

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

**FORM 10-K**

**(Mark One)**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the Fiscal Year Ended December 31, 2020**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number: 001-33033**

**LIMESTONE BANCORP, INC.**  
**(Exact name of registrant as specified in its charter)**

**Kentucky**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**61-1142247**  
**(I.R.S. Employer**  
**Identification No.)**

**2500 Eastpoint Parkway, Louisville, Kentucky**  
**(Address of principal executive offices)**

**40223**  
**(Zip Code)**

**(502) 499-4800**  
**(Registrant's telephone number, including area code)**

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common shares	LMST	The Nasdaq Stock Market

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

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer (as defined in Rule 405 of the Securities Act). Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

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

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

Large accelerated filer

Non-accelerated filer

Accelerated filer

Smaller reporting company

Emerging growth company

[Table of Contents](#)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards pursuant to Section 13(a) of the Exchange Act. Yes  No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. Yes  No

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold as of the close of business on June 30, 2020, was \$68,641,698 based upon the last sales price reported (for purposes of this calculation, the market value of non-voting common shares was based on the market value of the common shares into which they are convertible upon transfer).

6,594,499 Common Shares and 1,000,000 Non-Voting Common Shares were outstanding as of February 26, 2021.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the Annual Meeting of Shareholders to be held May 19, 2021 are incorporated by reference into Part III of this Form 10-K.

---

**TABLE OF CONTENTS**

	<b><u>Page No.</u></b>
<b><u>PART I</u></b>	1
Item 1. <a href="#">Business</a>	2
Item 1A. <a href="#">Risk Factors</a>	9
Item 1B. <a href="#">Unresolved Staff Comments</a>	18
Item 2. <a href="#">Properties</a>	18
Item 3. <a href="#">Legal Proceedings</a>	18
Item 4. <a href="#">Mine Safety Disclosures</a>	19
<b><u>PART II</u></b>	20
Item 5. <a href="#">Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</a>	20
Item 6. <a href="#">Selected Financial Data</a>	22
Item 7. <a href="#">Management’s Discussion and Analysis of Financial Condition and Results of Operation</a>	23
Item 7A. <a href="#">Quantitative and Qualitative Disclosures About Market Risk</a>	47
Item 8. <a href="#">Financial Statements and Supplementary Data</a>	49
Item 9. <a href="#">Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</a>	88
Item 9A. <a href="#">Controls and Procedures</a>	88
Item 9B. <a href="#">Other Information</a>	89
<b><u>PART III</u></b>	90
Item 10. <a href="#">Directors, Executive Officers and Corporate Governance</a>	90
Item 11. <a href="#">Executive Compensation</a>	90
Item 12. <a href="#">Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</a>	90
Item 13. <a href="#">Certain Relationships and Related Transactions, and Director Independence</a>	90
Item 14. <a href="#">Principal Accounting Fees and Services</a>	90
<b><u>PART IV</u></b>	91
Item 15. <a href="#">Exhibits, Financial Statement Schedules</a>	91
Item 16. <a href="#">Form 10-K Summary</a>	91
<a href="#">Index to Exhibits</a>	92
<a href="#">Signatures</a>	94

**PART I**

As used in this report, references to “the Company,” “we,” “our,” “us,” and similar terms refer to the consolidated entity consisting of Limestone Bancorp, Inc. and its wholly-owned subsidiary, Limestone Bank, Inc., which is referred to in this report as “the Bank.”

**Preliminary Note Concerning Forward-Looking Statements**

This report contains statements about the future expectations, activities and events that constitute forward-looking statements. Forward-looking statements express the Company’s beliefs, assumptions and expectations of its future financial and operating performance and growth plans, taking into account information currently available to us. These statements are not statements of historical fact. The words “believe,” “may,” “should,” “anticipate,” “estimate,” “expect,” “intend,” “objective,” “seek,” “plan,” “strive” or similar words, or the negatives of these words, identify forward-looking statements.

Forward-looking statements involve risks and uncertainties that may cause the Company’s actual results to differ materially from the expectations of future results management expressed or implied in any forward-looking statements. These risks and uncertainties can be difficult to predict and may be beyond the Company’s control. Factors that could contribute to differences in the Company’s results include, but are not limited to:

- the impact and duration of the novel coronavirus disease 2019 (“COVID-19”) pandemic and national, state and local emergency conditions the pandemic has produced;
- deterioration in the financial condition of borrowers resulting in significant increases in loan losses and provisions for those losses;

- changes in the interest rate environment, which may reduce the Company’s margins or impact the value of securities, loans, deposits and other financial instruments;
- changes in loan underwriting, credit review or loss reserve policies associated with economic conditions, examination conclusions, or regulatory developments;
- general economic or business conditions, either nationally, regionally or locally in the communities the Bank serves, may be worse than expected, resulting in, among other things, a deterioration in credit quality or a reduced demand for credit;
- the results of regulatory examinations;
- any matter that would cause the Bank to conclude that there was impairment of any asset, including intangible assets;
- the continued service of key management personnel, the Company’s ability to attract, motivate and retain qualified employees;
- factors that increase the competitive pressure among depository and other financial institutions, including product and pricing pressures; the ability of the Company’s competitors with greater financial resources to develop and introduce products and services that enable them to compete more successfully
- inability to comply with regulatory capital requirements and to secure any required regulatory approvals for capital actions;
- legislative or regulatory developments, including changes in laws concerning taxes, banking, securities, insurance and other aspects of the financial services industry;
- future acquisitions, integrations and performance of acquired businesses; and
- fiscal and governmental policies of the United States federal government.

Other risks are detailed in Item 1A. “Risk Factors” of this Form 10-K all of which are difficult to predict and many of which are beyond the Company’s control.

Forward-looking statements are not guarantees of performance or results. A forward-looking statement may include the assumptions or bases underlying the forward-looking statement. Management has made assumptions and bases in good faith and believe they are reasonable. However, estimates based on such assumptions or bases frequently differ from actual results, and the differences can be material. The forward-looking statements included in this report speak only as of the date of the report. Management does not intend to update these statements unless required by applicable laws.

---

[Table of Contents](#)

**Item 1. Business**

Organized in 1988, Limestone Bancorp, Inc. (the Company) is a bank holding company headquartered in Louisville, Kentucky. The Company’s common stock is traded on Nasdaq’s Capital Market under the symbol LMST. The Company operates Limestone Bank, Inc. (the Bank), the eleventh largest bank domiciled in the Commonwealth of Kentucky based on total assets. The Bank operates banking offices in 14 counties in Kentucky. The Bank’s markets include metropolitan Louisville in Jefferson County and the surrounding counties of Bullitt and Henry. The Bank serves south central, southern, and western Kentucky from banking centers in Barren, Butler, Daviess, Edmonson, Green, Hardin, Hart, Ohio, and Warren counties. The Bank also has banking centers in Lexington, Kentucky, the second largest city in the state, and Frankfort, Kentucky, the state capital. The Bank is a traditional community bank with a wide range of personal and business banking products and services. As of December 31, 2020, the Company had total assets of \$1.31 billion, total loans of \$962.1 million, total deposits of \$1.12 billion and stockholders’ equity of \$116.0 million.

**Website Access to Reports**

The Company files reports with the SEC including the Annual Report on Form 10-K, quarterly reports on Form 10-Q, current event reports on Form 8-K, and proxy statements, as well as any amendments to those reports. The SEC maintains an internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at <http://www.sec.gov>. The Company’s Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to section 13(a) or 15(d) of the Exchange Act are also accessible at no cost on the Company’s web site at <http://www.limestonebank.com> after they are electronically filed with the SEC.

**Markets**

The Bank operates in markets that include the four largest cities in Kentucky – Louisville, Lexington, Bowling Green and Owensboro – and in other communities along the I-65, Western Kentucky Parkway, and Natcher Parkway corridors.

- **Louisville/Jefferson, Bullitt and Henry Counties:** The Company’s headquarters are in Louisville, the largest city in Kentucky. The Bank also has banking offices in Bullitt County, south of Louisville, and Henry County, east of Louisville. The Company’s banking offices in these counties also serve the contiguous counties of Spencer, Shelby and Oldham to the east and northeast of Louisville. The area’s major employers are diversified across many industries and include the Worldport air hub for United Parcel Service (“UPS”), two Ford assembly plants, Humana, Norton Healthcare, the University of Louisville, Brown-Forman, Churchill Downs, YUM! Brands, and Texas Roadhouse.
- **Lexington/Fayette County:** Lexington, located in Fayette County, is the second largest city in Kentucky. Lexington is the financial, educational,

retail, healthcare and cultural hub for Central and Eastern Kentucky. It is known worldwide for its horse farms and Keeneland Race Track, and proudly boasts of itself as “The Horse Capital of the World”. It is also the home of the University of Kentucky and Transylvania University. The area’s major employers include Toyota, Xerox, Lexmark, and Valvoline.

- **Frankfort/Franklin County:** Frankfort, located along Interstate 64 in Franklin County, is the capital of the Commonwealth of Kentucky and the seat of Franklin County. Frankfort is home to Kentucky’s General Assembly or Legislature which consists of the Kentucky Senate and the Kentucky House of Representatives. Frankfort is also the home of the Kentucky State University and major employers including Montaplast of North America, Inc., Buffalo Trace Distillery, Topy Corporation, Beam, Inc., and Nashville Wire Products.
- **Southern Kentucky:** This market includes Bowling Green, the third largest city in Kentucky, located about 120 miles south of Louisville and 60 miles north of Nashville, Tennessee. Bowling Green, located in Warren County, is the home of Western Kentucky University and is the economic hub of the area. This market also includes communities in the contiguous Barren County, including the city of Glasgow. Major employers in Barren and Warren Counties include General Motor’s Corvette plant, automotive supply chain manufacturers, and R.R. Donnelley’s regional printing facility.
- **Owensboro/Daviess County:** Owensboro, located on the banks of the Ohio River, is Kentucky’s fourth largest city. The city is called a festival city, with over 20 annual community celebrations that attract visitors from around the world, including its world famous Bar-B-Q Festival which attracts over 80,000 visitors. It is an industrial, medical, retail and cultural hub for Western Kentucky. The area employers include Owensboro Medical System, US Bank Home Mortgage, Titan Contracting, Specialty Food Group, and Toyotetsu.

---

[Table of Contents](#)

- **South Central Kentucky:** South of the Louisville metropolitan area, the Bank has banking offices in Butler, Edmonson, Green, Hardin, Hart, and Ohio Counties. This region includes stable community markets comprised primarily of agricultural and service-based businesses. Each of the Company’s banking offices in these markets has a stable customer and core deposit base.

### Products and Services

The Bank meets its customers’ banking needs with a broad range of financial products and services. Its lending services include real estate, commercial, mortgage, agriculture and equine, and consumer loans to those in its communities and to small to medium-sized businesses, the owners and employees of those businesses, as well as other executives and professionals. Lending operations are complemented with an array of retail and commercial deposit products. In addition, the Bank offers customers drive-through banking facilities, curbside banking services, automatic teller machines, night depository, personalized checks, credit cards, debit cards, internet banking, mobile banking, curbside banking, treasury management services, remote deposit services, electronic funds transfers through ACH services, domestic and foreign wire transfers, cash management and vault services, and loan and deposit sweep accounts.

### Human Capital Resources

At December 31, 2020, the Company had 219 full-time equivalent employees and a total of 226 employees (“team members”). The Bank’s team members are instrumental in building, maintaining, and servicing the customer relationships that make the community banking model a success. The Bank strives to attract and retain a well-qualified, enthusiastic workforce by offering competitive compensation packages, comprehensive benefits, training, and opportunities for professional development and advancement. Team members are held accountable to the Bank’s core values, which are:

- Commitment to honesty and integrity;
- Commitment to have a positive and constructive attitude;
- Commitment to be a team player;
- Commitment to conduct oneself in a professional manner; and
- Commitment to celebrate successes.

The Company’s team members are not subject to a collective bargaining agreement, and management considers the Company’s relationship with its team members to be good. The Bank was recognized as one of the “Best Places to Work in Kentucky” in 2014, 2015, 2016, 2017, 2018, and 2020.

### Acquisitions

On November 15, 2019, the Bank completed the acquisition of four branch banking centers located in the Kentucky cities of Elizabethtown, Frankfort, and Owensboro. The purchase included approximately \$126.8 million in performing loans and \$1.5 million in premises and equipment, as well as approximately \$131.8 million in customer deposits. This acquisition has allowed the Bank to further optimize its branch footprint regionally and to better serve customers in Daviess, Hardin, and Franklin counties.

### Competition

The banking business is highly competitive, and the Bank experiences competition from a number of other financial institutions and non-bank financial competitors, many of whom may not be subject to the same extensive regulatory regime as the Bank. Competition is based upon relationships, the quality and scope of services levels, interest rates offered on deposit accounts, interest rates charged on loans, other credit and service charges relating to loans, the convenience of banking facilities, the availability of technology channels, and, in the case of loans to commercial borrowers, relative lending limits. The Bank

competes with commercial banks, credit unions, savings and loan associations, mortgage banking firms, consumer finance companies, farm credit organizations, securities brokerage firms, insurance companies, money market funds and other mutual funds, as well as super-regional, national, and international financial institutions that operate offices within the Company's market area and beyond.

## Supervision and Regulation

**Bank and Holding Company Laws, Rules and Regulations.** The Company and the Bank are subject to an extensive system of the laws, rules, and regulations that are intended primarily for the protection of customers, the Deposit Insurance Fund (DIF), and the banking system in general and not for the protection of shareholders and creditors. These laws and regulations govern areas such as capital, permissible activities, allowance for loan and lease losses, loans and investments, interest rates that can be charged on loans, and consumer protection communications and disclosures. Certain elements of selected laws, rules, and regulations are described in the sections that follow. These descriptions are not intended to be complete and are qualified in their entirety by reference to the full text of the laws, rules, and regulations.

---

### [Table of Contents](#)

**Limestone Bancorp.** The Company is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended, and is subject to supervision and regulation by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"). As such, the Company must file with the Federal Reserve Board annual and quarterly reports and other information regarding the Company's business operations and the business operations of the Company's subsidiaries. The Company is also subject to examination by the Federal Reserve Board and to operational guidelines established by the Federal Reserve Board. The Company is subject to the Bank Holding Company Act and other federal laws on the types of activities in which it may engage, and to other supervisory requirements, including regulatory enforcement actions for violations of laws and regulations.

*Acquisitions.* As a bank holding company, the Company must obtain Federal Reserve Board approval before acquiring, directly or indirectly, ownership or control of more than 5% of any class of voting stock or all or substantially all of the assets of a bank, before merging or consolidating with any other bank holding company, and before engaging, or acquiring a company that is not a bank and is engaged in certain non-banking activities. For any acquisition transaction structured as a merger of the Bank, the approval of the Federal Deposit Insurance Corporation ("FDIC") and the Kentucky Department of Financial Institutions ("KDFI") would be required.

The Bank Holding Company Act and the Change in Bank Control Act prohibit a person or group of persons from acquiring "control" of a bank holding company without notifying the Federal Reserve Board in advance and obtaining the Federal Reserve Board's approval of, or non-objection to, the proposed transaction. The Federal Reserve Board has established a rebuttable presumptive standard that the acquisition of 10% or more of any class of voting securities of a bank holding company that has registered securities under Section 12 of the Securities Exchange Act of 1934 (such as the Company) constitutes an acquisition of control of the bank holding company for purposes of the Change in Bank Control Act. An acquisition of 25% of any class of voting securities of a bank holding company will conclusively be deemed to be an acquisition of control under the Change in Bank Control Act.

*Permissible Activities.* The Company is generally permitted under the Bank Holding Company Act to own up to 5% of the voting shares of a company and, subject to the receipt of any required approval by the Federal Reserve Board, to engage in or acquire direct or indirect control of more than 5% of the voting shares of any bank, bank holding company or company engaged in any activity that the Federal Reserve Board determines to be so closely related to banking as to be a proper incident to the business of banking.

Under current federal law, a bank holding company may elect to become a financial holding company, which enables the holding company to conduct activities that are "financial in nature," incidental to financial activity, or complementary to financial activity that do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally. Activities that are "financial in nature" include securities underwriting, dealing and market making in securities; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities; and activities that the Federal Reserve Board has determined to be closely related to banking. No prior regulatory approval or notice is required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board. The Company has not filed an election to become a financial holding company.

*Source of Financial Strength.* Under Federal Reserve policy, a bank holding company is expected to act as a source of financial strength to, and to commit resources to support, its bank subsidiaries. This support may be required at times when, absent such a policy, the bank holding company may not be inclined to provide it. In addition, any capital loans by the bank holding company to its bank subsidiaries are subordinate in right of payment to depositors and to certain other indebtedness of the bank subsidiary. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of subsidiary banks will be assumed by the bankruptcy trustee and entitled to a priority of payment. The Federal Reserve's "Source of Financial Strength" policy was codified in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act").

*Dividends.* Under Federal Reserve Board policy, bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. The policy provides that bank holding companies should not declare a level of cash dividends that undermines the bank holding company's ability to serve as a source of strength to its banking subsidiaries.

---

### [Table of Contents](#)

The Company is a legal entity separate and distinct from the Bank. Historically, the majority of the Company's revenue has been from dividends paid to it by the Bank. The Bank is subject to laws and regulations that limit the amount of dividends it can pay. If, in the opinion of a federal regulatory agency, an institution under its jurisdiction is engaged in or is about to engage in an unsafe or unsound practice, the agency may require, after notice and hearing, that the institution cease such practice. The federal banking agencies have indicated that paying dividends that deplete an institution's capital base to an inadequate level would be an

unsafe and unsound banking practice. The Bank is prohibited from paying any dividend if payment would cause it to become undercapitalized or if it already is undercapitalized, and it must maintain a sufficient capital conservation buffer under the capital adequacy guidelines in order to avoid limitations on dividends. Moreover, the Federal Reserve and the FDIC have issued policy statements providing that bank holding companies and banks should generally pay dividends only out of current operating earnings. A bank holding company may still declare and pay a dividend if it does not have current operating earnings if the bank holding company expects profits for the entire year and the bank holding company obtains the prior consent of the Federal Reserve.

Under Kentucky law, dividends by Kentucky banks may be paid only from current or retained net profits. The KDFI must approve the declaration of dividends if the total dividends to be declared by a bank for any calendar year would exceed the bank's total net profits for such year combined with its retained net profits for the preceding two years, less any required transfers to surplus or a fund for the retirement of preferred stock or debt. Additionally, retained earnings must be positive. The Company is also subject to the Kentucky Business Corporation Act, which generally prohibits dividends to the extent they result in the insolvency of the corporation from a balance sheet perspective or if the corporation is unable to pay its debts as they come due. The Bank did not pay any dividends in 2020 or 2019. The Bank has negative retained earnings of \$9.0 million at December 31, 2020 and, as such, cannot pay dividends without prior regulatory approval until retained earnings are restored through profits.

**Limestone Bank.** The Bank, a Kentucky chartered commercial bank, is subject to regular bank examinations and other supervision and regulation by both the FDIC and the KDFI. Kentucky's banking statutes contain a "super-parity" provision that permits a well-rated Kentucky banking corporation to engage in any banking activity which could be engaged in by a national bank operating in Kentucky; a state bank, a thrift or savings bank operating in any other state; or a federal chartered thrift or federal savings association meeting the qualified thrift lender test and operating in any state could engage, provided the Kentucky bank first obtains a legal opinion specifying the statutory or regulatory provisions that permit the activity.

*Capital Adequacy Requirements.* The Company and the Bank are required to comply with capital adequacy guidelines. Guidelines are established by the Federal Reserve Board for the Company and the FDIC for the Bank. Both the Federal Reserve Board and the FDIC have substantially similar risk based and leverage ratio guidelines for banking organizations, which are intended to ensure that banking organizations have adequate capital related to the risk levels of assets and off-balance sheet instruments. The capital adequacy guidelines are minimum supervisory ratios generally applicable to banking organizations that meet certain specified criteria, assuming they have the highest regulatory rating. Banking organizations not meeting these criteria are expected to operate with capital positions well above the minimum ratios. The federal bank regulatory agencies may set capital requirements for a particular banking organization that are higher than the minimum ratios when circumstances warrant. Federal Reserve Board guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets.

The minimum capital level requirements applicable to the Company and the Bank are a common equity Tier 1 capital ratio of 4.5%, a Tier 1 risk-based capital ratio of 6%, a total risk-based capital ratio of 8%, and a Tier 1 leverage ratio of 4% for all institutions. The rules also require a "capital conservation buffer" of 2.5% above the regulatory minimum risk-based capital ratios. Including this buffer, the required ratios are: a common equity Tier 1 risk-based capital ratio of 7.0%, a Tier 1 risk-based capital ratio of 8.5%, and a total risk-based capital ratio of 10.5%.

An institution is subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if capital levels fall below minimum levels plus the buffer amounts. These limitations establish a maximum percentage of eligible capital that can be utilized for such actions.

Under the capital rules, Tier 1 capital generally consists of common stock (plus related surplus) and retained earnings, limited amounts of minority interest in the form of additional Tier 1 capital instruments, and non-cumulative preferred stock and related surplus, subject to certain eligibility standards, less goodwill and other specified intangible assets and other regulatory deductions. Tier 2 capital may consist of subordinated debt, certain hybrid capital instruments, qualifying preferred stock, and a limited amount of the allowance for loan losses. Proceeds of trust preferred securities are excluded from Tier 1 capital unless issued before 2010 by an institution with less than \$15 billion of assets. Total capital is the sum of Tier 1 and Tier 2 capital.

---

[Table of Contents](#)

*Prompt Corrective Action.* Pursuant to the Federal Deposit Insurance Act ("FDIA"), the FDIC must take prompt corrective action to resolve the problems of undercapitalized institutions. FDIC regulations define the levels at which an insured institution would be considered "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized". A bank is "undercapitalized" if it fails to meet any one of the ratios required to be adequately capitalized. A depository institution may be deemed to be in a capitalization category that is lower than is indicated by its actual capital position if it receives an unsatisfactory examination rating. The degree of regulatory scrutiny increases and the permissible activities of a bank decrease as the bank moves downward through the capital categories. Depending on a bank's level of capital, an institution may be required to submit a capital restoration plan, and its holding company must guarantee compliance with the capital restoration plan up to 5% of the institution's assets at the time it became undercapitalized.

*Deposit Insurance Assessments.* The deposits of the Bank are insured by the Deposit Insurance Fund ("DIF") of the FDIC up to the limits set forth under applicable law and are subject to the deposit insurance premium assessments of the DIF. The FDIC imposes a risk-based deposit premium assessment system, which calculates a bank's premium assessment by multiplying its risk-based assessment rate by its assessment base. As required by the Dodd-Frank Act, a bank's assessment base is determined by its consolidated total assets less average tangible equity rather than deposits.

*Safety and Soundness Standards.* The FDIA requires the federal bank regulatory agencies to prescribe standards, by regulations or guidelines, relating to internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings, stock valuation and compensation, fees and benefits, and such other operational and managerial standards as the agencies deem appropriate. Guidelines adopted by the federal bank regulatory agencies establish general standards relating to these matters. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risk and exposures specified in the guidelines. In addition, the agencies adopted regulations that authorize, but do not require, an agency to order an institution that has been given notice by an agency that it is not satisfying any of such safety and soundness standards to submit a compliance plan. If, after being so notified, an institution fails to submit an acceptable compliance plan or fails in any material respect to implement an acceptable compliance plan, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions of the types to which an undercapitalized institution is subject under the "prompt corrective action" provisions of FDIA. See "Prompt Corrective Actions" above. If an institution fails to

comply with such an order, the agency may seek to enforce such order in judicial proceedings and to impose civil money penalties.

*Incentive Compensation.* The Dodd-Frank Act requires the federal bank regulatory agencies and the SEC to establish joint regulations or guidelines prohibiting incentive-based payment arrangements at specified regulated entities having at least \$1 billion in total assets, such as the Company and the Bank, that encourage inappropriate risks by providing an executive officer, employee, director, or principal shareholder with excessive compensation, fees, or benefits or that could lead to material financial loss to the entity. In addition, these regulators must establish regulations or guidelines requiring enhanced disclosure to regulators of incentive-based compensation arrangements. The agencies proposed such regulations in April 2011, but the regulations have not been finalized. If the regulations are adopted in the form initially proposed, they will impose limitations on the manner in which the Company may structure compensation for its executives.

In June 2010, the Federal Reserve, OCC, and FDIC issued comprehensive final guidance on incentive compensation policies of banking organizations intended to ensure that these policies do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees who have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors. These three principles are incorporated into the proposed joint compensation regulations under the Dodd-Frank Act, discussed above.

The Federal Reserve will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Company, that are not "large, complex banking organizations." These reviews will be tailored to each organization based on the scope and complexity of the organization's activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization's supervisory ratings, which can affect the organization's ability to make acquisitions and take other actions.

Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

---

[Table of Contents](#)

*Branching.* Kentucky law permits Kentucky chartered banks to establish a banking office in any county in Kentucky. A Kentucky bank may also establish a banking office outside of Kentucky. Well capitalized Kentucky banks that have been in operation at least three years and satisfy certain criteria relating to, among other things, their composite and management ratings, may establish a banking office in Kentucky without the approval of the KDFI upon notice to the KDFI and any other state bank with its main office located in the county where the new banking office will be located. Otherwise, branching requires the approval of the KDFI, which must ascertain and determine that the public convenience and advantage will be served and promoted and that there is reasonable probability of the successful operation of the banking office. The transaction must also be approved by the FDIC, which considers a number of factors, including financial history, capital adequacy, earnings prospects, character of management, needs of the community, and consistency with corporate powers.

Section 613 of the Dodd-Frank Act effectively eliminated the interstate branching restrictions set forth in the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. Banks located in any state may now de novo branch in any other state, including Kentucky. Such unlimited branching power may increase competition within the markets in which the Company and the Bank operate.

*Insider Credit Transactions.* The restrictions on loans to directors, executive officers, principal shareholders and their related interests (collectively referred to as "insiders") contained in the Federal Reserve Act and Regulation O apply to all insured depository institutions and their subsidiaries. These restrictions include limits on loans to one borrower and conditions that must be met before such a loan can be made. There is also an aggregate limitation on all loans to insiders and their related interests, which may not exceed the institution's total unimpaired capital and surplus.

*Consumer Protection Laws.* The Bank is subject to federal consumer protection statutes and regulations promulgated under those laws, including, but not limited to, the:

- Truth-In-Lending Act and Regulation Z, governing disclosures of credit terms to consumer borrowers;
- Home Mortgage Disclosure Act and Regulation C, requiring financial institutions to provide certain information about home mortgage and refinanced loans;
- Real Estate Settlement Procedures Act ("RESPA"), requiring lenders to provide borrowers with disclosures regarding the nature and cost of real estate settlements and prohibiting certain abusive practices;
- Secure and Fair Enforcement for Mortgage Licensing Act ("S.A.F.E. Act"), requiring residential loan originators who are employees of financial institutions to meet registration requirements;
- Fair Credit Reporting Act and Regulation V, governing the provision of consumer information to credit reporting agencies and the use of consumer information;
- Equal Credit Opportunity Act and Regulation B, and the Fair Housing Act, prohibiting discrimination on the basis of race, religion, national origin, sex, and a variety of other prohibited factors in the extension of credit;
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies;
- Truth in Savings Act, which requires disclosure of deposit terms to consumers;
- Regulation CC, which relates to the availability of deposit funds to consumers;
- Right to Financial Privacy Act, which imposes a duty to maintain the confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- Electronic Funds Transfer Act and Regulation E, establishing rights, liabilities, and responsibilities of participants in electronic fund transfer systems such as automated teller machine transfers, telephone bill-payment services, point-of-sale (POS) terminal transfers in stores, and preauthorized transfers from or to a consumer's account; and
- Automated Overdraft Payment Regulations, requiring financial institutions to provide customer notices, monitor overdraft payment programs, and



prohibiting financial institutions from charging consumer fees for paying overdrafts on automated teller machine and one time debit card transactions unless a consumer consents, or opts in to the service for those types of transactions.

The Dodd-Frank Act created the Consumer Financial Protection Bureau (“CFPB”), which has broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws. As a bank with less than \$10 billion or more in assets, the Bank is subject to rules promulgated by the CFPB, but continues to be examined and supervised by the FDIC, its federal banking regulator for consumer compliance purposes. The CFPB has authority to prevent unfair, deceptive, or abusive acts or practices in connection with the offering of consumer financial products. The CFPB has established certain minimum standards for the origination of residential mortgages including a determination of the borrower’s ability to repay. The Dodd-Frank Act allows borrowers to raise certain defenses to foreclosure if they receive any loan other than a “qualified mortgage” as defined by the CFPB. The Economic Growth, Regulatory Relief and Consumer Protection Act created a qualified mortgage safe harbor for eligible loans that are originated and retained by a bank with total assets of less than \$10 billion.

The Dodd-Frank Act also permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

7

---

[Table of Contents](#)

*Loans to One Borrower.* Under current limits, loans and extensions of credit outstanding at one time to a single borrower and not fully secured generally may not exceed 20% of an institution’s unimpaired capital and unimpaired surplus. Loans and extensions of credit fully secured by collateral may represent an additional 10% of unimpaired capital and unimpaired surplus.

*Privacy.* Federal law currently contains extensive customer privacy protection provisions. Under these provisions, the Bank must provide to its customers, at the inception of the customer relationship and annually thereafter, its policies and procedures regarding the handling of customers’ nonpublic personal financial information. Except for certain limited exceptions, the Bank may not provide such personal information to unaffiliated third parties unless it discloses to the customer that such information may be so provided and the customer is given the opportunity to opt out of such disclosure. Federal law makes it a criminal offense, except in limited circumstances, to obtain or attempt to obtain customer information of a financial nature by fraudulent or deceptive means.

*Community Reinvestment Act.* The Community Reinvestment Act (“CRA”) requires the FDIC to assess the Company’s record in meeting the credit needs of the communities the Bank serves, including low- and moderate-income neighborhoods and persons. The FDIC’s assessment of the Company’s record is made available to the public. The assessment also is part of the Federal Reserve Board’s and the FDIC’s consideration of applications to acquire, merge or consolidate with another banking institution or its holding company, to establish a new banking office or to relocate an office.

*Bank Secrecy Act.* The Bank Secrecy Act of 1970 (“BSA”) was enacted to deter money laundering, establish regulatory reporting standards for currency transactions, and improve detection and investigation of criminal, tax, and other regulatory violations. BSA and subsequent laws and regulations require steps to be taken to prevent the use of the Bank in the flow of illegal or illicit money, including, without limitation, ensuring effective management oversight, establishing sound policies and procedures, developing effective monitoring and reporting capabilities, ensuring adequate training, and establishing a comprehensive internal audit of BSA compliance activities. Rules issued under the BSA require the Bank to identify the beneficial owners who own or control certain legal entity customers at the time an account is opened and to include in its anti-money laundering program risk-based procedures for conducting ongoing customer due diligence.

*USA Patriot Act.* The USA Patriot Act of 2001 (the “Patriot Act”) contains anti-money laundering measures affecting insured depository institutions, broker-dealers, and certain other financial institutions. The Patriot Act requires financial institutions to implement policies and procedures to combat money laundering and the financing of terrorism. This includes standards for verifying customer identification at account opening, as well as rules to promote cooperation among financial institutions, regulators, and law enforcement entities in identifying parties that may be involved in terrorism or money laundering. It grants the Secretary of the Treasury broad authority to establish regulations and to impose requirements and restrictions on the operations of financial institutions. In addition, the Patriot Act requires the federal bank regulatory agencies to consider the effectiveness of a financial institution’s anti-money laundering activities when reviewing bank mergers and bank holding company acquisitions.

**The Dodd-Frank Act.** The Dodd-Frank Act imposed new restrictions and requirements and an expanded framework of regulatory oversight for financial institutions, including depository institutions and their holding companies. The implementation of the Dodd-Frank Act has resulted in greater compliance costs and higher fees paid to regulators. The Economic Growth, Regulatory Relief and Consumer Protection Act of 2018 provided some regulatory relief to banking organizations, primarily small, community banking organizations, by adjusting thresholds at which certain increased regulatory requirements imposed under the Dodd-Frank Act begin to apply. As a result, traditional community banking organizations with assets of less than \$10 billion, such as the Company, are exempt from the Volker Rule under the Dodd-Frank Act, which places limits and restrictions on trading and hedging activities. In addition, community banking organizations with assets of less than \$10 billion are now subject to reduced reporting requirements and, effective January 1, 2020, an optional simplified capital adequacy measure is available to those that have a leverage ratio greater than 9%. The Bank has not elected to use this optional capital adequacy measure.

**Effect on Economic Environment.** The policies of regulatory authorities, including the monetary policy of the Federal Reserve Board, have a significant effect on the operating results of bank holding companies and bank subsidiaries. Among the means available to the Federal Reserve Board to affect the money supply are open market operations in U.S. government securities, changes in the discount rate on member bank borrowings, and changes in reserve requirements against member bank deposits. These means are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits. Their use may affect interest rates charged on loans or paid for deposits.

Federal Reserve Board monetary policies have materially affected the operating results of commercial banks in the past and are expected to continue to do so in the future. The nature of future monetary policies and the effect of such policies on the Company’s business and earnings and those of the Company’s subsidiaries cannot be predicted.

8

**Legislative and Regulatory Initiatives.** From time to time various laws, regulations, and governmental programs affecting financial institutions and the financial industry are introduced in Congress or otherwise promulgated by regulatory agencies. Such measures may change the environment in which the Company and its subsidiaries operate in substantial and unpredictable ways. The nature and extent of future legislative, regulatory, or other changes affecting financial institutions are unpredictable at this time. Future legislation, policies, and the effects thereof might have a significant influence on overall growth and distribution of loans, investments, and deposits. They also may affect interest rates charged on loans or paid on time and savings deposits. New legislation and policies have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future.

## **Item 1A. Risk Factors**

### **FACTORS THAT MAY AFFECT FUTURE RESULTS**

An investment in the Company's common stock is subject to certain risks, which are particular to the Company, as well as the industry and markets in which the Company operates. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included in this filing. In addition to the risks and uncertainties described below, other risks and uncertainties not currently known to the Company or that the Company currently deems to be immaterial also may materially and adversely affect its business, financial condition, and results of operations in the future. The value or market price of the Company's common stock could decline due to any of these identified or other risks, and an investor could lose all or part of their investment.

There are factors, many beyond the Company's control, which may significantly change the results or expectations of the Company. Some of these factors are described below, however, many are described in the other sections of this Annual Report on Form 10-K.

#### **Pandemic**

##### **The COVID-19 pandemic creates significant risks and uncertainties for the Company's business.**

In March 2020, the World Health Organization declared COVID-19 as a global pandemic. The COVID-19 pandemic has negatively impacted the global economy, disrupted global supply chains, lowered equity market valuations, created significant volatility and disruption in financial markets, and increased unemployment levels. In addition, the pandemic has resulted in temporary closures of many businesses and the institution of social distancing and sheltering in place requirements in many states and communities, including those in markets in which the Company is located or does business.

As a result, the demand for the Company's products and services has been, and will continue to be, significantly impacted. Furthermore, the pandemic could influence the recognition of credit losses in the Company's loan portfolio and increase its allowance for loan losses as both businesses and consumers are negatively impacted by the economic downturn. In addition, governmental actions are meaningfully influencing the interest-rate environment, which could adversely affect the Company's results of operations and financial condition. The business operations of the Bank may also be disrupted if significant portions of its workforce are unable to work effectively, including because of illness, quarantines, government actions, or other restrictions in connection with the pandemic, travel restrictions, technology limitations, and/or disruptions. Furthermore, the business operations of the Company and Bank have been, and may again in the future be, disrupted due to vendors and third-party service providers being unable to work or provide services effectively, including because of illness, quarantines, government actions, or other restrictions in connection with the pandemic.

In response to the pandemic, the Bank has made certain accommodations to customers, which may negatively impact revenue and other results of operations of the Company in the near term and, if not effective in mitigating the effect of COVID-19 on the Company's customers, may adversely affect the Company's business and results of operations more substantially over a longer period of time.

The extent to which the COVID-19 pandemic impacts the Company's business, liquidity, asset valuations such as goodwill, loan collections, results of operations, and financial condition, as well as its regulatory capital and liquidity ratios, will depend on future developments, which are highly uncertain, including the scope and duration of the pandemic and actions taken by governmental authorities and other third parties in response to the pandemic.

#### **Bank Lending, Allowance for Loan Losses and Other Real Estate Owned**

##### **The Company's business may be adversely affected by conditions in the financial markets and by economic conditions generally.**

Weakness in business and economic conditions generally or specifically in the Company's markets may have one or more of the following adverse effects on the Company's business:

- A decrease in the demand for loans and other products and services the Bank offers;
- A decrease in the value of collateral securing the Bank's loans; and
- An increase in the number of customers who become delinquent, file for protection under bankruptcy laws, or default on their loans.

Adverse conditions in the general business environment have had an adverse effect on the Company's business in the past. Certain economic indicators, such as real estate asset values, rents, and unemployment, may vary between geographic markets. These economic indicators typically affect the real estate and financial services industries, in which the Bank has a significant number of customers, more significantly than other economic sectors. Furthermore, the Bank has a substantial lending business that depends upon the ability of borrowers to make debt service payments on loans. Should economic conditions experience stress, the Company's business, financial condition, or results of operations could be adversely affected.

**The Bank's profitability depends significantly on local economic conditions.**

Most of the Bank's business activities are conducted in Kentucky and contiguous states with most of its credit exposure is in that region. The Bank is at risk from adverse economic or business developments affecting this area, including declining regional and local business and employment activity, a downturn in real estate values and agricultural activities, and natural disasters. To the extent the economy weakens, delinquency rates, foreclosures, bankruptcies, and losses in the Bank's loan portfolio will likely increase. Moreover, the value of real estate or other collateral that secures the loans could be adversely affected by the economic downturn or a localized natural disaster. Events that adversely affect business activity and real estate values have had in the past and may in the future to have a negative impact on the Bank's business, financial condition, results of operations, and future prospects.

**Small to medium-sized business portfolio may have fewer resources to weather a downturn in the economy.**

The loan portfolio includes loans to small and medium-sized businesses and other commercial enterprises. Small and medium-sized businesses frequently have smaller market shares than their competitors, may be more vulnerable to economic downturns, often need additional capital to expand or compete, and may experience variations in operating results, any of which may impair a borrower's ability to repay a loan. In addition, the success of a small or medium-sized business often depends on the management talents and efforts of one or two persons or a small group of persons. The death, disability, or resignation of one or more of these persons could have a material adverse impact on the business and its ability to repay the loan. A continued economic downturn may have a more pronounced negative impact on the target market, causing the Bank to incur substantial credit losses that could materially harm operating results.

**The Bank's decisions regarding credit risk may not be accurate, and its allowance for loan losses may not be sufficient to cover actual losses, which could adversely affect its business, financial condition, and results of operations.**

The Bank maintains an allowance for loan losses at a level management believes is adequate to absorb probable incurred losses in the loan portfolio based on historical loan loss experience, economic and environmental factors, specific problem loans, value of underlying collateral, and other relevant factors. If management's assessment of these factors is ultimately inaccurate, the allowance may not be sufficient to cover actual future loan losses, which would adversely affect operating results. Management's estimates are subjective, and their accuracy depends on the outcome of future events. Changes in economic, operating, and other conditions that are generally beyond the Bank's control could cause actual loan losses to increase significantly. In addition, bank regulatory agencies, as an integral part of their supervisory functions, periodically review the adequacy of the allowance for loan losses. Regulatory agencies may require an increase in provision for loan losses or to recognize additional loan charge-offs when their judgment differs. Any of these events could have a material negative impact on operating results.

Levels of classified loans and non-performing assets may increase in the future if economic conditions cause borrowers to default. Furthermore, the value of the collateral underlying a given loan, and the realizable value of such collateral in a foreclosure sale, may decline, making it less likely to realize a full recovery if a borrower defaults on a loan. Any increases in the level of non-performing assets, loan charge-offs or provision for loan losses, or the inability to realize the estimated net value of underlying collateral in the event of a loan default, could negatively affect the Bank's business, financial condition, results of operations, and the trading price of the Company's common shares.

---

[Table of Contents](#)

**If the Bank experiences greater credit losses than anticipated, its operating results would be adversely affected.**

As a lender, the Bank is exposed to the risk that borrowers will be unable to repay their loans according to their terms and that any collateral securing the payment of their loans may not be sufficient to assure repayment. Credit losses are inherent in the business of making loans and could have a material adverse effect on operating results. Credit risk with respect to the real estate and construction loan portfolio will relate principally to the creditworthiness of borrowers and the value of the real estate serving as security for the repayment of loans. Credit risk with respect to the commercial and consumer loan portfolio will relate principally to the general creditworthiness of businesses and individuals within the local markets.

Management makes various assumptions and judgments about the collectability of its loan portfolio and provides an allowance for estimated loss losses based on a number of factors. Management believes the Bank's allowance for loan losses is adequate. However, if assumptions or judgments are wrong, the allowance for loan losses may not be sufficient to cover actual loan losses. Management may have to increase the allowance in the future at the request of one of the Bank's primary regulators, to adjust for changing conditions and assumptions, or as a result of any deterioration in the quality of the loan portfolio. The actual amount of future provisions for loan losses cannot be determined at this time and may vary from the amounts of past provisions.

**A large percentage of the Bank's loans are collateralized by real estate, and any prolonged weakness in the real estate market may result in losses and adversely affect profitability.**

Approximately 70.7% of the Bank's loan portfolio as of December 31, 2020, was comprised of commercial and residential loans collateralized by real estate. Adverse economic conditions could decrease demand for real estate and depress real estate values in the Company's markets. Persistent weakness in the real estate market could significantly impair the value of loan collateral and the ability to sell the collateral upon foreclosure. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. If real estate values decline, it will become more likely that management would be required to increase the Bank's allowance for loan losses. If during a period of depressed real estate values, management was required to liquidate the collateral securing a loan to satisfy the debt or to increase the allowance for loan losses, it could materially reduce the Bank's profitability and adversely affect its financial condition.

**The Bank offers real estate construction and development loans, which carry a higher degree of risk than other real estate loans.**

Approximately 9.7% of the Company's loan portfolio as of December 31, 2020 consisted of real estate construction and development loans, up from 7.0% at December 31, 2019 and down from 11.4% at December 31, 2018. These loans generally carry a higher degree of risk than long-term financing of existing

properties because repayment depends on the ultimate completion of the project and permanent financing or sale of the property. If the Bank is forced to foreclose on a project prior to its completion, it may not be able to recover the entire unpaid portion of the loan or it may be required to fund additional money to complete the project, or hold the property for an indeterminate period of time. Any of these outcomes may result in losses and adversely affect profitability and financial condition.

**The CECL accounting standard will result in a significant change in how the Company recognizes credit losses and may have a material impact on the Company's financial condition or results of operations.**

In June 2016, the FASB issued ASU, "Financial Instruments—Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments," which replaces the current "incurred loss" model for recognizing credit losses with an "expected loss" model. Whereas the incurred loss model delays recognition of loss on financial instruments until it is probable a loss has occurred, the expected loss model will recognize a loss at the time the loan is first added to the balance sheet. As a result of this differing methodology, the Company expects adoption of the CECL model will materially affect the determination of the allowance and could require a significant increase to the allowance. Any material increase to the required level of loan loss allowance could adversely affect the Company's business, financial condition, and results of operations. The CECL standard will become effective for the Company for fiscal years beginning January 1, 2023. See Note 1, "New Accounting Standards" for discussion regarding the standard. Adoption will likely result in a one-time cumulative-effect adjustment to the allowance and stockholders' equity. Interagency guidance issued in December 2018 allows for a three-year phase-in of the cumulative-effect adjustment for regulatory capital reporting.

---

[Table of Contents](#)

**The Bank may acquire or hold from time to time OREO properties, which could increase operating expenses and result in future losses to the Company.**

In the past, the Bank has acquired and disposed of a significant amount of real estate as a result of foreclosure or by deed in lieu of foreclosure that is listed on the balance sheet as other real estate owned ("OREO"). An increase in the OREO portfolio increases the expenses incurred to manage and dispose of these properties, which sometimes includes funding construction required to facilitate sale.

Properties in the Company's OREO portfolio are recorded at fair value, which represents the estimated sales price of the properties on the date acquired less estimated selling costs. Generally, in determining "fair value" an orderly disposition of the property is assumed, except where a different disposition strategy is expected. Significant judgment is required in estimating the fair value of OREO, and the period of time within which such estimates can be considered current may change during periods of market volatility. Any decreases in market prices of real estate may lead to additional OREO write downs, with a corresponding expense in the statement of operations. Management evaluates OREO property values periodically and writes down the carrying value of the properties if and when the results of the Company's analysis require it.

In response to market conditions and other economic factors, management may utilize alternative sale strategies other than orderly disposition as part of the Bank's OREO disposition strategy, such as auctions or bulk sales. In this event, as a result of the significant judgments required in estimating fair value and the variables involved in different methods of disposition, the net proceeds realized from such sales transactions could differ significantly from appraisals, comparable sales, and other estimates used to determine the fair value of OREO properties. In addition, the disposition of OREO through alternative sales strategies could impact the fair value of comparable OREO properties remaining in the portfolio. Generally, state regulatory requirements limit the period a Bank is permitted to hold OREO to ten years. All OREO properties held by the Bank at December 31, 2020 are currently under contract for sale.

**Interest Rates, Asset-Liability Management, Liquidity, and Common Stock**

**Profitability is vulnerable to fluctuations in interest rates.**

Changes in interest rates could harm financial condition or results of operations. The results of operations depend substantially on net interest income, the difference between interest earned on interest-earning assets (such as investments and loans) and interest paid on interest-bearing liabilities (such as deposits and borrowings). Interest rates are highly sensitive to many factors, including governmental monetary policies and domestic or international economic or political conditions. Factors beyond the Company's control, such as inflation, recession, unemployment, and money supply may also affect interest rates. If, as a result of decreasing interest rates, interest-earning assets mature or reprice more quickly than interest-bearing liabilities in a given period, net interest income may decrease. Likewise, net interest income may decrease if interest-bearing liabilities mature or reprice more quickly than interest-earning assets in a given period as a result of increasing interest rates.

Fixed-rate loans increase the exposure to interest rate risk in a rising rate environment because interest-bearing liabilities may be subject to repricing before assets become subject to repricing. Fixed rate investment securities are subject to fair value declines as interest rates rise. Adjustable-rate loans decrease the risk associated with rising interest rates but involve other risks, such as the inability of borrowers to make higher payments in an increasing interest rate environment. At the same time, for secured loans, the marketability of the underlying collateral may be adversely affected by higher interest rates. In a declining interest rate environment, there may be an increase in prepayments on loans as the borrowers refinance their loans at lower interest rates, which could reduce net interest income and harm results of operations.

**The planned phasing out of the LIBOR as a financial benchmark presents risks to the financial instruments originated or held by the Company.**

The LIBOR is the reference rate used for many transactions, including lending and borrowing, as well as the derivatives that may be used to manage risk related to such transactions. LIBOR will cease to exist as a published rate after 2021. The expected discontinuation of LIBOR could have a significant impact on the financial markets and market participants such as the Company. As of December 31, 2020, the Company had approximately \$138.5 million in variable rate loans with interest rates tied to LIBOR, of which approximately \$121.5 million have maturity dates beyond December 31, 2021.

The Federal Reserve Bank, through the Alternative Reference Rate Committee, has recommended a replacement benchmark rate, the Secured Overnight Financing Rate (SOFR). All loan contracts extending beyond 2021 will need to be managed effectively to ensure appropriate benchmark rate replacements are provided for

---

[Table of Contents](#)

Failure to identify a replacement benchmark rate and/or update data processing systems could result in future interest rate changes not being correctly captured, which could result in interest rate risk not being mitigated as intended, or interest earned being miscalculated, which could adversely impact the Company's business, financial condition, and results of operations. Uncertainty regarding LIBOR and the taking of discretionary actions or negotiations of fall-back provisions could result in pricing volatility, adverse tax or accounting impacts, or additional compliance, legal and operational costs.

**If the Bank cannot obtain adequate funding, it may not be able to meet the cash flow requirements of its depositors and borrowers, or meet the operating cash needs of the Company.**

The Company's liquidity policies and limits are established by the Board of Directors of the Bank, with operating limits managed and monitored by the Asset Liability Committee ("ALCO"), based upon analyses of the ratio of loans to deposits and the percentage of assets funded with non-core or wholesale funding. The ALCO regularly monitors the overall liquidity position of the Bank and the Company to ensure that various alternative strategies exist to meet unanticipated events that could affect liquidity. Liquidity is the ability to meet cash flow needs on a timely basis at a reasonable cost. If the Company's liquidity policies and strategies do not work as well as intended, the Bank may be unable to make loans and repay deposit liabilities as they become due or are demanded by customers. The ALCO follows established board approved policies and monitors guidelines to diversify the Company's wholesale funding sources to avoid concentrations in any one-market source. Wholesale funding sources include Federal funds purchased, securities sold under repurchase agreements, and Federal Home Loan Bank ("FHLB") advances that are collateralized with mortgage-related assets.

The Bank maintains a portfolio of securities that can be used as a secondary source of liquidity. There are other available sources of liquidity, including additional collateralized borrowings such as FHLB advances, the issuance of debt securities, and the issuance of preferred or common shares in public or private transactions. If the Bank is unable to access any of these funding sources when needed, it might not be able to meet the needs of customers, which could adversely impact its financial condition, its results of operations, cash flows, and its level of regulatory-qualifying capital.

**As a bank holding company, the Company depends on dividends and distributions paid to it by its banking subsidiary.**

The Company is a legal entity separate and distinct from the Bank and its other subsidiaries. The principal source of cash flow, from which it would fund any dividends paid to shareholders, has historically been dividends the Company receives from the Bank. Regulations of the FDIC and the KDFI govern the ability of the Bank to pay dividends and other distributions to the Company, and regulations of the Federal Reserve govern the ability to pay dividends or make other distributions to shareholders. Since the Bank will not be in a position to pay dividends to the Company without prior regulatory approval until retained earnings are positive, cash inflows for the Company are limited to proceeds from common stock, preferred stock, or debt issuances. See the "Item 1. Business" "Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities – Dividends."

**The Company may sell capital stock in the future to raise additional capital or for additional liquidity. Future sales or other dilution of equity may adversely affect the market price of the Company's common shares.**

The issuance of additional common shares or securities convertible into common shares would dilute the ownership interest of the Company's existing common shareholders. The market price of the Company's common shares could decline as a result of such an offering as well as other sales of a large block of shares of common shares or similar securities in the market after such an offering, or the perception that such sales could occur. The Company's common shares have traded from time-to-time at a price below book value per share. A sale of common shares at or below book value would be dilutive to current shareholders. The sale of shares at a price below market value could negatively impact the market price of the Company's common shares.

**Deferred Tax Assets**

**The Company may not be able to realize the value of its deferred tax assets.**

Due to losses in prior years, the Company has a net operating loss carry-forward of \$22.0 million, credit carry-forwards of \$208,000, and other net deferred tax assets of \$3.5 million. In order to realize the benefit of these tax losses, credits, and deductions, the Company must generate substantial taxable income in future periods. Deferred tax assets are calculated using a federal corporate tax rate of 21%. Changes in tax laws and rates may affect deferred tax assets in the future. If higher federal corporate tax rates are enacted, net deferred tax assets would be increased commensurate with the rate increase. Additionally, should the Company need to raise additional capital by issuing new common shares or securities convertible into common shares, then depending on the number of common share equivalents issued, it could trigger a "change in control," as defined by Section 382 of the Internal Revenue Code. Such an event could negatively impact or limit the ability to utilize net operating loss carry-forwards, credit loss carry-forwards, and other net deferred tax assets.

---

[Table of Contents](#)

**Acquisitions**

**Acquisitions may not produce revenue enhancements or cost savings at levels or within timeframes originally anticipated and may result in unforeseen integration difficulties.**

The Company regularly explores opportunities to acquire banks, branches, financial institutions, or other financial services businesses or assets. The Company cannot predict the number, size, or timing of acquisitions. Difficulty in integrating an acquired business or company may cause the Company not to realize expected revenue increases, cost savings, increases in geographic or product presence, and/or other projected benefits from the acquisition. The integration could

result in higher than expected deposit attrition (run-off), loss of key employees, disruption of the Company's business or the business of the acquired company, or otherwise adversely affect the Company's ability to maintain relationships with customers and employees or achieve the anticipated benefits of the acquisition. Also, the negative effect of any divestitures required by regulatory authorities in acquisitions or business combinations may be greater than expected. The Company may also issue equity securities in connection with acquisitions, which could cause ownership and economic dilution to current shareholders.

## **Litigation**

### **Risk related to legal proceedings.**

From time to time, the Company is involved in judicial, regulatory, and arbitration proceedings concerning matters arising from the Company's business activities and fiduciary responsibilities. The Company establishes reserves for legal claims when payments associated with the claims become probable and the costs can be reasonably estimated. The Company may still incur legal costs for a matter even if a reserve has not been established. In addition, the actual cost of resolving a legal claim may be substantially higher than any amounts reserved for that matter. The ultimate resolution of a pending or future legal proceeding, depending on the remedy sought and granted, could materially adversely affect results of operations and financial condition.

## **Deposit Insurance Expense**

### **FDIC deposit insurance premiums and assessments can impact non-interest expense.**

The Bank's deposits are insured by the FDIC up to legal limits and, accordingly, the Bank is subject to FDIC deposit insurance premiums and assessments. FDIC assessments for deposit insurance are based on the average total consolidated assets of the insured institution during the assessment period, less the average tangible equity of the institution during the assessment period. Any increase in assessment rates may adversely affect the Bank's business, financial condition, or results of operations.

## **Competition, Management**

### **The Bank faces strong competition from other financial institutions and financial service companies, which could adversely affect the results of operations and financial condition.**

The Bank competes with other financial institutions in attracting deposits and making loans. The competition in attracting deposits comes principally from other commercial banks, credit unions, savings and loan associations, securities brokerage firms, insurance companies, money market funds, and other mutual funds. The competition in making loans comes principally from other commercial banks, credit unions, farm credit associations, savings and loan associations, mortgage banking firms, and consumer finance companies. In addition, competition for business in the Louisville and Lexington metropolitan areas has grown in recent years as changes in banking law have allowed banks to enter those markets by establishing new branches.

Competition in the banking industry may also limit the ability to attract and retain banking clients. The Bank maintains smaller staffs of associates and have fewer financial and other resources than larger institutions with which it competes. Financial institutions that have far greater resources and greater efficiencies than the Bank may have several marketplace advantages resulting from their ability to:

- offer higher interest rates on deposits and lower interest rates on loans than the Bank can;
- offer a broader range of services than the Bank does;
- maintain more branch locations than the Bank does; and
- mount extensive promotional and advertising campaigns.

In addition, banks and other financial institutions with larger capitalization and other financial intermediaries may not be subject to the same regulatory restrictions and may have larger lending limits. Some of the Company's current commercial banking clients may seek alternative banking sources as they develop needs for credit facilities larger than the Bank can accommodate. If the Bank is unable to attract and retain customers, it may not be able to maintain growth and the results of operations and financial condition may otherwise be negatively impacted.

---

## **[Table of Contents](#)**

### **The Company depends on its senior management team, and the unexpected loss of one or more of the senior executives could impair relationships with customers and adversely affect business and financial results.**

Future success significantly depends on the continued services and performance of key management personnel. Future performance will depend on the ability to motivate and retain these and other key officers. The Dodd-Frank Act, and the policies of bank regulatory agencies have placed restrictions on executive compensation practices. Such restrictions and standards may further impact the ability to compete for talent with other businesses that are not subject to the same limitations. The loss of the services of members of senior management or other key officers or the inability to attract additional qualified personnel as needed could materially harm its business.

## **Accounting Estimates, Internal Controls, Cybersecurity**

### **Reported financial results depend on management's selection of accounting methods and certain assumptions and estimates.**

Accounting policies and assumptions are fundamental to the reported financial condition and results of operations. Management must exercise judgment in selecting and applying many of these accounting policies and methods so they comply with generally accepted accounting principles and reflect management's judgment of the most appropriate manner in which to report the financial condition and results. In some cases, management must select the accounting policy or method to apply from two or more alternatives, any of which may be reasonable under the circumstances, yet may result in reporting materially different results

than would have been reported under a different alternative.

Certain accounting policies require management to make difficult, subjective, or complex judgments about matters that are uncertain. Materially different amounts could be reported under different conditions or using different assumptions or estimates. These accounting policies include the valuation of securities, allowance for loan losses, valuation of OREO, and valuation of net deferred income tax asset. Because of the uncertainty of estimates involved in these matters, the Company may be required, among other things, to recognize other-than-temporary impairment on securities, significantly increase the allowance for credit losses, sustain credit losses that are higher than the reserve provided, recognize impairment on OREO, or permanently impair deferred tax assets.

**While management continually monitors and improves the system of internal controls, data processing systems, and corporate wide processes and procedures, the Company may suffer losses from operational risk in the future.**

Management maintains internal operational controls and has invested in technology to help process large volumes of transactions. However, the Company may not be able to continue processing at the same or higher levels of transactions. If systems of internal controls should fail to work as expected, if systems were to be used in an unauthorized manner, or if employees were to subvert the system of internal controls, significant losses could occur.

The Company processes large volumes of transactions on a daily basis exposing it to numerous types of operational risk, which could cause it to incur substantial losses. Operational risk resulting from inadequate or failed internal processes, people, and systems includes the risk of fraud by employees or persons outside of the company, the execution of unauthorized transactions by employees, errors relating to transaction processing and systems, and breaches of the internal control system and compliance requirements. This risk of loss also includes potential legal actions that could arise as a result of the operational deficiency or as a result of noncompliance with applicable regulatory standards.

The Company establishes and maintains systems of internal operational controls that provide management with timely and accurate information about its level of operational risk. While not foolproof, these systems have been designed to manage operational risk at appropriate, cost effective levels. The Company has also established procedures that are designed to ensure policies relating to conduct, ethics and business practices are followed. Nevertheless, the Company experiences loss from operational risk from time to time, including the effects of operational errors, and these losses may be substantial.

**Information systems may experience an interruption or security breach.**

Failure in or breach of operational or security systems or infrastructure, or those of third party vendors and other service providers, including as a result of cyber-attacks, could disrupt the Bank's businesses, result in the disclosure or misuse of confidential or proprietary information, damage its reputation, increase costs, and cause losses. As a financial institution, the Bank depends on its ability to process, record, and monitor a large number of customer transactions on a continuous basis. As customer, public and regulatory expectations regarding operational and information security have increased, operational systems and infrastructure must continue to be safeguarded and monitored for potential failures, disruptions, and breakdowns. Business, financial, accounting, data processing systems, or other operating systems and facilities may stop operating properly or become disabled or damaged as a result of a number of factors including events that are wholly or partially beyond the Bank's control. For example, there could be sudden increases in customer transaction volume, electrical or telecommunications outages, natural disasters such as earthquakes, tornadoes, and hurricanes; disease pandemics, events arising from local or larger scale political or social matters, including terrorist acts, and, as described below, cyber-attacks. Although the Bank has business continuity plans and other safeguards in place, its business operations may be adversely affected by significant and widespread disruption to its physical infrastructure or operating systems that support its businesses and customers.

---

[Table of Contents](#)

Information security risks for financial institutions have generally increased in recent years in part because of the proliferation of new technologies, the use of the Internet and telecommunications technologies to conduct financial transactions, and the increased sophistication and activities of organized crime, hackers, terrorists, activists, and other external parties. As noted above, the Bank's operations rely on the secure processing, transmission, and storage of confidential information in its computer systems and networks. In addition, to access the Bank's products and services, its customers may use personal smartphones, tablet PC's, and other mobile devices that are beyond its control systems. Although the Bank believes it has appropriate information security procedures and controls, its technologies, systems, networks, and its customers' devices may become the target of cyber-attacks or information security breaches. These events could result in the unauthorized release, gathering, monitoring, misuse, loss, or destruction of the Bank's customers' confidential, proprietary, and other information or that of its customers, or otherwise disrupt the business operations of the Bank, its customers, or other third parties.

Third parties with which the Bank does business or that facilitate its business activities could also be sources of operational and information security risk to the Bank, including from breakdowns or failures of their own systems or capacity constraints. Although to date the Bank has not experienced any material losses relating to cyber-attacks or other information security breaches, the Bank can give no assurance that it will not suffer such losses in the future. Risk and exposure to these matters remains heightened because of, among other things, the evolving nature of these threats and the prevalence of Internet and mobile banking. As cyber threats continue to evolve, the Bank may be required to expend significant additional resources to continue to modify or enhance its protective measures or to investigate and remediate any information security vulnerabilities. Disruptions or failures in the physical infrastructure or operating systems that support the Bank's businesses and customers, or cyber-attacks or security breaches of the networks, systems, or devices that the Bank's customers use to access its products and services could result in customer attrition, regulatory fines, penalties or intervention, reputational damage, reimbursement or other compensation costs, and/or additional compliance costs, any of which could materially adversely affect the Bank's business, results of operations, or financial condition.

**Bank Regulation**

**The Company operates in a highly regulated environment and, as a result, is subject to extensive regulation and supervision that could adversely affect financial performance and ability to implement growth and operating strategies.**

The Company is subject to examination, supervision, and comprehensive regulation by federal and state regulatory agencies, as described under "Item 1 – Business-Supervision and Regulation." Regulatory oversight of banks is primarily intended to protect depositors, the federal deposit insurance funds, and the banking system as a whole, and not shareholders. Compliance with these regulations is costly and may make it more difficult to operate profitably.

Federal and state banking laws and regulations govern numerous matters including the payment of dividends, the acquisition of other banks, and the establishment of new banking offices. The Company must also meet specific regulatory capital requirements. Failure to comply with these laws, regulations, and policies or to maintain required capital could affect the ability to pay dividends on common shares, the ability to grow through the development of new offices, make acquisitions, and remain independent. These limitations may prevent the Company from successfully implementing growth and operating strategies.

In addition, the laws and regulations applicable to banks could change at any time, which could significantly impact the Company's business and profitability. For example, new legislation or regulation could limit the manner in which the Company may conduct its business, including its ability to attract deposits and make loans. Events that may not have a direct impact on us, such as the bankruptcy or insolvency of a prominent U.S. corporation, can cause legislators and banking regulators and other agencies such as the Consumer Financial Protection Bureau, the SEC, the Public Company Accounting Oversight Board, and various taxing authorities to respond by adopting and or proposing substantive revisions to laws, regulations, rules, standards, policies, and interpretations. The nature, extent, and timing of the adoption of significant new laws and regulations, or changes in or repeal of existing laws and regulations may have a material impact on the Company's business and results of operations. Changes in regulation may cause the Company to devote substantial additional financial resources and management time to compliance, which may negatively affect operating results.

[Table of Contents](#)

**Changes in banking laws could have a material adverse effect.**

The Bank is subject to changes in federal and state laws as well as changes in banking and credit regulations, and governmental economic and monetary policies. Management cannot predict whether any of these changes could adversely and materially affect us. The current regulatory environment for financial institutions entails significant potential increases in compliance requirements and associated costs. Federal and state banking regulators also possess broad powers to take supervisory actions as they deem appropriate. These supervisory actions may result in higher capital requirements, higher insurance premiums, and limitations on the Bank's activities that could have a material adverse effect on its business and profitability.

**Item 1B. Unresolved Staff Comments**

Not applicable.

**Item 2. Properties**

The Bank operates 20 banking offices in Kentucky. The following table shows the location, square footage, and ownership of each property. Management believes that each of these locations is adequately insured. Support operations are located at the main office in Louisville and in Canmer.

<b>Markets</b>	<b>Square Footage</b>	<b>Owned/Leased</b>
<b>Frankfort/Franklin County</b>		
Frankfort Office: 100 Highway 676, Frankfort	3,000	Leased
<b>Elizabethtown/Hardin County</b>		
Elizabethtown Office: 1690 Ring Road, Suite 100, Elizabethtown	4,000	Leased
<b>Louisville/Jefferson, Bullitt and Henry Counties</b>		
Main Office: 2500 Eastpoint Parkway, Louisville	30,000	Owned
Eminence Office: 646 Elm Street, Eminence	1,500	Owned
Hillview Office: 6890 North Preston Highway, Hillview	3,500	Owned
Pleasureville Office: 5440 Castle Highway, Pleasureville	10,000	Owned
Conestoga Office: 155 Conestoga Parkway, Shepherdsville	3,900	Owned
<b>Lexington/Fayette County</b>		
Lexington Office: 2424 Harrodsburg Road, Suite 100, Lexington	8,500	Leased
City Center Office: 130 West Main Street, Lexington	2,400	Leased
<b>South Central Kentucky</b>		
Brownsville Office: 113 East Main Cross Street, Brownsville	8,500	Owned
Greensburg Office: 202 North Main Street, Greensburg	11,000	Owned
Horse Cave Office: 201 East Main Street, Horse Cave	5,000	Owned
Morgantown Office: 112 West G.L. Smith Street, Morgantown	7,500	Owned
Munfordville Office: 949 South Dixie Highway, Munfordville	9,000	Owned
Beaver Dam Office: 1300 North Main Street, Beaver Dam	3,200	Owned
<b>Owensboro/Daviess County</b>		
Owensboro Frederica Office: 3500 Frederica Street, Owensboro	5,000	Owned
Owensboro Villa Point: 3332 Villa Point Drive, Owensboro	2,000	Leased



**Southern Kentucky**

Campbell Lane Office: 751 Campbell Lane, Bowling Green	7,500	Owned
Glasgow Office: 1006 West Main Street, Glasgow	12,000	Owned

**Other Properties**

Office Building: 2708 North Jackson Highway, Canmer	3,500	Owned
---	-------	-------

**Other Properties - Held for Sale**

Office Building: 701 Columbia Avenue, Glasgow	20,000	Owned
Owensboro Office: 1819 Frederica Street, Owensboro	3,000	Owned

**Item 3. Legal Proceedings**

In the normal course of business, the Company and its subsidiaries have been named, from time to time, as defendants in various legal actions. Certain of the actual or threatened legal actions may include claims for substantial compensatory and/or punitive damages or claims for indeterminate amount of damages. Litigation is subject to inherent uncertainties and unfavorable outcomes could occur.

18

[Table of Contents](#)

The Company contests liability and/or the amount of damages as appropriate in each pending matter. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases where claimants seek substantial or indeterminate damages or where investigations and proceedings are in the early stages, the Company cannot predict with certainty the loss or range of loss, if any, related to such matters, how or if such matters will be resolved, when they will ultimately be resolved, or what the eventual settlement, or other relief, if any, might be. Subject to the foregoing, the Company believes, based on current knowledge and after consultation with counsel, that the outcome of such pending matters will not have a material adverse effect on the consolidated financial condition of the Company, although the outcome of such matters could be material to the Company's operating results and cash flows for a particular future period, depending on, among other things, the level of the Company's revenues or income for such period. The Company will accrue for a loss contingency if (1) it is probable that a future event will occur and confirm the loss and (2) the amount of the loss can be reasonably estimated.

The Company is not currently involved in any material litigation.

**Item 4. Mine Safety Disclosure**

Not applicable.

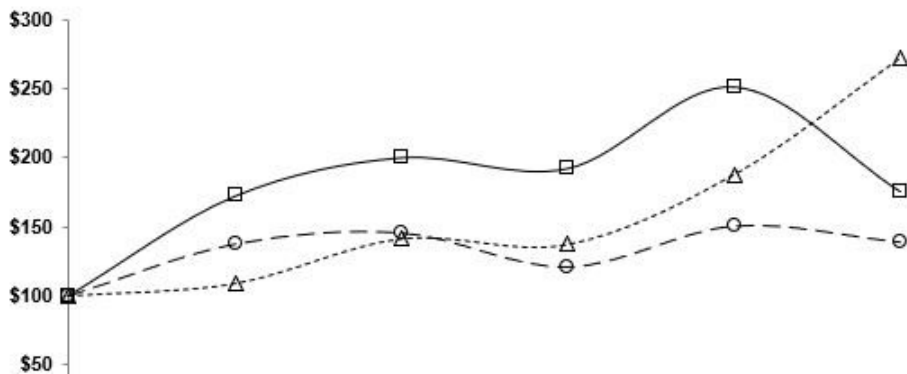
19

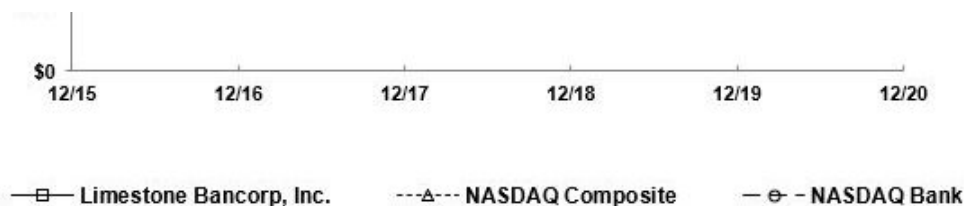
**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities****Market Information**

The Company's common shares are traded on the Nasdaq Capital Market under the ticker symbol "LMST".

As of January 31, 2021, the Company's common shares were held by approximately 1,384 shareholders, including 330 shareholders of record and approximately 1,054 beneficial owners whose shares are held in "street" name by securities broker-dealers or other nominees, and the Company's non-voting common shares were held by one holder.

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\***  
Among Limestone Bancorp, Inc., the NASDAQ Composite Index  
and the NASDAQ Bank Index





\*\$100 invested on 12/31/15 in stock or index, including reinvestment of dividends.  
Fiscal year ending December 31.

## Dividends

As a bank holding company, the Company's ability to declare and pay dividends depends on various federal regulatory considerations, including the guidelines of the Federal Reserve regarding capital adequacy and dividends.

The principal source of revenue with which to pay dividends on common shares are dividends the Bank may declare and pay out of funds legally available for payment of dividends. Currently, the Bank must obtain the prior written consent of its primary regulators prior to declaring or paying any dividends until retained earnings are positive. A Kentucky chartered bank may declare a dividend of an amount of the bank's net profits as the board deems appropriate. The approval of the KDFI is required if the total of all dividends declared by a bank in any calendar year exceeds the total of its net profits for that year combined with its retained net profits for the preceding two years, less any required transfers to surplus or a fund for the retirement of preferred stock or debt.

20

## [Table of Contents](#)

### Purchase of Equity Securities by Issuer

During the fourth quarter of 2020, the Company did not repurchase any of its common shares, which is its only registered class of equity securities.

### Equity Compensation Plan Information

The following table provides information about the Company's equity compensation plans as of December 31, 2020:

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column 1)
Equity compensation plans approved by shareholders	—	—	262,374
Equity compensation plans not approved by shareholders	—	—	—
<b>Total</b>	<b>—</b>	<b>—</b>	<b>262,374</b>

At December 31, 2020, 262,374 common shares remain available for issuance under the Company's 2018 Omnibus Equity Compensation Plan.

21

## Item 6. Selected Financial Data

The following table summarizes the Company's selected historical consolidated financial data from 2016 to 2020. You should read this information in conjunction with Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 8. "Financial Statements and Supplementary Data."

### Selected Consolidated Financial Data

(Dollars in thousands except per share data)	As of and for the Years Ended December 31,				
	2020	2019	2018	2017	2016
<b>Income Statement Data:</b>					
Interest income	\$ 50,753	\$ 49,584	\$ 43,461	\$ 37,522	\$ 35,602
Interest expense	10,152	14,234	9,790	6,405	5,981
Net interest income	40,601	35,350	33,671	31,117	29,621
Provision (negative provision) for loan losses	4,400	—	(500)	(800)	(2,450)

Non-interest income	6,844	5,918	5,779	5,404	5,218
Non-interest expense (1)	32,416	30,270	29,126	30,767	40,021
Income (loss) before income taxes	10,629	10,998	10,824	6,554	(2,732)
Income tax expense (benefit) (2)	1,624	480	2,030	(31,899)	21
Net income (loss)	9,005	10,518	8,794	38,453	(2,753)
Less:					
Earnings (loss) allocated to participating securities	68	106	144	967	(88)
Net income (loss) attributable to common	\$ 8,937	\$ 10,412	\$ 8,650	\$ 37,486	\$ (2,665)

### Common Share Data: (3)

Basic earnings (loss) per common share	\$ 1.20	\$ 1.41	\$ 1.23	\$ 6.15	\$ (0.46)
Diluted earnings (loss) per common share	1.20	1.41	1.23	6.15	(0.46)
Cash dividends declared per common share	—	—	—	—	—
Book value per common share	15.47	14.15	12.34	11.17	4.81
Tangible book value per common share (4)	14.34	12.98	12.34	11.17	4.79

### Balance Sheet Data (at period end): (1)

Total assets	\$ 1,312,302	\$ 1,245,779	\$ 1,069,692	\$ 970,801	\$ 945,177
Debt obligations:					
FHLB advances	20,623	61,389	46,549	11,797	22,458
Junior subordinated debentures	21,000	21,000	21,000	21,000	21,000
Subordinated capital notes	25,000	17,000	—	2,250	3,150
Senior debt	—	5,000	10,000	10,000	—

### Average Balance Data: (1)

Average assets	\$ 1,294,934	\$ 1,112,388	\$ 1,026,310	\$ 947,961	\$ 929,140
Average loans	964,088	801,813	743,352	667,474	621,275
Average deposits	1,099,383	936,243	860,825	864,278	852,717
Average FHLB advances	34,101	35,038	43,363	9,184	2,967
Average junior subordinated debentures	21,000	21,000	21,000	21,000	21,000
Average subordinated capital notes	20,366	7,545	791	2,805	3,708
Average senior debt	2,896	7,781	10,000	5,068	—
Average stockholders' equity	109,958	100,126	84,860	37,851	39,423

- On November 15, 2019, the Company completed a four branch acquisition. The purchase included \$126.8 million in performing loans and \$1.5 million in premises and equipment, as well as \$131.8 million in customer deposits. Acquisition related costs totaled \$775,000, or \$0.08 per common share after taxes.
- For 2020 and 2019, income tax expense benefitted from the establishment of a net deferred tax asset related to a change in Kentucky tax law enacted during 2019. Income tax expense benefitted \$478,000 and \$1.6 million for the years ended December 31, 2020 and 2019, respectively, or \$0.06 per basic and diluted share, and \$0.21 per basic and diluted share, respectively. Income tax expense for 2017 benefitted \$54.0 million from the reversal of the deferred tax valuation allowance offset by \$20.3 million of income tax expense related to the revaluation of the deferred tax asset to 21%.

### [Table of Contents](#)

- On December 16, 2016, the Company completed a 1-for-5 reverse stock split of its issued and outstanding common and non-voting common shares. As a result of the reverse stock split, all share and per share data has been adjusted in the accompanying tables. Preferred shares were not impacted by the 1-for-5 reverse stock split.
- Tangible book value per common share is a non-GAAP financial measure derived from GAAP based amounts. Tangible book value is calculated by excluding the balance of intangible assets from common stockholders' equity. Tangible book value per common share is calculated by dividing tangible common equity by common shares outstanding, as compared to book value per common share, which is calculated by dividing common stockholders' equity by common shares outstanding. Management believes this is consistent with bank regulatory agency treatment, which excludes tangible assets from the calculation of risk-based capital.

	As of and for the Years Ended December 31,				
	2020	2019	2018	2017	2016
	(in thousands, except share and per share data)				
<b>Tangible Book Value Per Share</b>					
Common stockholder's equity	\$ 116,024	\$ 105,750	\$ 92,097	\$ 69,902	\$ 29,962
Less: Goodwill	6,252	6,252	—	—	—
Less: Intangible assets	2,244	2,500	—	—	140
Tangible common equity	107,528	96,998	92,097	69,902	29,822
Shares outstanding	7,498,865	7,471,975	7,462,720	6,259,864	6,224,533
Tangible book value per common share	\$ 14.34	\$ 12.98	\$ 12.34	\$ 11.17	\$ 4.81
Book value per common share	15.47	14.15	12.34	11.17	4.79

## Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operation

Management’s discussion and analysis of financial condition and results of operations analyzes the consolidated financial condition and results of operations of Limestone Bancorp, Inc. (the “Company”) and its wholly owned subsidiary, Limestone Bank, Inc. (the “Bank”). The Company is a Louisville, Kentucky-based bank holding company that operates banking offices in fourteen Kentucky counties. The Bank’s markets include metropolitan Louisville in Jefferson County and the surrounding counties of Bullitt and Henry. The Bank serves south central, southern, and western Kentucky from banking offices in Barren, Butler, Daviess, Edmonson, Green, Hardin, Hart, Ohio, and Warren Counties. The Bank also has an office in Lexington, the second largest city in the state, and Frankfort, the state capital. The Bank is a traditional community bank with a wide range of personal and business banking products and services.

The following discussion should be read in conjunction with the Company’s consolidated financial statements and accompanying notes and other schedules presented elsewhere in the report.

### Overview

For the year ended December 31, 2020, the Company reported net income of \$9.0 million compared with net income of \$10.5 million for the year ended December 31, 2019 and net income of \$8.8 million for the year ended December 31, 2018. Basic and diluted income per common share were \$1.20 for the year ended December 31, 2020, compared with net income per common share of \$1.41 for 2019, and net income per common share of \$1.23 for 2018.

Net income before taxes was \$10.6 million for the year ended December 31, 2020 compared to \$11.0 million for the year ended December 31, 2019. Income tax expense was \$1.6 million for 2020 and \$480,000 for 2019. For 2020 and 2019, income tax expense benefitted from the establishment of a net deferred tax assets related to a change in Kentucky tax law enacted during 2019. Income tax expense benefitted \$478,000 and \$1.6 million for the years ended December 31, 2020 and 2019, respectively, or \$0.06 per basic and diluted common share, and \$0.21 per basic and diluted common share, respectively. The new law eliminates the Kentucky bank franchise tax, which is assessed at a rate of 1.1% of average capital, and implements a state income tax for the Bank at a statutory rate of 5%. The new Kentucky income tax went into effect on January 1, 2021.

The following significant items are of note for the year ended December 31, 2020:

- Loan growth outpaced paydowns during 2020. Average loans receivable increased approximately \$162.3 million, or 20.2%, to \$964.1 million for the year ended December 31, 2020, compared with \$801.8 million for the year ended December 31, 2019. Loan interest income benefitted from an increase in interest revenue volume of approximately \$7.9 million, which was offset by a decrease in interest revenue of \$5.0 million due to declining rates for the year ended December 31, 2020, compared with the year ended December 31, 2019. Average loans for 2020 were positively impacted by the branch purchase transaction on November 15, 2019, which included \$126.8 million in loans at the time of purchase, along with loan growth during 2020 and 2019, as well as \$42.4 million of loans originated under the SBA Paycheck Protection Program (“PPP”) in 2020. After forgiveness and paydowns, PPP loans declined to \$20.3 million at December 31, 2020.

---

### [Table of Contents](#)

- Net interest margin decreased four basis points to 3.36% for the year ended 2020 compared with 3.40% in the year ended December 31, 2019. The yield on earning assets decreased to 4.20% in 2020, compared to 4.76% in 2019. The yield on earning assets was negatively impacted by falling interest rates on the Bank’s fed funds, certain floating rate investment securities, and loans with variable rate pricing features as the Federal Reserve lowered the federal funds target rate by 75 basis points in the latter half of 2019 and an additional 150 basis points in March 2020. The negative impact of falling rates was offset by \$1.1 million in fees earned on PPP loans during 2020. The cost of interest-bearing liabilities decreased to 1.05% in 2020 from 1.66% in 2019 as a result of decreases in short-term interest rates during 2019 and 2020 and an improvement in deposit mix.
- A provision for loan losses of \$4.4 million was recorded in 2020, compared to no provision for loan losses in 2019. The 2020 loan loss provisions were attributable to the net loan charge-offs during the year, trends within the portfolio during the year, and primarily to changes in the economic and business environment attributable to COVID-19, the state and national emergencies that have been declared, and the resultant risk the pandemic poses for business disruptions for the Bank’s borrowers which may lead to credit quality deterioration. Net loan charge-offs were \$333,000 for 2020, compared to net loan charge-offs of \$504,000 for 2019 and net loan recoveries of \$1.2 million for 2018.
- In response to requests from borrowers who have been impacted by COVID-19 through business and cash flow interruption, the Bank made short-term loan modifications involving principal deferrals (interest only) and, in other cases, principal and interest deferrals. Deferrals were 16.6% of the total loan portfolio at June 30, 2020 and declined to 1.6% at December 31, 2020. See the table under the “COVID-19 Short-term Loan Concessions” section for detailed discussion.
- The ratio of non-performing assets to total assets decreased to 0.30% at December 31, 2020, compared with 0.42% at December 31, 2019, and 0.60% at December 31, 2018.
- The Bank made significant progress improving deposit mix throughout 2020. Deposits were \$1.12 billion at December 31, 2020, compared with \$1.03 billion at December 31, 2019. Non-interest bearing demand deposits increased \$55.5 million, or 29.6%, to \$243.0 million compared with \$187.6 million at December 31, 2019. Interest checking accounts increased \$44.6 million, or 30.5%, to \$190.6 million at December 31, 2020, compared with \$146.0 million at December 31, 2019. Money market accounts increased \$14.9 million or 9.3% to \$175.8 million compared with \$160.8 million at December 31, 2019. Savings accounts increased \$86.6 million to \$142.6 million compared to \$56.0 million at December 31, 2019. Certificate of deposit balances decreased \$109.0 million, or 22.9%, to \$367.6 million at December 31, 2020, from \$476.5 million at December 31, 2019.
- On July 31, 2020, the Company completed the issuance of an additional \$8.0 million in subordinated notes pursuant to the July 23, 2019 indenture under which the Company’s outstanding subordinated notes were previously issued. The Company used \$5.0 million of the net proceeds from the offering to retire its senior secured debt and retained the remaining balance for general corporate purposes. The subordinated capital notes qualify as Tier 2

regulatory capital.

These items are discussed in further detail throughout this Item 7.

### Application of Critical Accounting Policies

The Company's accounting and reporting policies comply with GAAP and conform to general practices within the banking industry. Management believes the following significant accounting policies may involve a higher degree of management assumptions and judgments that could result in materially different amounts to be reported if conditions or underlying circumstances were to change.

**Allowance for Loan Losses** – The Bank maintains an allowance for loan losses believed to be sufficient to absorb probable incurred credit losses existing in the loan portfolio. The Board of Directors evaluates the adequacy of the allowance for loan losses on a quarterly basis. Management evaluates the adequacy of the allowance using, among other things, historical loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of the underlying collateral, and current economic conditions and trends. The allowance may be allocated for specific loans or loan categories, but the entire allowance is also available for any loan. The allowance consists of specific and general components. The specific component relates to loans that are individually evaluated and measured for impairment. The general component is based on historical loss experience adjusted for qualitative environmental factors. Management develops allowance estimates based on actual loss experience adjusted for current economic conditions and trends. Allowance estimates are a prudent measurement of the risk in the loan portfolio applied to individual loans based on loan type. If the mix and amount of future charge-off percentages differ significantly from the assumptions used by management in making its determination, management may be required to materially increase its allowance for loan losses and provision for loan losses, which could adversely affect results.

24

[Table of Contents](#)

### Results of Operations

The following table summarizes components of income and expense and the change in those components for 2020 compared with 2019:

	For the		Change from Prior Period	
	Years Ended December 31, 2020	2019	Amount	Percent
	(dollars in thousands)			
Gross interest income	\$ 50,753	\$ 49,584	\$ 1,169	2.4%
Gross interest expense	10,152	14,234	(4,082)	(28.7)
Net interest income	40,601	35,350	5,251	14.9
Provision for loan losses	4,400	—	4,400	100.0
Non-interest income	6,849	5,923	926	15.6
Gains on sale of securities, net	(5)	(5)	—	—
Non-interest expense	32,416	30,270	2,146	7.1
Net income before taxes	10,629	10,998	(369)	(3.4)
Income tax expense	1,624	480	1,144	238.3
Net income	9,005	10,518	(1,513)	(14.4)

Net income of \$9.0 million for the year ended December 31, 2020 decreased by \$1.5 million from net income of \$10.5 million for 2019. Income tax expense for 2020 and 2019 benefitted \$478,000 and \$1.6 million, respectively, from the establishment of a state net deferred tax asset related to the 2019 tax law enactments. The new laws eliminate the Kentucky bank franchise tax, which is assessed at a rate of 1.1% of average capital, and implements a state income tax for the Bank at a statutory rate of 5%. The new Kentucky income tax went into effect on January 1, 2021. A provision for loan losses of \$4.4 million was recorded in 2020, compared to no provision for loan losses expense in 2019. The 2020 loan loss provision was attributable to the net loan charge-offs during the year, trends within the portfolio during the year, and primarily to changes in the economic and business environment attributable to COVID-19.

Non-interest income increased \$926,000 during 2020. There was an increase of \$938,000 in bank card interchange fees, primarily as a result of the deposit accounts acquired in the branch purchase transaction.

Non-interest expense increased \$2.1 million during 2020 due primarily to an increase in salaries and employee benefits of \$1.5 million, \$666,000 in deposit account related expense, and \$479,000 in occupancy expense. The Bank added sales talent and customer facing associates during the latter half of 2019 and branch staff in connection with the branch purchase transaction in November 2019. These increases were muted somewhat by efforts in 2020 to reduce FTEs from 248 at March 31, 2020 to 219 as of December 31, 2020 through attrition and workforce reduction. The increase in deposit account related expense and occupancy expense is the result of the branch purchase transaction.

The following table summarizes components of income and expense and the change in those components for 2019 compared with 2018:

	For the		Change from Prior Period	
	Years Ended December 31, 2019	2018	Amount	Percent
	(dollars in thousands)			
Gross interest income	\$ 49,584	\$ 43,461	\$ 6,123	14.1%
Gross interest expense	14,234	9,790	4,444	45.4

Net interest income	35,350	33,671	1,679	5.0
Provision (negative provision) for loan losses	—	(500)	500	(100.0)
Non-interest income	5,923	5,785	138	2.4
Gains on sale of securities, net	(5)	(6)	1	(16.7)
Non-interest expense	30,270	29,126	1,144	3.9
Net income before taxes	10,998	10,824	174	1.6
Income tax expense	480	2,030	(1,550)	(76.4)
Net income	10,518	8,794	1,724	19.6

25

[Table of Contents](#)

Net income of \$10.5 million for the year ended December 31, 2019 increased by \$1.7 million from net income of \$8.8 million for 2018. Income tax expense for 2019 benefitted \$1.6 million from the establishment of a state net deferred tax asset related to the 2019 tax law enactments. The new laws eliminate the Kentucky bank franchise tax, which is assessed at a rate of 1.1% of average capital, and implements a state income tax for the Bank at a statutory rate of 5%. The new Kentucky income tax went into effect on January 1, 2021. Based upon historically strong trends in asset quality and management's assessment of risk within the portfolio, the Company recorded no provision for loan losses expense in 2019, compared to \$500,000 negative provision for loan losses expense for 2018. Non-interest income increased \$139,000 million during 2019. There was an increase of \$607,000 in bank card interchange fees, partially offset by a decrease in other non-interest income of \$468,000 related to the \$150,000 one-time gain on the sale of the secondary market residential servicing rights portfolio in the third quarter of 2018 and a \$632,000 gain on the sale of a subdivided lot at the Company's headquarters offset by a \$392,000 impairment charge associated with the transfer of the Bank's former data processing center to Premises Held for Sale in the fourth quarter of 2018.

Non-interest expense increased \$1.1 million during 2019 due primarily to \$775,000 of expenses attributable to the branch purchase transaction. There was also an increase of \$744,000 in salary and employee benefits, as the Bank added sales talent and customer facing associates during 2019, and branch staff added in connection with the branch purchase transaction. Deposit account related expense increased \$401,000, which was offset by decreases in OREO expenses of \$500,000, and FDIC insurance expense of \$346,000.

**Net Interest Income** – Net interest income was \$40.6 million for the year ended December 31, 2020, an increase of \$5.3 million, or 14.9%, compared with \$35.4 million for the same period in 2019. Net interest spread and margin were 3.15% and 3.36%, respectively, for 2020, compared with 3.10% and 3.40%, respectively, for 2019.

The interest rate environment was challenging during 2020 as the Federal Reserve, after lowering rates 75 basis points in the latter half of 2019, lowered the federal funds target rate by 50 basis points on March 6, 2020 and 100 basis points on March 15, 2020. In particular, the Federal Reserve's actions served to lower rates on the short end of the yield curve impacting yields on fed funds, certain floating rate investment securities, and loans with variable rate pricing features.

The yield on earning assets decreased to 4.20% for the year ended December 31, 2020, as compared to 4.76% for the year ended December 31, 2019. The yield on earning assets was negatively impacted by falling interest rates on the Bank's fed funds, certain floating rate investment securities, loans with variable rate repricing features, and new loan production during the year. Average loans increased approximately \$162.3 million during 2020. Average loans were positively impacted from the branch purchase transaction on November 15, 2019, along with loan growth during 2019 and 2020, as well as PPP loan originations. The increase in average loans resulted in an increase in interest revenue volume of approximately \$7.9 million for 2020, which was partially offset by a decrease in interest revenue due declining rates of \$5.0 million, as compared to 2019. Loan fee income can meaningfully impact net interest income, loan yields, and net interest margin. The amount of loan fee income included in total interest income represents 18 basis points of yield on earning assets and net interest margin for the year ended December 31, 2020 as compared to 11 basis points for the year ended December 31, 2019. Loan fee income for 2020 included \$1.1 million in fees earned on PPP loans. Total interest income increased 2.4%, or \$1.2 million, for 2020 as compared 2019.

The cost of interest-bearing liabilities decreased to 1.05% for the year ended December 31, 2020, as compared to 1.66% for the year ended December 31, 2019 primarily based on the downward repricing of time deposits. Average interest-bearing liabilities increased by \$106.3 million during 2020 due to deposit growth and the completion of the branch purchase transaction in 2019. Total interest expense decreased by 28.7% to \$10.2 million for the year ended December 31, 2020 as compared to \$14.2 million for the year ended December 31, 2019. The cost of interest-bearing liabilities for 2020 was also impacted by the subordinated debt issuances and senior debt repayments in July 2019 and July 2020. As of December 31, 2020, time deposits comprise \$367.6 million of the Company's liabilities with \$272.0 million, or 74%, set to reprice or mature within one year of which, \$104.9 million with a current average rate of 0.99% reprice or mature within the first quarter of 2021.

Net interest income was \$35.4 million for the year ended December 31, 2019, an increase of \$1.7 million, or 5.0%, compared with \$33.7 million for the same period in 2018. Net interest spread and margin were 3.10% and 3.40%, respectively, for 2019, compared with 3.32% and 3.53%, respectively, for 2018.

The Federal Reserve lowered the federal funds target rate by 25 basis points on July 31, 2019, September 18, 2019, and October 31, 2019. This represented a change in direction as the Federal Reserve had increased rates by 25 basis points on four occasions in 2018.

26

[Table of Contents](#)

Average interest-earning assets were \$1.04 billion for 2019, compared with \$957.5 million for 2018, an 8.9% increase, primarily attributable to higher average loans and average investment securities. Average loans were \$801.8 million for 2019, compared with \$743.4 million for 2018, a 7.9% increase due to loan growth, as well as the completion of the branch purchase transaction on November 15, 2019. This resulted in an increase in interest revenue volume of approximately \$3.0 million and an increase of \$1.8 million attributable to increasing interest rates for 2019 as compared to 2018. Average investment securities were \$206.2 million for 2019, compared with \$178.9 million for 2018, a 15.2% increase. Total interest income increased 14.1% to \$49.6 million for 2019, compared with \$43.5 million for 2018.

Average interest-bearing liabilities increased by 7.2% to \$856.3 million for 2019, compared with \$799.0 million for 2018 due to deposit growth, as well as the completion of the branch purchase transaction on November 15, 2019. Total interest expense increased by 45.4% to \$14.2 million for 2019, compared with \$9.8 million during 2018, due primarily to increases in rates paid on certificates of deposits and other time deposits in 2019 compared to 2018. Average volume of certificates of deposit increased 9.9% to \$483.2 million for 2019, compared with \$439.6 million for 2018. The average interest rate paid on certificates of deposit increased to 1.98% for 2019, compared with 1.35% for 2018. Average volume of interest checking and money market deposit accounts increased 6.5% to \$265.7 million for 2019, compared with \$249.4 million for 2018. The average interest rate paid on interest checking and money market deposit accounts increased to 0.76% for 2019, compared with 0.62% for 2018. The cost of interest-bearing liabilities for 2019 was also impacted by the subordinated debt issuance at a fixed rate of 5.75%.

### Average Balance Sheets

The following table sets forth the average daily balances, the interest earned or paid on such amounts, and the weighted average yield on interest-earning assets and weighted average cost of interest-bearing liabilities for the periods indicated. Dividing income or expense by the average daily balance of assets or liabilities, respectively, derives such yields and costs for the periods presented.

	For the Years Ended December 31,					
	2020			2019		
	Average Balance	Interest Earned/Paid	Average Yield/Cost	Average Balance	Interest Earned/Paid	Average Yield/Cost
	(dollars in thousands)					
<b>ASSETS</b>						
Interest-earning assets:						
Loans receivables (1)(2)						
Real estate	\$ 684,447	\$ 32,572	4.76%	\$ 576,441	\$ 30,139	5.23%
Commercial	200,260	8,398	4.19	134,735	6,660	4.94
Consumer	39,931	2,051	5.14	51,001	2,863	5.61
Agriculture	38,833	2,058	5.30	39,116	2,480	6.34
Other	617	14	2.27	520	11	2.12
U.S. Treasury and agencies	20,239	491	2.43	23,263	558	2.40
Mortgage-backed securities	82,330	1,863	2.26	91,609	2,495	2.72
Collateralized loan obligations	45,595	1,234	2.71	49,881	2,015	4.04
State and political subdivision securities (non-taxable) (3)	14,139	370	3.31	11,759	326	3.51
State and political subdivision securities (taxable)	16,301	494	3.03	18,270	583	3.19
Corporate bonds	23,572	960	4.07	11,376	618	5.43
FHLB stock	6,208	143	2.30	6,691	348	5.20
Federal funds sold	72	—	—	182	4	2.20
Interest-bearing deposits in other financial institutions	38,525	105	0.27	27,809	484	1.74
<b>Total interest-earning assets</b>	<b>1,211,069</b>	<b>50,753</b>	<b>4.20%</b>	<b>1,042,653</b>	<b>49,584</b>	<b>4.76%</b>
Less: Allowance for loan losses	(9,819)			(8,786)		
Non-interest-earning assets	93,684			78,521		
<b>Total assets</b>	<b>\$ 1,294,934</b>			<b>\$ 1,112,388</b>		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>						
Interest-bearing liabilities						
Certificates of deposit and other time deposits	\$ 436,083	\$ 5,802	1.33%	\$ 483,222	\$ 9,564	1.98%
Interest checking and money market deposits	336,596	1,464	0.43	265,687	2,026	0.76
Savings accounts	111,559	530	0.48	36,035	67	0.19
FHLB advances	34,101	371	1.09	35,038	810	2.31
Junior subordinated debentures	21,000	660	3.14	21,000	1,005	4.79
Subordinated capital notes	20,366	1,206	5.92	7,545	433	5.74
Senior debt	2,896	119	4.11	7,781	329	4.23
<b>Total interest-bearing liabilities</b>	<b>962,601</b>	<b>10,152</b>	<b>1.05%</b>	<b>856,308</b>	<b>14,234</b>	<b>1.66%</b>
Non-interest-bearing liabilities						
Non-interest-bearing deposits	215,145			151,299		
Other liabilities	7,230			4,655		
<b>Total liabilities</b>	<b>1,184,976</b>			<b>1,012,262</b>		

Stockholders' equity	109,958	100,126
<b>Total liabilities and stockholders' equity</b>	<b>\$ 1,294,934</b>	<b>\$ 1,112,388</b>
<b>Net interest income</b>	<b>\$ 40,601</b>	<b>\$ 35,350</b>
<b>Net interest spread</b>	<b>3.15%</b>	<b>3.10%</b>
<b>Net interest margin</b>	<b>3.36%</b>	<b>3.40%</b>
<b>Ratio of average interest-earning assets to average interest-bearing liabilities</b>	<b>125.81%</b>	<b>121.76%</b>

- (1) Includes loan fees in both interest income and the calculation of yield on loans.  
(2) Calculations include non-accruing loans of \$1.7 million and \$2.2 million in average loan amounts outstanding.  
(3) Taxable equivalent yields are calculated assuming a 21% federal income tax rate.

28

	For the Years Ended December 31,					
	2019			2018		
	Average Balance	Interest Earned/Paid	Average Yield/Cost	Average Balance	Interest Earned/Paid	Average Yield/Cost
	(dollars in thousands)					
<b>ASSETS</b>						
Interest-earning assets:						
Loans receivables (1)(2)						
Real estate	\$ 576,441	\$ 30,139	5.23%	\$ 548,877	\$ 27,296	4.97%
Commercial	134,735	6,660	4.94	123,044	5,934	4.82
Consumer	51,001	2,863	5.61	32,049	1,765	5.51
Agriculture	39,116	2,480	6.34	38,796	2,334	6.02
Other	520	11	2.12	586	13	2.22
U.S. Treasury and agencies	23,263	558	2.40	23,732	549	2.31
Mortgage-backed securities	91,609	2,495	2.72	81,771	2,142	2.62
Collateralized loan obligations	49,881	2,015	4.04	32,163	1,177	3.66
State and political subdivision securities (non-taxable) (3)	11,759	326	3.51	14,189	383	3.42
State and political subdivision securities (taxable)	18,270	583	3.19	18,890	570	3.02
Corporate bonds	11,376	618	5.43	8,162	442	5.42
FHLB stock	6,691	348	5.20	7,280	429	5.89
Federal funds sold	182	4	2.20	1,152	22	1.91
Interest-bearing deposits in other financial institutions	27,809	484	1.74	26,763	405	1.51
<b>Total interest-earning assets</b>	<b>1,042,653</b>	<b>49,584</b>	<b>4.76%</b>	<b>957,454</b>	<b>43,461</b>	<b>4.55%</b>
Less: Allowance for loan losses	(8,786)			(8,692)		
Non-interest-earning assets	78,521			77,548		
<b>Total assets</b>	<b>\$ 1,112,388</b>			<b>\$ 1,026,310</b>		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>						
Interest-bearing liabilities						
Certificates of deposit and other time deposits	\$ 483,222	\$ 9,564	1.98%	\$ 439,597	\$ 5,949	1.35%
Interest checking and money market deposits	265,687	2,026	0.76	249,415	1,543	0.62
Savings accounts	36,035	67	0.19	34,866	57	0.16
FHLB advances	35,038	810	2.31	43,363	867	2.00
Junior subordinated debentures	21,000	1,005	4.79	21,000	946	4.50
Subordinated capital notes	7,545	433	5.74	791	39	4.93
Senior debt	7,781	329	4.23	10,000	389	3.89
<b>Total interest-bearing liabilities</b>	<b>856,308</b>	<b>14,234</b>	<b>1.66%</b>	<b>799,032</b>	<b>9,790</b>	<b>1.23%</b>
Non-interest-bearing liabilities						



Non-interest-bearing deposits	151,299	136,947
Other liabilities	4,655	5,471
<b>Total liabilities</b>	<b>1,012,262</b>	<b>941,450</b>
Stockholders' equity	100,126	84,860
<b>Total liabilities and stockholders' equity</b>	<b>\$ 1,112,388</b>	<b>\$ 1,026,310</b>
<b>Net interest income</b>	<b>\$ 35,350</b>	<b>\$ 33,671</b>
<b>Net interest spread</b>	<b>3.10%</b>	<b>3.32%</b>
<b>Net interest margin</b>	<b>3.40%</b>	<b>3.53%</b>
<b>Ratio of average interest-earning assets to average interest-bearing liabilities</b>	<b>121.76%</b>	<b>119.83%</b>

- (1) Includes loan fees in both interest income and the calculation of yield on loans.
- (2) Calculations include non-accruing loans of \$2.2 million and \$3.5 million in average loan amounts outstanding.
- (3) Taxable equivalent yields are calculated assuming a 21% federal income tax rate.

### Rate/Volume Analysis

The table below sets forth information regarding changes in interest income and interest expense for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (1) changes in rate (changes in rate multiplied by old volume); (2) changes in volume (changes in volume multiplied by old rate); and (3) changes in rate-volume (change in rate multiplied by change in volume). Changes in rate-volume are proportionately allocated between rate and volume variance.

	Year Ended December 31, 2020 vs. 2019			Year Ended December 31, 2019 vs. 2018		
	Increase (decrease) due to change in			Increase (decrease) due to change in		
	Rate	Volume	Net Change	Rate	Volume	Net Change
	(in thousands)					
<b>Interest-earning assets:</b>						
Loan receivables	\$ (4,982)	\$ 7,922	\$ 2,940	\$ 1,789	\$ 3,022	\$ 4,811
U.S. Treasury and agencies	6	(73)	(67)	20	(11)	9
Mortgage-backed securities	(395)	(237)	(632)	87	266	353
Collateralized loan obligations	(620)	(161)	(781)	133	705	838
State and political subdivision securities	(57)	12	(45)	47	(91)	(44)
Corporate bonds	(186)	528	342	1	175	176
FHLB stock	(182)	(23)	(205)	(48)	(33)	(81)
Federal funds sold	(3)	(1)	(4)	3	(21)	(18)
Interest-bearing deposits in other financial institutions	(516)	137	(379)	63	16	79
<b>Total increase (decrease) in interest income</b>	<b>(6,935)</b>	<b>8,104</b>	<b>1,169</b>	<b>2,095</b>	<b>4,028</b>	<b>6,123</b>
<b>Interest-bearing liabilities:</b>						
Certificates of deposit and other time deposits	(2,899)	(863)	(3,762)	2,977	638	3,615
Interest checking and money market accounts	(1,014)	452	(562)	377	106	483
Savings accounts	197	266	463	8	2	10
FHLB advances	(418)	(21)	(439)	123	(180)	(57)
Junior subordinated debentures	(345)	—	(345)	59	—	59
Subordinated capital notes	14	759	773	7	387	394
Senior debt	(9)	(201)	(210)	32	(92)	(60)
<b>Total increase (decrease) in interest expense</b>	<b>(4,474)</b>	<b>392</b>	<b>(4,082)</b>	<b>3,583</b>	<b>861</b>	<b>4,444</b>
<b>Increase (decrease) in net interest income</b>	<b>\$ (2,461)</b>	<b>\$ 7,712</b>	<b>\$ 5,251</b>	<b>\$ (1,488)</b>	<b>\$ 3,167</b>	<b>\$ 1,679</b>

**Non-interest Income** – The following table presents for the periods indicated the major categories of non-interest income:

	For the Years Ended December 31,		
	2020	2019	2018
	(in thousands)		
Service charges on deposit accounts	\$ 2,268	\$ 2,381	\$ 2,355
Bank card interchange fees	3,376	2,438	1,831
Income from bank owned life insurance	424	410	437
Net gain (loss) on sales and calls of securities	(5)	(5)	(6)
Other	781	694	1,162
Total non-interest income	<u>\$ 6,844</u>	<u>\$ 5,918</u>	<u>\$ 5,779</u>

#### *Non-interest Income Comparison – 2020 to 2019*

Non-interest income increased by \$926,000 for 2020 to \$6.8 million compared with \$5.9 million for the year ended December 31, 2019. This increase was primarily related to bank card interchange fees of \$938,000 as a result of the deposit accounts acquired in the branch purchase transaction on November 15, 2019.

30

#### [Table of Contents](#)

#### *Non-interest Income Comparison – 2019 to 2018*

Non-interest income increased by \$139,000 for 2019 to \$5.9 million compared with \$5.8 million for the year ended December 31, 2018. This increase was primarily due to growth in bank card interchange fees of \$607,000 partially offset by a decrease in other non-interest income of \$468,000 related to the \$150,000 one-time gain on the sale of the secondary market residential servicing rights portfolio in the third quarter of 2018 and a \$632,000 gain on the sale of a subdivided lot at the Company's headquarters offset by a \$392,000 impairment charge associated with the transfer of the Bank's former data processing center to held for sale in the fourth quarter of 2018.

**Non-interest Expense** – The following table presents the major categories of non-interest expense:

	For the Years Ended December 31,		
	2020	2019	2018
	(in thousands)		
Salary and employee benefits	\$ 17,751	\$ 16,233	\$ 15,489
Occupancy and equipment	4,001	3,522	3,586
FDIC insurance	229	211	557
Data processing expense	1,502	1,259	1,192
Marketing expense	629	908	1,114
State franchise and deposit tax	1,475	1,210	1,118
Deposit account related expense	1,890	1,224	823
Professional fees	937	769	814
Communications	856	772	701
Insurance expense	428	444	478
Postage and delivery	627	544	364
Litigation and loan collection expense	200	189	245
Other real estate owned expense	63	368	868
Acquisition costs	—	775	—
Other	1,828	1,842	1,777
Total non-interest expense	<u>\$ 32,416</u>	<u>\$ 30,270</u>	<u>\$ 29,126</u>

#### *Non-interest Expense Comparison – 2020 to 2019*

Non-interest expense for the year ended December 31, 2020 of \$32.4 million represented a \$2.1 million, or 7.1%, increase from \$30.3 million for 2019. The increase in non-interest expense was primarily due to an increase in salaries and employee benefits of \$1.5 million. The Bank added sales talent and customer facing associates during the latter half of 2019 and branch staff in connection with the branch purchase transaction in November 2019. These increases were muted somewhat by efforts in 2020 to reduce FTEs from 248 at March 31, 2020 to 219 as of December 31, 2020 through attrition and workforce reduction. Deposit account related expense increased by \$666,000 and occupancy expense increased by \$479,000 as a result of the branch purchase transaction. Franchise tax expense increased by \$265,000 as a function of growth in the Bank's taxable capital. These increases were offset by a decrease in OREO expenses of \$305,000 due to lower valuation write-downs and operating expenses in 2020 compared to 2019. Non-interest expense for 2019 also included \$775,000 of acquisition expenses associated with the branch purchase transaction.

#### *Non-interest Expense Comparison – 2019 to 2018*

Non-interest expense for the year ended December 31, 2019 of \$30.3 million represented a 3.9% increase from \$29.1 million for 2018. The increase in non-interest expense was attributable primarily to \$775,000 of expenses related to the branch purchase transaction. There was also an increase of \$744,000 in salary and employee benefits, as the Bank added sales talent and customer facing associates during 2019, and branch staff added in connection with the branch purchase transaction. Deposit account related expense increased \$401,000, which correlated to growth in card interchange income, and was offset by decreases in OREO expenses of \$500,000, and FDIC insurance expense of \$346,000. OREO expense decreased due to lower valuation adjustment write-downs during 2019 compared

to 2018. During the year ended December 31, 2019, fair value write-downs of \$260,000 were recorded compared with \$850,000 for the year ended December 31, 2018. The write-downs reflect declines in the fair value due to changes in marketing strategies. There were no OREO sales in 2019 compared to \$876,000 during 2018.

[Table of Contents](#)

**Income Tax Expense** – Effective tax rates differ from the federal statutory rate applied to income before income taxes due to the following:

	2020	2019 (in thousands)		2018
Statutory tax rate	21%	21%	21%	21%
Federal statutory rate times financial statement income	\$ 2,232	\$ 2,310		\$ 2,273
Effect of:				
Tax-exempt income	(73)	(66)		(80)
Establish state deferred tax asset	(478)	(1,577)		—
Non-taxable life insurance income	(89)	(86)		(92)
Restricted stock vesting	7	(137)		(115)
Other, net	25	36		44
Total	<u>\$ 1,624</u>	<u>\$ 480</u>		<u>\$ 2,030</u>

For 2020 and 2019, income tax expense benefitted from the establishment of a net deferred tax assets related to a change in Kentucky tax law enacted during 2019. Income tax expense benefitted \$478,000 and \$1.6 million for the years ended December 31, 2020 and 2019, respectively, or \$0.06 per basic and diluted common share, and \$0.21 per basic and diluted common share, respectively. The new law eliminates the Kentucky bank franchise tax, which is assessed at a rate of 1.1% of average capital, and implements a state income tax for the Bank at a statutory rate of 5%. The new Kentucky income tax went into effect on January 1, 2021.

See Note 12, “Income Taxes”, to the financial statements for additional discussion of the Company’s income taxes.

**Analysis of Financial Condition**

Total assets at December 31, 2020 were \$1.31 billion compared with \$1.25 billion at December 31, 2019, an increase of \$66.5 million or 5.3%. This increase was primarily attributable to an increase in net loans of \$31.7 million, as well as \$34.9 million in interest-bearing deposits in banks.

Total assets at December 31, 2019 were \$1.25 billion compared with \$1.07 billion at December 31, 2018, an increase of \$176.1 million or 16.5%. This increase was primarily attributable to an increase in net loans of \$161.5 million, which resulted from \$124.7 million in outstanding loans at December 31, 2019 associated with the branch purchase transaction, as well as loan growth.

**Loans Receivable** – Loans receivable increased \$35.8 million, or 3.9%, during the year ended December 31, 2020, to \$962.1 million. At December 31, 2020, the Bank had \$20.3 million in loans outstanding under the SBA Paycheck Protection Program. The Bank’s commercial and commercial real estate portfolios increased by an aggregate of \$92.8 million, or 17.0%, during 2020 and comprised 66.3% of the total loan portfolio at December 31, 2020.

Loans receivable increased \$161.0 million, or 21.0%, during the year ended December 31, 2019, to \$926.3 million. The Bank’s commercial and commercial real estate portfolios increased by an aggregate of \$78.7 million, or 16.9%, during 2019 and comprised 58.8% of the total loan portfolio at December 31, 2019.

[Table of Contents](#)

**Loan Portfolio Composition** – The following table presents a summary of the loan portfolio at the dates indicated, net of deferred loan fees, by type. There are no foreign loans in the Bank’s portfolio and other than the categories noted, there is no concentration of loans in any industry exceeding 10% of total loans.

	As of December 31,			
	2020		2019	
	Amount	Percent	Amount	Percent
	(dollars in thousands)			
Commercial (1)	\$ 208,244	21.65%	\$ 145,551	15.71%
Commercial Real Estate:				
Construction	92,916	9.66	64,911	7.01
Farmland	70,272	7.30	79,118	8.54
Nonfarm nonresidential	266,394	27.69	255,459	27.58
Residential Real Estate:				
Multi-family	61,180	6.36	70,950	7.66
1-4 Family	188,955	19.64	226,629	24.47
Consumer	31,429	3.27	47,790	5.16
Agriculture	42,044	4.37	35,064	3.79
Other	647	0.06	799	0.08
Total loans	<u>\$ 962,081</u>	<u>100.00%</u>	<u>\$ 926,271</u>	<u>100.00%</u>

(1) Includes PPP loans of \$20.3 million at December 31, 2020.

	As of December 31,					
	2018		2017		2016	
	Amount	Percent	Amount	Percent	Amount	Percent
	(dollars in thousands)					
Commercial	\$ 129,368	16.91%	\$ 113,771	15.98%	\$ 97,761	15.29%
Commercial Real Estate:						
Construction	86,867	11.35	57,342	8.05	36,330	5.68
Farmland	77,937	10.18	88,320	12.40	71,507	11.19
Nonfarm nonresidential	172,177	22.50	156,724	22.01	149,546	23.39
Residential Real Estate:						
Multi-family	49,757	6.50	56,588	7.94	48,197	7.54
1-4 Family	175,761	22.97	179,222	25.17	188,092	29.42
Consumer	39,104	5.11	18,439	2.59	9,818	1.54
Agriculture	33,737	4.41	41,154	5.78	37,508	5.87
Other	536	0.07	555	0.08	477	0.08
Total loans	\$ 765,244	100.00%	\$ 712,115	100.00%	\$ 639,236	100.00%

Lending activities are subject to a variety of lending limits imposed by state and federal law. The Bank's secured legal lending limit to a single borrower or guarantor was approximately \$46.0 million at December 31, 2020.

The Bank had 18 and 14 loan relationships each with aggregate extensions of credit in excess of \$10.0 million at year end 2020 and 2019, respectively, 17 of which were classified as pass and one classified as watch by the Bank's internal loan review process at December 31, 2020 and all 14 classified as pass at December 31, 2019.

As of December 31, 2020, the Bank had \$74.3 million of loan participations purchased from, and \$21.3 million of loan participations sold to, other banks. As of December 31, 2019, the Bank had \$64.1 million of loan participations purchased from, and \$15.7 million of loan participations sold to, other banks.

[Table of Contents](#)

**Loan Maturity Schedule** – The following table sets forth at December 31, 2020, the dollar amount of loans, net of deferred loan fees, maturing in the loan portfolio based on their contractual terms to maturity:

	As of December 31, 2020			
	Maturing Within One Year	Maturing 1 through 5 Years	Maturing Over 5 Years	Total Loans
	(dollars in thousands)			
<b>Loans with fixed rates:</b>				
Commercial	\$ 30,489	\$ 43,091	\$ 29,282	\$ 102,862
Commercial Real Estate:				
Construction	10,163	6,681	4,950	21,794
Farmland	3,529	16,899	7,983	28,411
Nonfarm nonresidential	38,436	40,568	75,979	154,983
Residential Real Estate:				
Multi-family	2,242	19,573	11,238	33,053
1-4 Family	7,870	21,941	67,439	97,250
Consumer	23,830	4,586	730	29,146
Agriculture	3,474	7,490	360	11,324
Other	282	293	—	575
Total fixed rate loans	\$ 120,315	\$ 161,122	\$ 197,961	\$ 479,398
<b>Loans with floating rates:</b>				
Commercial	\$ 32,728	\$ 61,439	\$ 11,215	\$ 105,382
Commercial Real Estate:				
Construction	51,438	15,189	4,495	71,122
Farmland	4,960	6,955	29,946	41,861
Nonfarm nonresidential	1,751	45,271	64,389	111,411
Residential Real Estate:				
Multi-family	3,331	18,216	6,580	28,127
1-4 Family	6,249	8,649	76,807	91,705
Consumer	1,999	134	150	2,283

Agriculture	30,121	466	133	30,720
Other	—	—	72	72
Total floating rate loans	\$ 132,577	\$ 156,319	\$ 193,787	\$ 482,683

**Loan Portfolio by Risk Category** – The following table presents a summary of the loan portfolio at the dates indicated, by risk category.

	As of December 31,				
	2020	2019	2018	2017	2016
	(in thousands)				
Pass	\$ 926,025	\$ 888,707	\$ 745,604	\$ 673,033	\$ 586,430
Watch	18,879	27,522	13,164	25,715	30,431
Special Mention	—	—	113	164	497
Substandard	17,177	10,042	6,363	13,203	21,878
Doubtful	—	—	—	—	—
Total	\$ 962,081	\$ 926,271	\$ 765,244	\$ 712,115	\$ 639,236

Loans receivable increased \$35.8 million, or 3.9%, during the year ended December 31, 2020. Since December 31, 2019, the pass category increased approximately \$37.3 million, the watch category decreased approximately \$8.6 million, and the substandard category increased approximately \$7.1 million. The \$7.1 million increase in loans classified as substandard was primarily driven by \$11.7 million in loans moved to substandard, offset by \$3.9 million in principal payments received and \$643,000 in charge-offs during 2020. These trends were considered during the evaluation of qualitative trends in the portfolio when establishing the general component of the allowance for loan losses.

[Table of Contents](#)

**Loan Delinquency** – The following table presents a summary of loan delinquencies at the dates indicated.

	As of December 31,				
	2020	2019	2018	2017	2016
	(in thousands)				
<b>Past Due Loans:</b>					
30-59 Days	\$ 1,537	\$ 1,747	\$ 1,593	\$ 1,478	\$ 2,302
60-89 Days	372	670	331	171	315
90 Days and Over	—	—	—	1	—
Total Loans Past Due 30-90+ Days	1,909	2,417	1,924	1,650	2,617
<b>Nonaccrual Loans</b>	1,676	1,528	1,991	5,457	9,216
Total Past Due and Nonaccrual Loans	\$ 3,585	\$ 3,945	\$ 3,915	\$ 7,107	\$ 11,833

Loans past due 30-59 days decreased from \$1.7 million at December 31, 2019 to \$1.5 million at December 31, 2020, and loans past due 60-89 days decreased from \$670,000 at December 31, 2019 to \$372,000 at December 31, 2020. This represents a \$508,000 decrease in loans past due 30-89 days. This trend in delinquency levels is considered during the evaluation of qualitative trends in the portfolio when establishing the general component of the Bank's allowance for loan losses.

Nonaccrual loans increased \$148,000 from December 31, 2019 to December 31, 2020. This increase was primarily driven by \$1.3 million in paydowns and \$569,000 in charge-offs, offset by \$2.0 million in loans placed on non-accrual. The \$1.7 million in nonaccrual loans at December 31, 2020, and \$1.5 million at December 31, 2019, were generally secured by farmland and 1-4 family residential real estate loans. Management believes it has established adequate loan loss reserves for these credits.

**Troubled Debt Restructuring** – A troubled debt restructuring (TDR) occurs when the Bank has agreed to a loan modification in the form of a concession to a borrower who is experiencing financial difficulty. The Bank's TDRs typically involve a reduction in interest rate, a deferral of principal for a stated period of time, or an interest only period. TDRs are considered to be impaired loans, and the Bank has allocated reserves for these loans to reflect the present value of the concessionary terms granted to the borrower. If the loan is considered collateral dependent, it is reported net of allocated reserves, at the fair value of the collateral less cost to sell.

The Bank generally does not have a formal loan modification program. If a borrower is unable to make contractual payments, management reviews the particular circumstances of that borrower's situation and determine whether or not to negotiate a revised payment stream. The goal when restructuring a credit is to afford the borrower a reasonable period of time to remedy the issue causing cash flow constraints so that the credit may return to performing status over time. If a borrower fails to perform under the modified terms, the loan(s) are placed on nonaccrual status and collection actions are initiated.

At December 31, 2020, the Bank had four restructured loans totaling \$480,000 with borrowers who experienced deterioration in financial condition compared with three restructured loans totaling \$475,000 at December 31, 2019. In general, these loans were granted interest rate reductions to provide cash flow relief to borrowers experiencing cash flow difficulties. At December 31, 2020 and December 31, 2019, the Bank had no restructured loans that had been granted principal payment deferrals until maturity. There were no concessions made to forgive principal relative to these loans, although partial charge-offs have been recorded for certain restructured loans. In general, these loans are secured by first liens on 1-4 residential properties or commercial real estate properties. At December 31, 2020 and December 31, 2019, all TDRs were performing according to their modified terms.

There was one modification granted during 2020 that resulted in a loan being identified as TDRs. There were two modifications granted during 2019 that resulted

in loans being identified as TDRs. See “Note 3 – Loans,” to the financial statements for additional disclosure related to troubled debt restructuring.

**COVID-19 Short-term Loan Concessions** – The Bank has elected to account for eligible loan modifications under Section 4013 of the Coronavirus Aid Relief and Economic Security Act (“CARES Act”). To be an eligible loan under Section 4013 of the CARES Act, a loan modification must be (1) related to the COVID-19 pandemic; (2) executed on a loan that was not more than 30 days past due as of December 31, 2019; and (3) executed between March 1, 2020 and the earlier of (A) 60 days after the date of termination of the national emergency declared by the President on March 13, 2020 concerning the COVID-19 outbreak (the “national emergency”) or (B) January 1, 2022. Eligible loan modifications are not required to be classified as TDRs and will not be reported as past due provided that they are performing in accordance with the modified terms. Interest income will continue to be recognized in accordance with GAAP unless the loan is placed on nonaccrual status.

35

[Table of Contents](#)

Short-term loan modifications declined to \$15.3 million as of December 31, 2020, as compared to \$160.4 million at June 30, 2020. The following table details the status of the Bank’s short-term loan modifications by loan category or type as of December 31, 2020:

	<u>First Modification Active</u>	<u>Subsequent Modification Active</u>	<u>Modification Ended</u>	<u>Total Modified Loans</u>	<u>Total Loan Portfolio</u>	<u>% Modified to Total Portfolio</u>
	(in thousands)					
Hotel, Motel, & Lodging	\$ —	\$ —	\$ 7,822	\$ 7,822	\$ 51,822	15.1%
Retail Facility	—	4,355	—	4,355	67,785	6.4
Commercial Real Estate	—	346	—	346	160,433	0.2
1-4 Family Residential	—	—	—	—	188,955	—
Restaurant Full Service	—	—	—	—	15,094	—
Restaurant Limited Service	2,303	—	—	2,303	15,780	14.6
Multi-family	—	—	—	—	61,180	—
Construction and Development	—	—	—	—	48,396	—
Commercial & Industrial	—	—	—	—	208,244	—
Farmland	—	—	—	—	70,272	—
Consumer, Agriculture & Other	—	—	486	486	74,120	0.7
Total	<u>\$ 2,303</u>	<u>\$ 4,701</u>	<u>\$ 8,308</u>	<u>\$ 15,312</u>	<u>\$ 962,081</u>	<u>1.6%</u>

First Modification Active includes loans within the terms of the original modification agreement. Subsequent Modification Active includes loans with a matured original modification that have been further modified within the short-term parameters. Modification Ended includes loans that have reached final deferred payment and have yet to make a payment in accordance with the loan’s original terms or have yet to request a subsequent modification. Loans that returned to original contracted terms with a verified payment are considered cured and are no longer included as modified loans in the table above.

The table above includes one commercial real estate loan secured by a retail facility totaling \$4.4 million that remains subject to and is performing in accordance with an interest only short-term subsequent COVID-19 modification. The loan is graded substandard, has been evaluated under ASC-310-10, and allocated a specific reserve of \$2.2 million as of December 31, 2020.

Subsequent to December 31, 2020, \$8.3 million of the loans categorized as Modification Ended in the table above have received a verified payment and are now considered cured.

**Non-Performing Assets** – Non-performing assets consist of certain restructured loans for which interest rate or other terms have been renegotiated, loans past due 90 days or more still on accrual, loans on which interest is no longer accrued, real estate acquired through foreclosure and repossessed assets. Loans, including impaired loans, are placed on nonaccrual status when they become past due 90 days or more as to principal or interest, unless they are adequately secured and in the process of collection. Loans are considered impaired if full principal or interest payments are not anticipated in accordance with the contractual loan terms. Impaired loans are carried at the present value of expected future cash flows discounted at the loan’s effective interest rate or at the fair value of the collateral less cost to sell if the loan is collateral dependent. Loans are reviewed on a regular basis and normal collection procedures are implemented when a borrower fails to make a required payment on a loan. If the delinquency on a mortgage loan exceeds 120 days and is not cured through normal collection procedures or an acceptable arrangement is not agreed to with the borrower, management institutes measures to remedy the default, including commencing a foreclosure action. Consumer loans generally are charged off when a loan is deemed uncollectible and often before any available collateral has been disposed. Commercial business and real estate loan delinquencies are handled on an individual basis, generally with the advice of legal counsel.

Interest income on loans is recognized on the accrual basis except for those loans placed on nonaccrual status. The accrual of interest on impaired loans is discontinued when management believes, after consideration of economic and business conditions and collection efforts, that the borrowers’ financial condition is such that collection of interest is doubtful, which typically occurs after the loan becomes 90 days delinquent. When interest accrual is discontinued, existing accrued interest is reversed and interest income is subsequently recognized only to the extent cash payments are received on well-secured loans.

36

[Table of Contents](#)

Real estate acquired as a result of foreclosure or by deed in lieu of foreclosure is classified as real estate owned until such time as it is sold. New and used automobiles and other motor vehicles acquired as a result of foreclosure are classified as repossessed assets until they are sold. When such property is acquired it is recorded at its fair market value less cost to sell. Any write-down of the property at the time of acquisition is charged to the allowance for loan losses. Subsequent

gains and losses are included in non-interest expense.

The following table sets forth information with respect to non-performing assets as of the dates indicated:

	As of December 31,				
	2020	2019	2018	2017	2016
	(dollars in thousands)				
Loans on nonaccrual status	\$ 1,676	1,528	1,991	5,457	9,216
Troubled debt restructurings on accrual	480	475	910	1,217	5,350
Past due 90 days or more still on accrual	—	—	—	1	—
Total non-performing loans and TDRs on accrual	2,156	2,003	2,901	6,675	14,566
Real estate acquired through foreclosure	1,765	3,225	3,485	4,409	6,821
Other repossessed assets	—	—	—	—	—
Total non-performing assets and TDRs on accrual	\$ 3,921	\$ 5,228	\$ 6,386	\$ 11,084	\$ 21,387
Non-performing loans and TDRs on accrual to total loans	0.22%	0.22%	0.38%	0.94%	2.28%
Non-performing assets and TDRs on accrual to total assets	0.30%	0.42%	0.60%	1.14%	2.26%
Allowance for non-performing loans	\$ 22	\$ 48	\$ 83	\$ 108	\$ 241
Allowance for non-performing loans to non-performing loans and TDRs on accrual	1.02%	2.40%	2.86%	1.62%	1.65%

Interest income that would have been recorded if nonaccrual loans were on a current basis in accordance with their original terms was \$288,000, \$315,000, and \$274,000 for the years ended December 31, 2020, 2019, and 2018, respectively.

**Allowance for Loan Losses** – The allowance for loan losses is established to provide for probable losses on loans that may not be fully repaid. It is based on management’s continuing review and evaluation of individual loans, loss experience, current economic conditions, risk characteristics of various categories of loans and such other factors that, in management’s judgment, require current recognition in estimating loan losses. The allowance is an estimate and loss may vary from this estimate.

Management utilizes loan grading procedures that result in specific allowance allocations for the estimated risk of loss. For loans not individually evaluated, a general allowance allocation is computed using factors developed over time based on actual loss experience. The specific and general allocations plus consideration of qualitative factors represent management’s estimate of probable losses contained in the loan portfolio at the evaluation date. Although the allowance for loan losses is comprised of specific and general allocations, the entire allowance is available to absorb any credit losses.

[Table of Contents](#)

The following table sets forth an analysis of loan loss experience as of and for the periods indicated:

	As of December 31,				
	2020	2019	2018	2017	2016
	(dollars in thousands)				
Balances at beginning of period	\$ 8,376	\$ 8,880	\$ 8,202	\$ 8,967	\$ 12,041
Loans charged-off:					
Real estate	231	322	450	750	2,157
Commercial	32	37	50	5	276
Consumer	493	663	95	51	99
Agriculture	46	266	13	95	18
Other	—	—	8	—	79
Total charge-offs	802	1,288	616	901	2,629
Recoveries:					
Real estate	352	597	1,437	714	1,189
Commercial	29	106	261	59	334
Consumer	45	75	69	115	299
Agriculture	30	3	15	33	114
Other	13	3	12	15	69
Total recoveries	469	784	1,794	936	2,005
Net charge-offs (recoveries)	333	504	(1,178)	(35)	624
Provision (negative provision) for loan losses	4,400	—	(500)	(800)	(2,450)
Balance at end of period	\$ 12,443	\$ 8,376	\$ 8,880	\$ 8,202	\$ 8,967
Allowance for loan losses to period-end loans	1.29%	0.90%	1.16%	1.15%	1.40%
Net charge-offs (recoveries) to average loans	0.03%	0.06%	(0.16)%	(0.01)%	0.10%
Allowance for loan losses to non-performing loans and TDRs on accrual	577.13%	418.17%	306.10%	122.88%	61.16%

The allowance for loan losses is a reserve established through charges to earnings in the form of a provision for loan losses. The loan loss reserve, as a percentage of total loans at December 31, 2020, was 1.29% compared to 0.90% at December 31, 2019. Loans acquired in the November 2019 branch transaction totaled \$85.9 million at December 31, 2020 and \$124.7 million at December 31, 2019. These loans were recorded at fair value as determined by an independent third party. The remaining discount associated with the fair value purchase accounting adjustments on the acquired loans was \$288,000 at December 31, 2020, compared to \$480,000 at December 31, 2019. Additionally, management added a qualitative environmental adjustment for these loans as the fair value assessment at the time of purchase did not contemplate COVID-19. Any subsequent deterioration of these acquired loans may require an adjustment through the allowance for loan loss. The allowance for loan losses to non-performing loans was 577.13% at December 31, 2020, compared with 418.17% at December 31, 2019. Net charge-offs totaled \$333,000 for 2020 compared to net charge-offs of \$504,000 for 2019.

A general reserve is maintained for each loan type in the loan portfolio. In determining the amount of the general reserve portion of the allowance for loan losses, management considers factors such as the Bank's historical loan loss experience, the growth, composition and diversification of its loan portfolio, current delinquency levels, loan quality grades, the results of recent regulatory examinations, and general economic conditions. Based on these factors, management applies estimated loss percentages to the various categories of loans, not including any loan that has a specific allowance allocated to it.

Generally, all loans identified as impaired are reviewed individually on a quarterly basis in order to determine whether a specific allowance is required. A loan is considered impaired when, based on current information, it is probable that the Bank will not receive all amounts due in accordance with the contractual terms of the loan agreement. Once a loan has been identified as impaired, management measures impairment in accordance with ASC 310-10, "*Impairment of a Loan.*" When management's measured value of the impaired loan is less than the recorded investment in the loan, the amount of the impairment is recorded as a specific reserve or charged-off if the loan is deemed collateral dependent. Loans for which specific reserves have been provided are excluded from the general reserve calculations described below.

Management makes specific allowances for each impaired loan based on its type and risk classification as discussed above. Impaired loans have been assessed for collectability which considered, among other things, the borrower's ability to repay, the value of the underlying collateral, and other market conditions to ensure that the allowance for loan losses is adequate to absorb probable incurred losses.

---

[Table of Contents](#)

A significant portion of the portfolio is comprised of loans secured by real estate. A decline in the value of the real estate serving as collateral for loans may impact the Bank's ability to collect those loans. In general, management obtains updated appraisals on property securing the Bank's loans when circumstances are warranted such as at the time of renewal or when market conditions have significantly changed. Management uses qualified licensed appraisers approved by the Company's Board of Directors. These appraisers possess prerequisite certifications and knowledge of the local and regional marketplace.

Based on its assessment of the loan portfolio, management presents a quarterly review of the allowance for loan losses to the Bank's Board of Directors, indicating any change in the allowance for loan losses since the last review and any recommendations as to adjustments in the allowance for loan losses. This assessment is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as events change. Historical loss experience, risk grade classification metrics, charge-off levels, and past due trends remained stable between periods.

The Bank follows a loan grading program designed to evaluate the credit risk in the loan portfolio. Through this loan grading process, an internally classified watch list is maintained which helps management assess the overall quality of the loan portfolio and the adequacy of the allowance for loan losses. Loans categorized as watch list loans show warning elements where the present status exhibits one or more deficiencies that require attention in the short-term or where pertinent ratios of the loan account have weakened warranting more frequent monitoring. These loans do not have all of the characteristics of a classified loan (substandard or doubtful), but show weakened elements as compared with those of a satisfactory credit. These loans are considered in the assessment of the adequacy of the allowance for loan losses.

In establishing the appropriate risk rating for loans, management considers, among other factors, the borrower's ability to repay, the borrower's repayment history, the current delinquency status, the estimated value of the underlying collateral, and the capacity and willingness of a guarantor to satisfy the obligation. As a result of this process, loans are categorized as special mention, substandard or doubtful.

Loans classified as "special mention" do not have all of the characteristics of substandard or doubtful loans. They have one or more deficiencies that warrant special attention and which corrective action, such as accelerated collection practices, may remedy. Loans classified as "substandard" are those loans with clear and defined weaknesses such as a highly leveraged position, unfavorable financial ratios, uncertain repayment sources or poor financial condition that may jeopardize the repayment of the debt as contractually agreed. They are characterized by the distinct possibility that the Bank will sustain some losses if the deficiencies are not corrected. Loans classified as "doubtful" are those loans which have characteristics similar to substandard loans but with an increased risk that collection or liquidation in full is highly questionable and improbable.

Specific reserves may be carried for accruing TDRs in compliance with restructured terms. Once a loan is deemed impaired or uncollectible as contractually agreed (other than performing TDRs), the loan is charged-off either partially or in-full against the allowance for loan losses, based upon the expected future cash flows discounted at the loan's effective interest rate, or the fair value of collateral less estimated cost to sell with respect to collateral-based loans if collateral dependent.

As of December 31, 2020, \$17.2 million of loans were classified as substandard, there were no loans classified as special mention, and no loans classified as doubtful or loss. This compares with \$10.0 million of loans classified as substandard, no loans classified as special mention, and no loans classified as doubtful or loss as of December 31, 2019. The \$7.1 million increase in loans classified as substandard was primarily driven by \$11.7 million in loans moved to substandard, offset by \$3.9 million in principal payments received and \$643,000 in charge-offs during 2020. Substandard loans are primarily concentrated in the commercial and commercial real estate portfolios. As of December 31, 2020, \$2.8 million of the allowance for loan losses was allocated to substandard loans, compared to an allocation of \$401,000 at December 31, 2019. The increase in allocation between years is primarily related to one commercial real estate loan secured by a retail facility totaling \$4.4 million that remains subject to and is performing in accordance with an interest only, short-term subsequent COVID-19 modification. The loan is graded substandard, has been evaluated under ASC-310-10, and allocated a specific reserve of \$2.2 million at December 31, 2020.



[Table of Contents](#)

The following table depicts management's allocation of the allowance for loan losses by loan type based on the factors previously discussed. Since these factors and management's assumptions are subject to change, the allocation is not necessarily predictive of future portfolio performance. The allocation is made for analytical purposes and is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any segment of loans.

**Allocation of Allowance for Credit Losses**

	As of December 31,			
	2020		2019	
	Amount of Allowance	Percent of Loans to Total Loans	Amount of Allowance	Percent of Loans to Total Loans
	(dollars in thousands)			
Commercial	\$ 2,529	21.65%	\$ 1,710	15.71%
Commercial Real Estate:				
Construction	1,158	9.66	363	7.01
Farmland	775	7.30	654	8.54
Nonfarm nonresidential	5,117	27.69	3,063	27.58
Residential Real Estate:				
Multi-family	482	6.36	478	7.66
1-4 Family	1,417	19.64	1,265	24.47
Consumer	361	3.27	485	5.16
Agriculture	600	4.37	355	3.79
Other	4	0.06	3	0.08
Total	\$ 12,443	100.0%	\$ 8,376	100.0%

	As of December 31,					
	2018		2017		2016	
	Amount of Allowance	Percent of Loans to Total Loans	Amount of Allowance	Percent of Loans to Total Loans	Amount of Allowance	Percent of Loans to Total Loans
	(dollars in thousands)					
Commercial	\$ 1,299	16.91%	\$ 892	15.98%	\$ 475	15.29%
Commercial Real Estate:						
Construction	419	11.35	301	8.05	470	5.68
Farmland	543	10.18	449	12.40	288	11.19
Nonfarm nonresidential	3,714	22.50	3,282	22.01	4,136	23.39
Residential Real Estate:						
Multi-family	403	6.50	627	7.94	610	7.54
1-4 Family	2,049	22.97	2,273	25.17	2,816	29.42
Consumer	130	5.11	64	2.59	8	1.54
Agriculture	321	4.41	313	5.78	162	5.87
Other	2	0.07	1	0.08	2	0.08
Total	\$ 8,880	100.0%	\$ 8,202	100.0%	\$ 8,967	100.0%

**Provision for Loan Losses** – A provision for loan loss of \$4.4 million was recorded for the year ended December 31, 2020, compared with no provision for loan losses for 2019 and a negative provision for loan losses of \$500,000 for 2018. The 2020 loan loss provision was attributable to the net loan charge-offs during the year, trends within the portfolio during the year, and primarily to changes in the economic and business environment attributable to COVID-19. Net charge-offs were \$333,000 for 2020 compared to net charge-offs of \$504,000 in 2019 and net recoveries of \$1.2 million in 2018.

While the Company expects the U.S. Government's economic responses to the COVID-19 pandemic through monetary policy and fiscal stimulus have provided meaningful support to the economy, management deemed it prudent to increase the allowance for loan losses through its qualitative environmental factors and individual analysis to account for the pandemic risk.



Government and federal agencies	\$	—	—%	\$ 952	2.36%	\$ 7,954	2.70%	\$ 10,711	2.26%	\$ 19,617	2.44%
Agency mortgage-backed: residential		—	—	5,556	2.27	14,712	2.40	54,065	2.01	74,333	2.11
Collateralized loan obligations		—	—	—	—	17,902	2.35	25,250	1.73	43,152	1.99
State and municipal		4,358	3.54	11,810	2.98	3,115	2.98	16,772	2.90	36,055	3.01
Corporate bonds		—	—	1,658	4.02	19,187	4.27	9,860	2.80	30,705	3.74
Total available for sale	\$	<u>4,358</u>	3.54%	<u>\$ 19,976</u>	2.84%	<u>\$ 62,870</u>	3.02%	<u>\$ 116,658</u>	2.17%	<u>\$ 203,862</u>	2.52%

Average yields in the table above were calculated on a tax equivalent basis using a federal income tax rate of 21%. Mortgage-backed securities are securities that have been developed by pooling a number of real estate mortgages. These securities are issued by federal agencies such as Ginnie Mae, Fannie Mae and Freddie Mac, as well as non-agency company issuers. These securities are deemed to have high credit ratings, and minimum regular monthly cash flows of principal and interest. Cash flows from agency backed mortgage-backed securities are guaranteed by the issuing agencies.

Unlike U.S. Treasury and U.S. government agency securities, which have a lump sum payment at maturity, mortgage-backed securities provide cash flows from regular principal and interest payments and principal prepayments throughout the lives of the securities. Mortgage-backed securities that are purchased at a premium will generally return decreasing net yields as interest rates drop because home owners tend to refinance their mortgages. Thus, the premium paid must be amortized over a shorter period. Therefore, those securities purchased at a discount will obtain higher net yields in a decreasing interest rate environment. As interest rates rise, the opposite will generally be true. During a period of increasing interest rates, fixed rate mortgage-backed securities generally do not experience increasing prepayments of principal and, consequently, average life will not be shortened. When interest rates fall, prepayments will generally increase. Non-agency issuer mortgage-backed securities do not carry a government guarantee. Management limits purchases of these securities to bank qualified issues with high credit ratings. At this time, there are no holdings of this type in the portfolio. At December 31, 2020, 72.7% of the Bank's agency mortgage-backed securities had contractual final maturities of more than ten years with a weighted average life of 22.3 years.

The Bank owns Collateralized Loan Obligations (CLOs), which are debt securities secured by professionally managed portfolios of senior-secured loans to corporations. CLO are typically \$300 million to \$1 billion in size, contain one hundred or more loans and have five to six credit tranches ranging from AAA, AA, A, BBB, BB, B and equity tranche. Interest and principal are paid first to the AAA tranche then to the next lower rated tranche. Losses are borne first by the equity tranche then by the subsequently higher rated tranche. CLOs may be less liquid than government securities from time to time and volatility in the CLO market may cause the value of these investments to decline.

The market value of CLOs may be affected by, among other things, changes in composition of the underlying loans, changes in the market values of the underlying loans, changes in the cash flows from the underlying loans, defaults and recoveries on the underlying loans, capital gains and losses on the underlying loans, prepayments on the underlying loans, and other conditions or economic factors. During the first quarter of 2020, the fair value of the Bank's CLO portfolio declined as the market was disrupted by COVID-19. At March 31, 2020, the CLO portfolio had an unrealized loss of \$4.0 million, or 9.0% of amortized cost. At December 31, 2020, the CLO portfolio had improved to a net unrealized loss of \$1.6 million, or 3.5% of amortized cost.

Although the Bank attempts to mitigate the credit and liquidity risks associated with CLOs by purchasing CLOs with credit ratings of A or higher, completing pre-purchase due diligence, and through ongoing monitoring, no assurance can be given that these risk mitigation efforts will be successful. At December 31, 2020, \$27.1 million, \$13.6 million, and \$2.4 million of the Bank's CLOs were AA, A, and BBB rated, respectively. There was one CLO rated below A at BBB, which was downgraded during the third quarter of 2020. Stress testing was completed on each security in the CLO portfolio as of year-end to determine the conditions necessary for the Bank's investment to incur the first dollar of loss. Each security in the portfolio passed, without dollar loss, a stress scenario characterized as severe, which assumed a ten percent per annum constant prepayment rate, a twelve percent per annum constant default rate for four years followed by a four percent rate thereafter, and a forty-five percent recovery rate on a one-year lag. The Bank's CLOs are all floating rate with rates set on a quarterly basis at three-month LIBOR plus a spread.

## [Table of Contents](#)

The fair value of the Bank's corporate bond portfolio was also impacted by market disruption and declining rates in 2020. At December 31, 2020, the portfolio had a net unrealized loss of \$930,000, or 3% of amortized cost which was improved from an unrealized loss of 6% of amortized cost at March 31, 2020. The corporate bond portfolio consists of 13 subordinated debt securities and one senior debt security of U.S. banks and bank holding companies with maturities ranging from 2024 to 2037. The securities are either initially fixed for five years converting to floating at an index over LIBOR, or SOFR, or floating at an index over LIBOR, or SOFR, from inception. Management regularly monitors the financial condition of these corporate issuers by reviewing their regulatory and public filings.

The Bank has the intent and ability to hold its CLO and corporate debt securities to maturity and, at this juncture, has determined the value declines are temporary in nature.

**Deposits** – The Bank attracts both short-term and long-term deposits from the general public by offering a wide range of deposit accounts and interest rates.

The Bank primarily relies on its banking office network to attract and retain deposits in its local markets, as well as deposit listing services, deposit gathering networks, and the online channel to attract both in and out-of-market deposits. Market interest rates and rates on deposit products offered by competing financial institutions can significantly affect the Bank's ability to attract and retain deposits. During 2020, total deposits increased \$92.6 million compared with 2019. The increase in deposits for 2020 was primarily in savings account balances, as well as non-interest and interest-bearing demand deposit accounts. During 2019, total deposits increased \$132.7 million compared with 2018. The increase in deposits for 2019 was primarily related to the branch purchase transaction.

The Bank continues to offer attractively priced deposit products along its product line to allow it to retain deposit customers and reduce interest rate risk during various rising and falling interest rate cycles. The Bank offers savings accounts, interest checking accounts, money market accounts and fixed rate certificates with varying maturities. The flow of deposits is influenced significantly by general economic conditions, changes in interest rates and competition. Management adjusts interest rates, maturity terms, service fees and withdrawal penalties on the Bank's deposit products periodically. The variety of deposit products allows the Bank to compete more effectively in obtaining funds and to respond with more flexibility to the flow of funds away from depository institutions into outside investment alternatives. However, the ability to attract and maintain deposits at acceptable rates will continue to be significantly affected by market conditions.

The following table sets forth the average daily balances and weighted average rates paid for deposits for the periods indicated:

	For the Years Ended December 31,					
	2020		2019		2018	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
	(dollars in thousands)					
Demand	\$ 215,145		\$ 151,299		\$ 136,947	
Interest Checking	169,808	0.32%	104,077	0.30%	90,583	0.13%
Money Market	166,788	0.55	161,610	1.06	158,832	0.90
Savings	111,559	0.48	36,035	0.19	34,866	0.16
Certificates of Deposit	436,083	1.33	483,222	1.98	439,597	1.35
Total Deposits	\$ 1,099,383		\$ 936,243		\$ 860,825	
Weighted Average Rate		0.71%		1.25%		0.88%

The following table shows at December 31, 2020 the amount of the Bank's time deposits of \$250,000 or more by time remaining until maturity:

**Maturity Period**  
(in thousands)

Three months or less	\$ 13,491
Three months through six months	14,856
Six months through twelve months	7,605
Over twelve months	14,737
Total	<u>\$ 50,689</u>

The Bank maintains competitive pricing on its deposit products, which management believes allows it to retain a substantial percentage of the Bank's customers when their time deposits mature.

[Table of Contents](#)

**Borrowing** – Deposits are the primary source of funds for lending activities, investment activities, and for general business purposes. The Bank also uses borrowings from the FHLB of Cincinnati to supplement the pool of lendable funds, meet deposit withdrawal requirements and manage the terms of liabilities. FHLB borrowings are secured by the Bank's stock in the FHLB, substantially all of its first mortgage residential loans, as well as its outstanding PPP loans. At December 31, 2020, the Bank had \$20.6 million in outstanding borrowings from the FHLB and the capacity to increase borrowings by an additional \$93.9 million. The FHLB of Cincinnati functions as a central reserve bank providing credit for member financial institutions. As a member, the Bank is required to own capital stock in the FHLB and is authorized to borrow on the security of such stock and certain of its home mortgages and other assets (principally, securities that are obligations of, or guaranteed by, the United States) provided that it meets certain standards related to creditworthiness.

The following table sets forth information about the Bank's FHLB borrowings as of and for the periods indicated:

	December 31,		
	2020	2019	2018
	(dollars in thousands)		
Average balance outstanding	\$ 34,101	\$ 35,038	\$ 43,363
Maximum amount outstanding at any month-end during the period	71,376	61,389	71,630
End of period balance	20,623	61,389	46,549
Weighted average interest rate:			
At end of period	0.75%	1.70%	2.45%
During the period	1.09%	2.31%	2.00%

**Junior Subordinated Debentures** – At December 31, 2020, the Company had four issues of junior subordinated debentures outstanding totaling \$21.0 million as shown in the table below.

Description	Liquidation Amount Trust Preferred Securities (dollars in thousands)	Issuance Date	Interest Rate (1)	Junior Subordinated Debt and Investment in Trust	Maturity Date
Statutory Trust I	\$ 3,000	2/13/2004	3-month LIBOR + 2.85%	\$ 3,093	2/13/2034
Statutory Trust II	5,000	2/13/2004	3-month LIBOR + 2.85%	5,155	2/13/2034
Statutory Trust III	3,000	4/15/2004	3-month LIBOR + 2.79%	3,093	4/15/2034
Statutory Trust IV	10,000	12/14/2006	3-month LIBOR + 1.67%	10,435	3/1/2037
	<u>\$ 21,000</u>			<u>\$ 21,776</u>	

(1) As of December 31, 2020, the 3-month LIBOR was 0.24%.

The trust preferred securities are subject to mandatory redemption, in whole or in part, upon repayment of the subordinated debentures at maturity or their earlier redemption at the liquidation preference. The subordinated debentures are redeemable before the maturity date at the Company's option at their principal amount plus accrued interest.

The Company has the option to defer interest payments on the subordinated debentures from time to time for a period not to exceed 20 consecutive quarters. A deferral period may begin at the Company's discretion so long as interest payments are current. At December 31, 2020, the Company is current on all interest payments.

The Federal Reserve Board rules allow trust preferred securities issued prior to May 19, 2010 to be included in Tier 1 capital, subject to quantitative and qualitative limits. Currently, no more than 25% of the Company's Tier 1 capital can consist of trust preferred securities and qualifying perpetual preferred stock. To the extent the amount of the Company's trust preferred securities exceeds the 25% limit, the excess would be includable in Tier 2 capital. As of December 31, 2020, all of the Company's trust preferred securities were included in and comprised 20% of Tier 1 capital.

Each of the trusts issuing the trust preferred securities holds junior subordinated debentures issued with an original maturity of 30 years. In the last five years before the junior subordinated debentures mature, the associated trust preferred securities are excluded from Tier 1 capital and included in Tier 2 capital. In addition, the trust preferred securities during this five-year period are amortized out of Tier 2 capital by one-fifth each year and excluded from Tier 2 capital completely during the year before maturity.

**Subordinated Capital Notes** – The Company's subordinated notes mature on July 31, 2029. The notes carry interest at a fixed rate of 5.75% until July 30, 2024 and then convert to variable at three-month LIBOR plus 395 basis points until maturity. The subordinated capital notes qualify as Tier 2 regulatory capital. On July 31, 2020, the Company completed the issuance of an additional \$8.0 million in subordinated notes under the July 23, 2019 indenture with the same terms and with the additional commitment by the Company to extend the optional prepayment date to July 31, 2025 so long as the additional notes qualify as Tier 2 regulatory capital. The Company used the net proceeds from the issuance of the additional notes to retire its senior debt and retained the remaining balance for general corporate purposes. The subordinated capital notes qualify as Tier 2 regulatory capital.

[Table of Contents](#)

**Liquidity**

Liquidity risk arises from the possibility the Company may not be able to satisfy current or future financial commitments, or may become unduly reliant on alternative funding sources. The objective of liquidity risk management is to ensure that the Company meets the cash flow requirements of depositors and borrowers, as well as operating cash needs, taking into account all on- and off-balance sheet funding demands. Liquidity risk management also involves ensuring that cash flow needs are met at a reasonable cost. Management maintains an investment and funds management policy, which identifies the primary sources of liquidity, establishes procedures for monitoring and measuring liquidity, and establishes minimum liquidity requirements in compliance with regulatory guidance. The Asset Liability Committee regularly monitors and reviews the Company's liquidity position.

Funds are available to the Bank from a number of sources, including the sale of securities in the available for sale investment portfolio, principal pay-downs on loans and mortgage-backed securities, customer deposit inflows, and other wholesale funding.

The Bank also borrows from the FHLB to supplement funding requirements. At December 31, 2020, the Bank had an unused borrowing capacity with the FHLB of \$93.9 million. Advances are collateralized by first mortgage residential loans, as well as its outstanding PPP loans. Borrowing capacity is based on the underlying book value of eligible pledged loans.

The Bank also has available on an unsecured basis federal funds borrowing line from a correspondent bank totaling \$5.0 million. Management believes the sources of liquidity are adequate to meet expected cash needs for the foreseeable future. Historically, the Bank has also utilized brokered and wholesale deposits to supplement its funding strategy. At December 31, 2020, the Bank had no brokered deposits.

The Company uses cash on hand to service the subordinated capital notes, junior subordinated debentures, and to provide for operating cash flow needs. The

Company also may issue common equity, preferred equity and debt to support cash flow needs and liquidity requirements.

## Capital

Stockholders' equity increased \$10.3 million to \$116.0 million at December 31, 2020, compared with \$105.8 million at December 31, 2019. The increase was due primarily to current year net income of \$9.0 million.

The following table shows the ratios of common equity Tier 1, Tier 1 capital, total capital to risk-adjusted assets, and Tier 1 leverage for the Bank at December 31, 2020:

	Regulatory Minimums	Well- Capitalized Minimums	Basel III Plus Conservation Buffer	Limestone Bank
Common equity Tier 1 capital	4.5%	6.5%	7.0%	12.05%
Tier 1 capital	6.0	8.0	8.5	12.05
Total risk-based capital	8.0	10.0	10.5	13.20
Tier 1 leverage ratio	4.0	5.0	—	10.21

Failure to meet minimum capital requirements could result in discretionary actions by regulators that, if taken, could have a materially adverse effect on the Company's financial condition.

The Basel III rules require a "capital conservation buffer" of 2.5% above the regulatory minimum risk-based capital ratios. An institution is subject to limitations on paying dividends, engaging in share repurchases and paying discretionary bonuses if capital levels fall below minimum Basel III levels plus the buffer amounts. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions without prior regulatory approval.

## Off Balance Sheet Arrangements

In the normal course of business, the Bank enters into various transactions, which, in accordance with GAAP, are not included in the Company's consolidated balance sheets. The Bank enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets.

## [Table of Contents](#)

The commitments associated with outstanding standby letters of credit and commitments to extend credit as of December 31, 2020 are summarized below. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the amounts shown do not necessarily reflect the Bank's actual future cash funding requirements:

	One year or less	More than 1 year but less than 3 years	3 years or more but less than 5 years	5 years or more	Total
	(dollars in thousands)				
Commitments to extend credit	\$ 63,996	\$ 59,391	\$ 19,929	\$ 45,894	\$ 189,210
Standby letters of credit	1,502	11	4	—	1,517
Total	<u>\$ 65,498</u>	<u>\$ 59,402</u>	<u>\$ 19,933</u>	<u>\$ 45,894</u>	<u>\$ 190,727</u>

**Commitments to Extend Credit** – The Bank enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the Bank's commitments to extend credit are contingent upon borrowers maintaining specific credit standards at the time of loan funding. The Bank minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures.

**Standby Letters of Credit** – Standby letters of credit are written conditional commitments the Bank issues to guarantee the performance of a borrower to a third party. If the borrower does not perform in accordance with the terms of the agreement with the third party, the Bank may be required to fund the commitment. The maximum potential amount of future payments the Bank could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, the Bank would be entitled to seek recovery from the borrower. The Bank's policies generally require that standby letter of credit arrangements be underwritten in a manner consistent with a loan of similar characteristics.

**Risk Participation Agreements** – In connection with the purchase of loan participations, the Bank has entered into risk participation agreements, which had notional amounts totaling \$26.6 million at December 31, 2020 and December 31, 2019.

## Contractual Obligations

The following table summarizes the Company's contractual obligations by maturity date or scheduled payment date and other commitments to make future payments as of December 31, 2020:

	<u>One year or less</u>	<u>year but less than 3 years</u>	<u>more but less than 5 years</u>	<u>5 years or more</u>	<u>Total</u>
	(dollars in thousands)				
Time deposits	\$ 272,031	\$ 57,295	\$ 37,749	\$ 477	\$ 367,552
FHLB borrowing (1)	623	—	—	20,000	20,623
Operating leases	279	369	347	3,503	4,498
Junior subordinated debentures	—	—	—	21,000	21,000
Subordinated capital notes	—	—	—	25,000	25,000
Total	<u>\$ 272,933</u>	<u>\$ 57,664</u>	<u>\$ 38,096</u>	<u>\$ 69,980</u>	<u>\$ 438,673</u>

(1) Fixed rate borrowings with rates ranging from 0% to 0.77%, and maturities ranging from 2021 through 2030, averaging 0.75%. The \$20.0 million FHLB borrowing is callable quarterly at the option of the FHLB.

### Impact of Inflation and Changing Prices

The financial statements and related data presented herein have been prepared in accordance with U.S. generally accepted accounting principles, which require the measurement of financial position and operating results in historical dollars without considering changes in the relative purchasing power of money over time due to inflation.

The Bank has an asset and liability structure that is essentially monetary in nature. As a result, interest rates have a more significant impact on performance than the effects of general levels of inflation. Periods of high inflation are often accompanied by relatively higher interest rates, and periods of low inflation are accompanied by relatively lower interest rates. As market interest rates rise or fall in relation to the rates earned on loans and investments, the value of these assets decreases or increases respectively.

46

### Item 7A. Quantitative and Qualitative Disclosures About Market Risk

To minimize the volatility of net interest income and exposure to economic loss that may result from fluctuating interest rates, the Bank manages its exposure to adverse changes in interest rates through asset and liability management activities within guidelines established by the Asset Liability Committee (“ALCO”). The ALCO, which is comprised of senior officers, has the responsibility for approving and ensuring compliance with asset/liability management policies. Interest rate risk is the exposure to adverse changes in the net interest income as a result of market fluctuations in interest rates. The ALCO, on an ongoing basis, monitors interest rate and liquidity risk in order to implement appropriate funding and balance sheet strategies. Management considers interest rate risk to be the Bank’s most significant market risk.

The Company utilizes an earnings simulation model to analyze net interest income sensitivity. It then evaluates potential changes in market interest rates and their subsequent effects on net interest income. The model projects the effect of instantaneous movements in interest rates of both 100 and 200 basis points that are sustained for one year. Assumptions based on the historical behavior of the Company’s deposit rates and balances in relation to changes in interest rates are also incorporated into the model. These assumptions are inherently uncertain and, as a result, the model cannot precisely measure future net interest income or precisely predict the impact of fluctuations in market interest rates on net interest income. Actual results may differ from the model’s simulated results due to timing, magnitude and frequency of interest rate changes as well as changes in market conditions and the application and timing of various management strategies.

Given an instantaneous 100 basis point increase in interest rates, the base net interest income would increase by an estimated 0.8% at December 31, 2020 compared with a decrease of 2.3% at December 31, 2019. Given an instantaneous 100 basis point decrease in interest rates, the base net interest income would decrease by an estimated 2.9% at December 31, 2020 compared with an increase of 0.2% at December 31, 2019.

The following table indicates the estimated impact on net interest income under various interest rate scenarios for the year ended December 31, 2020, as calculated using the static shock model approach:

	<u>Change in Future Net Interest Income</u>	
	<u>Dollar Change</u>	<u>Percentage Change</u>
	(dollars in thousands)	
+ 200 basis points	\$ 923	2.2%
+ 100 basis points	345	0.8
- 100 basis points	(1,184)	(2.9)
- 200 basis points	(2,057)	(5.0)

Implementation of strategies to mitigate the risk of changing interest rates in the future, could lessen the Company’s forecasted “base case” net interest income in the event of no interest rate changes. Interest sensitivity at any point in time will be affected by a number of factors. These factors include the mix of interest sensitive assets and liabilities as well as their relative pricing schedules. It is also influenced by market interest rates, deposit growth, loan growth, deposit decay rates and asset prepayment speed assumptions.

47

The following table sets forth the amounts of the Company's interest-earning assets and interest-bearing liabilities outstanding at December 31, 2020, which management anticipates, based upon certain assumptions, to reprice or mature in each of the future time periods shown. The projected repricing of assets and liabilities anticipates prepayments and scheduled rate adjustments, as well as contractual maturities under an interest rate unchanged scenario within the selected time intervals. While management believes such assumptions are reasonable, management cannot provide assurance that assumed repricing rates will approximate actual future activity.

	Volume Subject to Repricing Within						Total
	0 – 90 Days	91 – 181 Days	182 – 365 Days	1 – 5 Years	Over 5 Years	Non- Interest Sensitive	
	(dollars in thousands)						
<b>Assets:</b>							
Interest bearing deposits in banks	\$ 56,863	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 56,863
Investment securities	89,993	6,944	15,004	57,406	32,637	1,878	203,862
FHLB stock	5,887	—	—	—	—	—	5,887
Loans, net of allowance	405,063	77,430	129,385	331,801	18,402	(12,443)	949,638
Fixed and other assets	—	—	—	—	—	96,052	96,052
Total assets	<u>\$ 557,806</u>	<u>\$ 84,374</u>	<u>\$ 144,389</u>	<u>\$ 389,207</u>	<u>\$ 51,039</u>	<u>\$ 85,487</u>	<u>\$ 1,312,302</u>
<b>Liabilities and Stockholders' Equity</b>							
Interest-bearing checking, savings, and money market accounts	\$ 509,033	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 509,033
Certificates of deposit	105,067	102,624	64,339	95,043	479	—	367,552
Borrowed funds	41,000	623	—	25,000	—	—	66,623
Other liabilities	—	—	—	—	—	253,070	253,070
Stockholders' equity	—	—	—	—	—	116,024	116,024
Total liabilities and stockholders' equity	<u>\$ 655,100</u>	<u>\$ 103,247</u>	<u>\$ 64,339</u>	<u>\$ 120,043</u>	<u>\$ 479</u>	<u>\$ 369,094</u>	<u>\$ 1,312,302</u>
Period gap	<u>\$ (97,294)</u>	<u>\$ (18,873)</u>	<u>\$ 80,050</u>	<u>\$ 269,164</u>	<u>\$ 50,560</u>		
Cumulative gap	<u>\$ (97,294)</u>	<u>\$ (116,167)</u>	<u>\$ (36,117)</u>	<u>\$ 233,047</u>	<u>\$ 283,607</u>		
Period gap to total assets	<u>(7.41)%</u>	<u>(1.44)%</u>	<u>6.10%</u>	<u>20.51%</u>	<u>3.85%</u>		
Cumulative gap to total assets	<u>(7.41)%</u>	<u>(8.85)%</u>	<u>(2.75)%</u>	<u>17.76%</u>	<u>21.61%</u>		
Cumulative interest-earning assets to cumulative interest-bearing liabilities	<u>85.15%</u>	<u>84.68%</u>	<u>95.61%</u>	<u>124.72%</u>	<u>130.07%</u>		

The one-year cumulative gap position as of December 31, 2020 was negative \$36.1 million or 2.8% of total assets. This is a one-day position that is continually changing and is not necessarily indicative of the Company's position at any other time. Any gap analysis has inherent shortcomings because certain assets and liabilities may not move proportionally as interest rates change.

## Item 8. Financial Statements and Supplementary Data

The following consolidated financial statements and reports are included in this section:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2020 and 2019

Consolidated Statements of Operations for the Years Ended December 31, 2020, 2019, and 2018

Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2020, 2019, and 2018

Consolidated Statements of Change in Stockholders' Equity for the Years Ended December 31, 2020, 2019, and 2018

Consolidated Statements of Cash Flows for the Years Ended December 31, 2020, 2019, and 2018

Notes to Consolidated Financial Statements



**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Shareholders and the Board of Directors of Limestone Bancorp, Inc.  
Louisville, Kentucky

**Opinions on the Financial Statements and Internal Control over Financial Reporting**

We have audited the accompanying consolidated balance sheets of Limestone Bancorp, Inc. (the "Company") as of December 31, 2020 and 2019, the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2020, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2020 and 2019, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2020, in conformity with accounting principles generally accepted in the United States of America.

**Basis for Opinions**

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

---

[Table of Contents](#)**Critical Audit Matter**

The critical audit matter communicated below is a matter arising from the current period audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of the critical audit matter does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

**Allowance for Loan Losses - Qualitative Risk Factors**

As described in Notes 1 and 3 to the consolidated financial statements, the Company's allowance for loan losses represents management's best estimate of probable incurred credit losses inherent in the held for investment loan portfolio as of the balance sheet date. Management assesses the risk inherent in the loan portfolio based on qualitative and quantitative risk factors. The allowance for loan losses consists of two components: the valuation allowance for loans that are individually classified as impaired and separately identified for impairment ("specific component"), totaling \$2,177,000 (or 17.5% of the reserve) and the valuation allowance for loans not considered impaired and collectively evaluated for impairment ("general component"), totaling \$10,266,000 (or 82.5% of the reserve).

The general component is based on historical loss rates adjusted for current factors. The historical loss rates are determined by loan portfolio segment and are based on actual loss history realized over the most recent five years with equal weighting. This actual loss experience is supplemented with other economic or qualitative factors based on the risks present for each portfolio segment. The qualitative risk factor identification and analysis requires significant judgment and allows management to adjust the estimate of losses based on the most recent information available and to address other limitations in the quantitative component that is based on historical loss rates. The Company's risk adjustments include the changes in lending policies, procedures and practices, effects of any change in risk selection and underwriting standards, national and local economic trends and conditions, industry conditions, trends in volume and terms of loans, experience, ability and depth of lending management and other relevant staff, levels of and trends in delinquencies and impaired loans, levels of and trends in charge-offs and recoveries, and effects of changes in credit concentrations. The evaluation of these risk factor adjustments contributes significantly to the general reserve component of the estimate of the allowance for loan losses.

We identified auditing the general component as a critical audit matter because of the necessary judgment applied by us to evaluate management's significant estimates and subjective assumptions related to the following:

- Adjustments to the historical loss ratios for qualitative factors including the selection of qualitative factors and the magnitude of such adjustments based on management's judgments regarding factors which impact asset quality.

- Accuracy of the loan risk ratings as different allocations are applied based on risk rating.

The primary procedures performed to address the critical audit matter included:

- Testing the effectiveness of controls over the evaluation of the allowance related to the general component, including controls addressing:
  - o Problem loan identification and delinquency monitoring.
  - o Management's review of the allowance for loan loss calculation, including data used as the basis for adjustments related to the quantitative and qualitative factors.
  - o Data inputs including the completeness and accuracy of loan data used in the computations.
- Substantively testing management's process, including evaluating their judgments and assumptions for developing the general component, which included:
  - o Evaluation of the reasonableness of management's judgments related to the qualitative factors including assessing the relevance of data used to develop factors. Our evaluation considered the weight of evidence from internal and external sources and loan portfolio performance.
  - o Evaluation of management's methodology to ensure it was consistently applied year over year.
  - o Evaluation of the allowance related to loans collectively evaluated for impairment by loan segment year over year for directional consistency.



We have served as the Company's auditor since 1998.

Louisville, Kentucky  
February 26, 2021

**LIMESTONE BANCORP, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**December 31,**  
(Dollar amounts in thousands except share data)

	2020	2019
<b>Assets</b>		
Cash and due from banks	\$ 10,830	\$ 8,241
Interest bearing deposits in banks	56,863	21,962
Cash and cash equivalents	67,693	30,203
Securities available for sale	203,862	209,000
Loans, net of allowance of \$12,443 and \$8,376, respectively	949,638	917,895
Premises and equipment, net	18,533	19,658
Premises held for sale	1,060	900
Other real estate owned	1,765	3,225
Federal Home Loan Bank stock	5,887	6,237
Bank owned life insurance	23,441	16,037
Deferred taxes, net	25,714	27,765
Goodwill	6,252	6,252
Other intangible assets, net	2,244	2,500
Accrued interest receivable and other assets	6,213	6,107
<b>Total assets</b>	<b>\$ 1,312,302</b>	<b>\$ 1,245,779</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Deposits</b>		
Non-interest bearing	\$ 243,022	\$ 187,551
Interest bearing	876,585	839,424
Total deposits	1,119,607	1,026,975
Federal Home Loan Bank advances	20,623	61,389
Accrued interest payable and other liabilities	10,048	8,665
Junior subordinated debentures	21,000	21,000
Subordinated capital notes	25,000	17,000
Senior debt	—	5,000
Total liabilities	1,196,278	1,140,029
Commitments and contingent liabilities (Note 15)	—	—
<b>Stockholders' equity</b>		
Common stock, no par, 39,000,000 shares authorized, 6,498,865 and 6,251,975 voting, and 1,000,000 and 1,220,000 non-voting shares issued and outstanding, respectively	140,639	140,639

Additional paid-in capital	25,013	24,508
Retained deficit	(46,678)	(55,683)
Accumulated other comprehensive loss	(2,950)	(3,714)
Total common stockholders' equity	116,024	105,750
Total liabilities and stockholders' equity	\$ 1,312,302	\$ 1,245,779

See accompanying notes.

52

**LIMESTONE BANCORP, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**Years Ended December 31,**  
(Dollar amounts in thousands except per share data)

	2020	2019	2018
<b>Interest income</b>			
Loans, including fees	\$ 45,093	\$ 42,153	\$ 37,342
Taxable securities	5,042	6,269	4,880
Tax exempt securities	370	326	383
Interest-bearing deposits and other	248	836	856
	<u>50,753</u>	<u>49,584</u>	<u>43,461</u>
<b>Interest expense</b>			
Deposits	7,796	11,657	7,549
Federal Home Loan Bank advances	371	810	867
Junior subordinated debentures	660	1,005	946
Subordinated capital notes	1,206	433	39
Senior debt	119	329	389
	<u>10,152</u>	<u>14,234</u>	<u>9,790</u>
Net interest income	40,601	35,350	33,671
Provision (negative provision) for loan losses	4,400	—	(500)
Net interest income after provision for loan losses	<u>36,201</u>	<u>35,350</u>	<u>34,171</u>
<b>Non-interest income</b>			
Service charges on deposit accounts	2,268	2,381	2,355
Bank card interchange fees	3,376	2,438	1,831
Income from bank owned life insurance	424	410	437
Net gain (loss) on sales and calls of investment securities	(5)	(5)	(6)
Other	781	694	1,162
	<u>6,844</u>	<u>5,918</u>	<u>5,779</u>
<b>Non-interest expense</b>			
Salaries and employee benefits	17,751	16,233	15,489
Occupancy and equipment	4,001	3,522	3,586
Professional fees	937	769	814
Marketing expense	629	908	1,114
FDIC insurance	229	211	557
Data processing expense	1,502	1,259	1,192
State franchise and deposit tax	1,475	1,210	1,118
Deposit account related expense	1,890	1,224	823
Other real estate owned expense	63	368	868
Litigation and loan collection expense	200	189	245
Communications expense	856	772	701
Insurance expense	428	444	478
Postage and delivery	627	544	364
Acquisition costs	—	775	—
Other	1,828	1,842	1,777
	<u>32,416</u>	<u>30,270</u>	<u>29,126</u>
Income before income taxes	10,629	10,998	10,824
Income tax expense	1,624	480	2,030
Net income	<u>9,005</u>	<u>10,518</u>	<u>8,794</u>
Basic and diluted income per common share	<u>\$ 1.20</u>	<u>\$ 1.41</u>	<u>\$ 1.23</u>

See accompanying notes.

53

**LIMESTONE BANCORP, INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**Years Ended December 31,**  
(in thousands)

	2020	2019	2018
Net income	\$ 9,005	\$ 10,518	\$ 8,794
Other comprehensive income (loss):			
Unrealized gain (loss) on securities:			
Unrealized gain (loss) arising during the period	1,012	3,773	(1,652)
Less reclassification adjustment for losses included in net income	(5)	(5)	(6)
Net unrealized gain (loss) recognized in comprehensive income	1,017	3,778	(1,646)
Tax effect	(253)	(864)	347
Other comprehensive income (loss)	764	2,914	(1,299)
Comprehensive income	\$ 9,769	\$ 13,432	\$ 7,495

See accompanying notes.

**LIMESTONE BANCORP, INC.**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
**Years Ended December 31, 2020**  
(Dollar amounts in thousands except share and per share data)

	Shares					Amount						
	Preferred		Common			Preferred		Common				
	Series E	Series F	Common	Non-Voting Common	Total Common	Series E	Series F	Common and Non-Voting Common	Additional Paid-In Capital	Retained Deficit	Accumulated Other Comprehensive Loss	Total
<b>Balances, December 31, 2017</b>	6,198	4,304	6,039,864	220,000	6,259,864	\$ 1,644	\$ 1,127	\$ 125,729	\$ 24,497	\$ (75,108)	\$ (5,216)	\$ 72,673
Stock issued for share-based awards, net of withholdings to satisfy employee tax obligations upon award	—	—	52,856	—	52,856	—	—	—	—	—	—	—
Issuance of stock	—	—	150,000	1,000,000	1,150,000	—	—	14,910	—	—	—	14,910
Redemption and retirement of preferred shares	(6,198)	(4,304)	—	—	—	(1,644)	(1,127)	—	(734)	—	—	(3,505)
Stock-based compensation expense	—	—	—	—	—	—	—	—	524	—	—	524
Net income	—	—	—	—	—	—	—	—	—	8,794	—	8,794
Reclassification of disproportionate tax effect due to change in federal tax rate	—	—	—	—	—	—	—	—	—	113	(113)	—
Net change in accumulated other comprehensive loss, net of taxes	—	—	—	—	—	—	—	—	—	—	(1,299)	(1,299)

<b>Balances, December 31, 2018</b>	—	—	6,242,720	1,220,000	7,462,720	\$	—	\$	—	\$ 140,639	\$	24,287	\$ (66,201)	\$	(6,628)	\$ 92,097
Stock issued for share-based awards, net of withholdings to satisfy employee tax obligations upon award	—	—	13,503	—	13,503	—	—	—	—	—	(314)	—	—	—	—	(314)
Forfeited unvested stock	—	—	(4,248)	—	(4,248)	—	—	—	—	—	—	—	—	—	—	—
Stock-based compensation expense	—	—	—	—	—	—	—	—	—	—	535	—	—	—	—	535
Net income	—	—	—	—	—	—	—	—	—	—	—	10,518	—	—	—	10,518
Net change in accumulated other comprehensive loss, net of taxes	—	—	—	—	—	—	—	—	—	—	—	—	—	—	2,914	2,914
<b>Balances, December 31, 2019</b>	—	—	6,251,975	1,220,000	7,471,975	\$	—	\$	—	\$ 140,639	\$	24,508	\$ (55,683)	\$	(3,714)	\$ 105,750
Stock issued for share-based awards, net of withholdings to satisfy employee tax obligations upon award	—	—	28,248	—	28,248	—	—	—	—	—	(75)	—	—	—	—	(75)
Forfeited unvested stock	—	—	(1,358)	—	(1,358)	—	—	—	—	—	—	—	—	—	—	—
Stock-based compensation expense	—	—	—	—	—	—	—	—	—	—	580	—	—	—	—	580
Non-voting shares converted to voting	—	—	220,000	(220,000)	—	—	—	—	—	—	—	—	—	—	—	—
Net income	—	—	—	—	—	—	—	—	—	—	—	9,005	—	—	—	9,005
Net change in accumulated other comprehensive loss, net of taxes	—	—	—	—	—	—	—	—	—	—	—	—	—	—	764	764
<b>Balances, December 31, 2020</b>	—	—	6,498,865	1,000,000	7,498,865	\$	—	\$	—	\$ 140,639	\$	25,013	\$ (46,678)	\$	(2,950)	\$ 116,024

See accompanying notes to unaudited consolidated financial statements.

[Table of Contents](#)

**LIMESTONE BANCORP, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**Years Ended December 31,**  
(in thousands)

	2020	2019	2018
<b>Cash flows from operating activities</b>			
Net income	\$ 9,005	\$ 10,518	\$ 8,794
Adjustments to reconcile net income (loss) to net cash from operating activities			
Depreciation and amortization	2,986	1,669	1,080
Provision (negative provision) for loan losses	4,400	—	(500)
Net amortization on securities	655	700	865
Stock-based compensation expense	580	535	524
Deferred taxes, net	1,798	653	2,376
Net gain on sales of loans held for sale	—	—	(1)
Proceeds from sales of loans held for sale	—	—	71
Net gain on sales of other real estate owned	—	—	(72)
Net write-down of other real estate owned	—	260	850
Net realized (gain) loss on sales and calls of investment securities	5	5	6
Net (gain) loss on sale of premises and equipment	—	(1)	(692)
Net write-down of premises held for sale	150	150	392
Increase in cash surrender value of life insurance, net of premium expense	(404)	(391)	(417)

Amortization of operating lease right-of-use assets	593	185	—
Net change in accrued interest receivable and other assets	(106)	(302)	(491)
Net change in accrued interest payable and other liabilities	1,383	(763)	(155)
Net cash from operating activities	21,045	13,218	12,630
<b>Cash flows from investing activities</b>			
Purchases of available for sale securities	(38,416)	(29,169)	(77,159)
Proceeds from sales and calls of available for sale securities	9,030	5,351	6,054
Proceeds from maturities and prepayments of available for sale securities	34,881	19,083	20,116
Proceeds from sale of other real estate owned	1,600	—	876
Improvements to other real estate owned	(140)	—	—
Purchases of Federal Home Loan Bank stock	(600)	—	—
Proceeds from mandatory redemption of Federal Home Loan Bank stock	950	996	90
Net changes in loans	(37,772)	(35,538)	(52,885)
Proceeds from sale of premises and equipment	—	1	1,590
Purchases of premises and equipment	(879)	(1,321)	(1,168)
Net cash paid for acquisition	—	(5,280)	—
Purchase of bank owned life insurance	(7,000)	—	—
Net cash from investing activities	(38,346)	(45,877)	(102,486)
<b>Cash flows from financing activities</b>			
Net change in deposits	92,632	975	47,207
Repayment of Federal Home Loan Bank advances	(145,766)	(160,160)	(120,248)
Advances from Federal Home Loan Bank	105,000	175,000	155,000
Repayment of subordinated capital note	—	—	(2,250)
Proceeds from issuance of subordinated capital notes	8,000	17,000	—
Repayment of senior debt	(5,000)	(5,000)	—
Proceeds from issuance of common stock, net	—	—	14,910
Common shares withheld for taxes	(75)	(314)	—
Redemption of preferred stock	—	—	(3,505)
Net cash from financing activities	54,791	27,501	91,114
Net change in cash and cash equivalents	37,490	(5,158)	1,258
Beginning cash and cash equivalents	30,203	35,361	34,103
Ending cash and cash equivalents	\$ 67,693	\$ 30,203	\$ 35,361
Supplemental cash flow information:			
Interest paid	\$ 10,422	\$ 13,763	\$ 10,607
Income taxes paid (refunded)	(346)	(346)	—
Supplemental non-cash disclosure:			
Transfer from loans to other real estate	—	\$ —	\$ 730
Transfer from premises and equipment to premises held for sale	310	—	1,050
Financed sales of other real estate owned	1,360	—	—
Initial recognition of right-of-use lease assets	—	507	—

See accompanying notes.

**LIMESTONE BANCORP, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2020, 2019 and 2018**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Principles of Consolidation and Nature of Operations** – The consolidated financial statements include Limestone Bancorp, Inc. (Company) and its wholly-owned subsidiary, Limestone Bank, Inc. (Bank). All significant intercompany transactions and accounts have been eliminated in consolidation.

The Bank, established in 1902, is a state chartered non-member financial institution providing financial services through its banking center locations in south central, southern, and western Kentucky, as well as Lexington, Louisville, and Frankfort.

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

In March 2020, the World Health Organization declared novel coronavirus disease 2019 (“COVID-19”) as a global pandemic. The COVID-19 pandemic has negatively impacted the global economy, disrupted global supply chains, created significant volatility and disruption in financial markets, and increased

unemployment levels. In addition, the pandemic has resulted in temporary closures of many businesses and the institution of social distancing and sheltering in place requirements in many states and communities, including those in markets in which the Company is located or does business.

The extent to which the COVID-19 pandemic impacts the Company's business, liquidity, asset valuations, results of operations, and financial condition, as well as its regulatory capital and liquidity ratios, will depend on future developments, which are highly uncertain, including the scope and duration of the pandemic and actions taken by governmental authorities and other third parties in response to the pandemic. Moreover, the effects of the COVID- 19 pandemic may have a material adverse effect on all or a combination of valuation impairments on the Company's intangible assets, investments, loans, or deferred tax assets.

**Cash and Cash Equivalents** – For the purpose of presentation in the statements of cash flows, the Company considers all cash and amounts due from depository institutions as well as interest bearing deposits in banks that mature within one year and are carried at cost to be cash equivalents. Included in cash and due from banks and interest bearing deposits are amounts required to be held at the Federal Reserve Bank of St. Louis or maintained in vault cash in accordance with regulatory reserve requirements. There were no balance requirements as of December 31, 2020 and \$10.1 million as of December 31, 2019.

**Securities** – Debt securities are classified as held to maturity and carried at amortized cost when management has the intent and ability to hold them to maturity. Debt 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, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method anticipating prepayments on mortgage backed securities. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

In evaluating securities for other-than-temporary impairment (“OTTI”), management considers the length of time and extent to which fair value has been less than cost, the financial condition, and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into 1) OTTI related to credit loss, which is recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

**Loans** – Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs, and an allowance for loan 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. The recorded investment in loans includes the outstanding principal balance and unamortized deferred origination costs and fees.

Interest income recognition on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the loan is well collateralized and in process of collection. Consumer loans are typically charged off no later than 90 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is not expected.

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.

The Bank participated in the SBA Paycheck Protection Program (“PPP”) as a lender to provide loans to small businesses for payroll and other basic expenses during the COVID-19 pandemic. These loans are eligible to be forgiven if certain conditions are satisfied and are fully guaranteed by the SBA. Additionally, loan payments are deferred for the first six months of the loan term. No collateral or personal guarantees were required. PPP loans were considered in the provision for loan losses in 2020, however, due to SBA guaranty the provision for loan losses impact was insignificant.

Loans purchased in a business acquisition are accounted for using one of the following accounting standards. 1) ASC Topic 310-20, Non Refundable Fees and Other Costs, is used to value loans that have not demonstrated post origination credit quality deterioration and the acquirer expects to collect all contractually required payments from the borrower. For these loans, the difference between the loan’s day-one fair value and amortized cost would be amortized or accreted into income using the interest method or 2) ASC Topic 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality, is used to value purchased credit impaired (PCI) loans. For these loans, it is probable the acquirer will be unable to collect all contractually required payments from the borrower. Under ASC Topic 310-30, the expected cash flows that exceed the initial investment in the loan, or fair value, represent the “accretable yield,” which is recognized as interest income on a level-yield basis over the expected cash flow periods of the loans. Additionally, the difference between contractual cash flows and expected cash flows of PCI loans is referred to as the “non-accretable discount.”

**Allowance for Loan Losses** – The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management’s judgment, should be charged off.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. A loan is deemed impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and treated as impaired.

Factors considered 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. The significance of payment delays and payment shortfalls is determined 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.

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 are not separately identified for impairment disclosures. Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan’s effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported at the fair value of the collateral. For troubled debt restructurings that subsequently default, the amount of reserve is determined in accordance with the accounting policy for the allowance for loan losses.

The general component covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on actual loss history experienced over the most recent five years with equal weighting. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: changes in lending policies, procedures, and practices; effects of any change in risk selection and underwriting standards; national and local economic trends and conditions; industry conditions; trends in volume and terms of loans; experience, ability and depth of lending management and other relevant staff; levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; and effects of changes in credit concentrations.



A portfolio segment is defined as the level at which an entity develops and documents a systematic methodology to determine its allowance for loan losses. Management identified the following portfolio segments: commercial, commercial real estate, residential real estate, consumer, agricultural, and other.

- Commercial loans are made to businesses and depend on the strength of the industries, related borrowers, and cash flow from the businesses. Commercial loans are advances for equipment purchases, or to provide working capital, or to meet other financing needs of business enterprises. These loans may be secured by accounts receivable, inventory, equipment or other business assets. Financial information is obtained from the borrowers to evaluate their ability to repay the loans.
- Commercial real estate loans are affected by the local commercial real estate market and the local economy. Commercial real estate loans include loans on commercial properties occupied by borrowers and/or tenants. Construction and development loans are a component of this segment. These loans are generally secured by land under development or homes and commercial buildings under construction. Loans secured by farmland are also a component of this segment. Appraisals are obtained to support the loan amount. Financial information is obtained from the borrowers and/or the individual project to evaluate cash flows sufficiency to service the debt.
- Residential real estate loans are affected by the local residential real estate market, local economy, and, for variable rate mortgages, movement in indices tied to these loans. For owner occupied residential loans, the borrowers' repayment ability is evaluated through a review of credit scores and debt to income ratios. For non-owner occupied residential loans, such as rental real estate, financial information is obtained from the borrowers and/or the individual project to evaluate cash flows sufficiency to service the debt. Appraisals are obtained to support the loan amount.
- Consumer loans depend on local economies. Consumer loans are generally unsecured, but may be secured by consumer assets. Management evaluates the borrowers' repayment ability through a review of credit scores and an evaluation of debt to income ratios. Consumer loans may be for consumer goods purchases, cash flow needs, or for student loans or student debt refinances.
- Agriculture loans depend on the industries tied to these loans and are generally secured by livestock, crops, and/or equipment, but may be unsecured. Management evaluates the borrowers' repayment ability through financial and business performance review.
- Other loans include loans to municipalities, loans secured by stock, and overdrafts. For municipal loans, management evaluates the borrowers' revenue streams as well as ability to repay from general funds. For loans secured by stock, management evaluates the market value of the stock securing the loan in relation to the loan amount. Overdrafts are funded based on pre-established criteria related to the deposit account relationship.

Management analyzes key relevant risk characteristics for each portfolio segment having determined that loans in each segment possess similar general risk characteristics that are analyzed in connection with loan underwriting processes and procedures. In determining the allocated allowance, the weighted average loss rates over the most recent five years are used with equal weighting. Commercial real estate qualitative adjustment considerations include trends in the markets for underlying collateral values, risks related to tenant rents, and economic factors such as decreased sales demand, elevated inventory levels, and declining collateral values. Residential real estate loan considerations include macro-economic factors such as unemployment rates, trends in vacancy rates, and home value trends. The commercial and agricultural portfolio qualitative adjustments are related to economic and portfolio performance trends. The agricultural, consumer and other portfolios are less significant in terms of size and risk is assessed based on the smaller dollar size of these loans and the geographical areas where the collateral is located.

**Transfers of Financial Assets** – Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

**Other Real Estate Owned (“OREO”)** – Assets acquired through or instead of loan foreclosure are initially recorded at fair value less estimated costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at the lower of cost or fair value, less estimated costs to sell. If fair value declines subsequent to foreclosure, a write-down is recorded through expense. Costs after acquisition are expensed unless the expenditure is for a recoverable improvement, which may be capitalized.

**Premises and Equipment** – Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation and are depreciated using the straight-line method with useful lives generally ranging from 3 to 40 years. Leasehold improvements are amortized using the straight-line or accelerated method over terms of the related leases, including expected renewals, or over the useful lives of the improvements, whichever is shorter. Maintenance and repairs are expensed as incurred while major additions and improvements are capitalized.

Premises and equipment held for sale are recorded at fair value less estimated cost to sell at the time of transfer based upon independent third party appraisal. If fair value declines subsequent to transfer, write-downs are recorded through expense.

Premises and equipment are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value through a charge to earnings.

**Federal Home Loan Bank (FHLB) Stock** – The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment. Because this stock is viewed as long term investment, impairment is based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

**Bank Owned Life Insurance** – The Bank has purchased life insurance policies on certain key executives. Company 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.

**Goodwill and Other Intangible Assets** – Goodwill arises from business combinations and is generally determined as the excess of the fair value of the consideration transferred, 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 or more frequently if events and circumstances exist that indicate that a goodwill impairment test should be performed. The Bank has selected November 30 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 Bank's balance sheet.

Other intangible assets consist of core deposit intangible assets arising from a branch acquisition, which were initially measured at fair value and then amortized on an accelerated method over the estimated useful life.

**Benefit Plans** – Employee 401(k) plan expense is the amount of matching contributions.

**Stock-Based Compensation** – Compensation cost is recognized for unvested stock awards issued to employees, based on the fair value of these awards at the date of grant. 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 forfeitures as they occur.

**Income Taxes** – Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between 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.

**Loan Commitments and Related Financial Instruments** – Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer-financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded upon funding.

**Comprehensive Income (Loss)** – Comprehensive loss consists of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale, which are also recognized as a separate component of equity.

**Earnings Per Common Share** – Basic earnings per common share is net income attributable to common shareholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share include the dilutive effect, if any, of additional potential common shares issuable under stock options, warrants, and any convertible securities. Earnings and dividends per share are restated for all stock splits and dividends through the date of issue of the financial statements.

**Earnings Allocated to Participating Securities** – The Company has issued and outstanding unvested common shares to employees and directors through its equity compensation plan. Earnings are allocated to these participating securities based on their percentage of total issued and outstanding shares.

**Loss Contingencies** – Loss contingencies, including claims and legal actions arising in the normal course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated.

**Dividend Restrictions** – Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the Company or by the Company to shareholders.

**Fair Value of Financial Instruments** – Fair values of financial instruments are estimated using relevant market information and other assumptions. 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.

**Derivatives** – Derivative financial instruments are carried at fair value and reflect the estimated amounts that would have been received to terminate these contracts at the reporting date based upon pricing or valuation models applied to current market information.

As part of the asset/liability management program, the Company utilizes, from time to time, risk participation agreements to reduce its sensitivity to changing interest rates. These are derivative instruments, which are recorded as assets or liabilities in the consolidated balance sheets at fair value. Changes in the fair values of derivatives are reported in the consolidated statements of operations or other comprehensive income (“OCI”) depending on the use of the derivative and whether the instrument qualifies for hedge accounting. The key criterion for the hedge accounting is that the hedged relationship must be found to be effective as determined by FASB ASC 815 Derivatives and Hedging.

The risk participation agreements are not designated against specific assets or liabilities under ASC 815, and, therefore, do not qualify for hedge accounting. The derivatives are recorded on the balance sheet at fair value and changes in fair value of both the borrower and the offsetting swap agreements are recorded (and essentially offset) in non-interest income. The fair value of the derivative instruments incorporates a consideration of credit risk in accordance with ASC 820, resulting in some volatility in earnings each period.

To date, the Company has not entered into a cash flow hedge. For cash flow hedges, changes in the fair values of the derivative instruments are reported in OCI to the extent the hedge is effective. The gains and losses on derivative instruments that are reported in OCI are reflected in the consolidated statements of income in the periods in which the results of operations are impacted by the variability of the cash flows of the hedged item. Generally, net interest income is increased or decreased by amounts receivable or payable with respect to the derivatives, which qualify for hedge accounting. At inception of the hedge, a Company must establish the method it uses for assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffective aspect of the hedge. The ineffective portion of the hedge, if any, is recognized currently in the consolidated statements of operations and time value expiration of the hedge when measuring ineffectiveness is excluded.

**New Accounting Standards** – In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The final standard will change estimates for credit losses related to financial assets measured at amortized cost such as loans, held-to-maturity debt securities, and certain other contracts. For estimating credit losses, the FASB is replacing the incurred loss model with an expected loss model, which is referred to as the current expected credit loss (CECL) model. Under the CECL model, certain financial assets that are carried at amortized cost, such as loans held for investment and held-to-maturity debt securities, are required to be presented at the net amount expected to be collected. The measurement of expected credit losses is to be based on information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This measurement will take place at the time the financial asset is first added to the balance sheet and periodically thereafter. This differs significantly from the “incurred loss” model required under current GAAP, which delays recognition until it is probable a loss has been incurred. The change could materially affect how the allowance for loan losses is determined. The impact of CECL model implementation is being evaluated, but it is expected that a one-time cumulative-effect adjustment to the allowance for loan losses will be recognized in retained earnings on the consolidated balance sheet as of the beginning of the first reporting period in which the new standard is effective, as is consistent with regulatory expectations set forth in interagency guidance. In December 2018, the OCC, The Board of Governors of the Federal Reserve System, and the FDIC approved a final rule to address changes to the credit loss accounting under GAAP, including banking organizations’ implementation of CECL. The final rule provides banking organizations the option to phase in over a three-year period the day-one adverse effects on regulatory capital that may result from adoption of the new accounting standard. In October 2019, the FASB voted to delay implementation for smaller reporting companies, private companies, and not-for-profit entities. The Company currently qualifies as a smaller reporting company and, as such, will be required to implement CECL for fiscal year and interim periods beginning after December 15, 2022.

In December 2019, the FASB issued ASU 2019-12, Income Taxes - Simplifying the Accounting for Income Taxes. The final standard removes specific exceptions to the general principles in Topic 740, improves financial statement preparers' application of income tax-related guidance, and simplifies GAAP. Certain provisions under ASU 2019-12 require prospective application, some require modified retrospective adoption, while other provisions require retrospective application to all periods presented in the consolidated financial statements upon adoption. ASU 2019-12 is effective for fiscal years beginning after December 15, 2020, with early adoption permitted. Adoption of this new guidance will not have a material impact on the consolidated financial statements.

**NOTE 2 – SECURITIES**

Securities are classified as available for sale (AFS). AFS securities may be sold if needed for liquidity, asset liability management, or other reasons. AFS securities are reported at fair value, with unrealized gains or losses included as a separate component of equity, net of tax.

The amortized cost and fair value of securities and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(in thousands)			
<b>December 31, 2020</b>				
Available for sale				
U.S. Government and federal agency	\$ 18,811	\$ 806	\$ —	\$ 19,617
Agency mortgage-backed: residential	71,582	2,777	(26)	74,333
Collateralized loan obligations	44,730	—	(1,578)	43,152
State and municipal	34,759	1,296	—	36,055
Corporate bonds	31,635	472	(1,402)	30,705
Total available for sale	<u>\$ 201,517</u>	<u>\$ 5,351</u>	<u>\$ (3,006)</u>	<u>\$ 203,862</u>

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(in thousands)			
<b>December 31, 2019</b>				
Available for sale				
U.S. Government and federal agency	\$ 22,281	\$ 196	\$ (147)	\$ 22,330
Agency mortgage-backed: residential	91,269	1,186	(255)	92,200
Collateralized loan obligations	49,831	—	(412)	49,419
State and municipal	27,819	550	(3)	28,366
Corporate bonds	16,472	213	—	16,685
Total available for sale	<u>\$ 207,672</u>	<u>\$ 2,145</u>	<u>\$ (817)</u>	<u>\$ 209,000</u>

Sales and calls of securities were as follows:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
	(in thousands)		
Proceeds	\$ 9,030	\$ 5,351	\$ 6,054
Gross gains	—	1	—
Gross losses	5	6	6

[Table of Contents](#)

The amortized cost and fair value of debt securities are shown by contractual maturity. Expected maturities may differ from actual maturities when borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities not due at a single maturity date are shown separately.

	December 31, 2020	
	Amortized Cost	Fair Value
(in thousands)		
<b>Maturity</b>		
Available for sale		
Within one year	\$ 19,141	\$ 18,217
One to five years	44,757	46,185
Five to ten years	44,902	45,148
Beyond ten years	21,135	19,979
Agency mortgage-backed: residential	71,582	74,333
Total	<u>\$ 201,517</u>	<u>\$ 203,862</u>

Securities pledged at year-end 2020 and 2019 had carrying values of approximately \$81.4 million and \$75.8 million, respectively, and were pledged to secure public deposits.

At December 31, 2020 and 2019, the Bank held securities issued by the Commonwealth of Kentucky or Kentucky municipalities having a book value of \$23.0 million and \$14.5 million, respectively. At year-end 2020, there were no other holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of stockholders' equity.

The Company evaluates securities for other-than-temporary impairment at least on a quarterly basis. Consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, underlying credit quality of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, the Company may consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, the sector or industry trends and cycles affecting the issuer, and the results of reviews of the issuer's financial condition. As of December 31, 2020, management does not believe any securities in the portfolio with unrealized losses should be classified as other than temporarily impaired.

The Bank owns Collateralized Loan Obligations (CLOs), which are debt securities secured by professionally managed portfolios of senior-secured loans to corporations. CLOs are typically \$300 million to \$1 billion in size, contain one hundred or more loans, have five to six credit tranches ranging from AAA, AA, A, BBB, BB, B and equity tranche. Interest and principal are paid first to the AAA tranche then to the next lower rated tranche. Losses are borne first by the equity tranche then by the subsequently higher rated tranche. CLOs may be less liquid than government securities from time to time and volatility in the CLO market may cause the value of these investments to decline.

The market value of CLOs may be affected by, among other things, changes in composition of the underlying loans, changes in the market values of the underlying loans, changes in the cash flows from the underlying loans, defaults and recoveries on the underlying loans, capital gains and losses on the underlying loans, prepayments on the underlying loans, and other conditions or economic factors.

At December 31, 2020, \$27.1 million, \$13.6 million, and \$2.4 million of the Bank's CLOs were AA, A, and BBB rated, respectively. There was one CLO rated below A at BBB, which was downgraded during the third quarter of 2020. Stress testing was completed on each security in the CLO portfolio as of year-end to determine the conditions necessary for the Bank's investment to incur the first dollar of loss. Each security in the portfolio passed, without dollar loss, a stress scenario characterized as severe, which assumed a ten percent per annum constant prepayment rate, a twelve percent per annum constant default rate for four years followed by a four percent rate thereafter, and a forty-five percent recovery rate on a one-year lag.

The corporate bond portfolio consists of 13 subordinated debt securities and one senior debt security of U.S. banks and bank holding companies with maturities ranging from 2024 to 2037. The securities are either initially fixed for five years converting to floating at an index over LIBOR, or SOFR, or floating at an index over LIBOR, or SOFR, from inception. Management regularly monitors the financial condition of these corporate issuers by reviewing their regulatory and public filings.

[Table of Contents](#)

Securities with unrealized losses at December 31, 2020 and December 31, 2019, aggregated by investment category and length of time the individual securities have been in a continuous unrealized loss position, are as follows:

Description of Securities	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
(in thousands)						
<b>2020</b>						
Available for sale						
U.S. Government and federal agency	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Agency mortgage-backed: residential	4,772	(26)	—	—	4,772	(26)
Collateralized loan obligations	8,794	(251)	34,358	(1,327)	43,152	(1,578)
State and municipal	—	—	—	—	—	—
Corporate bonds	10,849	(1,402)	—	—	10,849	(1,402)
Total temporarily impaired	<u>\$ 24,415</u>	<u>\$ (1,679)</u>	<u>\$ 34,358</u>	<u>\$ (1,327)</u>	<u>\$ 58,773</u>	<u>\$ (3,006)</u>

Description of Securities	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
(in thousands)						
<b>2019</b>						
Available for sale						
U.S. Government and federal agency	\$ 12,567	\$ (147)	\$ —	\$ —	\$ 12,567	\$ (147)
Agency mortgage-backed: residential	18,457	(97)	10,665	(158)	29,122	(255)
Collateralized loan obligations	9,539	(46)	35,336	(366)	44,875	(412)
State and municipal	911	(3)	—	—	911	(3)
Corporate bonds	—	—	—	—	—	—
Total temporarily impaired	<u>\$ 41,474</u>	<u>\$ (293)</u>	<u>\$ 46,001</u>	<u>\$ (524)</u>	<u>\$ 87,475</u>	<u>\$ (817)</u>

**NOTE 3 – LOANS**

Loans net of unearned income, deferred loan origination costs, and net premiums on acquired loans by class were as follows:

	2020	2019
	(in thousands)	
Commercial (1)	\$ 208,244	\$ 145,551
Commercial Real Estate:		
Construction	92,916	64,911
Farmland	70,272	79,118
Nonfarm nonresidential	266,394	255,459
Residential Real Estate:		
Multi-family	61,180	70,950
1-4 Family	188,955	226,629
Consumer	31,429	47,790
Agriculture	42,044	35,064
Other	647	799
Subtotal	962,081	926,271
Less: Allowance for loan losses	(12,443)	(8,376)
Loans, net	<u>\$ 949,638</u>	<u>\$ 917,895</u>

(1) Includes PPP loans of \$20.3 million at December 31, 2020.

[Table of Contents](#)

The following table presents the activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2020, 2019, and 2018:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate</u>	<u>Consumer (in thousands)</u>	<u>Agriculture</u>	<u>Other</u>	<u>Total</u>
<b>December 31, 2020:</b>							
Beginning balance	\$ 1,710	\$ 4,080	\$ 1,743	\$ 485	\$ 355	\$ 3	\$ 8,376
Provision (negative provision)	822	2,870	135	324	261	(12)	4,400
Loans charged off	(32)	(101)	(130)	(493)	(46)	–	(802)
Recoveries	29	201	151	45	30	13	469
Ending balance	<u>\$ 2,529</u>	<u>\$ 7,050</u>	<u>\$ 1,899</u>	<u>\$ 361</u>	<u>\$ 600</u>	<u>\$ 4</u>	<u>\$ 12,443</u>

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate</u>	<u>Consumer (in thousands)</u>	<u>Agriculture</u>	<u>Other</u>	<u>Total</u>
<b>December 31, 2019:</b>							
Beginning balance	\$ 1,299	\$ 4,676	\$ 2,452	\$ 130	\$ 321	\$ 2	\$ 8,880
Provision (negative provision)	342	(622)	(958)	943	297	(2)	–
Loans charged off	(37)	(47)	(275)	(663)	(266)	–	(1,288)
Recoveries	106	73	524	75	3	3	784
Ending balance	<u>\$ 1,710</u>	<u>\$ 4,080</u>	<u>\$ 1,743</u>	<u>\$ 485</u>	<u>\$ 355</u>	<u>\$ 3</u>	<u>\$ 8,376</u>

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate</u>	<u>Consumer (in thousands)</u>	<u>Agriculture</u>	<u>Other</u>	<u>Total</u>
<b>December 31, 2018:</b>							
Beginning balance	\$ 892	\$ 4,032	\$ 2,900	\$ 64	\$ 313	\$ 1	\$ 8,202
Provision (negative provision)	196	(192)	(599)	92	6	(3)	(500)
Loans charged off	(50)	(198)	(252)	(95)	(13)	(8)	(616)
Recoveries	261	1,034	403	69	15	12	1,794
Ending balance	<u>\$ 1,299</u>	<u>\$ 4,676</u>	<u>\$ 2,452</u>	<u>\$ 130</u>	<u>\$ 321</u>	<u>\$ 2</u>	<u>\$ 8,880</u>

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on the impairment method as of December 31, 2020:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate</u>	<u>Consumer (in thousands)</u>	<u>Agriculture</u>	<u>Other</u>	<u>Total</u>
<b>Allowance for loan losses:</b>							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	\$ –	\$ 2,176	\$ 1	\$ –	\$ –	\$ –	\$ 2,177
Collectively evaluated for impairment	2,529	4,874	1,898	361	600	4	10,266
Total ending allowance balance	<u>\$ 2,529</u>	<u>\$ 7,050</u>	<u>\$ 1,899</u>	<u>\$ 361</u>	<u>\$ 600</u>	<u>\$ 4</u>	<u>\$ 12,443</u>
<b>Loans:</b>							
Loans individually evaluated for impairment	\$ –	\$ 5,361	\$ 1,060	\$ –	\$ 91	\$ –	\$ 6,512
Loans collectively evaluated for impairment	208,244	424,221	249,075	31,429	41,953	647	955,569
Total ending loans balance	<u>\$ 208,244</u>	<u>\$ 429,582</u>	<u>\$ 250,135</u>	<u>\$ 31,429</u>	<u>\$ 42,044</u>	<u>\$ 647</u>	<u>\$ 962,081</u>

[Table of Contents](#)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on the impairment method as of December 31, 2019:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate</u>	<u>Consumer (in thousands)</u>	<u>Agriculture</u>	<u>Other</u>	<u>Total</u>
<b>Allowance for loan losses:</b>							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	\$ 3	\$ 37	\$ 2	\$ —	\$ —	\$ —	\$ 42
Collectively evaluated for impairment	1,707	4,043	1,741	485	355	3	8,334
Total ending allowance balance	<u>\$ 1,710</u>	<u>\$ 4,080</u>	<u>\$ 1,743</u>	<u>\$ 485</u>	<u>\$ 355</u>	<u>\$ 3</u>	<u>\$ 8,376</u>
<b>Loans:</b>							
Loans individually evaluated for impairment	\$ 74	\$ 1,064	\$ 892	\$ 98	\$ 42	\$ —	\$ 2,170
Loans collectively evaluated for impairment	145,477	398,424	296,687	47,692	35,022	799	924,101
Total ending loans balance	<u>\$ 145,551</u>	<u>\$ 399,488</u>	<u>\$ 297,579</u>	<u>\$ 47,790</u>	<u>\$ 35,064</u>	<u>\$ 799</u>	<u>\$ 926,271</u>

**Impaired Loans**

Impaired loans include restructured loans and loans on nonaccrual or classified as doubtful, whereby collection of the total amount is improbable, or loss, whereby all or a portion of the loan has been written off or a specific allowance for loss had been provided.

The following table presents information related to loans individually evaluated for impairment by class of loan as of and for the year ended December 31, 2020:

	<u>Unpaid Principal Balance</u>	<u>Recorded Investment</u>	<u>Allowance For Loan Losses Allocated (in thousands)</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	<u>Cash Basis Income Recognized</u>
<b>With No Related Allowance Recorded:</b>						
Commercial	\$ 308	\$ —	\$ —	\$ 82	\$ 16	\$ 16
Commercial real estate:						
Construction	—	—	—	—	—	—
Farmland	555	456	—	326	45	45
Nonfarm nonresidential	1,323	549	—	501	44	15
Residential real estate:						
Multi-family	—	—	—	—	—	—
1-4 Family	1,883	954	—	894	86	83
Consumer	259	—	—	55	3	3
Agriculture	393	91	—	27	—	—
Other	—	—	—	—	—	—
Subtotal	<u>4,721</u>	<u>2,050</u>	<u>—</u>	<u>1,885</u>	<u>194</u>	<u>162</u>
<b>With An Allowance Recorded:</b>						
Commercial	—	—	—	5	—	—
Commercial real estate:						
Construction	—	—	—	—	—	—
Farmland	—	—	—	198	4	—
Nonfarm nonresidential	6,465	4,356	2,176	901	263	—
Residential real estate:						
Multi-family	—	—	—	—	—	—
1-4 Family	106	106	1	102	9	—
Consumer	—	—	—	—	—	—
Agriculture	—	—	—	—	—	—
Other	—	—	—	—	—	—
Subtotal	<u>6,571</u>	<u>4,462</u>	<u>2,177</u>	<u>1,206</u>	<u>276</u>	<u>—</u>
Total	<u>\$ 11,292</u>	<u>\$ 6,512</u>	<u>\$ 2,177</u>	<u>\$ 3,091</u>	<u>\$ 470</u>	<u>\$ 162</u>



[Table of Contents](#)

The following table presents information related to loans individually evaluated for impairment by class of loan as of and for the year ended December 31, 2019:

	Unpaid Principal Balance	Recorded Investment	Allowance For Loan Losses Allocated (in thousands)	Average Recorded Investment	Interest Income Recognized	Cash Basis Income Recognized
<b>With No Related Allowance Recorded:</b>						
Commercial	\$ 138	\$ 50	\$ —	\$ 57	\$ 3	\$ 3
Commercial real estate:						
Construction	—	—	—	—	—	—
Farmland	380	293	—	179	23	23
Nonfarm nonresidential	1,057	489	—	295	34	3
Residential real estate:						
Multi-family	—	—	—	—	—	—
1-4 Family	1,679	745	—	1,402	219	191
Consumer	309	98	—	56	6	6
Agriculture	304	42	—	47	3	3
Other	—	—	—	—	—	—
Subtotal	3,867	1,717	—	2,036	288	229
<b>With An Allowance Recorded:</b>						
Commercial	24	24	3	15	2	—
Commercial real estate:						
Construction	—	—	—	—	—	—
Farmland	282	282	37	236	9	—
Nonfarm nonresidential	—	—	—	—	—	—
Residential real estate:						
Multi-family	—	—	—	—	—	—
1-4 Family	183	147	2	459	6	—
Consumer	—	—	—	—	—	—
Agriculture	—	—	—	—	—	—
Other	—	—	—	—	—	—
Subtotal	489	453	42	710	17	—
Total	\$ 4,356	\$ 2,170	\$ 42	\$ 2,746	\$ 305	\$ 229

[Table of Contents](#)

The following table presents information related to loans individually evaluated for impairment by class of loan as of and for the year ended December 31, 2018:

	<u>Unpaid Principal Balance</u>	<u>Recorded Investment</u>	<u>Allowance For Loan Losses Allocated</u> (in thousands)	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	<u>Cash Basis Income Recognized</u>
<b>With No Related Allowance Recorded:</b>						
Commercial	\$ 120	\$ 53	\$ —	\$ 125	\$ —	\$ —
Commercial real estate:						
Construction	—	—	—	—	—	—
Farmland	1,860	89	—	1,156	360	360
Nonfarm nonresidential	402	262	—	327	19	—
Residential real estate:						
Multi-family	—	—	—	—	—	—
1-4 Family	2,678	1,628	—	1,964	—	—
Consumer	12	—	—	1	—	—
Agriculture	—	—	—	—	—	—
Other	—	—	—	—	—	—
Subtotal	5,072	2,032	—	3,573	379	360
<b>With An Allowance Recorded:</b>						
Commercial	—	—	—	60	3	—
Commercial real estate:						
Construction	—	—	—	—	—	—
Farmland	—	—	—	—	—	—
Nonfarm nonresidential	159	159	35	100	—	—
Residential real estate:						
Multi-family	—	—	—	—	—	—
1-4 Family	720	720	168	1,111	—	—
Consumer	—	—	—	—	—	—
Agriculture	—	—	—	—	—	—
Other	—	—	—	—	—	—
Subtotal	879	879	203	1,271	3	—
Total	\$ 5,951	\$ 2,911	\$ 203	\$ 4,844	\$ 382	\$ 360

### Troubled Debt Restructuring

A troubled debt restructuring (TDR) occurs when the Bank has agreed to a loan modification in the form of a concession for a borrower who is experiencing financial difficulty. The Bank's TDRs typically involve a reduction in interest rate, a deferral of principal for a stated period of time, or an interest only period. All TDRs are considered impaired and the Bank has allocated reserves for these loans to reflect the present value of the concessionary terms granted to the borrower.

The following table presents the TDR loan modifications by portfolio segment outstanding as of December 31, 2020 and 2019:

	<u>TDRs Performing to Modified Terms</u>	<u>TDRs Not Performing to Modified Terms</u> (in thousands)	<u>Total TDRs</u>
<b>December 31, 2020</b>			
Commercial Real Estate:			
Nonfarm nonresidential	\$ 374	\$ —	\$ 374
Residential Real Estate:			
1-4 Family	106	—	106
Total TDRs	\$ 480	\$ —	\$ 480

	<b>TDRs Performing to Modified Terms</b>	<b>TDRs Not Performing to Modified Terms (in thousands)</b>	<b>Total TDRs</b>
<b>December 31, 2019</b>			
Commercial Real Estate:			
Nonfarm nonresidential	\$ 400	\$ —	\$ 400
Residential Real Estate:			
1-4 Family	75	—	75
Total TDRs	<u>\$ 475</u>	<u>\$ —</u>	<u>\$ 475</u>

At December 31, 2020 and 2019, 100% of the Company's TDRs were performing according to their modified terms. The Company allocated \$1,000 as of December 31, 2020 and 2019, in reserves to customers whose loan terms have been modified in TDRs. The Company has committed to lend no additional amounts as of December 31, 2020 or December 31, 2019 to customers with outstanding loans that are classified as TDRs.

During the years ended December 31, 2020, 2019, and 2018, no TDRs defaulted on their restructured loan within the twelve-month period following the loan modification. A default is considered to have occurred once the TDR is past due 90 days or more or it has been placed on nonaccrual.

The following table presents a summary of the TDR loan modifications by portfolio segment that occurred during the year ended December 31, 2020:

	<b>TDRs Performing to Modified Terms</b>	<b>TDRs Not Performing to Modified Terms (in thousands)</b>	<b>Total TDRs</b>
<b>December 31, 2020</b>			
Residential Real Estate:			
1-4 Family	33	—	33
Total TDRs	<u>\$ 33</u>	<u>\$ —</u>	<u>\$ 33</u>

The Company has not allocated any reserves to customers whose loan terms have been modified during 2020. For modifications occurring during the twelve months ended December 31, 2020, the post-modification balances approximate the pre-modification balances. There were no TDR loan modifications during the year ended December 31, 2019.

#### **Non-TDR Loan Modifications due to COVID-19**

The Company has elected to account for eligible loan modifications under Section 4013 of the Coronavirus Aid Relief and Economic Security Act ("CARES Act"). To be an eligible loan under Section 4013 of the CARES Act, a loan modification must be (1) related to the COVID-19 pandemic; (2) executed on a loan that was not more than 30 days past due as of December 31, 2019; and (3) executed between March 1, 2020 and the earlier of (A) 60 days after the date of termination of the national emergency declared by the President on March 13, 2020 concerning the COVID-19 outbreak (the "national emergency") or (B) January 1, 2022. Eligible loan modifications are not required to be classified as TDRs and will not be reported as past due provided that they are performing in accordance with the modified terms. Interest income will continue to be recognized in accordance with GAAP unless the loan is placed on nonaccrual status. Short-term loan modifications totaled \$15.3 million at December 31, 2020.

**Non-performing Loans**

Non-performing loans include impaired loans and smaller balance homogeneous loans, such as residential mortgage and consumer loans, that are collectively evaluated for impairment. The following table presents the recorded investment in nonaccrual and loans past due 90 days and still on accrual by class of loan as of December 31, 2020 and 2019:

	Nonaccrual		Loans Past Due 90 Days And Over Still Accruing	
	2020	2019	2020	2019
	(in thousands)			
Commercial	\$ —	\$ 50	\$ —	\$ —
Commercial Real Estate:				
Construction	—	—	—	—
Farmland	456	431	—	—
Nonfarm nonresidential	175	90	—	—
Residential Real Estate:				
Multi-family	—	—	—	—
1-4 Family	954	817	—	—
Consumer	—	98	—	—
Agriculture	91	42	—	—
Other	—	—	—	—
Total	<u>\$ 1,676</u>	<u>\$ 1,528</u>	<u>\$ —</u>	<u>\$ —</u>

The following table presents the aging of the recorded investment in past due loans by class as of December 31, 2020 and 2019:

	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days And Over Past Due	Nonaccrual	Total Past Due And Nonaccrual
	(in thousands)				
	<b>December 31, 2020</b>				
Commercial	\$ 20	\$ —	\$ —	\$ —	\$ 20
Commercial Real Estate:					
Construction	—	—	—	—	—
Farmland	325	53	—	456	834
Nonfarm nonresidential	—	26	—	175	201
Residential Real Estate:					
Multi-family	—	—	—	—	—
1-4 Family	1,110	217	—	954	2,281
Consumer	59	49	—	—	108
Agriculture	23	27	—	91	141
Other	—	—	—	—	—
Total	<u>\$ 1,537</u>	<u>\$ 372</u>	<u>\$ —</u>	<u>\$ 1,676</u>	<u>\$ 3,585</u>

	<b>30 – 59 Days Past Due</b>	<b>60 – 89 Days Past Due</b>	<b>90 Days And Over Past Due</b>	<b>Nonaccrual</b>	<b>Total Past Due And Nonaccrual</b>
(in thousands)					
<b>December 31, 2019</b>					
Commercial	\$ 14	\$ 3	\$ —	\$ 50	\$ 67
Commercial Real Estate:					
Construction	—	—	—	—	—
Farmland	274	—	—	431	705
Nonfarm nonresidential	206	—	—	90	296
Residential Real Estate:					
Multi-family	—	—	—	—	—
1-4 Family	1,162	503	—	817	2,482
Consumer	91	164	—	98	353
Agriculture	—	—	—	42	42
Other	—	—	—	—	—
Total	<u>\$ 1,747</u>	<u>\$ 670</u>	<u>\$ —</u>	<u>\$ 1,528</u>	<u>\$ 3,945</u>

**Credit Quality Indicators**

Management categorizes all loans into risk categories at origination based upon original underwriting. Thereafter, management 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. Additionally, loans are analyzed through internal and external loan review processes and are routinely analyzed through credit administration processes which classify the loans as to credit risk. The following definitions are used for risk ratings:

**Watch** – Loans classified as watch are those loans which have experienced or may experience a potentially adverse development which necessitates increased monitoring.

**Special Mention** – Loans classified as special mention do not have all of the characteristics of substandard or doubtful loans. They have one or more deficiencies which warrant special attention and which corrective action, such as accelerated collection practices, may remedy.

**Substandard** – Loans classified as substandard are those loans with clear and defined weaknesses such as a highly leveraged position, unfavorable financial ratios, uncertain repayment sources or poor financial condition which may jeopardize the repayment of the debt as contractually agreed. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

**Doubtful** – Loans classified as doubtful are those loans which have characteristics similar to substandard loans but with an increased risk that collection or liquidation in full is highly questionable and improbable.

[Table of Contents](#)

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be “Pass” rated loans. As of December 31, 2020 and 2019, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

	<u>Pass</u>	<u>Watch</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
(in thousands)						
<b>December 31, 2020</b>						
Commercial	\$ 201,240	\$ 192	\$ —	\$ 6,812	\$ —	\$ 208,244
Commercial Real Estate:						
Construction	92,916	—	—	—	—	92,916
Farmland	65,556	3,714	—	1,002	—	70,272
Nonfarm nonresidential	258,665	1,605	—	6,124	—	266,394
Residential Real Estate:						
Multi-family	50,732	10,448	—	—	—	61,180
1-4 Family	183,379	2,831	—	2,745	—	188,955
Consumer	31,387	3	—	39	—	31,429
Agriculture	41,503	86	—	455	—	42,044
Other	647	—	—	—	—	647
<b>Total</b>	<b>\$ 926,025</b>	<b>\$ 18,879</b>	<b>\$ —</b>	<b>\$ 17,177</b>	<b>\$ —</b>	<b>\$ 962,081</b>

	<u>Pass</u>	<u>Watch</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
(in thousands)						
<b>December 31, 2019</b>						
Commercial	\$ 130,312	\$ 11,280	\$ —	\$ 3,959	\$ —	\$ 145,551
Commercial Real Estate:						
Construction	64,911	—	—	—	—	64,911
Farmland	71,503	6,663	—	952	—	79,118
Nonfarm nonresidential	245,995	6,986	—	2,478	—	255,459
Residential Real Estate:						
Multi-family	70,950	—	—	—	—	70,950
1-4 Family	221,727	2,420	—	2,482	—	226,629
Consumer	47,657	5	—	128	—	47,790
Agriculture	34,853	168	—	43	—	35,064
Other	799	—	—	—	—	799
<b>Total</b>	<b>\$ 888,707</b>	<b>\$ 27,522</b>	<b>\$ —</b>	<b>\$ 10,042</b>	<b>\$ —</b>	<b>\$ 926,271</b>

**NOTE 4 – PREMISES AND EQUIPMENT**

Year-end premises and equipment were as follows:

	<u>2020</u>	<u>2019</u>
	(in thousands)	
Land and buildings	\$ 21,214	\$ 21,228
Furniture and equipment	9,323	8,884
Leased right-of-use asset	2,477	3,070
	33,014	33,182
Accumulated depreciation	(14,481)	(13,524)
	<u>\$ 18,533</u>	<u>\$ 19,658</u>

See ‘Note 5 – Leases’ for additional details regarding the Bank’s leased right-of-use asset and lease liability.

Depreciation expense was \$1.1 million, \$801,000 and \$833,000 for 2020, 2019 and 2018, respectively.

**NOTE 5 – LEASES**

As of December 31, 2020, the Company leases real estate for six branch offices or offsite ATM machines under various operating lease agreements. The lease agreements have maturity dates ranging from 2021 to 2045, including all expected extension periods. The weighted average remaining life of the lease term for these leases was 21 years as of December 31, 2020.

In determining the present value of lease payments, the Bank uses the implicit lease rate when readily determinable. As most of the Bank's leases do not provide an implicit rate, the incremental borrowing rate based on the information available at commencement date is used. The incremental borrowing rate is the estimated rate of interest that the Bank would have to pay to borrow on a collateralized basis over a similar term in an amount equal to the lease payments in a similar economic environment. The weighted average discount rate for the leases was 5.47% as of December 31, 2020.

Total rental expense was \$551,000 and \$294,000 for the years ended December 31, 2020 and December 31, 2019, respectively. During 2019, the Company assumed three leases as a result of the branch purchase transaction, and also commenced the lease for a new branch in Lexington. The right-of-use asset, included in premises and equipment, and lease liability, included in other liabilities, was \$2.5 million as of December 31, 2020 and \$3.1 million as of December 31, 2019.

Total estimated rental commitments for the operating leases were as follows as of December 31, 2020 (in thousands):

	<u>2020</u>
2021	279
2022	183
2023	186
2024	185
2025	162
Thereafter	3,503
Total minimum lease payments	4,498
Discount effect of cash flows	(2,021)
Present value of lease liabilities	<u>\$ 2,477</u>

At December 31, 2020, the Company has entered into two additional leases for new branch offices that have yet to commence. The right of use asset and lease liability for the leases yet to commence are estimated to be approximately \$3.3 million and are expected to be recorded in the first quarter of 2021.

**NOTE 6 – OTHER REAL ESTATE OWNED**

Other real estate owned (OREO) is real estate acquired as a result of foreclosure or by deed in lieu of foreclosure. It is classified as real estate owned until such time as it is sold. When property is acquired as a result of foreclosure or by deed in lieu of foreclosure, it is recorded at its fair market value less estimated cost to sell. Any write-down of the property at the time of acquisition is charged to the allowance for loan losses.

The following table presents the major categories of OREO at the period-ends indicated:

	<u>2020</u>	<u>2019</u>
	<u>(in thousands)</u>	
Commercial Real Estate:		
Construction, land development, and other land	1,765	3,225
	<u>\$ 1,765</u>	<u>\$ 3,225</u>

Residential loans secured by 1-4 family residential properties in the process of foreclosure totaled \$35,000 and \$172,000 at December 31, 2020 and December 31, 2019, respectively.

Activity relating to OREO during the years indicated is as follows:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
	(in thousands)		
<b>OREO Activity</b>			
OREO as of January 1	\$ 3,225	\$ 3,485	\$ 4,409
Real estate acquired	—	—	730
Valuation adjustment write-downs	—	(260)	(850)
Net gain on sale	—	—	72
Proceeds from sale of properties	(1,600)	—	(876)
Improvements	140	—	—
OREO as of December 31	<u>\$ 1,765</u>	<u>\$ 3,225</u>	<u>\$ 3,485</u>

Expenses related to OREO include:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
	(in thousands)		
Net gain on sale	\$ —	\$ —	\$ (72)
Valuation adjustment write-downs	—	260	850
Operating expense	63	108	90
Total	<u>\$ 63</u>	<u>\$ 368</u>	<u>\$ 868</u>

#### NOTE 7 – GOODWILL AND INTANGIBLE ASSETS

The following table summarizes the Company's acquired goodwill and intangible assets as of December 31, 2020 and December 31, 2019:

	<u>2020</u>		<u>2019</u>	
	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>
	(in thousands)			
Goodwill	\$ 6,252	\$ —	\$ 6,252	\$ —
Core deposit intangibles	2,500	256	2,500	—
Outstanding, ending	<u>\$ 8,752</u>	<u>\$ 256</u>	<u>\$ 8,752</u>	<u>\$ —</u>

During 2019, the Company recorded \$6.3 million of goodwill related to a branch purchase transaction. Goodwill represents the excess of the total purchase price paid over the fair value of the identifiable assets acquired, net of the fair value of the liabilities assumed. Goodwill is not amortized but is evaluated for impairment on an annual basis or whenever events or changes in circumstances indicate the carrying value may not be recoverable. Impairment exists when a reporting unit's carrying amount exceeds its fair value. Given the current economic environment, the Company engaged an independent third party expert to perform a quantitative assessment as of November 30, 2020 to determine if it was more likely than not that the fair value of the reporting unit exceeded its carrying value, including goodwill. The assessment indicated that the fair value of the reporting unit exceeded its carrying value, resulting in no impairment. Goodwill is the only intangible asset with an indefinite life on the Company's balance sheet.

The Company recorded \$256,000 intangible amortization expense during 2020. During 2019, the Company did not record any intangible amortization expense.



[Table of Contents](#)

The estimated amortization expense of the core deposit intangible for the years ending December 31 is as follows (in thousands):

	<b>Amortization Expense</b>
2021	\$ 256
2022	256
2023	256
2024	256
2025	256
Thereafter	964
	<u>\$ 2,244</u>

**NOTE 8 – DEPOSITS**

The following table details deposits by category:

	<b>December 31, 2020</b>	<b>December 31, 2019</b>
	<b>(in thousands)</b>	
Non-interest bearing	\$ 243,022	\$ 187,551
Interest checking	190,625	146,038
Money market	175,785	160,837
Savings	142,623	56,015
Certificates of deposit	367,552	476,534
Total	<u>\$ 1,119,607</u>	<u>\$ 1,026,975</u>

Time deposits of \$250,000 or more were approximately \$50.7 million and \$51.2 million at year-end 2020 and 2019, respectively.

Scheduled maturities of total time deposits for each of the next five years are as follows (in thousands):

	<b>Total</b>
2021	\$ 272,031
2022	39,876
2023	17,419
2024	11,092
2025	26,657
Thereafter	477
	<u>\$ 367,552</u>

**NOTE 9 – ADVANCES FROM FEDERAL HOME LOAN BANK**

At year-end, advances from the Federal Home Loan Bank were as follows:

	<b>December 31, 2020</b>	<b>December 31, 2019</b>
	<b>(in thousands)</b>	
Short term advance (fixed rate 0.00%) maturing April 2021	\$ 623	\$ 60,000
Long term advance (fixed rate 0.77%) maturing February 2030	20,000	1,389
Total advances from the Federal Home Loan Bank	<u>\$ 20,623</u>	<u>\$ 61,389</u>

FHLB advances had a weighted-average rate of 0.75% at December 31, 2020 and 1.70% at December 31, 2019. Each advance is payable per terms on agreement, with a prepayment penalty. No prepayment penalties were incurred during 2020 or 2019. The \$20.0 million long term advance is callable quarterly at the FHLB's option. The advances were collateralized by approximately \$133.7 million and \$166.0 million of first mortgage loans, under a blanket lien arrangement at December 31, 2020 and December 31, 2019, respectively and \$20.3 million of loans originated under the SBA Payment Protection Plan at December 31, 2020. At December 31, 2020, the Bank's additional borrowing capacity with the FHLB was \$93.9 million.

Scheduled principal payments during the next five years and thereafter (in thousands):

	<b>Advances</b>
2021	\$ 623
2022	—
2023	—
2024	—
2025	—
Thereafter	20,000
	<u>\$ 20,623</u>

At year-end 2020, the Company had a \$5.0 million federal funds line of credit available on an unsecured basis from a correspondent institution.

**NOTE 10 – BORROWINGS**

**Junior Subordinated Debentures** - The junior subordinated debentures are redeemable at par prior to maturity at the option of the Company as defined within the trust indenture. The Company has the option to defer interest payments on the junior subordinated debentures from time to time for a period not to exceed 20 consecutive quarters. A deferral period may begin at the Company’s discretion so long as interest payments are current. The Company is prohibited from paying dividends on preferred and common shares when interest payments are in deferral. At December 31, 2020, the Company is current on all interest payments.

A summary of the junior subordinated debentures is as follows:

<b>Description</b>	<b>Issuance Date</b>	<b>Interest Rate (1)</b>	<b>Junior Subordinated Debt Owed To Trust</b>	<b>Maturity Date (2)</b>
Statutory Trust I	2/13/2004	3-month LIBOR + 2.85%	\$ 3,000,000	2/13/2034
Statutory Trust II	2/13/2004	3-month LIBOR + 2.85%	5,000,000	2/13/2034
Statutory Trust III	4/15/2004	3-month LIBOR + 2.79%	3,000,000	4/15/2034
Statutory Trust IV	12/14/2006	3-month LIBOR + 1.67%	10,000,000	3/01/2037
			<u>\$ 21,000,000</u>	

(1) As of December 31, 2020, the 3-month LIBOR was 0.24%.

(2) The debentures are callable at the Company’s option at their principal amount plus accrued interest.

**Subordinated Capital Notes** - The Company’s subordinated notes mature on July 31, 2029. The notes carry interest at a fixed rate of 5.75% until July 30, 2024 and then convert to variable at three-month LIBOR plus 395 basis points until maturity. The subordinated capital notes qualify as Tier 2 regulatory capital. On July 31, 2020, the Company completed the issuance of an additional \$8.0 million in subordinated notes under the July 23, 2019 indenture with the same terms and with the additional commitment by the Company to extend the optional prepayment date to July 31, 2025 so long as the additional notes qualify as Tier 2 regulatory capital. The Company used the net proceeds from the issuance of the additional notes to retire its senior debt and retained the remaining balance for general corporate purposes. The subordinated capital notes qualify as Tier 2 regulatory capital.

**NOTE 11 – OTHER BENEFIT PLANS**

**401(k) Plan** – The Company’s 401(k) Savings Plan allows employees to contribute up to the annual limits as determined by the Internal Revenue Service, which is matched 100% of the first 1% of compensation contributed and 50% of the next 5% contributed by employees. The Company, at its discretion, may make additional contributions. Total contributions made by the Company to the plan totaled approximately \$399,000, \$362,000 and \$347,000 in 2020, 2019 and 2018, respectively.

**NOTE 12 – INCOME TAXES**

Income tax expense was as follows:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
	(in thousands)		
Current	\$ (173)	\$ (173)	\$ (346)
Deferred	1,372	505	121
Net operating loss	903	1,725	2,255
Establish state deferred tax asset	(478)	(1,577)	—
	<u>\$ 1,624</u>	<u>\$ 480</u>	<u>\$ 2,030</u>

For 2020 and 2019, income tax expense benefitted from the establishment of a net deferred tax assets related to a change in Kentucky tax law enacted during 2019. Income tax expense benefitted \$478,000 and \$1.6 million for the years ended December 31, 2020 and 2019, respectively, or \$0.06 per basic and diluted common share, and \$0.21 per basic and diluted common share, respectively. The new law eliminates the Kentucky bank franchise tax, which is assessed at a rate of 1.1% of average capital, and implements a state income tax for the Bank at a statutory rate of 5%. The new Kentucky income tax went into effect on January 1, 2021.

Effective tax rates differ from federal statutory rate applied to income before income taxes due to the following:

	<u>2020</u>	<u>2019</u>	<u>2018</u>
	(in thousands)		
Federal statutory rate	21%	21%	21%
Federal statutory rate times financial statement income	\$ 2,232	\$ 2,310	\$ 2,273
Effect of:			
Tax-exempt income	(73)	(66)	(80)
Establish state deferred tax asset	(478)	(1,577)	—
Non-taxable life insurance income	(89)	(86)	(92)
Restricted stock vesting	7	(137)	(115)
Other, net	25	36	44
Total	<u>\$ 1,624</u>	<u>\$ 480</u>	<u>\$ 2,030</u>

Year-end deferred tax assets and liabilities were due to the following:

	<u>2020</u>	<u>2019</u>
	(in thousands)	
Deferred tax assets:		
Net operating loss carry-forward	\$ 22,012	\$ 22,915
Allowance for loan losses	3,104	2,090
OREO write-down	914	2,665
Alternative minimum tax credit carry-forward	—	173
Net assets from acquisitions	72	228
New market tax credit carry-forward	208	208
Nonaccrual loan interest	315	303
Accrued expenses	131	102
Lease liability	618	766
Other	332	309
	<u>27,706</u>	<u>29,759</u>
Deferred tax liabilities:		
FHLB stock dividends	478	563
Fixed assets	71	57
Deferred loan costs	172	170
Net unrealized gain on securities	585	331
Lease right-of-use assets	618	766
Other	68	107
	<u>1,992</u>	<u>1,994</u>
Net deferred tax assets	<u>\$ 25,714</u>	<u>\$ 27,765</u>

[Table of Contents](#)

At December 31, 2020, the Company had net federal net operating loss carryforwards of \$98.2 million, which will begin to expire in 2032, and state net operating loss carryforwards of \$35.0 million, which will begin to expire in 2025. During 2020, the \$173,000 alternative minimum tax credit carry-forward was refunded due to the enactment of CARES Act.

The Company does not have any beginning and ending unrecognized tax benefits. The Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months. There were no interest and penalties recorded in the income statement or accrued for the years ended December 31, 2020 or December 31, 2019 related to unrecognized tax benefits.

Under Section 382 of the Internal Revenue Code, as amended (“Section 382”), the Company’s net operating loss carryforwards and other deferred tax assets can generally be used to offset future taxable income and therefore reduce federal income tax obligations. However, the Company's ability to use its NOLs would be limited if there was an “ownership change” as defined by Section 382. This would occur if shareholders owning (or deemed to own under the tax rules) 5% or more of the Company's voting and non-voting common shares increase their aggregate ownership of the Company by more than 50 percentage points over a defined period of time.

In 2015, the Company took two measures to preserve the value of its NOLs. First, the Company adopted a tax benefits preservation plan designed to reduce the likelihood of an “ownership change” occurring as a result of purchases and sales of the Company's common shares. Upon adoption of this plan, the Company declared a dividend of one preferred stock purchase right for each common share outstanding as of the close of business on July 10, 2015. Any shareholder or group that acquires beneficial ownership of 5% or more of the Company (an “acquiring person”) could be subject to significant dilution in its holdings if the Company's Board of Directors does not approve such acquisition. Existing shareholders holding 5% or more of the Company will not be considered acquiring persons unless they acquire additional shares, subject to certain exceptions described in the plan. In addition, as amended November 25, 2019, the Board of Directors has the discretion to exempt certain transactions and certain persons whose acquisition of securities is determined by the Board not to jeopardize the Company's deferred tax assets. The rights plan was extended in May 2018 to expire upon the earlier of (i) June 30, 2021, (ii) the beginning of a taxable year with respect to which the Board of Directors determines that no tax benefits may be carried forward, (iii) the repeal or amendment of Section 382 or any successor statute, if the Board of Directors determines that the plan is no longer needed to preserve the tax benefits, and (iv) certain other events as described in the plan.

On September 23, 2015, the Company’s shareholders approved an amendment to its articles of incorporation to further help protect the long-term value of the Company’s NOLs. The amendment provides a means to block transfers of the Company’s common shares that could result in an ownership change under Section 382. The transfer restrictions were extended in May 2018 by shareholder vote and will expire on the earlier of (i) May 23, 2021, (ii) the beginning of a taxable year with respect to which the Board of Directors determines that no tax benefit may be carried forward, (iii) the repeal of Section 382 or any successor statute if the Company’s Board determines that the transfer restrictions are no longer needed to preserve the tax benefits of its NOLs, or (iv) such date as the Board otherwise determines that the transfer restrictions are no longer necessary.

The Company and its subsidiaries are subject to U.S. federal income tax and the Company is subject to income tax in the Commonwealth of Kentucky. The Company is no longer subject to examination by taxing authorities for years before 2017.

**NOTE 13 – RELATED PARTY TRANSACTIONS**

Loans to principal officers, directors, significant shareholders, and their affiliates in 2020 were as follows (in thousands):

Beginning balance	\$	13,045
New loans and advances		4,750
Repayments		(3,500)
Ending balance	\$	<u>14,295</u>

Deposits from principal officers, directors, significant shareholders, and their affiliates at year-end 2020 and 2019 were \$1.3 million and \$505,000, respectively.

Hogan Development Company assists the Bank in onboarding, managing, and selling the Bank’s OREO. Hogan Development Company is owned by W. Glenn Hogan, a director. The agreement with Hogan Development Company is periodically reviewed and evaluated by the Audit Committee. The Bank paid real estate management fees of \$26,000 in 2020 and \$20,000 in 2019. The Bank paid no real estate sales and leasing commissions in 2020 or 2019.

**NOTE 14 – REGULATORY CAPITAL MATTERS**

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, 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 result in regulatory action.

The Basel III rules established a “capital conservation buffer” of 2.5% above the regulatory minimum risk-based capital ratios. Including the capital conservation buffer, the minimum ratios are a common equity Tier 1 risk-based capital ratio of 7.0%, a Tier 1 risk-based capital ratio of 8.5%, and a total risk-based capital ratio of 10.5%. An institution is subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if capital levels fall below minimum levels plus the buffer amounts. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions without prior regulatory approval.

The Company’s capital ratios were positively impacted by the additional \$8.0 million of subordinated notes issued on July 21, 2020, as the subordinated notes meet the requirements to qualify as Tier 2 capital.

As of December 31, 2020, the Company and Bank meet all capital adequacy requirements to which they are subject. At year end 2020 and 2019, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since the notification that management believes have changed the institution’s category.

The following tables show the ratios (excluding capital conservation buffer) and amounts of common equity Tier 1, Tier 1 capital, and total capital to risk-adjusted assets and the leverage ratios for the Bank at the dates indicated (dollars in thousands):

	Actual		Minimum Requirement for Capital Adequacy Purposes		Minimum Requirement to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of December 31, 2020:</b>						
Total risk-based capital (to risk-weighted assets)	\$ 142,449	13.20%	\$ 86,302	8.00%	\$ 107,878	10.00%
Total common equity Tier 1 risk-based capital (to risk-weighted assets)	130,006	12.05	48,545	4.50	70,120	6.50
Tier 1 capital (to risk-weighted assets)	130,006	12.05	64,727	6.00	86,302	8.00
Tier 1 capital (to average assets)	130,006	10.21	50,908	4.00	63,636	5.00

	Actual		Minimum Requirement for Capital Adequacy Purposes		Minimum Requirement to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of December 31, 2019:</b>						
Total risk-based capital (to risk-weighted assets)	\$ 121,335	12.08%	\$ 80,341	8.00%	\$ 100,426	10.00%
Total common equity Tier 1 risk-based capital (to risk-weighted assets)	112,959	11.25	45,192	4.50	65,277	6.50
Tier 1 capital (to risk-weighted assets)	112,959	11.25	60,256	6.00	80,341	8.00
Tier 1 capital (to average assets)	112,959	9.99	45,208	4.00	56,510	5.00

Kentucky banking laws limit the amount of dividends that may be paid to a holding company by its subsidiary banks without prior approval. These laws limit the amount of dividends that may be paid in any calendar year to current year’s net income, as defined in the laws, combined with the retained net income of the preceding two years, less any dividends declared during those periods. In addition, a bank must have positive retained earnings.

**NOTE 15 – OFF BALANCE SHEET RISKS, COMMITMENTS, AND CONTINGENT LIABILITIES**

The Company, in the normal course of business, is party to financial instruments with off balance sheet risk. The financial instruments include commitments to extend credit and standby letters of credit. The contract or notional amounts of these instruments reflect the potential future obligations of the Company pursuant to those financial instruments. Creditworthiness for all instruments is evaluated on a case-by-case basis in accordance with the Company's credit policies. Collateral from the client may be required based on the Company's credit evaluation of the client and may include business assets of commercial clients, as well as personal property and real estate of individual clients or guarantors.

An approved but unfunded loan commitment represents a potential credit risk and a liquidity risk, since the Company's client(s) may demand immediate cash that would require funding. In addition, unfunded loan commitments represent interest rate risk as market interest rates may rise above the rate committed to the Company's client. Since a portion of these loan commitments normally expire unused, the total amount of outstanding commitments at any point in time may not require future funding. Commitments to make loans are generally made for periods of one year or less.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a client to a third party. The terms and risk of loss involved in issuing standby letters of credit are similar to those involved in issuing loan commitments and extending credit. In addition to credit risk, the Company also has liquidity risk associated with standby letters of credit because funding for these obligations could be required immediately. The Company does not deem this risk to be material. No liability is currently established for standby letters of credit.

The following table presents the contractual amounts of financial instruments with off-balance sheet risk for each year ended:

	2020		2019	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
	(in thousands)			
Commitments to make loans	\$ 20,990	\$ 17,466	\$ 11,577	\$ 20,415
Unused lines of credit	5,964	144,790	7,916	111,230
Standby letters of credit	175	1,342	531	3,164

Commitments to make loans are generally made for periods of one year or less.

In connection with the purchase of loan participations, the Bank entered into risk participation agreements, which had notional amounts totaling \$26.6 million at December 31, 2020 and December 31, 2019. The risk participation agreements are not designated against specific assets or liabilities under ASC 815, Derivatives and Hedging, and, therefore, do not qualify for hedge accounting. The derivatives are recorded in other liabilities on the balance sheet at fair value and changes in fair value of both the borrower and the offsetting swap agreements are recorded (and essentially offset) in non-interest income. The fair value of the derivative instruments incorporates a consideration of credit risk in accordance with ASC 820, resulting in some volatility in earnings each period. At December 31, 2020 and December 31, 2019, the fair value of the risk participation agreements were \$188,000 and \$87,000, respectively.

In the normal course of business, the Company and its subsidiaries have been named, from time to time, as defendants in various legal actions. Certain of the actual or threatened legal actions may include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages.

The Company contests liability and/or the amount of damages as appropriate in each pending matter. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases where claimants seek substantial or indeterminate damages or where investigations and proceedings are in the early stages, the Company cannot predict with certainty the loss or range of loss, if any, related to such matters, how or if such matters will be resolved, when they will ultimately be resolved, or what the eventual settlement, or other relief, if any, might be. Subject to the foregoing, the Company believes, based on current knowledge and after consultation with counsel, that the outcome of such pending matters will not have a material adverse effect on the consolidated financial condition of the Company, although the outcome of such matters could be material to the Company's operating results and cash flows for a particular future period, depending on, among other things, the level of the Company's revenues or income for such period. The Company will accrue for a loss contingency if (1) it is probable that a future event will occur and confirm the loss and (2) the amount of the loss can be reasonably estimated. The Company is not currently involved in any material litigation.

## NOTE 16 – FAIR VALUES

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. Various valuation techniques are used to determine fair value, including market, income and cost approaches. 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 an entity has the ability to access as of the measurement date, or observable inputs.

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

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

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. When that occurs, the fair value hierarchy is classified on the lowest level of input that is significant to the fair value measurement. The following methods and significant assumptions are used to estimate fair value.

**Securities:** The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges, if available. This valuation method is classified as Level 1 in the fair value hierarchy. For securities where quoted prices are not available, fair values are calculated on market prices of similar securities, or matrix pricing, which is a mathematical technique used widely 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. Matrix pricing relies on the securities' relationship to similarly traded securities, benchmark curves, and the benchmarking of like securities. Matrix pricing utilizes observable market inputs such as benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, and industry and economic events. In instances where broker quotes are used, these quotes are obtained from market makers or broker-dealers recognized to be market participants. This valuation method is classified as Level 2 in the fair value hierarchy. For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators. This valuation method is classified as Level 3 in the fair value hierarchy. Discounted cash flows are calculated using spread to swap and LIBOR curves that are updated to incorporate loss severities, volatility, credit spread and optionality. During times when trading is more liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations.

**Impaired Loans:** An impaired loan is evaluated at the time the loan is identified as impaired and is recorded at fair value less costs to sell. Fair value is measured based on the value of the collateral securing the loan and is classified as Level 3 in the fair value hierarchy. Fair value is determined using several methods. Generally, the fair value of real estate is determined based on appraisals by qualified licensed appraisers. 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. These routine adjustments are made to adjust the value of a specific property relative to comparable properties for variations in qualities such as location, size, and income production capacity relative to the subject property of the appraisal. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value.

Management routinely applies internal discounts to the value of appraisals used in the fair value evaluation of the Bank's impaired loans. The deductions to the appraisal take into account changing business factors and market conditions, as well as potential value impairment in cases where the Bank's appraisal date predates a likely change in market conditions. These deductions range from 10% for routine real estate collateral to 25% for real estate that is determined to have a thin trading market or to be specialized collateral. This is in addition to estimated discounts for cost to sell of six to ten percent.

Management also applies discounts to the expected fair value of collateral for impaired loans where the likely resolution involves litigation or foreclosure. Resolution of this nature generally results in receiving lower values for real estate collateral in a more aggressive sales environment. Discounts ranging from 10% to 33% have been utilized in the Bank's impairment evaluations when applicable.

Impaired loans are evaluated quarterly for additional impairment. Management obtains updated appraisals on properties securing the Bank's loans when circumstances are warranted such as at the time of renewal or when market conditions have significantly changed. This determination is made on a property-by-property basis in light of circumstances in the broader economic climate and the assessment of deterioration of real estate values in the market in which the property is located.

**Other Real Estate Owned (OREO):** OREO is evaluated at the time of acquisition and recorded at fair value as determined by independent appraisal or internal evaluation less estimated cost to sell. Quarterly evaluations of OREO for impairment are driven by property type. For smaller dollar single family homes, management consults with staff from the Bank's special assets group as well as external realtors and appraisers. Based on these consultations, management determines asking prices for OREO properties being marketed for sale. If the internally evaluated fair value or asking price is below the recorded investment in the property, appropriate write-downs are taken.

For larger dollar commercial real estate properties, management obtains a new appraisal of the subject property or has staff in the special assets group evaluate the latest in-file appraisal in connection with the transfer to OREO. Management generally obtains updated appraisals within five quarters of the anniversary date of ownership unless a sale is imminent. When an asking price is lowered below the most recent appraised value, appropriate write-downs are taken.

Financial assets measured at fair value on a recurring basis are summarized below:

Description	Fair Value Measurements at December 31, 2020			
	Carrying Value	Using (in thousands)		
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Available for sale securities</b>				
U.S. Government and federal agency	\$ 19,617	\$ —	\$ 19,617	\$ —
Agency mortgage-backed: residential	74,333	—	74,333	—
Collateralized loan obligations	43,152	—	40,764	2,388
State and municipal	36,055	—	36,055	—
Corporate bonds	30,705	—	18,789	11,916
Total	\$ 203,862	\$ —	\$ 189,558	\$ 14,304

Description	Fair Value Measurements at December 31, 2019 Using			
	Carrying Value	(in thousands)		
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Available for sale securities</b>				
U.S. Government and federal agency	\$ 22,330	\$ —	\$ 22,330	\$ —
Agency mortgage-backed: residential	92,200	—	92,200	—
Collateralized loan obligations	49,419	—	49,419	—
State and municipal	28,366	—	28,366	—
Corporate bonds	16,685	—	16,685	—
Total	\$ 209,000	\$ —	\$ 209,000	\$ —

There were no transfers between Level 1 and Level 2 during 2020 or 2019.

The Company's policy is to transfer assets or liabilities from one level to another when the methodology to obtain the fair value changes such that there are more or fewer unobservable inputs as of the end of the reporting period. During the year ended December 31, 2020, the Company reclassified one collateralized loan obligation and six corporate bonds from Level 2 to Level 3. The Company's collateralized loan obligations and corporate bond valuations were supported by an analysis prepared by an independent third party and approved by management.





[Table of Contents](#)

The following table presents qualitative information about level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2020:

	Fair Value (in thousands)	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Impaired loans - Commercial real estate	\$ 2,180	Sales comparison approach	Adjustment for differences between the comparable sales	0% - 65% (33%)
		Income approach	Discount or capitalization rate	12% (12%)

Carrying amount and estimated fair values of financial instruments were as follows at year-end 2020:

	Carrying Amount	Fair Value Measurements at December 31, 2020 Using			
		Level 1	Level 2 (in thousands)	Level 3	Total
<b>Financial assets</b>					
Cash and cash equivalents	\$ 67,693	\$ 67,693	\$ —	\$ —	\$ 67,693
Securities available for sale	203,862	—	189,558	14,304	203,862
Federal Home Loan Bank stock	5,887	N/A	N/A	N/A	N/A
Loans, net	949,638	—	—	941,330	941,330
Accrued interest receivable	4,444	—	925	3,519	4,444
<b>Financial liabilities</b>					
Deposits	\$ 1,119,607	\$ 243,022	\$ 878,309	\$ —	\$ 1,121,331
Federal Home Loan Bank advances	20,623	—	20,665	—	20,665
Junior subordinated debentures	21,000	—	—	16,194	16,194
Subordinated capital notes	25,000	—	—	25,207	25,207
Accrued interest payable	859	—	231	628	859

Carrying amount and estimated fair values of financial instruments were as follows at year-end 2019:

	Carrying Amount	Fair Value Measurements at December 31, 2019 Using			
		Level 1	Level 2 (in thousands)	Level 3	Total
<b>Financial assets</b>					
Cash and cash equivalents	\$ 30,203	\$ 30,203	\$ —	\$ —	\$ 30,203
Securities available for sale	209,000	—	209,000	—	209,000
Federal Home Loan Bank stock	6,237	N/A	N/A	N/A	N/A
Loans, net	917,895	—	—	925,388	925,388
Accrued interest receivable	4,257	—	1,118	3,139	4,257
<b>Financial liabilities</b>					
Deposits	\$ 1,026,975	\$ 187,551	\$ 839,882	\$ —	\$ 1,027,433
Federal Home Loan Bank advances	61,389	—	61,395	—	61,395
Junior subordinated debentures	21,000	—	—	17,466	17,466
Subordinated capital notes	17,000	—	—	17,003	17,003
Senior debt	5,000	—	—	5,022	5,022
Accrued interest payable	1,129	—	647	482	1,129

**NOTE 17 – STOCK PLANS AND STOCK BASED COMPENSATION**

Shares available for issuance under the 2018 Omnibus Equity Compensation Plan (“2018 Plan”) total 262,374. Shares issued to employees under the plan vest annually on the anniversary date of the grant over three years. Shares issued annually to each non-employee director have a fair market value of \$25,000 and vest on December 31 in the year of grant.

The fair value of the 2020 unvested shares issued was \$534,000, or \$15.33 per weighted-average share. The Company recorded \$580,000, \$535,000, and \$524,000 of stock-based compensation during 2020, 2019, and 2018, respectively, to salaries and employee benefits. Management expects substantially all of the unvested shares outstanding at the end of the period to vest according to the vesting schedule. A deferred tax benefit of \$122,000, \$112,000, and \$110,000 was recognized related to this expense in 2020, 2019, and 2018, respectively.

The following table summarizes unvested share activity as of and for the periods indicated for the Company’s equity compensation plan:

	Twelve Months Ended December 31, 2020		Twelve Months Ended December 31, 2019	
	Shares	Weighted Average Grant Price	Shares	Weighted Average Grant Price
Outstanding, beginning	57,774	\$ 13.35	116,909	\$ 8.69
Granted	34,858	15.33	34,501	14.81
Vested	(43,836)	12.69	(89,388)	7.83
Forfeited	(1,358)	15.95	(4,248)	13.07
Outstanding, ending	<u>47,438</u>	<u>\$ 15.34</u>	<u>57,774</u>	<u>\$ 13.35</u>

Unrecognized stock based compensation expense related to unvested shares for 2021 and beyond is estimated as follows (in thousands):

2021	\$ 305
2022	134
2023	16
2024 & thereafter	—

**NOTE 18 – EARNINGS PER SHARE**

The factors used in the basic and diluted earnings per share computation follow:

	2020	2019	2018
	(in thousands, except share and per share data)		
Net income	\$ 9,005	\$ 10,518	\$ 8,794
Less:			
Earnings allocated to unvested shares	68	106	144
Net income attributable to common shareholders, basic and diluted	<u>\$ 8,937</u>	<u>\$ 10,412</u>	<u>\$ 8,650</u>

**Basic**

Weighted average common shares including unvested common shares and participating preferred shares outstanding	7,492,190	7,468,215	7,159,723
Less:			
Weighted average unvested common shares	56,809	75,084	117,030
Weighted average common shares outstanding	<u>7,435,381</u>	<u>7,393,131</u>	<u>7,042,693</u>
Basic income per common share	<u>\$ 1.20</u>	<u>\$ 1.41</u>	<u>\$ 1.23</u>

**Diluted**

Add: Dilutive effects of assumed exercises of common stock warrants	—	—	—
Weighted average common shares and potential common shares	<u>7,435,381</u>	<u>7,393,131</u>	<u>7,042,693</u>
Diluted income per common share	<u>\$ 1.20</u>	<u>\$ 1.41</u>	<u>\$ 1.23</u>

The Company had no outstanding stock options at December 31, 2020, 2019 or 2018.

#### NOTE 19 – REVENUE FROM CONTRACTS WITH CUSTOMERS

All of the Company’s revenue from customers in the scope of ASC 606 is recognized within non-interest income. A description of the Company’s revenue streams accounted for under ASC 606 follows:

**Service Charges on Deposit Accounts:** The Company earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as ATM use fees, stop payment charges, statement rendering, and ACH fees, 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 that the overdraft occurs. Service charges are withdrawn from the customer’s account balance.

**Bank Card Interchange Income:** The Company earns interchange fees from bank cardholder transactions conducted through a third party payment network. 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.

**Gains/Losses on Sales of OREO:** The Company records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of OREO to the buyer, the Company assess whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the OREO asset is derecognized and the gain or loss on sale is recorded upon transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Company adjusts the transaction price and related gain (loss) on sale if a significant financing component is present. Gains and losses on sales of OREO are netted with OREO expense and reported in non-interest expense.

**Other Non-interest Income:** Other non-interest income includes revenue from several sources that are within the scope of ASC 606, including title insurance commissions, income from secondary market loan sales, gains on sales of premises and equipment, and other transaction-based revenue that is individually immaterial. Other non-interest income included approximately \$558,000, \$501,000, and \$660,000 of revenue for the years ended December 31, 2020, 2019, and 2018, respectively, within the scope of ASC 606. The remaining other non-interest income for the year is excluded from the scope of ASC 606.

#### NOTE 20 – PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION

Condensed financial information of Limestone Bancorp Inc. is presented as follows:

##### CONDENSED BALANCE SHEETS

	December 31,	
	2020	2019
	(in thousands)	
<b>ASSETS</b>		
Cash and cash equivalents	\$ 5,037	\$ 4,769
Investment in banking subsidiary	150,560	138,321
Investment in and advances to other subsidiaries	776	776
Deferred taxes, net	5,953	5,138
Other assets	1,180	1,083
<b>Total assets</b>	<b>\$ 163,506</b>	<b>\$ 150,087</b>
<b>LIABILITIES AND SHAREHOLDERS’ EQUITY</b>		
Debt	\$ 46,775	\$ 43,775
Accrued expenses and other liabilities	707	562
Shareholders’ equity	116,024	105,750
<b>Total liabilities and shareholders’ equity</b>	<b>\$ 163,506</b>	<b>\$ 150,087</b>

**CONDENSED STATEMENTS OF OPERATIONS**

	Years ended December 31,		
	2020	2019	2018
	(in thousands)		
Interest income	\$ 37	\$ 83	\$ 45
Dividends from subsidiaries	23	36	35
Other income	20	19	38
Interest expense	(2,008)	(1,803)	(1,370)
Other expense	(1,357)	(1,179)	(1,290)
Loss before income tax and undistributed subsidiary income	(3,285)	(2,844)	(2,542)
Income tax expense (benefit)	(815)	(1,997)	(645)
Equity in undistributed subsidiary income	11,475	11,365	10,691
<b>Net income</b>	<b>\$ 9,005</b>	<b>\$ 10,518</b>	<b>\$ 8,794</b>

**CONDENSED STATEMENTS OF CASH FLOWS**

	Years ended December 31,		
	2020	2019	2018
	(in thousands)		
<b>Cash flows from operating activities</b>			
Net income	\$ 9,005	\$ 10,518	\$ 8,794
Adjustments:			
Equity in undistributed subsidiary income	(11,475)	(11,365)	(10,691)
Deferred taxes, net	(815)	(1,996)	(645)
Stock-based compensation expense	580	535	524
Net change in other assets	(97)	(401)	30
Net change in other liabilities	145	423	(1,093)
Net cash used in operating activities	(2,657)	(2,286)	(3,081)
<b>Cash flows from investing activities</b>			
Investments in subsidiaries	—	(10,000)	(5,000)
Net cash used in investing activities	—	(10,000)	(5,000)
<b>Cash flows from financing activities</b>			
Proceeds from issuance of common stock	—	—	14,910
Redemption of preferred stock	—	—	(3,505)
Proceeds from issuance of subordinated capital notes	8,000	17,000	—
Repayment of senior debt	(5,000)	(5,000)	—
Common shares withheld for taxes	(75)	(314)	—
Net cash provided by financing activities	2,925	11,686	11,405
Net change in cash and cash equivalents	268	(600)	3,324
Beginning cash and cash equivalents	4,769	5,369	2,045
Ending cash and cash equivalents	<b>\$ 5,037</b>	<b>\$ 4,769</b>	<b>\$ 5,369</b>

**NOTE 21 – QUARTERLY FINANCIAL DATA (UNAUDITED)**

	<u>Interest Income</u>	<u>Net Interest Income</u>	<u>Provision For Loan Losses</u>	<u>Income Before Income Taxes</u>	<u>Net Income</u>	<u>Earnings Per Common Share</u>	
						<u>Basic (1)</u>	<u>Diluted (1)</u>
						(in thousands, except per share data)	
<b>2020</b>							
First quarter (2)	\$ 13,267	\$ 9,762	\$ 1,050	\$ 2,201	\$ 1,840	\$ 0.25	\$ 0.25
Second quarter (2)(3)	12,786	10,110	1,100	2,375	1,982	0.26	0.26
Third quarter (2)(3)	12,094	9,943	1,350	2,256	2,066	0.28	0.28
Fourth quarter (2)(3)	12,606	10,786	900	3,797	3,117	0.42	0.42
<b>2019</b>							
First quarter (2)	\$ 12,186	\$ 8,959	\$ —	\$ 2,962	\$ 2,839	\$ 0.38	\$ 0.38
Second quarter (2)	12,376	8,800	—	3,022	3,633	0.49	0.49
Third quarter (2)	12,485	8,730	—	2,813	2,282	0.31	0.31
Fourth quarter (2)(4)	12,537	8,861	—	2,201	1,764	0.24	0.24

- (1) The sum of the quarterly net income per share (basic and diluted) differs from the annual net income per share (basic and diluted) because of the differences in the weighted average number of common shares outstanding and the common shares used in the quarterly and annual computations as well as differences in rounding.
- (2) Income tax expense for 2020 and 2019 benefitted from the establishment of a state net deferred tax assets related to the 2019 tax law enactments.

	<u>Income Tax Benefit (Expense)</u>	<u>Basic and Diluted per Share Impact</u>
<b>2020:</b>		
First quarter	\$ 72,000	\$ 0.01
Second quarter	79,000	0.01
Third quarter	245,000	0.03
Fourth quarter	82,000	0.01
<b>2019:</b>		
First quarter	\$ 341,000	\$ 0.05
Second quarter	1,209,000	0.16
Third quarter	34,000	NM
Fourth quarter	(7,000)	NM

- (3) Interest income benefitted \$179,000, or \$0.02 per basic and diluted share, in the second quarter of 2020, \$195,000, or \$0.02 per basic and diluted share, in the third quarter of 2020, and \$767,000, or \$0.08 per basic and diluted share, in the fourth quarter of 2020 from fees earned on PPP loans.
- (4) On November 15, 2019, the Company completed a four branch acquisition. Acquisition related costs totaled \$775,000, or \$0.08 per common share after taxes.

**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure**

None

**Item 9A. Controls and Procedures**

**Disclosure Controls and Procedures**

Management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934. The Company's management, under the supervision and with the participation of its Chief Executive Officer and its Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of December 31, 2020. Based on that evaluation, management believes that the Company's disclosure controls and procedures were effective to collect, process, and disclose the information required to be disclosed in the reports filed or submitted under the Securities Exchange Act of 1934 within the required time periods as of the end of the period covered by this report.

There was no change in the internal control over financial reporting, as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

### **Management's Report on Internal Control Over Financial Reporting**

The management of Limestone Bancorp, Inc. (the "Company") is responsible for the preparation, integrity, and fair presentation of the Company's annual consolidated financial statements. All information has been prepared in accordance with U.S. generally accepted accounting principles and, as such, includes certain amounts that are based on management's best estimates and judgments.

Management is responsible for establishing and maintaining adequate internal control over financial reporting presented in conformity with U.S. generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Two of the objectives of internal control are to provide reasonable assurance to management and the Board of Directors that transactions are properly authorized and recorded in the Company's financial records, and that the preparation of the Company's financial statements and other financial reporting is done in accordance with U.S. generally accepted accounting principles. There are inherent limitations in the effectiveness of internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even effective internal control can provide only reasonable assurance with respect to reliability of financial statements. Furthermore, internal control can vary with changes in circumstances.

Management has made its own assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2020, in relation to the criteria described in the report, *Internal Control — Integrated Framework (2013)*, issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

Based on its assessment, management believes that as of December 31, 2020, the Company's internal control over financial reporting was effective in achieving the objectives stated above.

This annual report does not include an attestation report of our registered public accounting firm regarding internal controls over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit us to provide only management's report in this annual report.

### **Item 9B. Other Information**

None

---

## **PART III**

### **Item 10. Directors, Executive Officers and Corporate Governance.**

The Company has adopted a code of ethics applicable to the Chief Executive Officer and the senior financial officers, which is posted on the Bank's website at <http://www.limestonebank.com> under the Investors Relations section of the 'About Us' tab. If the Company amends or waives any of the provisions of the Code of Ethics applicable to its Chief Executive Officer or senior financial officers, management intends to disclose the amendment or waiver on its website. The Company will provide to any person without charge, upon request, a copy of this Code of Ethics. You can request a copy by contacting Limestone Bancorp, Inc., Chief Financial Officer, 2500 Eastpoint Parkway, Louisville, Kentucky, 40223, (telephone) 502-499-4800.

Additional information required by this Item 10 is omitted because the Company is filing a definitive proxy statement pursuant to Regulation 14A on or before April 30, 2021, which includes the required information. The required information contained in the Company's proxy statement under the headings "Proposal 1: Election of Directors," "Corporate Governance," and "Certain Relationships and Related Transactions – Delinquent Section 16(a) Reports" is incorporated herein by reference.

### **Item 11. Executive Compensation.**

The information required by this Item 11 is omitted because the Company is filing a definitive proxy statement pursuant to Regulation 14A on or before April 30, 2021, which includes the required information. The required information contained in the Company's proxy statement under the headings "Corporate Governance," "Compensation Discussion and Analysis," "Executive Compensation," and "Compensation Committee Report" is incorporated herein by reference.

### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Certain information required by this Item 12 is omitted because the Company is filing a definitive proxy statement pursuant to Regulation 14A on or before April 30, 2021, which includes the required information. The required information contained in the Company's proxy statement under the heading "Stock Ownership of Directors, Officers, and Principal Shareholders" is incorporated herein by reference.

Certain information required by this Item 12 appears under the heading “Equity Compensation Plan Information” in Item 5 of this report and is incorporated herein by reference.

**Item 13. Certain Relationships and Related Transactions, and Director Independence.**

The information required by this Item 13 is omitted because the Company is filing a definitive proxy statement pursuant to Regulation 14A on or before April 30, 2021, which includes the required information. The required information contained in the Company’s proxy statement under the headings “Corporate Governance” and “Certain Relationships and Related Transactions” is incorporated herein by reference.

**Item 14. Principal Accounting Fees and Services.**

The information required by this Item 14 is omitted because the Company is filing a definitive proxy statement pursuant to Regulation 14A on or before April 30, 2021, which includes the required information. The required information contained in the Company’s proxy statement under the heading “Principal Accountant Fees and Services” is incorporated herein by reference.

---

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

- (a) 1. The following financial statements are included in this Form 10-K:

Consolidated Balance Sheets as of December 31, 2020 and 2019  
Consolidated Statements of Operations for the Years Ended December 31, 2020, 2019, and 2018  
Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2020, 2019, and 2018  
Consolidated Statements of Change in Stockholders’ Equity for the Years Ended December 31, 2020, 2019, and 2018  
Consolidated Statements of Cash Flows for the Years Ended December 31, 2020, 2019, and 2018  
Notes to Consolidated Financial Statements  
Report of Independent Registered Public Accounting Firm

- (a) 2. List of Financial Statement Schedules

Financial statement schedules are omitted because the information is not applicable.

- (a) 3. List of Exhibits

The Exhibit Index appearing before the required signatures in this report is incorporated by reference. The compensatory plans or arrangement required to be filed as exhibits to this Form 10-K pursuant to Item 15(c) are noted with an asterisk in the Exhibit Index as noted therein.

**Item 16. Form 10-K Summary**

None

---

**EXHIBIT INDEX**

<b>Exhibit No. (1)</b>	<b>Description</b>
2.1+	<a href="#"><u>Branch Purchase and Assumption Agreement between Republic Bank &amp; Trust Company and Limestone Bank, Inc. dated July 24, 2019. Exhibit 2.1 to Form 8-K filed July 25, 2019 is incorporated by reference.</u></a>
3.1	<a href="#"><u>Articles of Incorporation of the Company, restated to reflect amendments. Filed as Exhibit 3.1 to the Quarterly Report on Form 10-Q filed August 2, 2019 and incorporated by reference.</u></a>
3.3	<a href="#"><u>Amended and Restated Bylaws of Limestone Bancorp, Inc. dated June 18, 2018. Exhibit 3.2 to Form 8-K filed June 6, 2018 is hereby incorporated by reference.</u></a>
4.1	<a href="#"><u>Tax Benefits Preservation Plan, dated as of June 25, 2015, between the Company and American Stock Transfer Company, as Rights Agent. Exhibit 4.1 to Form 8-K filed June 29, 2015 is incorporated by reference.</u></a>
4.2	<a href="#"><u>Amendment No. 1 to the Tax Benefits Preservation Plan, dated August 4, 2015. Exhibit 4.2 to the Quarterly Report on Form 10-Q filed</u></a>



[August 5, 2015 is incorporated by reference.](#)

- 4.3+ [Amendment No. 2 to the Tax Benefits Preservation Plan dated May 23, 2018. Exhibit 4 to the Form 8-K filed May 23, 2018 is incorporated by reference.](#)
- 4.4 [Amendment No. 3 to the Limestone Bancorp, Inc. Tax Benefits Preservation Plan, dated November 25, 2019. Exhibit 4.4 to the Form 8-K filed November 27, 2019 is incorporated herein by reference.](#)
- 4.5 [Indenture, dated July 23, 2019, by and between Limestone Bancorp, Inc. and Wilmington Trust National Association, as trustee. Exhibit 4.1 to Form 8-K filed July 25, 2019 is incorporated by reference.](#)
- 4.6 [Form of 5.75% Fixed-to-Floating Subordinated Notes due 2029 of Limestone Bancorp, Inc. Exhibit 4.2 to Form 8-K filed July 25, 2019 is incorporated by reference.](#)
- 4.7 [Company Order of Limestone Bancorp, Inc. dated July 21, 2020. Exhibit 4.2 to Form 8-K filed July 24, 2020 is incorporated by reference.](#)
- 4.8 [Form of 5.75% Fixed-to-Floating Subordinated Notes due 2029 of Limestone Bancorp, Inc. issued July 31, 2020. Exhibit 4.7 to the Quarterly Report on Form 10-Q filed July 31, 2020 is incorporated by reference.](#)
- 4.9 [Description of Securities of Limestone Bancorp, Inc. registered under Section 12 of the Securities Exchange Act of 1934, as amended.](#)
- 10.1 [Form of Subordinated Note Purchase Agreement, dated July 23, 2019, by and among Limestone Bancorp, Inc. and the Purchasers. Exhibit 10.1 to Form 8-K filed July 25, 2019 is incorporated by reference.](#)
- 10.2 [Form of Subordinated Note Purchase Agreement dated July 21, 2020 by and among Limestone Bancorp, Inc. and the Purchasers. Exhibit 10.1 to Form 8-K filed July 24, 2020 is incorporated by reference.](#)

---

[Table of Contents](#)

<b>Exhibit No. (1)</b>	<b>Description</b>
10.3*	<a href="#">Limestone Bancorp, Inc. 2018 Omnibus Equity Compensation Plan, Appendix B to Schedule 14A Proxy Statement (DEF 14A) filed April 13, 2018 is incorporated by reference.</a>
10.4*	<a href="#">Form of Restricted Stock Award Agreement. Exhibit 10.11 to Form 10-K filed March 8, 2019 is incorporated herein by reference.</a>
10.5*	<a href="#">Employment Agreement, dated April 24, 2019, with John T. Taylor. Exhibit 10.1 to Form 8-K filed April 26, 2019 is incorporated by reference.</a>
10.6*	<a href="#">Employment Agreement, dated April 24, 2019, with John R. Davis. Exhibit 10.3 to Form 8-K filed April 26, 2019 is incorporated by reference.</a>
10.7*	<a href="#">Employment Agreement, dated April 24, 2019, with Joseph C. Seiler. Exhibit 10.4 to Form 8-K filed April 26, 2019 is incorporated by reference.</a>
10.8*	<a href="#">Employment Agreement, dated April 24, 2019, with Phillip W. Barnhouse. Exhibit 10.2 to Form 8-K filed April 26, 2019 is incorporated by reference.</a>
10.9	<a href="#">Securities Purchase Agreement, dated March 30, 2018, between Limestone Bancorp, Inc. and Patriot Financial Partners III, L.P., incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K dated March 30, 2018.</a>
10.10	<a href="#">Registration Rights Agreement, dated March 30, 2018, between Limestone Bancorp, Inc. and Patriot Financial Partners III, L.P., incorporated by reference to Exhibit 10.2 of the Current Report on Form 8-K dated March 30, 2018.</a>
10.11*	<a href="#">Description of Non-employee Director Restricted Stock Awards. Exhibit 10.19 to Form 10-K filed February 28, 2020 is incorporated herein by reference.</a>
21.1	<a href="#">List of Subsidiaries of Limestone Bancorp, Inc.</a>
23.1	<a href="#">Consent of Crowe LLP, Independent Registered Public Accounting Firm.</a>
31.1	<a href="#">Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14 or 15d-14.</a>
31.2	<a href="#">Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14 or 15d-14.</a>
32.1	<a href="#">Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(b) or 15d-14(b) and 18 U.S.C. Section 1350.</a>
32.2	<a href="#">Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(b) or 15d-14(b) and U.S.C. Section 1350.</a>

101 The following financial statements from the Company's Annual Report on Form 10-K for the year ended December 31, 2020, formatted in Inline XBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Changes in Stockholders' Equity, (v) Consolidated Statements of Cash Flows, (vi) Notes to Consolidated Financial Statements.

104 Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)

\* Management contract or compensatory plan or arrangement.

- (1) The Company has other long-term debt agreements that meet the exclusion set forth in Section 601(b)(4)(iii)(A) of Regulation S-K. The Company hereby agrees to furnish a copy of such agreements to the Securities and Exchange Commission upon request.
- + Schedules and similar attachments to the Purchase and Assumption Agreement have been omitted pursuant to Item 601(a)(5) of Regulation S-K. A copy of any omitted schedule or similar attachment will be furnished to the Securities

93

[Table of Contents](#)

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

### LIMESTONE BANCORP, INC.

February 26, 2021

By: /s/ John T. Taylor

John T. Taylor  
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated.

/s/ John T. Taylor Chief Executive Officer February 26, 2021  
John T. Taylor

/s/ Phillip W. Barnhouse Chief Financial Officer February 26, 2021  
Phillip W. Barnhouse

/s/ Celia P. Catlett Director February 26, 2021  
Celia P. Catlett

/s/ W. Glenn Hogan Director February 26, 2021  
W. Glenn Hogan

/s/ Kevin J. Kooman Director February 26, 2021  
Kevin J. Kooman

/s/ Michael T. Levy Director February 26, 2021  
Michael T. Levy

/s/ James M. Parsons Director February 26, 2021  
James M. Parsons

/s/ Bradford T. Ray Director February 26, 2021  
Bradford T. Ray

/s/ Dr. Edmond J. Seifried Director February 26, 2021  
Dr. Edmond J. Seifried

94

## Description of Securities

Limestone Bancorp, Inc., a Kentucky corporation (the “Company”), has two classes of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”): its Common Stock, no par value; and the preferred share purchase rights distributed to the Company’s shareholders pursuant to the Tax Benefits Preservation Plan dated as of June 25, 2015 between the Company and American Stock Transfer & Trust Company, LLC, as amended by Amendment No. 1 thereto, dated August 5, 2015, and Amendment No. 2 thereto, dated May 23, 2018, and Amendment No. 3 thereto dated November 25, 2019 (the “Preservation Plan”).

The following description of these securities is qualified by reference to the Preservation Plan and to the Company’s Articles of Incorporation and Bylaws, which are the instruments defining the rights of the shareholders. These instruments are identified as, and incorporated by reference to, Exhibits 3.1, 3.2, 4.1, 4.2, 4.3 and 4.4 of the Company’s Form 10-K for the year ended December 31, 2020.

### Authorized Capital Stock

The Company is authorized to issue 28,000,000 common shares (referred to in this description as “Common Stock”); 10,000,000 non-voting common shares (“Non-Voting Common Stock”); and 1,000,000 preferred shares. Of the 1,000,000 authorized preferred shares, 38,000 shares have been designated as Series G Participating Preferred Shares. Neither the Non-Voting Common Stock nor the preferred shares are registered under the Exchange Act and no preferred shares are issued and outstanding as of December 31, 2020. The Common Stock and the Non-Voting Common Stock are referred to collectively in this description as the “common shares.”

### Common Stock

Subject to the voting rights of any series of preferred shares, the Company’s Common Stock has the exclusive right to vote in the election of directors and on all other matters in which shareholders are generally entitled to vote. Shares of Common Stock are entitled to one vote per share on matters on which holders of Common Stock are entitled to vote.

Subject to any preferential rights of preferred shares that may be issued, holders of Common Stock are entitled to receive such dividends that may be declared from time to time by the Company’s board of directors.

Upon the Company’s voluntary or involuntary liquidation, distribution or sale of assets, dissolution or winding-up, the holders of Common Stock and Non-Voting Common Stock are entitled to share ratably in any distribution of all remaining assets, tangible or intangible, available for distribution. This right is also subject to any preferential liquidation rights of preferred shares that may be issued by the Company.

### Non-Voting Common Stock

Holders of the Company’s Non-Voting Common Stock generally have no voting rights but are entitled to receive the same dividends and distributions that are paid to holders of Common Stock. These rights are subject to any preferential voting or distribution rights of preferred shares that may be issued from time to time. Kentucky law requires that a class of shares vote separately when a proposed amendment to the Articles of Incorporation would increase or decrease the number of authorized shares of the class or change the designation, rights, preferences or limitations of all or part of the shares of the class.

Shares of our Non-Voting Common Stock automatically convert into shares of Common Stock on a one-for-one basis, upon the transfer in (a) a widespread public distribution, including pursuant to a registration statement filed with and declared effective by the SEC or pursuant to Rule 144 under the Securities Act of 1933, (b) a transfer in which no transferee (or group of associated transferees) would receive more than 2% of any class of our voting securities or (c) a transfer to a transferee that controls more than 50% of our voting securities without any transfer from the transferor. This automatic conversion may occur as to some or all of the shares of Non-Voting Common Stock held by any holder.

The one-for-one conversion ratio is subject to adjustment in the event of (i) any recapitalization by means of a stock dividend on, or a stock split or combination of, outstanding voting and non-voting common shares or (ii) any merger, consolidation or other reorganization with another corporation. Upon conversion, the authorized non-voting common shares will be automatically redesignated as additional authorized common shares.

## Preferred Shares

The Company's Articles of Incorporation authorize the board of directors, without further shareholder approval unless otherwise required by governing laws or regulations, to authorize the issuance of 1,000,000 preferred shares in series and to fix the voting powers, designations, preferences and relative, participating, optional or other special rights of the shares of each series of the preferred shares and the qualifications, limitations and restrictions thereof. Currently, the Company has only one designated series of preferred shares: Series G Participating Preferred Shares. The Series G Participating Preferred Shares were authorized for possible use in connection with the Preservation Plan, described below. The terms of the Series G Participating Preferred Shares are described in Article IV.D. of the Company's Articles of Incorporation. If issued, the voting, dividend and liquidation rights of the Series G Participating Preferred Shares will generally be aligned with the Common Stock, subject to a multiplier.

## Preferred Share Purchase Rights

The terms of the Company's preferred share purchase rights are set out in the Tax Benefits Preservation Plan. The Preservation Plan is designed to deter transfers of the Company's common shares that could result in an "ownership change" as determined under Section 382 of the Internal Revenue Code of 1986, as amended (the "Code") and jeopardize, or limit, the Company's ability to use its net operating losses and other tax benefits (collectively, "NOLs") to reduce its future income tax liability.

The Company's board of directors adopted the Preservation Plan on June 24, 2015, and declared a dividend of one preferred stock purchase right (each a "Right" and collectively, the "Rights") for each of the Company's outstanding common shares. The dividend was payable to holders of record as of the close of business on July 10, 2015.

Exercise. Each Right entitles the registered holder to purchase from the Company one one-thousandth of one Series G Participating Preferred Share of the Company (the "Preferred Share"), at a purchase price equal to \$10.00 per one one-thousandth of a share, subject to adjustment (the "Purchase Price").

The Rights are not exercisable before a Distribution Date. After a Distribution Date, each Right is exercisable to purchase one one-thousandth of a share of the Company's Series G Participating Preferred Shares (the "Preferred Shares") at a purchase price of \$50.00 (the "Purchase Price"), subject to adjustment. Distribution Date means the earlier of:

- the 10th business day after the first public announcement that any person or group has become an Acquiring Person (as defined below); and
- the 10th business day after the date of the commencement of a tender or exchange offer by any person which would or could, if consummated, result in such person becoming an Acquiring Person, subject to extension by the Company's board of directors.

Flip-In. If any person or group becomes a "5-percent shareholder" (an "Acquiring Person") (subject to certain exceptions described in the Preservation Plan), then on a Distribution Date, each Right (other than Rights beneficially owned by the Acquiring Person and certain affiliated persons) will entitle the holder to purchase, for the Purchase Price, a number of shares of Common Stock of the Company equal to the quotient of (x) two times the Purchase Price divided by (y) the then current market price of the Company's Common Stock; provided that

- none of the Company and certain affiliates of the Company shall be an Acquiring Person,
- none of certain existing "5-percent shareholders" (including certain persons who are "5-percent shareholders" following specified exchange offers with the Company) shall be an Acquiring Person unless and until any such "5-percent shareholder" increases its percentage stock ownership in the Company by more than one-tenth of one percentage point,
- none of certain other "grandfathered persons" (as described in the Preservation Plan) shall be an Acquiring Person so long as any such "grandfathered person" satisfies the applicable requirements set forth in the Preservation Plan,
- no person or group who or which the board of directors determines, in its sole discretion, has inadvertently become a "5-percent shareholder" (or inadvertently failed to continue to qualify as a "grandfathered person") shall be an Acquiring Person so long as such Person promptly enters into, and delivers to the Company, an irrevocable commitment promptly to divest, and thereafter promptly divests (without exercising or retaining any power, including voting, with respect to such securities), sufficient securities of the Company so that such person's (or such group's) percentage stock ownership in the Company is less than 5 percent (or, in the case of any person or group that has inadvertently failed to qualify as a "grandfathered person," the securities of the Company that caused such person or group to fail to qualify as a "grandfathered person").

- no person or group that has become a “5-percent shareholder” shall be an Acquiring Person if the board of directors in good faith determines that such person's or group's attainment of “5-percent shareholder” status has not jeopardized or endangered the Company's utilization of the Tax Benefits or is otherwise in the best interests of the Company; provided that such a person or group shall be an “Acquiring Person” if the board of directors makes a contrary determination in good faith, and
- an acquisition by a person or group of at least a majority of the Company's Common Stock made by that person or group as part of a “qualified offer” (as defined in the Preservation Plan) shall not result in any person or group becoming an Acquiring Person; and
- the board of directors, or a board committee, may, in its discretion, approve and exempt (with or without conditions) an acquisition of common shares and the person acquiring common shares in an acquisition so approved and exempted will not become an Acquiring Person as a result of such acquisition.

Exchange. At any time after any person has become an Acquiring Person (but before any person becomes the beneficial owner of 50% or more of the Company's Common Stock), the Company's board of directors may elect to exchange all or part of the Rights (other than the Rights beneficially owned by the Acquiring Person and certain affiliated persons) for two shares of Common Stock (or, at the option of the board of directors, fractional Preferred Shares with an aggregate current market price that equals the current market price of two common shares) per Right, subject to adjustment.

Redemption. The Company's board of directors may, at its option, redeem all, but not less than all, of the then outstanding Rights at a redemption price of \$0.00005 per Right at any time prior to a Distribution Date.

Expiration. Unless the board of directors amends the Preservation Plan to extend its outside expiration date, the Rights will expire on the earliest of (i) June 30, 2021, (ii) the time at which all Rights are redeemed or exchanged, (iii) the first day of a taxable year of the Company as to which the board of directors determines that no NOLs may be carried forward, (iv) a date on which the board of directors determines that a limitation on the use of the NOLs under Section 382 of the Code, would no longer be material to the Company, provided that such date is prior to public disclosure that a person became an Acquiring Person, or (v) the repeal or amendment of Section 382 or any successor statute, if the board of directors determines that the Preservation Plan is no longer necessary for the preservation of tax benefits.

Amendments. At any time on or prior to a Distribution Date, the Company may, and the Rights Agent shall if the Company so directs, supplement or amend any provision of the Preservation Plan without the approval of any holders of Rights. After a Distribution Date, the Company may, and the Rights Agent shall if the Company so directs, supplement or amend the Preservation Plan without the approval of any holders of Rights; provided however, that no such supplement or amendment may (a) adversely affect the interests of the holders of Rights as such (other than an Acquiring Person), (b) cause the Preservation Plan again to become amendable other than in accordance with this sentence or (c) cause the Rights again to become redeemable.

Shareholder Rights. Rights holders, in their capacity as such, have no rights as a shareholder of the Company, including the right to vote and to receive dividends.

Antidilution Provisions. The Preservation Plan includes antidilution provisions designed to prevent efforts to diminish the efficacy of the Rights.

#### **Additional NOL Protective Transfer Restrictions on Common Shares**

In addition to the Preservation Plan, Article VIII of the Company's Articles of Incorporation (the “NOL Protective Amendment”) imposes restrictions on transfers of common shares that are designed to block transfers of common shares which could result in an ownership change under Section 382 of the Code.

Prohibited Transfers. The NOL Protective Amendment generally restricts any direct or indirect transfer (such as transfers that result from the transfer of interests in other entities that own the Company's common shares) if the effect would be to:

- increase the direct or indirect ownership of the Company's common shares by any person or persons from less than 5.0% to 5.0% or more of the Company's common shares; or
- increase the ownership percentage of a person owning or deemed to own 5.0% or more of the Company's common shares (which includes, without limitation, the Company and its affiliates).

Consequences of Prohibited Transfers. Any direct or indirect transfer attempted in violation of the NOL Protective Amendment would be void. The NOL Protective Amendment specifies procedures to be followed with respect to any common shares which are the subject of a prohibited transfer (including restrictions on voting rights) and, to the extent permitted by law, imposes liability on any shareholder who knowingly violates the NOL Protective Amendment for any damages the Company suffers as a result of such violation.

**Public Groups Modification and Waiver of Transfer Restrictions.** To facilitate sales by shareholders into the market, the NOL Protective Amendment permits otherwise prohibited transfers of the Company's common shares where the transferee is a "public group," as defined. In addition, the Company's board of directors has the discretion to approve (with or without conditions) a transfer of the Company's common shares that would otherwise violate the transfer restrictions (including, without limitation, a transfer to the Company and its affiliates) if it determines that the transfer is in the best interests of the Company and its shareholders.

**Expiration of the NOL Protective Amendment.** Unless the shareholders of the Company approve an amendment to the Articles of Incorporation extending them, the transfer restrictions contained in the NOL Protective Amendment will expire on the earliest of (i) the close of business on June 30, 2021, (ii) the repeal of Section 382 or any successor statute if the Company's board of directors determines that the NOL Protective Amendment is no longer necessary or desirable for the preservation of the Company's NOLs, (iii) the close of business on the first day of the Company's taxable year as to which the Company's board of directors determines that none of the Company's NOLs may be carried forward, and (iv) such date as the Company's board of directors otherwise determines that the NOL Protective Amendment is no longer necessary for the preservation of the Company's NOLs. The Company's board of directors may also accelerate or extend the expiration date of the NOL Protective Amendment in the event of a change in the law; provided that the board has determined that such action is reasonably advisable to preserve the NOLs or that continuation of the restrictions contained in the NOL Protective Amendment is no longer reasonably necessary for the preservation of the NOLs.

### **Voting Rights**

Except with respect to certain special matters that are required by statute to be submitted to shareholders for a greater number of affirmative votes, any act of the shareholders of a Kentucky corporation requires that more votes be cast for than against the matter at a meeting at which a quorum is present. The affirmative vote of a majority of all the outstanding shares entitled to vote is required to approve actions specified by statute such as mergers, share exchanges, certain sales of assets, and amendments of the Articles of Incorporation, among other things.

Directors of the Company are elected by a plurality of votes cast by the shares entitled to vote in the election at a meeting at which a quorum is present. Shareholders are not entitled to cumulative voting rights in the election of directors.

### **Other Provisions that Could Have an Anti-Takeover Effect**

In addition to the Company's Tax Benefits Preservation Plan and the NOL Protection Amendment (Article VIII of the Articles of Incorporation) described above, the Company's Articles of Incorporation and Bylaws also contain provisions that could, in certain circumstances, have the effect of preventing, discouraging or delaying a change in the control of the Company and may make it more difficult to remove a member of the board of directors or management. These provisions include:

#### ***Preferred Shares.***

As noted above, the Company's board of directors has the authority to issue preferred shares with voting or other rights or preferences that could impede the success of any attempt to effect a change in control or takeover of the Company.

#### ***Vacancies on the Board of Directors.***

The Company's Articles of Incorporation provide that the number of directors may not be less than two, nor more than 15, with the number of directors to be fixed within that range by the board of directors or the shareholders. The Company's Bylaws provide that any vacancy occurring on the board of directors, including an increase in the number of directors, may be filled by the affirmative vote of a majority of the directors then in office, even if less than a quorum of the entire board of directors. A director elected to fill a vacancy will serve for the remainder of the term to which the director has been elected and until the director's successor has been elected and qualified.

### ***Advance Notice of Shareholder Proposals and Nominations.***

Any one or more of the Company's shareholders may nominate one or more persons for election as a director of the Company's company or propose business to be conducted at a meeting of shareholders if the shareholder complies with the prior notice and information provisions set forth in the Company's amended and restated Bylaws.

In order for a director nomination or other business proposal to be timely brought before an annual meeting of shareholders, a shareholder's notice must be received by the Company's Corporate Secretary at the Company's principal executive office no later than the 120th day before the first anniversary of the date of the Company's proxy statement issued in connection with the prior year's annual meeting of shareholders in the case of an annual meeting, and not less than 60 days before a special meeting of shareholders; provided, however, that if the date of the annual meeting is advanced more than 30 days prior to or delayed by more than 30 days after the anniversary of the preceding year's annual meeting, or if a public announcement of the date of a special meeting is not given at least 70 days before the scheduled date of the special meeting, then notice by the shareholder shall be timely if delivered not later than the close of business on the 10th day following the day on which public announcement of the date of the meeting is first made. The shareholder's notice must contain certain specified information concerning the person to be nominated or the matter to be brought before the meeting and concerning the shareholder submitting the proposal.

For special meetings of shareholders, only the business set forth in the notice of the meeting may be conducted at the meeting. However, when directors will be elected at the special meeting, shareholders may nominate persons for election to the board by following the notice procedures described above, except that such notice will be deemed to be timely if it is received by the Corporate Secretary not earlier than the 120th day prior to the special meeting and not later than the close of business on the 10th day on which the date of the public meeting is publicly announced.

### **Dividends**

Holders of common shares are entitled to such dividends and other distributions, including liquidating distributions, as may be declared from time to time by the Company's board of directors out of funds legally available for payment of distributions. The instruments under which the Company's junior subordinated debentures and subordinated notes are outstanding will restrict the Company from paying dividends on its common shares if the Company elects to defer payments of the interest on its junior subordinated debentures or an event of default has occurred with respect to its junior subordinated debentures or subordinated notes. The Company's board of directors is authorized to issue preferred shares that may have preferential rights to receive dividends before dividends may be paid on common shares.

## SUBSIDIARIES OF LIMESTONE BANCORP, INC.

<b>Direct Subsidiary</b>	<b>Jurisdiction of Organization</b>	<b>Does Business As</b>
Limestone Bank, Inc.	Kentucky	Limestone Bank, Inc.
Statutory Trust I	Connecticut	Statutory Trust I
Statutory Trust II	Connecticut	Statutory Trust II
Statutory Trust III	Connecticut	Statutory Trust III
Statutory Trust IV	Connecticut	Statutory Trust IV
PBIB Corporation, Inc.	Kentucky	PBIB Corporation, Inc.

<b>Indirect Subsidiary</b>	<b>Jurisdiction of Organization</b>	<b>Does Business As</b>	<b>Parent Entity</b>
PBI Title Services, LLC	Kentucky	PBI Title Services, LLC	Limestone Bank, Inc.



**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in Registration Statement Nos. 333-188988; 333-189005; 333-202746; 333-202749; and 333-225384 on Form S-8 of Limestone Bancorp, Inc. of our report dated February 26, 2021 with respect to the consolidated financial statements of Limestone Bancorp, Inc., which report appears in this Annual Report on Form 10-K of Limestone Bancorp, Inc. for the year ended December 31, 2020.

/s/ Crowe LLP

Louisville, Kentucky  
February 26, 2021

**LIMESTONE BANCORP, INC.**  
**RULE 13A-14(A) CERTIFICATION OF CHIEF EXECUTIVE OFFICER**

I, John T. Taylor, Chief Executive Officer of Limestone Bancorp, Inc. (the "Company"), certify that:

1. I have reviewed this Annual Report on Form 10-K of the Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: February 26, 2021

/s/ John T. Taylor  
John T. Taylor Chief Executive  
Officer

**LIMESTONE BANCORP, INC.**  
**RULE 13A-14(A) CERTIFICATION OF CHIEF FINANCIAL OFFICER**

I, Phillip W. Barnhouse, Chief Financial Officer of Limestone Bancorp, Inc. (the "Company"), certify that:

1. I have reviewed this Annual Report on Form 10-K of the Company;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: February 26, 2021

/s/ Phillip W. Barnhouse  
Phillip W. Barnhouse  
Chief Financial Officer

**SECTION 906 CERTIFICATION**

In connection with the Annual Report on Form 10-K of Limestone Bancorp, Inc. (the "Company") for the annual period ended December 31, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John T. Taylor, Chief Executive Officer of the Company, do hereby certify, in accordance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

LIMESTONE BANCORP, INC.

Dated: February 26, 2021

By: /s/ John T. Taylor  
John T. Taylor  
Chief Executive Officer

**SECTION 906 CERTIFICATION**

In connection with the Annual Report on Form 10-K of Limestone Bancorp, Inc. (the "Company") for the annual period ended December 31, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Phillip W. Barnhouse, Chief Financial Officer of the Company, do hereby certify, in accordance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

LIMESTONE BANCORP, INC.

Dated: February 26, 2021

By: /s/ Phillip W. Barnhouse

Phillip W. Barnhouse  
Chief Financial Officer