the CEO and CFO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's management, including the CEO and CFO, concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report. There have been no changes in the Company's internal control over financial reporting that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1 LEGAL PROCEEDINGS

None

ITEM 1A RISK FACTORS

There have been no material changes in the Company's risk factors from those disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2020.

ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Treasury stock repurchased the quarter ended September 30, 2021.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plan or Programs ⁽¹⁾	(d) Maximum Number of Shares that may yet be purchased under the Plans or Programs
7/1/2021 to 7/31/2021	—	—	—	491,500
8/1/2021 to 8/31/2021	4,732 ⁽²⁾	22.68 ⁽²⁾	—	491,500
9/1/2021 to 9/30/2021	—	—	—	491,500
Total	4,732	22.68	—	491,500

(1) From time to time, the Company purchases shares in the market pursuant to a stock repurchase program publicly announced on January 15, 2021. On that date, the Board of Directors authorized the repurchase of 500,000 common shares between January 15, 2021 and December 31, 2021.

(2) Shares which were returned to account for tax payable on vested stock awards are outside of the Company's stock repurchase program.

ITEM 3 DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4 MINE SAFETY DISCLOSURES

Not applicable

ITEM 5 OTHER INFORMATION

None

ITEM 6 EXHIBITS

- 2.1 [Agreement and Plan of Reorganization and Merger between Farmers & Merchants Bancorp, Inc. and Ossian Financial Services, Inc. dated December 21, 2020 \(incorporated by reference to Exhibit 2.1 to Registrant's Current Report on Form 8-K filed with the Commission on December 21, 2020\).](#)
- 2.2 [Agreement and Plan of Reorganization and Merger between Farmers & Merchants Bancorp, Inc. and Perpetual Federal Savings Bank dated May 4, 2021 \(incorporated by reference to Exhibit 2.1 to Registrant's Current Report on Form 8-K filed with the Commission on May 4, 2021\).](#)
- 3.1 [Amended Articles of Incorporation of the Registrant \(incorporated by reference to Exhibit 3.1 to Registrant's Quarterly Report on Form 10-Q filed with the Commission on October 25, 2017\).](#)
- 3.2 [Amended and Restated Code of Regulations of the Registrant \(incorporated by reference to Exhibit 3.2 to Registrant's Quarterly Report on Form 10-Q filed with the Commission on July 26, 2017\).](#)
- 4.1 [Description of Registrant's Common Stock \(incorporated by reference to Exhibit 4.1 to Registrant's Annual Report on Form 10-K filed with the Commission on February 26, 2020\).](#)
- 10.1 [Employment Agreement between Farmers & Merchants State Bank and Lars B. Eller dated as of September 1, 2021 \(incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K filed with the Commission on August 18, 2021\).](#)
- 31.1 [Rule 13-a-14\(a\) Certification - CEO](#)
- 31.2 [Rule 13-a-14\(a\) Certification - CFO](#)
- 32.1 [Section 1350 Certification - CEO](#)
- 32.2 [Section 1350 Certification - CFO](#)
- 101.INS Inline XBRL Instance Document - The instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document. (1)
- 101.SCH Inline XBRL Taxonomy Extension Schema Document (1)
- 101.CAL Inline XBRL Taxonomy Extension Calculation Linkbase Document (1)
- 101.DEF Inline XBRL Taxonomy Extension Definition Linkbase Document (1)
- 101.LAB Inline XBRL Taxonomy Extension Label Linkbase Document (1)
- 101.PRE Inline XBRL Taxonomy Extension Presentation Linkbase Document (1)
- 104 The cover page from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2021, has been formatted in Inline XBRL.

(1) Pursuant to Rule 406T of Regulation S-T, the interactive Data Files in Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

SIGNATURES

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Farmers & Merchants Bancorp, Inc.,

Date: October 26, 2021

By: /s/ Lars B. Eller
Lars B. Eller
President and Chief Executive Officer

Date: October 26, 2021

By: /s/ Barbara J. Britenriker
Barbara J. Britenriker
Executive Vice-President and
Chief Financial Officer

CERTIFICATIONS

I, Lars B. Eller, President and CEO of Farmers & Merchants Bancorp, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Farmers & Merchants Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Acts Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 26, 2021

/s/ Lars B. Eller

Lars B. Eller

President and Chief Executive Officer

CERTIFICATIONS

I, Barbara J. Britenriker, Executive Vice President and CFO of Farmers & Merchants Bancorp, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Farmers & Merchants Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Acts Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 26, 2021

/s/ Barbara J. Britenriker

Barbara J. Britenriker
Executive Vice President and
Chief Financial Officer

Exhibit 32.1

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350

In connection with the Quarterly Report of Farmers & Merchants Bancorp, Inc. on Form 10-Q for the period ending September 30, 2021, as filed with the Securities and Exchange Commission ("the report"), I, Lars B. Eller, President and Chief Executive Officer, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Farmers & Merchants Bancorp, Inc. as of the dates and for the periods expressed in the Report.

Date: October 26, 2021

/s/ Lars B. Eller

Lars B. Eller

President and Chief Executive Officer

A signed original of this written statement required by Section 906 has been provided to Farmers & Merchants Bancorp, Inc. and will be retained by Farmers & Merchants Bancorp, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350

In connection with the Quarterly Report of Farmers & Merchants Bancorp, Inc. on Form 10-Q for the period ending September 30, 2021, as filed with the Securities and Exchange Commission ("the report"), I, Barbara J. Britenriker, Executive Vice President and Chief Financial Officer, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Farmers & Merchants Bancorp, Inc. as of the dates and for the periods expressed in the Report.

Date: October 26, 2021

/s/ Barbara J. Britenriker

Barbara J. Britenriker
Executive Vice President and
Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to Farmers & Merchants Bancorp, Inc. and will be retained by Farmers & Merchants Bancorp, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.