F S BANCORP

ANNUAL REPORT
December 31, 2023 and 2022

F S BANCORP
LaGrange, Indiana

ANNUAL REPORT
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Crowe LLP
Independent Member Crowe Global

INDEPENDENT AUDITOR'S REPORT

Shareholders and Board of Directors
F S Bancorp
LaGrange, Indiana

Report on the Audit of the Financial Statements

Opinion

We have audited the consolidated financial statements of F S Bancorp, which comprise the consolidated balance sheets as of December 31, 2023 and 2022, and the related consolidated statements of income, comprehensive income(loss), changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of F S Bancorp as of December 31, 2023 and 2022, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with auditing standards generally accepted in the United States of America, F S Bancorp's internal control over financial reporting as of December 31, 2023, based on criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) relevant to reporting objectives for the express purpose of meeting the regulatory requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) and our report dated March 5, 2024 expressed an unmodified opinion.

Basis for Opinion

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

Emphasis of Matter

As discussed in Note 1 and 4 to the financial statements, the Company has changed its method of accounting for credit losses effective January 1, 2023 due to the adoption of Financial Accounting Standards Board (FASB) Accounting Standards Codification No. 326, Financial Instruments – Credit Losses (ASC 326). The Company adopted the new credit loss standard using the modified retrospective method such that prior period amounts are not adjusted and continue to be reported in accordance with previously applicable generally accepted accounting principles. Our opinion is not modified with respect to this matter.

(Continued)

Responsibilities of Management for the Financial Statements

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

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about F S Bancorp's ability to continue as a going concern for one year from the date the consolidated financial statements are available to be issued.

Auditor's Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

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

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

Crowe LLP

Crowe LLP

South Bend, Indiana
March 5, 2024

F S BANCORP
CONSOLIDATED BALANCE SHEETS
December 31, 2023 and 2022

	2023	2022
ASSETS		
Cash and deposits with other financial institutions	$ 93,765,000	$ 86,408,000
Interest earning deposits with banks	590,000	3,295,000
Short term investments	6,486,000	6,636,000
Securities available for sale	168,286,000	229,527,000
Securities held to maturity (fair value $51,967,000 - 2023, $50,990,000 - 2022)	57,441,000	58,328,000
Federal Home Loan Bank (FHLB) stock	3,348,000	2,143,000
Loans held for sale	-	-
Loans		
Total loans, net of deferred loan fees	794,938,000	747,160,000
Allowance for credit losses[1]	(7,145,000)	(6,708,000)
Loans - net	787,793,000	740,452,000
Premises and equipment, net	10,219,000	10,404,000
Accrued interest receivable	4,618,000	4,172,000
Bank owned life insurance	18,342,000	19,014,000
Goodwill	2,604,000	2,604,000
Other assets	11,315,000	16,326,000
Total assets	$ 1,164,807,000	$ 1,179,309,000
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits		
Noninterest-bearing demand deposits	$ 255,298,000	$ 286,637,000
Interest-bearing deposits	795,808,000	780,325,000
Total deposits	1,051,106,000	1,066,962,000
Securities sold under agreements to repurchase	5,068,000	6,970,000
Advances from FHLB	-	10,000,000
Accrued interest payable	599,000	193,000
Other liabilities	6,628,000	7,184,000
Total liabilities	1,063,401,000	1,091,309,000
Shareholders' equity		
Common stock: no par value; 10,000,000 shares authorized; 4,763,904 shares issued; 4,283,122 and 4,300,070 shares outstanding 2023 and 2022	149,000	149,000
Additional paid-in capital	3,084,000	3,088,000
Retained earnings	125,737,000	117,283,000
Accumulated other comprehensive income (loss), net of tax of $(4,796,000) - 2023 and $(6,282,000) - 2022	(18,043,000)	(23,633,000)
Treasury stock, at cost, 480,782 and 463,834 shares 2023 and 2022	(9,521,000)	(8,887,000)
Total shareholders' equity	101,406,000	88,000,000
Total liabilities and shareholders' equity	$ 1,164,807,000	$ 1,179,309,000

[1] Allowance for credit losses in 2023 and allowance for loan losses in 2022

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

F S BANCORP
CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2023 and 2022

	2023	2022
Interest and dividend income		
Interest and fees on loans		
Taxable	$ 40,193,000	$ 31,868,000
Tax-exempt	80,000	118,000
Total interest and fees on loans	40,273,000	31,986,000
Interest and dividends on securities		
Interest on taxable securities	3,766,000	3,260,000
Interest on tax-exempt securities	2,163,000	2,472,000
Total interest on securities	5,929,000	5,732,000
Other interest and dividend income	3,687,000	1,434,000
Total interest income	49,889,000	39,152,000
Interest expense		
Deposits	14,250,000	3,733,000
Securities sold under agreements to repurchase	18,000	3,000
Advances from FHLB and other borrowings	641,000	33,000
Total interest expense	14,909,000	3,769,000
Net interest income	34,980,000	35,383,000
Credit loss expense – loans[2]	192,000	160,000
Net interest income after credit loss expense[2]	34,788,000	35,223,000
Non-interest income		
Service charges on deposit accounts	2,023,000	1,973,000
Net gains on mortgage banking activities	199,000	390,000
Security and interest bearing deposit gains (losses)	(2,947,000)	(26,000)
Interest rate cap gains (losses)	(256,000)	(310,000)
Credit and debit card income	3,424,000	3,447,000
Other income	1,211,000	1,139,000
Total non-interest income	3,654,000	6,613,000
Non-interest expenses		
Salaries and employee benefits	13,233,000	12,499,000
Occupancy expense of premises, furniture and equipment net	1,937,000	1,966,000
Data processing	2,374,000	2,140,000
FDIC assessment	533,000	314,000
FHLB prepayment penalties (gains)	(531,000)	-
Advertising and marketing	566,000	499,000
Other expenses	5,107,000	4,802,000
Total non-interest expenses	23,219,000	22,220,000
Income before income taxes	15,223,000	19,616,000
Provision for income taxes	2,271,000	3,145,000
Net income	$ 12,952,000	$ 16,471,000
Basic earnings per share	$3.02	$3.82
Diluted earnings per share	$3.01	$3.80

[2] Credit loss expense- loans in 2023 and provision for loan losses in 2022

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

F S BANCORP
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
Years ended December 31, 2023 and 2022

	2023	2022
Net income	$ 12,952,000	$ 16,471,000
Other comprehensive income (loss):		
Unrealized gains/losses on securities:		
Unrealized holding gain (loss) arising during the period	3,474,000	(32,796,000)
Reclassification adjustment for losses (gains) included in net income[1]	2,947,000	26,000
Reclassification adjustment for (accretion) amortization of unrealized holding gain (loss) included in accumulated other comprehensive income from the transfer of securities from available for sale to held to maturity	655,000	499,000
Net unrealized gains (losses)	7,076,000	(32,271,000)
Tax effect	(1,486,000)	6,777,000
Total other comprehensive income (loss)	5,590,000	(25,494,000)
Comprehensive income (loss)	$ 18,542,000	$ (9,023,000)

[1] Amounts reclassified out of accumulated other comprehensive income (loss) are $(2,947,000) and $(26,000) for 2023 and 2022 and included in "Security and interest bearing deposit gains (losses)" and $(655,000) and $(499,000) for 2023 and 2022 and included in "Total interest on securities" on the Consolidated Statements of Income, and the income tax expense (benefit) of the amounts reclassified out of accumulated other comprehensive income (loss) are $(756,000) and $(110,000) for 2023 and 2022.

F S BANCORP
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years ended December 31, 2023 and 2022

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net of Tax	Treasury Stock	Total Shareholders' Equity
BALANCES – JANUARY 1, 2022	$ 149,000	$ 3,152,000	$104,910,000	$ 1,861,000	$ (7,507,000)	$102,565,000
Net income	-	-	16,471,000	-	-	16,471,000
Other comprehensive loss	-	-	-	(25,494,000)	-	(25,494,000)
Purchase of 54,974 shares of treasury stock	-	-	-	-	(1,791,000)	(1,791,000)
Issuance of 13,168 shares of treasury stock upon exercise of stock options	-	(111,000)	-	-	245,000	134,000
Issuance of 9,560 shares of treasury stock upon granting restricted stock awards	-	(166,000)	-	-	166,000	-
Stock compensation expense	-	213,000	-	-	-	213,000
Cash dividends ($0.95 per share)	-	-	(4,098,000)	-	-	(4,098,000)
BALANCES – DECEMBER 31, 2022	$ 149,000	$ 3,088,000	$117,283,000	$(23,633,000)	$ (8,887,000)	$ 88,000,000
Cumulative change in accounting principal, net (Note 4)	-	-	(250,000)	-	-	(250,000)
Balance at January 1, 2023 (as adjusted for change in Accounting principle)	$ 149,000	$ 3,088,000	$117,033,000	$(23,633,000)	$ (8,887,000)	$ 87,750,000
Net income	-	-	12,952,000	-	-	12,952,000
Other comprehensive income	-	-	-	5,590,000	-	5,590,000
Purchase of 32,675 shares of treasury stock	-	-	-	-	(937,000)	(937,000)
Issuance of 5,767 shares of treasury stock upon exercise of stock options	-	(112,000)	-	-	112,000	-
Issuance of 9,960 shares of treasury stock upon granting restricted stock awards	-	(191,000)	-	-	191,000	-
Stock compensation expense	-	299,000	-	-	-	299,000
Cash dividends ($0.99 per share)	-	-	(4,248,000)	-	-	(4,248,000)
BALANCES – DECEMBER 31, 2023	$ 149,000	$ 3,084,000	$125,737,000	$(18,043,000)	$ (9,521,000)	$101,406,000

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

F S BANCORP
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2023 and 2022

	2023	2022
Cash flows from operating activities		
Net income	$ 12,952,000	$ 16,471,000
Adjustments to reconcile net income to net cash from operating activities		
Depreciation and amortization	738,000	713,000
Credit loss expense	192,000	160,000
Stock compensation expense	299,000	213,000
Loans originated for sale	(250,000)	(2,725,000)
Proceeds from sales of loans held for sale	255,000	3,511,000
Security and interest-bearing deposit (gains) losses	2,947,000	26,000
Net gains on sales of mortgage loans	-	(224,000)
Net change in short term investments	145,000	(2,348,000)
Net gains on sales of fixed assets	(2,000)	(11,000)
Net losses on interest rate cap	256,000	310,000
Change in accrued interest receivable	(446,000)	(672,000)
Change in accrued interest payable	406,000	126,000
Earnings, net of fees, on life insurance	(456,000)	(376,000)
Change in other assets	3,290,000	(5,901,000)
Change in other liabilities	(556,000)	1,896,000
Net cash from operating activities	19,770,000	11,169,000
Cash flows from investing activities		
Net change in interest earning deposits with banks	2,705,000	745,000
Proceeds from maturities of securities available for sale	7,940,000	21,455,000
Proceeds from sales of securities available for sale	107,636,000	-
Proceeds from maturities of securities held to maturity	1,199,000	1,395,000
Purchase of securities available for sale	(50,381,000)	(27,028,000)
Purchase of securities held to maturity	-	(1,500,000)
Proceeds from redemption of FHLB stock	2,788,000	200,000
Purchase of FHLB stock	(3,993,000)	-
Purchase of Bank owned life insurance	-	(4,000,000)
Proceeds from Bank owned life insurance death benefit	1,128,000	-
Net change in loans	(47,813,000)	(75,092,000)
Premises and equipment expenditures, net	(679,000)	(911,000)
Net cash from investing activities	20,530,000	(84,736,000)
Cash flows from financing activities		
Net change in deposits	(15,856,000)	88,103,000
Net change in securities sold under agreements to repurchase	(1,902,000)	(637,000)
Proceeds from stock option exercises	-	134,000
Proceeds from Federal Home Loan Bank advances	110,000,000	10,000,000
Repayments of FHLB advances	(120,000,000)	-
Proceeds from notes payable	8,000,000	-
Repayments of notes payable	(8,000,000)	-
Dividends paid	(4,248,000)	(4,098,000)
Purchase of treasury stock	(937,000)	(1,791,000)
Net cash from financing activities	(32,943,000)	91,711,000
Net change in cash and cash equivalents	7,357,000	18,144,000
Cash and cash equivalents at beginning of year	86,408,000	68,264,000
Cash and cash equivalents at end of year	$ 93,765,000	$ 86,408,000

(Continued)

		2023		2022
Supplemental cash flow information				
Interest paid	$	14,503,000	$	3,643,000
Income taxes paid (refunded)		(334,000)		6,252,000
Supplemental noncash disclosures				
Transfers from portfolio loans to other real estate owned	$	30,000	$	-
Transfer of securities from available for sale to held to maturity		-		50,740,000
Transfer of Farmer Mac stock from other assets to securities available for sale		4,000		-

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

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of F S Bancorp and its wholly-owned subsidiaries, Farmers State Bank (the "Bank") and Farmers State Risk Management, Inc. together referred to as (“the Company”). On December 7, 2023, Farmers State Risk Management was dissolved. Also included in the consolidated financial statements is FSB Investments of Nevada, Inc., a wholly-owned subsidiary of the Bank, and its wholly-owned subsidiaries FSB Holdings, Inc. and FSB of Nevada LLC, Nevada corporations and a limited liability corporation, formed for the purpose of managing and investing in certain securities. Also included in the consolidated financial statements is the majority owned subsidiary of FSB Holdings, Inc., FSB Properties, a Real Estate Investment Trust (the “REIT”). The REIT was formed for the purpose of holding mortgage loans originated by the Bank. The REIT is permitted a deduction for Federal income tax purposes of all dividends paid to its shareholders. Farmers State Risk Management, Inc. is a captive insurance company. All significant intercompany balances and transactions have been eliminated in consolidation.

Nature of Operations: The Company grants commercial, residential and consumer loans to customers primarily in LaGrange and Steuben counties, Indiana, St. Joseph and Branch counties, Michigan and the neighboring regions. Substantially all loans are secured by specific items of collateral including business assets, consumer assets and real estate. One to four family residential real estate loans make up approximately 54% of the loan portfolio and include revolving and closed end loans secured by one to four family residential real estate. Other commercial real estate loans make up approximately 29% of the loan portfolio and include loans secured by farmland, multifamily real estate, and commercial real estate.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the consolidated financial statements and disclosures provided, and future results could differ.

Subsequent Events: The Company has evaluated subsequent events for recognition and disclosure through March 5, 2024, which is the date the financial statements were available to be issued.

Financial Instruments With Off-Balance-Sheet Risk: The Company, in the normal course of business, makes commitments to extend credit which are not reflected in the financial statements. Such financial instruments are recorded when they are funded. A summary of these commitments is disclosed in Note 15.

Securities: Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income or loss, net of tax. Equity securities consist of money market mutual funds that are primarily invested in U.S. Government and U.S. government agencies, and are included in Short Term Investments on the Consolidated Balance Sheets. Equity securities are held principally for resale in the near term, and are recorded at fair value with changes in fair value included in earnings. Interest and dividends are included in net interest income.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized to the earliest call date.

A summary of securities transferred from available for sale to held to maturity is disclosed in Note 3.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Credit Losses – Held-to-Maturity Securities: Management measures expected credit losses on held-to-maturity debt securities on a collective basis by major security type. Accrued interest receivable on held-to-maturity debt securities totals $603,000 and $617,000 at December 31, 2023 and 2022 and is excluded from the estimate of credit losses.

The estimate of expected credit losses considers historical credit loss information that is adjusted for current conditions and reasonable and supportable forecasts.

Management classifies the held-to-maturity portfolio into the following major security types: Obligations of state and political subdivisions.

Allowance for Credit Losses – Available-For-Sale Securities: For available-for-sale debt securities in an unrealized loss position, the Company first assesses whether it intends to sell, or it is more likely than not that it will be required to sell the security before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the security's amortized cost basis is written down to fair value through income. For debt securities available-for-sale that do not meet the aforementioned criteria, the Company evaluates whether the decline in fair value has resulted from credit losses or other factors. In making this assessment, management considers the extent to which fair value is less than amortized cost, any changes to the rating of the security by a rating agency, and adverse conditions specifically related to the security, among other factors. If this assessment indicates that a credit loss exists, the present value of cash flows expected to be collected from the security are compared to the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis, a credit loss exists and an allowance for credit losses is recorded for the credit loss, limited by the amount that the fair value is less than the amortized cost basis. Any impairment that has not been recorded through an allowance for credit losses is recognized in other comprehensive income.

Changes in the allowance for credit losses are recorded as credit loss expense (or reversal). Losses are charged against the allowance when management believes the collectability of an available-for-sale security is confirmed or when either of the criteria regarding intent or requirement to sell is met.

Accrued interest receivable on available-for-sale debt securities totaled $859,000 and $1,032,000 at December 31, 2023 and 2022 and is excluded from the estimate of credit losses.

Federal Home Loan Bank Stock: As a condition of borrowing through the Federal Home Loan Bank system, the Bank is to maintain an investment in the capital stock of the Federal Home Loan Bank (FHLB) and may invest in additional amounts. The investment is carried at cost. Dividend income on FHLB stock of Indianapolis was $200,000 and $62,000 for the years ended December 31, 2023 and 2022.

Loans Held for Sale: Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at amortized cost net of allowance for credit losses. Amortized cost is the principal balance outstanding, net of deferred loan fees and costs and the allowance for credit losses. Accrued interest receivable totaled $3,154,000 and $2,509,000 at December 31, 2023 and 2022 and was reported in Accrued Interest Receivable on the consolidated balance sheets and is excluded from the estimate of credit losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method without anticipating prepayments.

Interest income is not reported when full loan repayment is in doubt, typically when payments are past due 90 days or more. Past due status is based on the contractual terms of the loan. All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Concentration of Credit Risk: Most of the Company's business activity is with customers located within LaGrange and Steuben Counties of Indiana. Therefore, the Company's exposure to credit risk is significantly affected by changes in the economy in these counties.

Allowance for Credit Losses – Loans: The allowance for credit losses is a valuation account that is deducted from, or added to, the loans' amortized cost basis to present the net amount expected to be collected on the loans. Loans are charged off against the allowance when management believes the collectability of a loan balance is confirmed. Expected recoveries do not exceed the aggregate of amounts previously charged-off and expected to be charged-off.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful. The general component covers non-classified loans. Management estimates the allowance balance using relevant available information, from internal and external sources, related to past events, current conditions and reasonable and supportable forecasts. Historical credit loss experience provides the basis for the estimation of expected credit losses. Adjustments to historical loss information are made for differences in current loan-specific risk characteristics such as differences in underwriting standards, portfolio mix, delinquency level, or term as well as for changes in environmental conditions, such as changes in unemployment rates, property values, or other relevant factors.

A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement.

Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

We aggregate loans into the following portfolio segments: construction and land; revolving 1-4 family residential real estate; closed end 1-4 family residential real estate; other real estate; non-real estate commercial and agricultural; mortgage warehouse participations; and consumer and other. Risk factors impacting loans in each of the portfolio segments include broad deterioration of property values, reduced consumer and business spending as a result of continued high unemployment and reduced credit availability and lack of confidence in a sustainable recovery. Loans that do not share risk characteristics are evaluated on an individual basis. Loans evaluated individually are not also included in the collective evaluation. When management determines that foreclosures is probable expected credit losses are based on the fair value of the collateral at the reporting date, adjusted for selling costs as appropriate.

Other real estate loans and non-real estate commercial and agricultural loans are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures.

Determining the Contractual Term: Expected credit losses are estimated over the contractual term of the loans, adjusted for expected prepayments when appropriate. The contractual term excludes expected extensions, renewals, and modifications unless the extension or renewal options are included in the original or modified contract at the reporting date and are not unconditionally cancelable by the Company.

Occasionally, the Company modifies loans to borrowers in financial distress by providing principal forgiveness, term extension, and other-than-insignificant payment delay or interest rate reduction. When principal forgiveness is provided, the amount of forgiveness is charged-off against the allowance for credit losses.

<u>Mortgage Warehouse Participations</u>: The Bank has purchased participation interests in mortgage warehouse participation loans from another community bank which has approved specific mortgage companies through which individual mortgage loans are originated by the mortgage company and funded by the bank as a secured borrowing with the pledge of collateral under the bank's agreement with the mortgage company. The individual mortgage loans are held between the time of origination and subsequent repurchase by the mortgage company for sale of the loan into the secondary market. Each individual mortgage is assigned to the community bank from which we are acquiring the participation loans until the loan is repurchased and sold to the secondary market by the mortgage company. Also, the bank from which we are acquiring the participation interests takes possession of each original note and forwards such note to the end investor once the mortgage company has sold the loan. The individual mortgage loans are typically sold by the mortgage companies within 30 days of origination and are seldom held more than 90 days. Interest income is accrued during this period.

<u>Premises and Equipment</u>: Land is carried at cost. Premises and equipment are reported net of accumulated depreciation. Depreciation expense is calculated on straight-line and accelerated methods over asset useful lives. These assets are reviewed for impairment under current accounting literature when events indicate the carrying amount may not be recoverable.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Goodwill and Other Intangible Assets: Goodwill resulting from business combinations prior to January 1, 2009 represents the excess of the purchase price over the fair value of the net assets of businesses acquired. Goodwill resulting from business combinations after January 1, 2009, is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. The Company has selected December 31 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on the consolidated balance sheet.

Derivatives: At the inception of a derivative contract, the Company designates the derivative as one of three types based on the Company's intentions and belief as to likely effectiveness as a hedge. These three types are (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value hedge"), (2) a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to the recognized asset or liability ("cash flow hedge"), or (3) an instrument with no hedging designation ("stand-alone" derivative). For a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk, are recognized in current earnings as fair values change. For a cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income and reclassified into earnings in the same periods during which the hedged transaction affects earnings. Changes in the fair value of derivatives not designated or that do not qualify for hedge accounting are reported currently in earnings, as non-interest income.

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

The Company is exposed to losses if a counterparty fails to make its payments under a contract in which the Company is in the net receiving position. The Company anticipates that the counterparties will be able to fully satisfy their obligations under the agreements. All the contracts to which the Company is a party settle monthly.

Income Taxes: Income tax expense is the sum of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax consequences of temporary differences between the carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

Retirement Plans: The Company maintains a 401(k) profit sharing plan covering substantially all employees. Contributions are made and expensed annually. For details concerning the plan, see Note 9. Deferred compensation plan expense allocates benefits over years of service.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Stock Compensation: Compensation cost is recognized for stock options and restricted stock awards issued to employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. The Company's accounting policy is to recognize compensation cost net of estimated forfeitures.

Fair Values of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 16. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates. The fair value estimates of existing on- and off-balance-sheet financial instruments does not include the value of anticipated future business or the values of assets and liabilities not considered financial instruments.

Earnings Per Share and Other Per Share Data: Basic earnings per share is based on net income divided by the weighted average number of common shares outstanding during the period. All outstanding unvested share-based payment awards that contain rights for non-forfeitable dividends are considered participating securities for this calculation. Diluted earnings per share shows the dilutive effect of any additional potential common shares. Earnings and dividends per share and stock option related pricing are restated for all stock splits and stock dividends through the date of issuance of the financial statements for all periods presented. The Company declared a two-for-one stock split resulting in the distribution of one additional share for each share held that was distributed on February 14, 2022.

Statement of Cash Flows: For purposes of the statement of cash flows, cash and cash equivalents is defined to include the Company's cash on hand and its demand deposits in other financial institutions with an original maturity of 90 days or less. The Company reports net cash flows for customer loan transactions, deposit transactions, interest earning deposits with banks and short-term borrowings.

Cash Reserve Requirements: At December 31, 2023, the Bank was not required to have cash on hand or on deposit with the Federal Reserve Bank to meet regulatory reserve and clearing balance requirements.

Equity: Stock dividends for 20% or less are reported by transferring the fair value as of the ex-dividend date, of the stock issued from retained earnings to common stock and additional paid-in capital. Fractional share amounts are paid in cash with a reduction in retained earnings. Treasury stock is carried at cost. The Company declared a two-for-one stock split resulting in the distribution of one additional share for each share held that was distributed on February 14, 2022. Since the common stock does not have a par value, the stock split had no impact on shareholders' equity.

Dividend Restriction: The Company and its subsidiary bank are subject to banking regulations which require the maintenance of certain capital levels and which limit the amount of dividends which may be paid. A summary of regulatory capital requirements is disclosed in Note 11.

Comprehensive Income (Loss): Comprehensive income (loss) consists of net income and other comprehensive income or loss. Other comprehensive income or loss includes the net change in unrealized appreciation and depreciation on securities available for sale, net of tax, which is also recognized as a separate component of shareholders' equity.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Bank Owned Life Insurance: The Company has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Other Real Estate Owned: Real estate acquired in settlement of loans is initially reported at fair value less estimated costs to sell, establishing a new cost basis at the acquisition date. Any excess of the loan balance at the time of foreclosure over the new cost basis is treated as a loan loss and is charged against the allowance for credit losses. A credit loss for estimated losses on other real estate is charged to earnings upon subsequent declines in value. Costs related to the development and improvement of property are capitalized, holding costs are charged to expense. There was $64,000 and $0 of other real estate owned at December 31, 2023 and 2022, which are included in other assets on the consolidated balance sheets. Total expense related to other real estate owned was $6,000 and $0 during the years ended December 31, 2023 and 2022. During 2023 and 2022, the Company recorded net gains of $0 on other real estate owned. At December 31, 2023 and 2022, the recorded investment of loans secured by residential real estate properties for which formal foreclosure proceedings are in process is $696,000 and $52,000, respectively.

Reclassifications: Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

Adoption of new Accounting Standards: On January 1, 2023, the Company adopted ASU 2016-13 *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, as amended, which replaces the incurred loss methodology with an expected loss methodology that is referred to as the current expected credit loss (CECL) methodology. The measurement of expected credit losses under the CECL methodology is applicable to financial assets measured at amortized cost, including loan receivables and held-to-maturity debt securities. It also applies to off-balance sheet (OBS) credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments). In addition, ASC 326 made changes to the account for available-for-sale debt securities management does not intend to sell or believes that it is more likely than not they will be required to sell.

The Company adopted ASC 326 using the modified retrospective method for all financial assets measured at amortized cost and off-balance sheet credit exposures. Results for reporting periods beginning after January 1, 2023 are presented under ASC 326 while prior period amounts continue to be reported in accordance with previous applicable GAAP. The Company recorded a decrease, net of tax, to retained earnings of $250,000 as of January 1, 2023 for the cumulative effect of adopting ASC 326.

On March 31, 2022, the FASB issued ASU 2022-02, *"Financial Instruments - Credit Losses (ASC 326): Troubled Debt Restructurings (TDRs) and Vintage Disclosures."* The guidance amends ASC 326 to eliminate the accounting guidance for TDR's by creditors, while enhancing disclosure requirements for certain loan refinancing and restructuring activities by creditors when a borrower is experiencing financial difficulty. Specifically, rather than applying TDR recognition and measurement guidance, creditors will determine whether a modification results in a new loan or continuation of an existing loan. These amendments are intended to enhance existing disclosure requirements and introduce new requirements related to certain modifications of receivables made to borrowers experiencing financial difficulty. The Company adopted the provisions of the ASU related to modifications made to borrowers experiencing financial difficulty, with retrospective application. Adoption of this standard did not have a material impact on the consolidated financial statements.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The following table illustrates the impact of ASC 326.

	January 1, 2023		
	As Reported Under ASC 326	Pre-ASC 326 Adoption	Impact of ASC 326 Adoption
Assets:			
Allowance for credit losses on:			
Held to Maturity Investments			
Obligations of states and political subdivisions	$ -	$ -	$ -
Loans			
Construction and land	$ 37,000	$ 373,000	$ (336,000)
Revolving 1-4 family residential real estate	278,000	371,000	(93,000)
Closed end 1-4 family residential real estate	3,694,000	2,681,000	1,013,000
Other real estate	1,561,000	2,468,000	(907,000)
Non-real estate commercial and agricultural	715,000	680,000	35,000
Consumer and other	450,000	60,000	390,000
Unallocated	290,000	75,000	215,000
Total	7,025,000	6,708,000	317,000

We have not recognized an allowance for credit losses for unfunded commitments. The allowance is limited to unfunded commitments on loans that are not unconditionally cancellable, which are primarily revolving 1-4 family residential real estate loans, and the required estimated allowance on those loans is not material.

NOTE 2 - EARNINGS PER SHARE

	2023	2022
Basic		
Net income	$ 12,952,000	$ 16,471,000
Weighted average common shares outstanding	4,293,000	4,317,000
Basic earnings per share	$ 3.02	$ 3.82

	2023	2022
Diluted		
Net income	$ 12,952,000	$ 16,471,000
Weighted average common shares outstanding for basic earnings per share	4,293,000	4,317,000
Add: Dilutive effects of assumed exercises of stock options	11,000	19,000
Average shares and dilutive potential common shares	4,304,000	4,336,000
Diluted earnings per share	$ 3.01	$ 3.80

Stock options for 86,000 and 54,000 shares of common stock were not considered in computing diluted earnings per common share for 2023 and 2022, respectively, because they were antidilutive.

NOTE 3 - SECURITIES

Year end securities were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale - 2023				
U.S. Treasury and federal agency	$ 43,384,000	$ -	$ (858,000)	$ 42,526,000
Obligations of states and political subdivisions	48,162,000	24,000	(4,914,000)	43,272,000
SBA pools	11,346,000	1,000	(987,000)	10,360,000
Mortgage-backed - residential	21,461,000	6,000	(2,928,000)	18,539,000
Mortgage-backed - commercial	52,030,000	-	(6,765,000)	45,265,000
Bank holding company subordinated notes	10,116,000	-	(1,792,000)	8,324,000
	$ 186,499,000	$ 31,000	$(18,244,000)	$ 168,286,000

	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
Held to maturity - 2023				
Obligations of states and political subdivisions	$ 57,441,000	$ -	$(5,474,000)	$ 51,967,000
	$ 57,441,000	$ -	$(5,474,000)	$ 51,967,000

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale - 2022				
U.S. Treasury and federal agency	$ 84,150,000	$ -	$(5,956,000)	$ 78,194,000
Obligations of states and political subdivisions	73,361,000	91,000	(6,884,000)	66,568,000
SBA pools	7,379,000	2,000	(987,000)	6,394,000
Mortgage-backed - residential	23,454,000	7,000	(3,157,000)	20,304,000
Mortgage-backed - commercial	55,662,000	-	(6,421,000)	49,241,000
Bank holding company subordinated notes	10,155,000	-	(1,329,000)	8,826,000
	$ 254,161,000	$ 100,000	$(24,734,000)	$ 229,527,000

	Amortized Cost	Gross Unrecognized Gains	Gross Unrecognized Losses	Fair Value
Held to maturity - 2022				
Obligations of states and political subdivisions	$ 58,328,000	$ 7,000	$(7,345,000)	$ 50,990,000
	$ 58,328,000	$ 7,000	$(7,345,000)	$ 50,990,000

(Continued)

NOTE 3 – SECURITIES (Continued)

The Company reassessed classification of certain investments and effective April 1, 2022 the Company transferred at fair value, $50,740,000 of obligations of states and political subdivisions from available for sale to held to maturity securities. These investments had an amortized cost of $56,520,000. The related unrealized loss of $5,780,000 included in accumulated other comprehensive loss will be accreted out of other comprehensive loss with an offsetting entry to interest as a yield adjustment through earnings over the remaining term of the securities. As of December 31, 2023 the remaining balance in accumulated other comprehensive loss is $4,626,000. No gain or loss was recorded at the time of transfer. Subsequent to transfer, the allowance for credit losses on these securities are evaluated under the accounting policy for HTM securities.

Contractual maturities of debt securities at year end 2023 were as follows. Expected maturities may differ from contractual maturities because borrowers may have the right to call or repay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	Available for Sale December 31, 2023		Held to Maturity December 31, 2023	
	Fair Value	Amortized Cost	Fair Value	Carrying Amount
Due in one year or less	$ 5,797,000	$ 5,844,000	$ 1,946,000	$ 1,958,000
Due after one year through five years	62,508,000	65,514,000	3,016,000	3,016,000
Due after five years through ten years	27,074,000	29,874,000	3,024,000	3,187,000
Due after ten years	9,103,000	11,776,000	43,981,000	49,280,000
Mortgage-backed	63,804,000	73,491,000	-	-
	$ 168,286,000	$ 186,499,000	$ 51,967,000	$ 57,441,000

Securities pledged at year-end 2023 and 2022 had a carrying amount of $8,779,000 and $77,442,000 and were pledged to secure securities sold under agreements to repurchase and Federal Home Loan Bank advances.

At year-end 2023 and 2022, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders' equity.

During 2023, proceeds from sales of securities available for sale were $107,636,000, and gross gains and losses on these sales were $167,000 and ($3,112,000). Gross gains and losses on calls of securities available for sale were $3,000 and $0. Proceeds from sales of interest-bearing deposits were $1,220,000 and gross gains and losses on these sales were $0 and ($5,000).

During 2022, proceeds from sales of securities available for sale were $0, and gross gains and losses on these sales were $0. Gross gains and losses on calls of securities available for sale were $20,000 and ($46,000).

NOTE 3 - SECURITIES (Continued)

Securities with unrealized losses at year end 2023 and 2022 not recognized in income are as follows:

2023:

	Continued Unrealized Loss for Less than 12 Months		Continued Unrealized Loss for 12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Loss
U.S. Treasury and federal agency	$19,581,000	$ (3,000)	$ 12,851,000	$ (855,000)	$ 32,432,000	$ (858,000)
Obligations of states and political subdivisions	-	-	41,491,000	(4,914,000)	41,491,000	(4,914,000)
SBA pools	4,243,000	(32,000)	5,769,000	(955,000)	10,012,000	(987,000)
Mortgage-backed-residential	225,000	(1,000)	17,987,000	(2,927,000)	18,212,000	(2,928,000)
Mortgage-backed-Commercial	-	-	45,265,000	(6,765,000)	45,265,000	(6,765,000)
Bank holding company subordinated notes	-	-	8,324,000	(1,792,000)	8,324,000	(1,792,000)
Total available-for-sale	$24,049,000	$ (36,000)	$131,687,000	$(18,208,000)	$155,736,000	$ (18,244,000)

	Continued Unrecognized Loss for Less than 12 Months		Continued Unrecognized Loss for 12 Months or More		Total	
Description of Securities	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Loss
Obligations of states and political subdivisions	$ 642,000	$ (54,000)	$ 44,865,000	$ (5,420,000)	$ 45,507,000	$ (5,474,000)
Total held-to-maturity	$ 642,000	$ (54,000)	$ 44,865,000	$ (5,420,000)	$ 45,507,000	$ (5,474,000)

2022:

	Continued Unrealized Loss for Less than 12 Months		Continued Unrealized Loss for 12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Loss
U.S. Treasury and federal agency	$ 3,266,000	$ (95,000)	$ 74,928,000	$ (5,861,000)	$ 78,194,000	$ (5,956,000)
Obligations of states and political subdivisions	27,684,000	(1,969,000)	29,088,000	(4,915,000)	56,772,000	(6,884,000)
SBA pools	-	-	6,035,000	(987,000)	6,035,000	(987,000)
Mortgage-backed-residential	8,559,000	(546,000)	11,371,000	(2,611,000)	19,930,000	(3,157,000)
Mortgage-backed-Commercial	16,456,000	(366,000)	32,785,000	(6,055,000)	49,241,000	(6,421,000)
Bank holding company subordinated notes	2,980,000	(408,000)	5,846,000	(921,000)	8,826,000	(1,329,000)
Total available-for-sale	$58,945,000	$(3,384,000)	$160,053,000	$(21,350,000)	$218,998,000	$ (24,734,000)

(Continued)

NOTE 3 - SECURITIES (Continued)

	Continued Unrecognized Loss for Less than 12 Months		Continued Unrecognized Loss for 12 Months or More		Total	
Description of Securities	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Losses	Fair Value	Unrecognized Loss
Obligations of states and political subdivisions	$ 8,881,000	$ (1,414,000)	$ 34,094,000	$ (5,931,000)	$ 42,975,000	$ (7,345,000)
Total held-to-maturity	$ 8,881,000	$ (1,414,000)	$ 34,094,000	$ (5,931,000)	$ 42,975,000	$ (7,345,000)

Unrealized losses on these securities have not been recognized into income because the issuers bonds are of high credit quality, management does not intend to sell and it is likely that management will not be required to sell securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates and other market conditions. The fair value is expected to recover as the securities approach maturity.

There was no allowance for credit losses for debt securities held-to-maturity for the year ended December 31, 2023.

Credit Quality Indicators:

The Company monitors the credit quality of debt securities held-to-maturity through the use of credit rating. The Company monitors the credit rating on a quarterly basis. The following table summarizes the amortized cost of debt securities held-to-maturity at December 31, 2023, aggregated by credit quality indicator:

	Obligations Of State And Political Subdivisions
December 31, 2023	
AAA/AA/A	$ 50,980,000
Non-rated	6,461,000
Total	$ 57,441,000

For non-rated investments, the Company also evaluates credit quality based on the aging status of the security. Nonperforming securities are nonaccrual securities and securities past due 90 days or more that are still accruing. The following table presents the amortized cost of non-rated securities based on payment activity:

	Obligations Of State And Political Subdivisions
December 31, 2023	
Performing	$ 6,461,000
Nonperforming	-
Total	$ 6,461,000

There were no held-to-maturity debt securities on nonaccrual or past due more than 29 days as of December 31, 2023.

(Continued)

NOTE 4 - LOANS

Year end loans, net of deferred loan fees, were as follows:

	2023	2022
Construction and land	$ 48,019,000	$ 37,613,000
Revolving 1-4 family residential real estate	57,525,000	50,307,000
Closed end 1-4 family residential real estate	372,346,000	358,047,000
Other real estate	227,749,000	221,024,000
Non-real estate commercial and agricultural	70,277,000	60,321,000
Mortgage warehouse participations	-	-
Consumer and other	19,022,000	19,848,000
	$ 794,938,000	$ 747,160,000

(Continued)

NOTE 4 - LOANS (Continued)

The following table presents the activity in the allowance for credit losses by portfolio segment for the year ending December 31, 2023:

2023	Construction & Land	Revolving 1-4 Family Residential Real Estate	Closed End 1-4 Family Residential Real Estate	Other Real Estate	Non-Real Estate Commercial & Agriculture	Mortgage Warehouse Participations	Consumer & Other	Unallocated	Total
Allowance for credit losses:									
Beginning balance, prior to Adoption of ASC 326	$ 373,000	$ 371,000	$ 2,681,000	$ 2,468,000	$ 680,000	$ -	$ 60,000	$ 75,000	$ 6,708,000
Impact of adopting ASC 326	(336,000)	(93,000)	1,013,000	(907,000)	35,000	-	390,000	215,000	317,000
Credit loss expense	10,000	30,000	62,000	(93,000)	174,000	-	58,000	(49,000)	192,000
Loans charged-off	-	-	(4,000)	-	-	-	(135,000)	-	(139,000)
Recoveries collected	-	-	6,000	14,000	-	-	47,000	-	67,000
Total ending allowance balance	$ 47,000	$ 308,000	$ 3,758,000	$ 1,482,000	$ 889,000	$ -	$ 420,000	$ 241,000	$ 7,145,000

Prior to the adoption of ASC 326 on January 1, 2023, the Company calculated the allowance for loan losses using the incurred loss methodology. The following table presents the activity in the allowance for loan losses by portfolio segment for the year ending December 31, 2022:

2022	Construction & Land	Revolving 1-4 Family Residential Real Estate	Closed End 1-4 Family Residential Real Estate	Other Real Estate	Non-Real Estate Commercial & Agriculture	Mortgage Warehouse Participations	Consumer & Other	Unallocated	Total
Allowance for loan losses:									
Beginning balance	$ 309,000	$ 305,000	$ 2,404,000	$ 2,462,000	$ 725,000	$ 97,000	$ 71,000	$ 225,000	$ 6,598,000
Provision for loan losses	64,000	70,000	264,000	(7,000)	(45,000)	(97,000)	61,000	(150,000)	160,000
Loans charged-off	-	(4,000)	-	-	-	-	(117,000)	-	(121,000)
Recoveries	-	-	13,000	13,000	-	-	45,000	-	71,000
Total ending allowance balance	$ 373,000	$ 371,000	$ 2,681,000	$ 2,468,000	$ 680,000	$ -	$ 60,000	$ 75,000	$ 6,708,000

(Continued)

NOTE 4 - LOANS (Continued)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2022:

2022	Construction & Land	Revolving 1-4 Family Residential Real Estate	Closed End 1-4 Family Residential Real Estate	Other Real Estate	Non-Real Estate Commercial & Agriculture	Mortgage Warehouse Participations	Consumer & Other	Unallocated	Total
Ending allowance balance attributable to loans:									
Individually evaluated for impairment	$ -	$ -	$ 45,000	$ -	$ -	$ -	$ -	$ -	$ 45,000
Collectively evaluated for impairment	373,000	371,000	2,636,000	2,468,000	680,000	-	60,000	75,000	6,663,000
Total ending allowance balance	$ 373,000	$ 371,000	$ 2,681,000	$ 2,468,000	$ 680,000	$ -	$ 60,000	$ 75,000	$ 6,708,000
Loans:									
Individually evaluated for impairment	$ -	$ -	$ 1,114,000	$ -	$ -	$ -	$ -	$ -	$ 1,114,000
Collectively evaluated for impairment	37,613,000	50,307,000	356,933,000	221,024,000	60,321,000	-	19,848,000	-	746,046,000
Total ending loan balance	$ 37,613,000	$ 50,307,000	$ 358,047,000	$ 221,024,000	$ 60,321,000	$ -	$ 19,848,000	$ -	$ 747,160,000

NOTE 4 - LOANS (Continued)

The following table presents information related to impaired loans by class of loans as of and for the year ended December 31, 2022:

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
December 31, 2022						
With no related allowance recorded:						
Construction and land	$ -	$ -	$ -	$ -	$ -	$ -
Revolving 1-4 family residential real estate	-	-	-	-	-	-
Closed end 1-4 family residential real estate	555,000	540,000	-	554,000	26,000	26,000
Other real estate	-	-	-	23,000	5,000	5,000
Non-real estate commercial and agricultural	-	-	-	116,000	6,000	6,000
Mortgage warehouse participations	-	-	-	-	-	-
Consumer and other	-	-	-	-	-	-
Subtotal	555,000	540,000	-	693,000	37,000	37,000
With an allowance recorded:						
Construction and land	-	-	-	-	-	-
Revolving 1-4 family residential real estate	-	-	-	-	-	-
Closed end 1-4 family residential real estate	574,000	574,000	45,000	587,000	28,000	28,000
Other real estate	-	-	-	-	-	-
Non-real estate commercial and agricultural	-	-	-	-	-	-
Mortgage warehouse participations	-	-	-	-	-	-
Consumer and other	-	-	-	-	-	-
Subtotal	574,000	574,000	45,000	587,000	28,000	28,000
Total	$ 1,129,000	$ 1,114,000	$ 45,000	$ 1,280,000	$ 65,000	$ 65,000

The recorded investment in loans excludes accrued interest receivable due to immateriality.

(Continued)

NOTE 4 - LOANS (Continued)

Nonaccrual loans and loans past due 90 days or more still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. The following tables present the recorded investment in nonaccrual loans and loans past due 90 days or more still on accrual by class of loans as of December 31, 2023 and 2022:

	2023		2022	
	Nonaccrual	Loans Past Due 90 Days or More Still Accruing	Nonaccrual	Loans Past Due 90 Days or More Still Accruing
Construction and land	$ -	$ -	$ -	$ -
Revolving 1-4 family residential real estate	28,000	582,000	32,000	-
Closed end 1-4 family residential real estate	339,000	-	220,000	-
Other real estate	72,000	-	72,000	-
Non-real estate commercial and agricultural	-	-	-	-
Mortgage warehouse participations	-	-	-	-
Consumer and other	11,000	-	3,000	-
Total	$ 450,000	$ 582,000	$ 327,000	$ -

All nonaccrual loans had an allowance for credit loss. The Company recognized $0 of interest income on nonaccrual loans during the year ended December 31, 2023 and 2022.

The following table presents the aging of the recorded investment in past due loans as of December 31, 2023 by class of loans:

2023	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans Not Past Due	Total
Construction and land	$ -	$ -	$ -	$ -	$ 48,019,000	$ 48,019,000
Revolving 1-4 family residential real estate	108,000	-	582,000	690,000	56,835,000	57,525,000
Closed end 1-4 family residential real estate	1,035,000	349,000	86,000	1,470,000	370,876,000	372,346,000
Other real estate	65,000	8,000	72,000	145,000	227,604,000	227,749,000
Non-real estate commercial and agricultural	688,000	-	-	688,000	69,589,000	70,277,000
Mortgage warehouse participations	-	-	-	-	-	-
Consumer and other	21,000	37,000	11,000	69,000	18,953,000	19,022,000
Total	$ 1,917,000	$ 394,000	$ 751,000	$ 3,062,000	$ 791,876,000	$ 794,938,000

(Continued)

NOTE 4 - LOANS (Continued)

The following table presents the aging of the recorded investment in past due loans as of December 31, 2022 by class of loans:

2022	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans Not Past Due	Total
Construction and land	$ -	$ -	$ -	$ -	$ 37,613,000	$ 37,613,000
Revolving 1-4 family residential real estate	28,000	-	32,000	60,000	50,247,000	50,307,000
Closed end 1-4 family residential real estate	592,000	-	78,000	670,000	357,377,000	358,047,000
Other real estate	144,000	-	-	144,000	220,880,000	221,024,000
Non-real estate commercial and agricultural	82,000	-	-	82,000	60,239,000	60,321,000
Mortgage warehouse participations	-	-	-	-	-	-
Consumer and other	-	-	3,000	3,000	19,845,000	19,848,000
Total	$ 846,000	$ -	$ 113,000	$ 959,000	$ 746,201,000	$ 747,160,000

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

	Mixed use commercial and residential building	Commercial retail building	1-4 family residential building
Revolving 1-4 family residential real estate	$ -	$ -	$ 581,000
Other real estate	80,000	2,394,000	-
Total	$ 80,000	$ 2,394,000	$ 581,000

Occasionally, the Company modifies loans to borrowers in financial distress by providing principal forgiveness, term extension, an other- than-insignificant payment delay or interest rate reduction. When principal forgiveness is provided, the amount of forgiveness is charged-off against the allowance for credit losses.

In some cases, the Company provides multiple types of concessions on one loan. Typically, one type of concession, such as a term extension, is granted initially. If the borrower continues to experience financial difficulty, another concession, such as principal forgiveness, may be granted. For the loans included in the “combination columns below, multiple types of modifications have been made on the same loan within the current reporting period. The combination is at least two of the following: principal forgiveness, term extension, an other- than-insignificant payment delay or interest rate reduction.

NOTE 4 - LOANS (Continued)

There were no loans modified during the year ended December 31, 2023 to borrowers that were experiencing financial difficulty.

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes non-homogenous loans with an outstanding balance greater than $100,000, such as commercial and commercial real estate loans. This analysis is primarily performed on an annual basis. The Company uses the following definitions for risk ratings:

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. Loans listed as not rated are either less than $100,000 or are included in groups of homogeneous loans.

(Continued)

NOTE 4 - LOANS (Continued)

Based on the most recent analysis performed, the risk categories of loans by class of loans and the current period gross write offs is as follows:

	Amortized Cost Basis by Origination Year						
	2023	2022	2021	2020	2019	Prior	Total
As of December 31, 2023							
Other real estate							
Risk rating							
Pass	$ 36,058,000	$ 43,234,000	$ 50,611,000	$ 28,717,000	$ 14,214,000	$ 45,662,000	$ 218,496,000
Special mention	-	-	8,157,000	-	-	372,000	8,529,000
Substandard	-	-	-	621,000	-	103,000	724,000
Doubtful	-	-	-	-	-	-	-
Total other real estate	$ 36,058,000	$ 43,234,000	$ 58,768,000	$ 29,338,000	$ 14,214,000	$ 46,137,000	$ 227,749,000
Other real estate							
Current period gross write offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Non-real estate							
Commercial & agricultural							
Risk rating							
Pass	$ 29,455,000	$ 20,454,000	$ 8,885,000	$ 2,747,000	$ 1,815,000	$ 6,744,000	$ 70,100,000
Special mention	29,000	16,000	-	-	-	44,000	89,000
Substandard	42,000	-	35,000	11,000	-	-	88,000
Doubtful	-	-	-	-	-	-	-
Total non-real estate commercial & agricultural	$ 29,526,000	$ 20,470,000	$ 8,920,000	$ 2,758,000	$ 1,815,000	$ 6,788,000	$ 70,277,000
Other real estate							
Current period gross write offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -

(Continued)

NOTE 4 - LOANS (Continued)

Based on the most recent analysis performed, the risk categories of loans by class of loans is as follows:

	Pass	Special Mention	Substandard	Doubtful	Not Rated
As of December 31, 2022					
Construction and land	$ -	$ -	$ -	$ -	$ 37,613,000
Revolving 1-4 family residential real estate	-	-	32,000	-	50,275,000
Closed end 1-4 family residential real estate	-	-	716,000	-	357,331,000
Other real estate	210,692,000	9,565,000	767,000	-	-
Non-real estate commercial & agricultural	60,089,000	114,000	118,000	-	-
Mortgage warehouse participations	-	-	-	-	-
Consumer and other	-	-	-	-	19,848,000
Total	$ 270,781,000	$ 9,679,000	$ 1,633,000	$ -	$ 465,067,000

(Continued)

NOTE 4 - LOANS (Continued)

The Company considers the performance of the loan portfolio and its impact on the allowance for credit losses. For homogenous loan classes, the Company also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the amortized cost in homogenous loans based on payment activity:

	Amortized Cost Basis by Origination Year						
	2023	2022	2021	2020	2019	Prior	Total
As of December 31, 2023							
Construction and land							
Payment performance							
Performing	$ 26,180,000	$ 16,843,000	$ 2,965,000	$ 1,245,000	$ 213,000	$ 573,000	$ 48,019,000
Nonperforming	-	-	-	-	-	-	-
Total construction and land	$ 26,180,000	$ 16,843,000	$ 2,965,000	$ 1,245,000	$ 213,000	$ 573,000	$ 48,019,000
Construction and land							
Current period gross write offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Revolving 1-4 family residential real estate							
Payment performance							
Performing	$ 15,031,000	$ 16,389,000	$ 9,857,000	$ 4,461,000	$ 3,656,000	$ 7,521,000	$ 56,915,000
Nonperforming	-	-	582,000	-	-	28,000	610,000
Total revolving 1-4 family residential real estate	$ 15,031,000	$ 16,389,000	$ 10,439,000	$ 4,461,000	$ 3,656,000	$ 7,549,000	$ 57,525,000
Revolving 1-4 family residential							
Current period gross write offs	$ -	$ -	$ -	$ -	$ -	$ -	$ -

(Continued)

NOTE 4 - LOANS (Continued)

	Amortized Cost Basis by Origination Year						
	2023	2022	2021	2020	2019	Prior	Total
Closed end 1-4 family residential real estate							
Payment performance							
Performing	$ 29,175,000	$ 102,687,000	$ 90,407,000	$ 70,287,000	$ 17,887,000	$ 61,564,000	$ 372,007,000
Nonperforming	-	-	86,000	-	-	253,000	339,000
Total closed end 1-4 family residential real estate	$ 29,175,000	$ 102,687,000	$ 90,493,000	$ 70,287,000	$ 17,887,000	$ 61,817,000	$ 372,346,000
Closed end 1-4 family residential							
Current period gross write offs	$ -	$ -	$ -	$ -	$ -	$ 4,000	$ 4,000
Consumer and other							
Payment performance							
Performing	$ 7,954,000	$ 6,678,000	$ 2,849,000	$ 858,000	$ 428,000	$ 244,000	$ 19,011,000
Nonperforming	-	-	-	11,000	-	-	11,000
Total consumer and other	$ 7,954,000	$ 6,678,000	$ 2,849,000	$ 869,000	$ 428,000	$ 244,000	$ 19,022,000
Consumer and other							
Current period gross write offs	$ 131,000	$ -	$ -	$ 1,000	$ -	$ 3,000	$ 135,000

(Continued)

NOTE 4 - LOANS (Continued)

The Company considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential and consumer loan classes, the Company also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. Nonperforming loans are nonaccrual loans and loans past due 90 days or more that are still accruing. The following table presents the recorded investment based on payment activity:

	Construction & Land	Revolving 1-4 Family Residential Real Estate	Closed End 1-4 Family Residential Real Estate	Mortgage Warehouse Participations	Consumer & Other
December 31, 2022					
Performing	$ 37,613,000	$ 50,275,000	$ 357,827,000	$ -	$ 19,845,000
Nonperforming	-	32,000	220,000	-	3,000
Total	$ 37,613,000	$ 50,307,000	$ 358,047,000	$ -	$ 19,848,000

The Company sold closed end 1-4 family residential real estate loans totaling $250,000 and $3,457,000 during 2023 and 2022, respectively. The Company did not sell any other loans during 2023 and 2022, and it did not purchase any financing receivables during 2023 and 2022.

NOTE 5 - PREMISES AND EQUIPMENT

Year end premises and equipment were as follows:

	2023	2022
Land	$ 2,583,000	$ 2,583,000
Buildings and improvements	12,476,000	12,461,000
Construction in process	349,000	95,000
Furniture and equipment	7,818,000	7,946,000
Total cost	23,226,000	23,085,000
Accumulated depreciation	(13,007,000)	(12,681,000)
	$ 10,219,000	$ 10,404,000

Depreciation expense was $866,000 and $858,000 for 2023 and 2022.

NOTE 6 - GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill

The change in balance for goodwill during the year is as follows:

	2023	2022
Beginning of year	$ 2,604,000	$ 2,604,000
Acquired goodwill	-	-
End of year	$ 2,604,000	$ 2,604,000

Impairment exists when a reporting unit's carrying value of goodwill exceeds its fair value. At December 31, 2023, the Company's reporting unit had positive equity and the Company elected to perform a qualitative assessment to determine if it was more likely than not that the fair value of the reporting unit exceeded its carrying value, including goodwill. The qualitative assessment indicated that it was more likely than not that the fair value of the reporting unit exceeded its carrying value, resulting in no impairment.

NOTE 7 - DEPOSITS

Year end interest-bearing deposits were as follows:

	2023	2022
Interest-bearing transaction accounts	$ 435,906,000	$ 476,466,000
Savings	184,791,000	189,686,000
Time		
In denominations under $250,000	139,777,000	90,312,000
In denominations of $250,000 or more	35,334,000	23,861,000
	$ 795,808,000	$ 780,325,000

At year end 2023, scheduled maturities of time deposit were as follows:

2024	$ 87,181,000
2025	33,642,000
2026	46,401,000
2027	6,211,000
2028	1,676,000
	$ 175,111,000

(Continued)

NOTE 8 - BORROWINGS

Securities sold under agreements to repurchase ("Repurchase agreements") represent collateralized borrowings with customers located primarily within the Company's service area. All repurchase agreements at December 31, 2023 and 2022 mature on demand. Repurchase agreements are not covered by federal deposit insurance and are secured by securities owned. The Company retains the right to substitute similar type securities and has the right to withdraw all excess collateral applicable to repos whenever the collateral values are in excess of the related repurchase liabilities. However, as a means of mitigating market risk, the Company maintains excess collateral to cover normal changes in the repos liability by monitoring daily usage. The Company maintains control of these securities through the use of third-party safekeeping arrangements. Information concerning securities sold under agreements to repurchase is summarized as follows:

	2023	2022
Balance at end of year	$ 5,068,000	$ 6,970,000
Average daily balance during the year	5,712,000	7,257,000
Average interest rate during the year	0.31%	0.03%
Maximum month-end balance during the year	6,575,000	9,855,000

Securities underlying these agreements had fair values of $8,779,000 and $12,814,000 at December 31, 2023 and 2022, respectively.

The Bank had a line of credit with the Federal Home Loan Bank in the amount of $256,000,000 and $240,000,000 at December 31, 2023 and 2022. At December 31, 2023 and 2022, the Bank had advances against the line of credit in the amount of $0 and $10,000,000.

The Company recognized FHLB advance prepayment gains of $531,000 and $0 during 2023 and 2022. FHLB advance prepayment gains are included in other expense on the consolidated statements of income.

At December 31, 2023 and 2022, the Bank pledged its FHLB stock, mortgage loans with a carrying value of approximately $357,728,000 and $179,732,000, and U.S. Treasuries with a fair value of $0 and $64,628,000 to the Federal Home Loan Bank to secure advances outstanding.

The Company entered into an agreement with another financial institution for a line of credit of $10 million at an annual variable rate equal to the national prime rate minus 0.50% with a minimum rate of 5.00%. The rate on December 31, 2023 was 8.00%. The note payable is secured by 100% of the stock of the Bank. The note payable has a term of 1 year and requires quarterly interest payments. The balance of this note payable was $22,000 and $0 for 2023 and 2022. Under the terms of the agreement, the Bank is required to maintain certain levels of regulatory capital and maintain loan delinquency and nonperforming loan levels below established thresholds. As of December 31, 2023, the Company is in compliance with the loan covenants.

(Continued)

NOTE 9 - EMPLOYEE BENEFIT PLANS

401(k): The Company maintains a 401(k) profit sharing plan for the benefit of substantially all employees. The 401(k) plan contribution expense was approximately $325,000 and $298,000 in 2023 and 2022.

Deferred Compensation Plans: A deferred compensation plan covers all non-employee directors. Under the plan, the Company pays each participant, or their beneficiary, the amount of fees deferred plus interest over a period not to exceed ten years, beginning with the individual's termination of service. A liability is accrued for the obligation under this plan. The expense incurred for the deferred compensation plan was $3,000 and $2,000 for 2023 and 2022 resulting in a deferred compensation liability of $57,000 and $54,000 as of year-end 2023 and 2022.

A deferred compensation plan covers certain officers. Under the plan, the Company pays each participant, or their beneficiary, the amount of fees deferred plus discretionary contributions made by the Company, and interest over a period not to exceed 10 years, beginning with the individual's termination of service. A liability is accrued for the obligation under this plan. The expense incurred for the deferred compensation plan was $370,000 and $305,000 for 2023 and 2022, of which $169,000 and $123,000 represents salary deferrals of the officers. The deferred compensation liability was $1,604,000 and $1,234,000 as of year-end 2023 and 2022.

NOTE 10 - INCOME TAXES

The provision for income taxes consists of:

	2023	2022
Federal		
Current	$ 2,543,000	$ 2,997,000
Deferred	(272,000)	148,000
	2,271,000	3,145,000
State		
Current	-	-
Deferred	(280,000)	22,000
	(280,000)	22,000
Change in valuation allowance related to realization of net state deferred tax assets	280,000	(22,000)
	$ 2,271,000	$ 3,145,000

(Continued)

NOTE 10 - INCOME TAXES (Continued)

The effective tax rate differs from the statutory federal income tax rate as follows:

	2023	2022
Statutory tax rate	21%	21%
Income taxes computed on pretax income using the statutory tax rate	$ 3,197,000	$ 4,119,000
Add (subtract) tax effect of:		
Tax-exempt income	(526,000)	(583,000)
Cash surrender value increase on bank owned life insurance	(96,000)	(78,000)
Non-taxable captive insurance income	(105,000)	(199,000)
Non-deductible expenses, net	12,000	7,000
Low income housing tax credit	(147,000)	(62,000)
Stock option exercises	(28,000)	(49,000)
Other, net	(36,000)	(16,000)
	$ 2,271,000	$ 3,145,000

The components of the net deferred tax asset recorded in the consolidated balance sheets as of December 31, 2023 and 2022 are as follows:

	2023	2022
Total deferred tax assets	$ 8,440,000	$ 9,395,000
Total deferred tax liabilities	(1,351,000)	(1,439,000)
Valuation allowance	(465,000)	(185,000)
Net deferred tax asset	$ 6,346,000	$ 7,771,000

A valuation allowance of $465,000 and $185,000 was provided on the net state deferred tax assets as of December 31, 2023 and 2022. The Company has an Indiana net operating loss carry-forward of approximately $7,779,000 which will begin to expire in 2029, if not used. Other temporary differences between financial statements and tax returns are primarily due to bad debt deductions, net unrealized appreciation and depreciation on securities available for sale, fixed asset depreciation, spillover dividends from REIT, deferred compensation, accrued incentive payments, amortization of intangible assets, prepaid expenses, deferred loan fees, and accrued expenses.

The Company had no unrecognized tax benefits as of December 31, 2023 and 2022. The Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months.

The total amount of interest and penalties recorded in the consolidated statements of income for the years ended December 31, 2023 and 2022 was $0, and the amount accrued for interest and penalties at December 31, 2023 and 2022 was $0.

The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax of the State of Indiana. The Company is no longer subject to examination by taxing authorities for years before 2020.

(Continued)

NOTE 11 - REGULATORY MATTERS

Banks are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Bank on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under Basel III rules, the Company must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is 2.50% for December 31, 2023 and 2022. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes as of December 31, 2023, the Bank met all capital adequacy requirements to which it is subject.

The Bank's prompt corrective action regulations provide five classifications, including well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If the Bank is only adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and plans for capital restoration are required.

At December 31, 2023 and 2022, the Bank's actual capital levels (in millions) and minimum required levels are as follows:

	Actual		Minimum Required For Capital Adequacy Purposes		Minimum Required To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2023						
Total capital (to risk weighted assets)						
Bank	$121.2	17.0%	$57.2	8.0%	$ 71.5	10.0%
Tier 1 capital (to risk weighted assets)						
Bank	114.1	16.0	42.9	6.0	57.2	8.0
Common Equity Tier1 (CET 1)						
Bank	114.1	16.0	32.2	4.5	46.5	6.5
Tier 1 capital (to average assets)						
Bank	114.1	9.5	47.8	4.0	59.8	5.0
2022						
Total capital (to risk weighted assets)						
Bank	$112.8	16.3%	$55.4	8.0%	$ 69.3	10.0%
Tier 1 capital (to risk weighted assets)						
Bank	106.1	15.3	41.6	6.0	55.4	8.0
Common Equity Tier1 (CET 1)						
Bank	106.1	15.3	31.2	4.5	45.0	6.5
Tier 1 capital (to average assets)						
Bank	106.1	8.9	47.7	4.0	59.6	5.0

(Continued)

NOTE 11 - REGULATORY MATTERS (Continued)

The most recent regulatory notifications categorized the Bank as well capitalized at year end 2023 and 2022. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Company's ability to pay dividends is largely dependent upon the Bank's ability to pay dividends to the Company. Under Indiana law, the Bank may pay dividends of so much of its undivided profits (generally, earnings less losses, bad debts, taxes and other operating expenses) as is considered expedient by the Bank's Board of Directors. However, the Bank must obtain the approval of the Indiana Department of Financial Institutions for the payment of a dividend if the total of all dividends declared by the Bank during the current year, including the proposed dividend, would exceed the sum of retained net income for the current year to date plus its retained net income for the previous two years, or if the dividend payment would reduce the Bank's capital below the minimum required for capital adequacy purposes. For this purpose, "retained net income" means net income as calculated for call report purposes, less dividends declared for the applicable period. Moreover, the FDIC and the Federal Reserve Board may prohibit the payment of dividends if it determines that the payment of dividends would constitute an unsafe or unsound practice in the light of the financial condition of the Bank. The aggregate amount of dividends which may be declared by the Bank in 2024, without prior regulatory approval, approximates $19,142,000 plus current 2024 net profits.

NOTE 12 - DERIVATIVES

The Company purchased an interest rate cap as part of its asset liability management strategy to help manage its interest rate risk position for $910,000 in 2022. The interest rate cap is designated as a stand-alone derivative. The notional amount of the interest rate cap as of December 31, 2023 and 2022 was $100,000,000. The cap rate is based on the Fed Funds rate cap of 5.00% and terminates on May 16, 2025. The fair value was $183,000 and $600,000 as of December 31, 2023 and 2022 and is recorded in other assets on the consolidated balance sheets. The Company recorded a loss of $256,000 and $310,000 for 2023 and 2022 due to changes in the fair value of the interest rate cap. The loss is recorded in interest rate cap gains (losses) on the consolidated statements of income.

NOTE 13 - RELATED PARTY TRANSACTIONS

Certain officers, directors and companies with which they are affiliated have borrowed funds from the Bank. These loans totaled approximately $7,025,000 and $7,743,000 at December 31, 2023 and 2022, respectively. Related party deposits totaled $6,208,000 and $7,385,000 at year end 2023 and 2022.

(Continued)

NOTE 14 – STOCK-BASED COMPENSATION

On April 19, 2010, the Company's shareholders approved a Stock Option Plan to advance the interests of the Company and its shareholders by affording to directors, officers, and other employees of the Company an opportunity to acquire or increase their proprietary interest in the Company using stock options. Options were to be granted with an exercise period of ten years or less, at exercise prices of not less than the fair market value of the stock on the date the options are granted and a vesting period as determined by the Board of Directors. This plan's termination date was January 1, 2020. Accordingly, the Company's shareholders approved a new equity incentive plan on April 20, 2020 that will terminate on January 1, 2030. The 2020 Equity Incentive Plan authorizes the issuance of up to 200,000 shares of Company stock pursuant to multiple types of awards and grants. The types of awards available under the 2020 Equity Incentive Plan are: stock options, restricted stock, restricted stock units, and performance share awards. As of December 31, 2023, 170,920 shares remained available for future grants.

Stock Options

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected volatilities are based on historical volatilities of the Company's common stock. The Company uses historical data to estimate option exercise and post-vesting termination behavior. The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the options is based on the U.S. Treasury yield curve in effect at the time of the grant.

There were no options granted during 2023 or 2022.

A summary of the activity in the stock option plan for 2023 follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at beginning of year	145,200	$ 26.61		
Granted	-	-		
Exercised	(15,800)	(17.36)		
Forfeited or expired	(3,000)	(31.65)		
Outstanding at end of year	126,400	$ 27.65	4.8	$ 243,000
Vested or expected to vest	84,276	$ 25.53	4.3	$ 265,000
Exercisable at end of year	41,476	$ 22.72	3.6	$ 205,000

Information related to the stock option plan during each year follows:

	2023	2022
Intrinsic value of options exercised	$ 167,000	$ 281,000
Cash received from option exercises	-	134,000
Tax benefit realized from option exercises	28,000	49,000
Weighted average fair value of options granted	-	-

NOTE 14 - STOCK-BASED COMPENSATION (Continued)

Compensation cost related to stock options was $86,000 and $112,000 for 2023 and 2022. As of December 31, 2023, there was approximately $40,000 of total unrecognized compensation cost related to nonvested stock options granted under the Plan. The cost is expected to be recognized over a weighted-average period of approximately 1 year.

The Stock Option Plan permits optionholders to exercise options using a cashless method, whereby the Company withholds shares having an aggregate fair market value equal to the amount of the option price for the number of shares of stock with respect to which the option is being exercised. The Company withheld 10,033 and 7,984 shares for options exercised using the cashless method during 2023 and 2022.

Restricted Stock Awards

Compensation expense related to restricted stock awards is recognized over the vesting period of the awards based on the fair value of the stock at issue date. The fair value of the stock was determined using the closing stock price on the date of the grant. The grantee is the record owner of the shares and has the right to vote the shares and to receive all dividends or other distributions paid on the shares until forfeited or otherwise sold or disposed of. Shares may not be traded before vesting.

A summary of changes in the Company's nonvested shares for the year follows:

	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at beginning of year	16,730	$ 26.13
Granted	9,960	27.76
Vested	(4,780)	26.01
Forfeited	-	0.00
Nonvested at end of year	21,910	$ 26.90

Compensation cost related to restricted stock awards was $213,000 and $101,000 for 2023 and 2022. As of December 31, 2023, there was $419,000 of total unrecognized compensation cost related to nonvested shares granted under the Plan. The cost is expected to be recognized over a weighted-average period of 2 years. The total fair value of shares vested during the years ended December 31, 2023 and 2022 was $146,000 and $71,000.

NOTE 15 - COMMITMENTS AND CONTINGENCIES AND FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet financing needs of its customers. These financial instruments include commitments to make loans, unused lines of credit and standby letters of credit. The Company's exposure to credit loss in the event of nonperformance by the other party to financial instruments for commitments to make loans, unused lines of credit and standby letters of credit is represented by the contractual amount of those instruments. The Company follows the same policy to make such commitments as it uses for on-balance-sheet items.

NOTE 15 - COMMITMENTS AND CONTINGENCIES AND FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK (Continued)

The Company has the following commitments outstanding at December 31:

	2023	2022
Commitments to make loans	$ 12,391,000	$ 18,954,000
Unused lines of credit	162,042,000	150,298,000
Standby letters of credit	160,000	413,000
	$ 174,593,000	$ 169,665,000

There are various contingent liabilities that are not reflected in the consolidated financial statements, including claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material effect on the Company's consolidated financial condition or results of operations.

NOTE 16 - FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

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

The Company used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Investment Securities: The fair values for short term investments are determined by quoted market prices (Level 1). The fair values of most securities available for sale are determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

Interest Rate Cap: The fair value of the interest rate cap is based on valuation models using observable market data as of the measurement date (Level 2). Our derivatives are traded in an over-the-counter market where quoted market prices are not always available. Therefore, the fair values of derivatives are determined using quantitative models that utilize multiple market inputs including interest rates that are actively quoted and can be validated through external sources.

(Continued)

NOTE 16 - FAIR VALUE (Continued)

Collateral Dependent Loans: The fair value of collateral dependent loans with specific allocations of the allowance for credit losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available for similar loans and collateral underlying such loans. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Collateral dependent loans are evaluated on a quarterly basis for impairment and adjusted in accordance with the allowance for credit loss policy. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the borrower and borrower's business, resulting in Level 3 fair value classification.

Assets measured at fair value on a recurring basis, including financial assets for which the Company has elected the fair value option, are summarized below:

	Fair Value Measurements at December 31, 2023 Using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:			
Short term investments	$ 6,486,000	$ -	$ -
Securities available for sale			
U.S Treasury and federal agency	$42,526,000	$ -	$ -
Obligations of states and political subdivisions	-	43,272,000	-
SBA pools	-	10,360,000	-
Mortgage-backed – residential	-	18,539,000	-
Mortgage-backed – commercial	-	45,265,000	-
Bank holding company subordinated notes	-	8,324,000	-
Total securities available for sale	$42,526,000	$ 125,760,000	$ -
Interest rate cap	$ -	$ 183,000	$ -

(Continued)

NOTE 16 - FAIR VALUE (Continued)

	Fair Value Measurements at December 31, 2022 Using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:			
Short term investments	$ 6,636,000	$ -	$ -
Securities available for sale			
U.S Treasury and federal agency	$78,194,000	$ -	$ -
Obligations of states and political subdivisions	-	66,568,000	-
SBA pools	-	6,394,000	-
Mortgage-backed – residential	-	20,304,000	-
Mortgage-backed – commercial	-	49,241,000	-
Bank holding company subordinated notes	-	8,826,000	-
Total securities available for sale	$78,194,000	$ 151,333,000	$ -
Interest rate cap	$ -	$ 600,000	$ -

Assets measured at fair value on a non-recurring basis are summarized below:

	Fair Value Measurements at December 31, 2023 Using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Collateral dependent loans with specific loss allocations, based on collateral value:			
Closed end 1-4 family residential real estate	$ -	$ -	$ 60,000

(Continued)

NOTE 16 - FAIR VALUE (Continued)

	Fair Value Measurements at December 31, 2022 Using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans with specific loss allocations, based on collateral value:			
Closed end 1-4 family residential real estate	$ -	$ -	$ 529,000

The following table presents quantitative information about level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2023 and 2022:

December 31, 2023	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Collateral dependent loans				
Closed end 1-4 family residential real estate	$ 60,000	Sales comparison approach	Adjustment for differences between the comparable sales	20%

December 31, 2022	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Impaired loans				
Closed end 1-4 family residential real estate	$ 529,000	Sales comparison approach	Adjustment for differences between the comparable sales	20%

(Continued)

NOTE 16 - FAIR VALUE (Continued)

Fair Value of Financial Instruments

The following table contains the estimated fair values and the related carrying values of the Company's financial instruments, not previously presented.

The carrying amounts and estimated fair values of financial instruments not carried at fair value, at December 31, 2023 and 2022 are as follows:

		Fair Value Measurements at December 31, 2023 Using:		
	Carrying Amount	Level 1	Level 2	Level 3
Financial assets				
Cash and cash equivalents	$ 93,765,000	$ 93,765,000	$ -	$ -
Interest earning deposits with banks	590,000	-	590,000	-
Securities held to maturity	57,441,000	-	51,967,000	-
Loans, net	787,793,000	-	-	746,660,000
Financial liabilities				
Time deposits	(175,111,000)	-	(173,007,000)	-
Advances from FHLB	-	-	-	-

		Fair Value Measurements at December 31, 2022 Using:		
	Carrying Amount	Level 1	Level 2	Level 3
Financial assets				
Cash and cash equivalents	$ 86,408,000	$ 86,408,000	$ -	$ -
Interest earning deposits with banks	3,295,000	-	3,295,000	-
Securities held to maturity	58,328,000	-	50,990,000	-
Loans, net	740,452,000	-	-	705,176,000
Financial liabilities				
Time deposits	(114,173,000)	-	(111,574,000)	-
Advances from FHLB	(10,000,000)	-	(9,564,000)	-

(Continued)

NOTE 17 – REVENUE FROM CONTRACTS WITH CUSTOMERS

All of the Company's revenue from contracts with customers within the scope of ASC 606 is recognized within Non-interest Income. The following table presents the Company's sources of non-interest income for the year ended December 31, 2023 and 2022. Items outside the scope of ASC 606 are noted as such.

	2023	2022
Non-interest income		
Service charges on deposits	$ 2,023,000	$ 1,973,000
Net gains on mortgage banking activities[(a)]	199,000	390,000
Security gains (losses)[(a)]	(2,947,000)	(26,000)
Interest rate cap gains (losses) [(a)]	(256,000)	(310,000)
Credit and debit card income	3,424,000	3,447,000
Other income[(b)]	1,211,000	1,139,000
Total non-interest income	$ 3,654,000	$ 6,613,000

(a) Not within the scope of ASC 606
(b) The Other Income category includes other fee income, net gains on sale of other real estate owned, and credit card interchange fees totaling $532,000 and $530,000 for the year ended December 31, 2023 and 2022, which is within the scope of ASC 606; the remaining balance is outside the scope of ASC 606.

A description of the Company's revenue streams accounted for under ASC 606 follows:

Service charges on deposits: The Company earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include fees for services such as ATM use fees, stop payment charges, statement rendering, ACH fees, and wire transfers are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance.

Debit card income and Credit Card Interchange Income: The Company earns interchange fees from credit and debit cardholder transactions conducted through payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

Other income: The Company earns fees for transaction-based services, such as check cashing, purchasing checks and money order, and exchanging foreign currency. Fees are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request. The Company does not finance sales of other real estate owned so gains and losses are recognized when the sale is completed.