

U.S. Securities and Exchange Commission

Washington, D. C. 20549

Form 10-K

Annual report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2019

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 001-12053

Southwest Georgia Financial Corporation

(Exact Name of Corporation as specified in its charter)

<u>Georgia</u> (State Or Other Jurisdiction Of Incorporation Or Organization)	<u>58-1392259</u> (I.R.S. Employer Identification No.)
<u>201 First Street, S.E. Moultrie, Georgia</u> (Address of Principal Executive Offices)	<u>31768</u> (Zip Code)

(Corporation's telephone number, including area code) (229) 985-1120

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

<u>Title of each class</u>	<u>Trading Symbol</u>	<u>Name of each exchange on which registered</u>
<u>Common Stock, \$1.00 par value per share</u>	<u>SGB</u>	<u>NYSE American</u>

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 such shorter period that 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 and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

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

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

Aggregate market value of voting and non-voting stock held by nonaffiliates of the registrant as of June 30, 2019: \$41,776,791 based on 2,003,683 shares at the price of \$20.85 per share.

As of March 26, 2020, [2,547,424] shares of the \$1.00 par value common stock of Southwest Georgia Financial Corporation were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Pursuant to Instruction G of Form 10-K, Part III of this Annual Report on Form 10-K incorporates information by reference from the Registrant's definitive proxy statement or amendment hereto to be filed within 120 days after the close of the fiscal year covered by this annual report.

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PART I

ITEM 1. BUSINESS

Southwest Georgia Financial Corporation (the “Corporation”) is a Georgia bank holding company organized in 1980, which, in 1981, acquired 100% of the outstanding shares of Southwest Georgia Bank (the “Bank”). The Bank commenced operations as Moultrie National Bank in 1928. The Bank is a state-chartered bank insured by the Federal Deposit Insurance Corporation (the “FDIC”).

The Corporation’s primary business is providing banking services through the Bank to individuals and businesses principally in the following counties: Colquitt, Baker, Worth, Lowndes, and Tift as well as the surrounding counties of southwest Georgia. Empire Financial Services, Inc. (“Empire”), a provider of commercial mortgage banking services has been wholly owned by the Bank since 2001. In December 2017, the Bank dissolved Empire. The executive office of the Corporation is located at 25 Second Avenue, S. W., Moultrie, Georgia 31768, and its telephone number is (229) 985-1120.

All references herein to the Corporation include Southwest Georgia Financial Corporation and the Bank unless the context indicates a different meaning.

Recent Developments

On December 18, 2019, the Corporation entered into an Agreement and Plan of Merger (the “merger agreement”) with The First Bancshares, Inc., a Mississippi corporation (“First Bancshares”), whereby the Corporation will be merged with and into the First Bancshares. Pursuant to and simultaneously with entering into the merger agreement, the Bank, and First Bancshares’s wholly owned subsidiary bank, The First, A National Banking Association (“The First”), entered into a Plan of Bank Merger whereby the Bank will be merged with and into The First immediately following the merger of the Corporation with and into First Bancshares (the “merger”) with a purchase price, on the announcement date, of approximately \$88.0 million.

The merger agreement has been unanimously approved by the boards of directors of the Corporation and First Bancshares and by a majority of shareholders of the Corporation on March 27, 2020. The merger was further approved by the Office of the Comptroller of the Currency on March 18, 2020 and the transaction is expected to close in the second quarter of 2020.

The foregoing description of the merger and merger agreement is qualified in its entirety by reference to the merger agreement, which incorporated by reference into this Annual Report on Form 10-K. The merger agreement should not be read alone, but should instead be read in conjunction with the other information regarding the Corporation, First Bancshares, their respective affiliates and their respective businesses, the merger agreement and the merger contained in, or incorporated by reference into, the Registration Statement on Form S-4, filed by First Bancshares with the and reasonable and supportable forecasts. For Securities and Exchange Commission (the “SEC”) that includes a proxy statement of the Corporation and prospectus of First Bancshares, as well as in the Annual Reports on Forms 10-K, the Quarterly Reports on Forms 10-Q and other filings that each of the Corporation and First Bancshares has made with the SEC.

Please refer to Item 1A, “Risk Factors” for a discussion of certain risks related to the proposed merger.

Discussions in this Annual Report on Form 10-K that refer to the Corporation’s business, operations and risks in the future refer to the Corporation as a stand-alone entity up to the closing of the proposed merger or if the merger does not close, and that these considerations will be different with respect to the combined company after the closing of the merger.

General

The Corporation is a registered bank holding company. The Bank is community-oriented and offers customary banking services such as consumer and commercial checking accounts, NOW accounts, savings accounts, certificates of deposit, lines of credit, VISA® business accounts, and money transfers. The Bank finances commercial and consumer transactions, makes secured and unsecured loans, and provides a variety of other banking services. The Bank has a Wealth Strategies division that performs corporate, pension, and personal trust services and acts as trustee, executor, and administrator for estates and as administrator or trustee of various types of employee benefit plans for corporations and other organizations. Also, the Wealth Strategies division has a securities sales department which offers full-service brokerage services through a third party service provider. The Bank’s Southwest Georgia Insurance Services Division offers property and casualty insurance, life, health, and disability insurance.

Markets

The Corporation conducts banking activities in five counties in southwest and south central Georgia. Population characteristics in these counties range from rural to more metropolitan. In our most recent market, Tift County, we opened a full service banking center in August 2018. The total population of Tift County is 40,571. Our largest market is Lowndes County with a total population of 116,321 and the highest growth rate in our markets at 11.21% from 2008 to 2018. Due primarily to the location of a state university and a large air force base in Lowndes County, this market has a median age estimated at 30.2, younger than an average median age of 38.8 in the other four counties that the Bank primarily serves. These counties, Colquitt, Baker, Worth, and Tift, have an average total population of 27,389 and an average decline in population of (5.8)% from 2008 to 2018. Per capita income is approximately \$22,000 in the Bank's markets. Agriculture plays a major economic role in the Bank's markets. Colquitt, Baker, Worth, Lowndes, and Tift Counties produce a large portion of our state's crops, including cotton, peanuts, and a variety of vegetables.

Deposits

The Bank offers a full range of depository accounts and services to both consumers and businesses. At December 31, 2019, the Corporation's deposit base, totaling \$473,434,163, consisted of \$113,882,249 in noninterest-bearing demand deposits (24.1% of total deposits), \$233,333,973 in interest-bearing demand deposits including money market accounts (49.3% of total deposits), \$33,554,780 in savings deposits (7.1% of total deposits), \$67,580,453 in time deposits in amounts less than \$250,000 (14.2% of total deposits), and \$25,082,708 in time deposits of \$250,000 or more (5.3% of total deposits).

Loans

The Bank makes both secured and unsecured loans to individuals, corporations, and other businesses. Both consumer and commercial lending operations include various types of credit for the Bank's customers. Secured loans include first and second real estate mortgage loans. The Bank also makes direct installment loans to consumers on both a secured and unsecured basis. At December 31, 2019, consumer installment, real estate (including construction and mortgage loans), and commercial (including financial and agricultural) loans represented approximately 1.2%, 76.8% and 22.0%, respectively, of the Bank's total loan portfolio.

Lending Policy

The current lending policy of the Bank is to offer consumer and commercial credit services to individuals and businesses that meet the Bank's credit standards. The Bank provides each lending officer with written guidelines for lending activities. Lending authority is delegated by the Board of Directors of the Bank to loan officers, each of whom is limited in the amount of secured and unsecured loans which can be made to a single borrower or related group of borrowers.

The Loan Committee of the Bank's Board of Directors is responsible for approving and monitoring the loan policy and providing guidance and counsel to all lending personnel. The committee approves all individual loan or relationship requests that exceed \$800,000. The Loan Committee is composed of the Chief Executive Officer and President, and other executive officers of the Bank, as well as certain Bank directors.

Loan Review and Nonperforming Assets

The Bank regularly requires a review of its loan portfolio to determine deficiencies and corrective action to be taken. An independent loan review is conducted by an outside third party firm on a semiannual basis with their findings being reported annually to the Board's Loan Committee and the Audit Committee. Also, the Bank's external auditors as well as an outside third party firm conduct independent loan review adequacy tests and their findings are reviewed annually by the Audit Committee and the Board of Directors.

Certain loans are monitored more often by the Credit Administration Department and the Loan Committee. These loans include nonaccruing loans, loans more than 90 days past due, and other loans, regardless of size, that may be considered high risk-based on factors defined within the Bank's loan review policy.

Asset/Liability Management

The Asset/Liability Management Committee (“ALCO”) is established by the Bank’s Board of Directors and is charged with establishing policies to manage the assets and liabilities of the Bank. Its task is to manage asset growth, net interest margin, liquidity, and capital in order to maximize income and reduce interest rate risk. To meet these objectives while maintaining prudent management of risks, the ALCO manages the Bank’s overall acquisition and allocation of funds. At its quarterly meetings, the ALCO reviews and discusses the asset and liability funds budget and income and expense budget in relation to the actual composition and flow of funds; the ratio of the amount of rate sensitive assets to the amount of rate sensitive liabilities; the ratio of loan loss reserve to outstanding loans; and other variables, such as expected loan demand, investment opportunities, core deposit growth within specified categories, regulatory changes, monetary policy adjustments, and the overall state of the local, state, and national economy. The Board of Directors reviews ALCO data quarterly.

Investment Policy

The Bank’s investment portfolio policy is to maximize income consistent with liquidity, asset quality, and regulatory constraints. The policy is reviewed periodically by the Board of Directors. Individual transactions, portfolio composition, and performance are reviewed and approved monthly by the Board of Directors.

Employees

The Bank had 111 full-time employees and one part-time employee at December 31, 2019. The Bank is not a party to any collective bargaining agreement, and the Bank believes that its employee relations are good.

Competition

The banking business is highly competitive. The Bank competes with other depository institutions and other financial service organizations, including brokers, finance companies, financial technology companies, mutual funds, savings and loan associations, credit unions and certain governmental agencies. Many of these competitors have substantially greater resources than we do and offer services that we do not currently provide. Such competitors may also have greater lending limits than the Bank. In addition, nonbank competitors are generally not subject to the extensive regulations applicable to us. Price (the interest charged on loans and paid on deposits) remains a means of competition within the services industry. Use and advances in technology, such as internet and mobile banking, electronic payment processing channels, and cybersecurity are expected to have a significant impact on the competitive landscape of the financial services industry. The Bank also competes on the basis of service and convenience in providing financial services. The Bank ranks third out of twenty-one banks in a six county region (Colquitt, Baker, Worth, Lowndes, Brooks, and Tift) in deposit market share.

Monetary Policies

The results of operations of the Bank are affected by credit policies of monetary authorities, particularly the Board of Governors of the Federal Reserve System (the “Federal Reserve”). The instruments of monetary policy employed by the Federal Reserve include open market operations in U. S. government agency securities, changes in the discount rate on bank borrowings, and changes in reserve requirements against bank deposits. In view of changing conditions in the national economy and in the money markets, as well as the effect of action by monetary and fiscal authorities, including the Federal Reserve, no prediction can be made as to possible future changes in interest rates, deposit levels, loan demand, or the business and earnings of the Bank.

Payment of Dividends

The Corporation is a legal entity separate and distinct from the Bank. Most of the revenue of the Corporation results from dividends paid to it by the Bank. There are statutory and regulatory requirements applicable to the payment of dividends by the Bank, as well as by the Corporation to its shareholders.

Under the regulations of the Georgia Department of Banking and Finance (“DBF”), a state bank with positive retained earnings may declare dividends without DBF approval if it meets all the following requirements:

- (a) total classified assets as of the most recent examination of the bank do not exceed 80% of equity capital (as defined by regulation);
- (b) the aggregate amount of dividends declared or anticipated to be declared in the calendar year does not exceed 50% of the net profits after taxes but before dividends for the previous calendar year; and
- (c) the ratio of equity capital to adjusted assets is not less than 6%.

The payment of dividends by the Corporation and the Bank may also be affected or limited by other factors, such as the requirement to maintain adequate capital above regulatory guidelines. In addition, if, in the opinion of the applicable regulatory authority, a bank under its jurisdiction is engaged in or is about to engage in an unsafe or unsound practice (which, depending upon the financial condition of the bank, could include the payment of dividends), such authority may require, after notice and hearing, that such bank cease and desist from such practice. The FDIC has issued a policy statement providing that insured banks should generally only pay dividends out of current operating earnings. In addition to the formal statutes and regulations, regulatory authorities consider the adequacy of each of the Bank's total capital in relation to its assets, deposits and other such items. Capital adequacy considerations could further limit the availability of dividends to the Bank. At December 31, 2019, net assets available from the Bank to pay dividends without prior approval from regulatory authorities totaled \$2,750,464. For 2019, the Corporation's cash dividend payout to shareholders was \$1,221,766.

Supervision and Regulation

The following is a brief summary of the supervision and regulation of the Corporation and the Bank as financial institutions and is not intended to be a complete discussion of all NYSE American LLC, state or federal rules, statutes and regulations affecting their operations, or that apply generally to business corporations or companies listed on NYSE American LLC. Changes in the rules, statutes and regulations applicable to the Corporation and the Bank can affect the operating environment in substantial and unpredictable ways.

General. The Corporation is a registered bank holding company subject to regulation by the Federal Reserve under the Bank Holding Company Act of 1956, as amended (the "BHC Act"). The Corporation is required to file annual and quarterly financial information with the Federal Reserve and is subject to periodic examination by the Federal Reserve.

The BHC Act requires every bank holding company to obtain the Federal Reserve's prior approval before (1) it may acquire direct or indirect ownership or control of more than 5% of the voting shares of any bank that it does not already control; (2) it or any of its non-bank subsidiaries may acquire all or substantially all of the assets of a bank; and (3) it may merge or consolidate with any other bank holding company. In addition, a bank holding company is generally prohibited from engaging in, or acquiring, direct or indirect control of the voting shares of any company engaged in non-banking activities. This prohibition does not apply to activities listed in the BHC Act or found by the Federal Reserve, by order or regulation, to be closely related to banking or managing or controlling banks as to be a proper incident thereto. Some of the activities that the Federal Reserve has determined by regulation or order to be closely related to banking are:

- making, acquiring or servicing loans and certain types of leases;
- performing certain data processing services;
- acting as fiduciary or investment or financial advisor;
- providing brokerage services;
- underwriting bank eligible securities;
- underwriting debt and equity securities on a limited basis through separately capitalized subsidiaries; and
- making investments in corporations or projects designed primarily to promote community welfare.

Although the activities of bank holding companies have traditionally been limited to the business of banking and activities closely related or incidental to banking (as discussed above), the Gramm-Leach-Bliley Act (the “GLB Act”) relaxed the previous limitations and permitted bank holding companies to engage in a broader range of financial activities. Specifically, bank holding companies may elect to become financial holding companies which may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature. Among the activities that are deemed “financial in nature” include:

- lending, exchanging, transferring, investing for others or safeguarding money or securities;
- insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent, or broker with respect thereto;
- providing financial, investment, or economic advisory services, including advising an investment company;
- issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly; and
- underwriting, dealing in or making a market in securities.

Under this legislation, the Federal Reserve serves as the primary “umbrella” regulator of financial holding companies with supervisory authority over each parent company and limited authority over its subsidiaries. The primary regulator of each subsidiary of a financial holding company will depend on the type of activity conducted by the subsidiary. For example, broker-dealer subsidiaries will be regulated largely by securities regulators and insurance subsidiaries will be regulated largely by insurance authorities.

The Corporation has no current plans to register as a financial holding company.

The Corporation must also register with the DBF and file periodic information with the DBF. As part of such registration, the DBF requires information with respect to the financial condition, operations, management and intercompany relationships of the Corporation and the Bank and related matters. The DBF may also require such other information as is necessary to keep itself informed concerning compliance with Georgia law and the regulations and orders issued thereunder by the DBF have been complied with, and the DBF may examine the Corporation and the Bank.

The Corporation is an “affiliate” of the Bank under the Federal Reserve Act of 1913 (the “Federal Reserve Act”), which imposes certain restrictions on (1) loans by the Bank to the Corporation, (2) investments in the stock or securities of the Corporation by the Bank, (3) the Bank taking the stock or securities of an “affiliate” as collateral for loans by the Bank to a borrower, and (4) the purchase of assets from the Corporation by the Bank. Further, a bank holding company and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property or furnishing of services.

The Bank is regularly examined by the FDIC. As a state banking association organized under Georgia law, the Bank is subject to the supervision of and the regular examination of the DBF. Both the FDIC and the DBF must grant prior approval of any merger, consolidation or other corporation reorganization involving the Bank.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) was enacted in 2010, and resulted in sweeping changes in the regulation of financial institutions aimed at strengthening the sound operation of the financial services sector. In 2017, both the House of Representatives and the Senate introduced legislation that would repeal or modify provisions of the Dodd-Frank Act and significantly impact financial services regulation. In May 2018, certain provisions of these bills were signed into law as part of the Economic Growth, Regulatory Relief and Consumer Protection Act (the “Economic Growth Act”) and repealed or modified significant portions of the Dodd-Frank Act. Specifically, the Economic Growth Act delayed implementation of rules related to the Home Mortgage Disclosure Act, reformed and simplified certain Volcker Rule requirements, and raised the threshold for applying enhanced prudential standards to bank holding companies with total consolidated assets equal to or greater than \$50 billion to those with total consolidated assets equal to or greater than \$250 billion.

While federal legislation, including the Economic Growth Act, has scaled back portions of the Dodd-Frank Act, uncertainty about the timing and scope of such changes, as well as the cost of complying with a new regulatory regime and future reform, remains. Specific portions of Dodd-Frank and the Economic Growth Act applicable to the Corporation or the Bank are discussed in detail below.

Capital Adequacy. Banks and bank holding companies are subject to various regulatory capital requirements administered by state and federal banking agencies. Capital adequacy guidelines 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 about components, risk weighting and other factors.

The Federal Reserve and the FDIC have implemented substantially identical risk-based rules for assessing bank and bank holding company capital adequacy. These regulations establish minimum capital standards in relation to assets and off-balance sheet exposures as adjusted for credit risk. “Total capital” is composed of Tier 1 capital and Tier 2 capital. “Tier 1 capital” includes common equity, retained earnings, qualifying non-cumulative perpetual preferred stock, a limited amount of qualifying cumulative perpetual stock at the holding company level, minority interests in equity accounts of consolidated subsidiaries, less goodwill, most intangible assets and certain other assets. “Tier 2 capital” includes, among other things, perpetual preferred stock and related surplus not meeting the Tier 1 capital definition, qualifying mandatorily convertible debt securities, qualifying subordinated debt and allowances for possible loan and lease losses, subject to limitations.

The Federal Reserve and the FDIC use the leverage ratio in tandem with the risk-based ratio to assess the capital adequacy of banks and bank holding companies. The Federal Reserve will require a bank holding company to maintain a leverage ratio well above minimum levels if it is experiencing or anticipating significant growth or is operating with less than well-diversified risks in the opinion of the Federal Reserve. The FDIC, the Office of the Comptroller of the Currency (the “OCC”) and the Federal Reserve will also require banks to maintain capital well above minimum levels.

In July 2013, the Federal Reserve published the Basel III Capital Rules establishing a new comprehensive capital framework applicable to all depository institutions, bank holding companies with total consolidated assets of a certain threshold, and all savings and loan holding companies except for those that are substantially engaged in insurance underwriting or commercial activities (collectively, “banking organizations”). The rules implement the December 2010 framework proposed by the Basel Committee on Banking Supervision (the “Basel Committee”), known as “Basel III”, for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act.

The Basel III Capital Rules substantially revised the risk-based capital requirements applicable to bank holding companies and depository institutions compared to the prior U.S. risk-based capital rules. The Basel III Capital Rules:

- defined the components of capital and address other issues affecting the numerator in banking institutions’ regulatory capital ratios;
- addressed risk weights and other issues affecting the denominator in banking institutions’ regulatory capital ratios and replaced the prior risk-weighting approach, which was derived from the Basel I capital accords of the Basel Committee, with a more risk-sensitive approach based, in part, on the standardized approach in the Basel Committee’s 2004 “Basel II” capital accords;
- introduced a new capital measure called “common equity Tier 1” (“CET1”);
- specified that Tier 1 capital consists of CET1 and “additional Tier 1 capital” instruments meeting specified requirements; and
- implemented the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings from the federal banking agencies’ rules.

The Basel III Capital Rules became effective for the Bank on January 1, 2015, subject to a phase-in period ending January 1, 2019, but are not applicable to bank holding companies, like the Corporation, with less than \$1 billion in total consolidated assets that meet certain criteria.

The Basel III Capital Rules require the Bank to maintain;

- a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% “capital conservation buffer” (which is added to the 4.5% CET1 ratio effectively resulting in a minimum CET1 ratio of 7.0%);
- a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6%, plus the 2.5% capital conservation buffer (which is added to the 6% Tier 1 capital ratio effectively resulting in a minimum Tier 1 capital ratio of 8.5%);
- a minimum ratio of Total capital (that is, Tier 1 plus Tier 2) to risk-weighted assets of at least 8%, plus the 2.5% capital conservation buffer (which is added to the 8% Total capital ratio effectively resulting in a minimum Total capital ratio of 10.5%); and
- a minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average assets.

The Basel III Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Under prior capital standards, the effects of certain accumulated other comprehensive income items included in capital were excluded for the purposes of determining regulatory capital ratios. Under the Basel III Capital Rules, the effects of certain accumulated other comprehensive items are not excluded; however, certain banking organizations, including the Bank, may make a one-time permanent election to continue to exclude these items. The Bank made this election in the first quarter of 2015 in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of the Bank’s available-for-sale securities portfolio.

The “capital conservation buffer” is designed to absorb losses during periods of economic stress. Banking organizations with a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

As of December 31, 2019, the Bank met all capital adequacy requirements under the Basel III Capital Rules.

In addition, Section 38 of the Federal Deposit Insurance Act implemented the prompt corrective action provisions that Congress enacted as a part of the Federal Deposit Insurance Corporation Improvement Act of 1991 (the “1991 Act”). The prompt corrective action provisions set forth five regulatory zones in which all banks are placed largely based on their capital positions. Regulators are permitted to take increasingly harsh action as a bank’s financial condition declines. The FDIC is required to resolve a bank when its ratio of tangible equity to total assets reaches 2%. Better capitalized institutions are generally subject to less onerous regulation and supervision than banks with lesser amounts of capital.

The FDIC has adopted regulations implementing the prompt corrective action provisions of the 1991 Act, as revised by the Basel III Capital Rules effective January 1, 2015, which place financial institutions in the following five categories based upon capitalization ratios: (1) a “well-capitalized” institution has a Total risk-based capital ratio of at least 10%, a Tier 1 risk-based ratio of at least 8%, a CET1 risk-based ratio of 6.5% and a leverage ratio of at least 5%; (2) an “adequately capitalized” institution has a Total risk-based capital ratio of at least 8%, a Tier 1 risk-based ratio of at least 6%, a CET1 risk-based ratio of 4.5% and a leverage ratio of at least 4%; (3) an “undercapitalized” institution has a Total risk-based capital ratio of under 8%, a Tier 1 risk-based ratio of under 6%, a CET1 risk-based ratio of under 4.5% or a leverage ratio of under 4%; (4) a “significantly undercapitalized” institution has a Total risk-based capital ratio of under 6%, a Tier 1 risk-based ratio of under 4%, a CET1 risk-based ratio of under 3% or a leverage ratio of under 3%; and (5) a “critically undercapitalized” institution has a ratio of tangible equity to total assets of 2% or less. Institutions in any of the three undercapitalized categories would be prohibited from declaring dividends or making capital distributions. The FDIC regulations also allow it to “downgrade” an institution to a lower capital category based on supervisory factors other than capital.

As of December 31, 2019, the Bank was “well-capitalized” under current regulations. See “Part II. Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Capital Resources and Dividends” of this Annual Report on Form 10-K for further information.

In November 2017, the federal banking agencies adopted a final rule to extend the regulatory capital treatment applicable during 2017 under the capital rules for certain items, including regulatory capital deductions, risk weights, and certain minority interest limitations. The relief provided under the final rule applies to banking organizations that are not subject to the capital rules’ advanced approaches, such as the Corporation. Specifically, the final rule extends the current regulatory capital treatment of mortgage servicing assets, deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks, significant investments in the capital of unconsolidated financial institutions in the form of common stock, and common equity tier 1 minority interest, tier 1 minority interest, and total capital minority interest exceeding the capital rules’ minority interest limitations.

In December 2017, the Basel Committee on Banking Supervision published the last version of the Basel III accord, generally referred to as “Basel IV.” The Basel Committee stated that a key objective of the revisions incorporated into the framework is to reduce excessive variability of risk-weighted assets (“RWA”), which will be accomplished by enhancing the robustness and risk sensitivity of the standardized approaches for credit risk and operational risk, which will facilitate the comparability of banks’ capital ratios; constraining the use of internally modeled approaches; and complementing the risk-weighted capital ratio with a finalized leverage ratio and a revised and robust capital floor. Leadership of the federal banking agencies who are tasked with implementing Basel IV supported the revisions. Although it is uncertain at this time, we anticipate some, if not all, of the Basel IV accord may be incorporated into the capital requirements framework applicable to the Corporation.

The Economic Growth Act mandated the federal banking regulators, through notice and comment rulemaking, to develop an “off-ramp” exempting certain banking organizations with less than \$10.0 billion in consolidated assets and a low-risk profile from generally applicable leverage capital and risk-based capital requirements if such banking organization maintained a leverage ratio (calculated by dividing Tier 1 capital by average total consolidated assets) to be set by the federal banking regulators (the “Community Bank Leverage Ratio”). The Economic Growth Act requires the federal banking regulators set the Community Bank Leverage Ratio between 8% and 10%. On September 17, 2019, the federal banking regulators adopted a final rule to implementing Section 201 of the Economic Growth Act, which sets the Community Bank Leverage Ratio at 9% and allows these banking organizations to opt into the Community Bank Leverage Ratio framework beginning in the first quarter of 2020. Generally, community banking organizations that opt in and maintain a Community Bank Leverage ratio of 9% are considered to have satisfied the risk-based and leverage capital requirements in the generally applicable capital rules and further, these institutions are considered to have met the well-capitalized ratio requirements for purposes of Section 38 of the 1991 Act. The final rule also provides for a two quarter grace period, with certain exception if an electing banking organization ceases to satisfy any of the qualifying criteria to either meet the qualifying criteria or to comply with the generally applicable capital rule. The Corporation has not yet elected to maintain the Community Bank Leverage.

Consumer Protection Laws. The Dodd-Frank Act centralized responsibility for consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau (“CFPB”), and giving it the power to promulgate and enforce federal consumer protection laws. Depository institutions are subject to the CFPB’s rule writing authority, and existing federal bank regulatory agencies retain examination and enforcement authority for such institutions. The CFPB and the Corporation’s existing federal regulator, the FDIC, are focused on the following:

- risks to consumers and compliance with the federal consumer financial laws;
- the markets in which firms operate and risks to consumers posed by activities in those markets;
- depository institutions that offer a wide variety of consumer financial products and services;
- depository institutions with a more specialized focus; and
- non-depository companies that offer one or more consumer financial products or services.

The CFPB and FDIC have authority to prevent unfair, deceptive or abusive practices in connection with offering consumer financial products. The Dodd-Frank Act 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 states' attorneys general to enforce compliance with both state and federal laws and regulations.

Volcker Rule. The Dodd-Frank Act amended the BHC Act to require the federal bank regulatory agencies to adopt rules that prohibit banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (defined as hedge funds and private equity funds). The statutory provision is commonly called the "Volcker Rule". The Volcker Rule and the final rules adopted by the Federal Reserve thereunder, do not have a material effect on the Corporation and the Bank, as we do not engage in businesses prohibited by the Volcker Rule. In the future, the Corporation may incur costs to adopt additional policies and systems to ensure compliance with the Volcker Rule.

Commercial Real Estate. The federal bank regulatory agencies, including the FDIC, restrict concentrations in commercial real estate lending and have noted that recent increases in banks' commercial real estate concentrations have created safety and soundness concerns in the event of a significant economic downturn. The regulatory guidance mandates certain minimal risk management practices and categorizes banks with defined levels of such concentrations as banks requiring elevated examiner scrutiny. Although management believes that the Corporation's credit processes and procedures meet the risk management standards dictated by this guidance, regulatory outcomes could effectively limit increases in the real estate concentrations in the Bank's loan portfolio and require additional credit administration and management costs associated with those portfolios.

Source of Strength Doctrine. Federal Reserve regulations and policy requires bank holding companies to act as a source of financial and managerial strength to their subsidiary banks. Under this policy, the Corporation is expected to commit resources to support the Bank.

Loans. Inter-agency guidelines adopted by federal bank regulatory agencies mandate that financial institutions establish real estate lending policies with maximum allowable real estate loan-to-value limits, subject to an allowable amount of non-conforming loans as a percentage of capital.

Transactions with Affiliates. Under federal law, all transactions between and among a state nonmember bank and its affiliates, which include holding companies, are subject to Sections 23A and 23B of the Federal Reserve Act and Regulation W promulgated thereunder. Generally, these requirements limit these transactions to a percentage of the bank's capital and require all of them to be on terms at least as favorable to the bank as transactions with non-affiliates. In addition, a bank may not lend to any affiliate engaged in non-banking activities not permissible for a bank holding company or acquire shares of any affiliate that is not a subsidiary. The FDIC is authorized to impose additional restrictions on transactions with affiliates if necessary to protect the safety and soundness of a bank. The regulations also set forth various reporting requirements relating to transactions with affiliates.

Financial Privacy. In accordance with the GLB Act, federal banking regulatory agencies adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to non-affiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party. The privacy provisions of the GLB Act affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors.

Anti-Money Laundering Initiatives and the USA Patriot Act. A major focus of governmental policy on financial institutions in recent years has been aimed at combating terrorist financing. This has generally been accomplished by amending existing anti-money laundering laws and regulations. The United States Department of the Treasury has issued a number of implementing regulations which apply various requirements of the USA Patriot Act of 2001 to the Bank. These regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing and to verify the identity of their customers. Failure of a financial institution to maintain and implement adequate programs to combat terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution.

Incentive Compensation. The federal banking agencies have issued guidance on incentive compensation policies (the “Incentive Compensation Guidance”) intended to ensure that the incentive compensation policies of financial institutions do not undermine the safety and soundness of such institutions by encouraging excessive risk-taking. The Incentive Compensation Guidance, which covers all employees that have the ability to materially affect the risk profile of an institution, either individually or as part of a group, is based upon the key principles that a financial institution’s incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the institution 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 institution’s board of directors.

The Federal Reserve will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of financial institutions like the Corporation that are not “large, complex banking organizations.” These reviews will be tailored to each financial institution based on the scope and complexity of the institution’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 financial institution’s supervisory ratings, which can affect the institution’s ability to make acquisitions and take other actions. Enforcement actions may be taken against a financial institution if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the institution’s safety and soundness and the institution is not taking prompt and effective measures to correct the deficiencies.

The scope and content of banking regulators’ policies on executive compensation are continuing to develop and are likely to continue evolving in the near future. It cannot be determined at this time whether compliance with such policies will adversely affect our ability to hire, retain and motivate our key employees.

Cybersecurity. Cyber-attacks against banks and other financial institutions that resulted in unauthorized access to confidential customer information have prompted the federal bank regulatory agencies to issue extensive guidance on cybersecurity. These agencies are likely to continue to devote resources to this part of their safety and soundness examination for the foreseeable future.

Fair Value. The Corporation’s impaired loans and foreclosed assets may be measured and carried at “fair value”, the determination of which requires management to make assumptions, estimates and judgments. When a loan is considered impaired, a specific valuation allowance is allocated or a partial charge-off is taken, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan’s existing rate or at the fair value of collateral if repayment is expected solely from the collateral. In addition, foreclosed assets are carried at the lower of cost or “fair value”, less cost to sell, following foreclosure. “Fair value” is defined by U.S. GAAP “as the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date.” GAAP further defines an “orderly transaction” as “a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets; it is not a forced transaction (for example, a forced liquidation or distress sale).” Although management believes its processes for determining the value of these assets use appropriate factors and allow the Corporation to arrive at a fair value, the processes require management judgment and assumptions and the value of such assets at the time they are revalued or divested may be significantly different from management’s determination of fair value. Because of this increased subjectivity in fair value determinations, there is greater than usual grounds for differences in opinions, which may result in increased disagreements between management and the Bank’s regulators, disagreements which could impair the relationship between the Bank and its regulators.

Future Legislation. Various legislation affecting financial institutions and the financial industry is, from time to time, introduced in Congress. Such legislation may change banking statutes and the operating environment of the Corporation and its subsidiaries in substantial and unpredictable ways, and could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance depending upon whether any of this potential legislation will be enacted, and, if enacted, the effect that it or any implementing regulations would have on the financial condition or results of operations of the Corporation or any of its subsidiaries. With the current economic environment, the nature and extent of future legislative and regulatory changes affecting financial institutions is not known at this time.

Available Information

The Corporation's website where you can find more information is located at www.sgb.bank. We make available free of charge, through our website, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, proxy statements and other reports filed or furnished pursuant to Section 13(a) or 15(d) under the Securities Exchange Act of 1934 (the "Exchange Act"). These reports are available as soon as reasonably practicable after those materials are electronically filed with the SEC.

Our SEC filings are publicly available at the SEC's website located at www.sec.gov. You may also read and copy any document we file with the SEC at its Public Reference Facilities at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. You may obtain information about the Public Reference Room operations by calling the SEC at 1-800-SEC-0330. Information provided on our website is not part of this report, and is not incorporated herein by reference unless otherwise specifically referenced as such in this report.

Executive Officers of the Corporation and the Bank

Executive officers are elected by the Board of Directors annually in May and hold office until the following May at the pleasure of the Board of Directors. The principal executive officers of the Corporation and the Bank and their ages, positions, and terms of office as of March 26, 2020, are as follows:

<u>Name (Age)</u>	<u>Principal Position</u>	<u>Executive Officer Since</u>
DeWitt Drew (63)	President and Chief Executive Officer of the Corporation and Bank	1999
Donna S. Lott (44)	Executive Vice President and Chief Administrative Officer of the Corporation and Bank and Cashier of the Bank	2008
Danny E. Singley (65)	Executive Vice President and Chief Credit Officer of the Bank	2002
Jeffrey (Jud) Moritz (43)	Executive Vice President of the Bank and Valdosta Region President	2011
Ross K. Dekle (38)	Executive Vice President of the Bank and Moultrie Region President	2011
Gregory P. Costin (44)	Senior Vice President of the Bank	2012
Pamela J. Yeager (51)	Senior Vice President of the Bank	2015
Chad J. Carpenter (45)	Senior Vice President of the Bank and Tifton Region President	2015
Leslie W. Green (45)	Senior Vice President of the Bank	2018
T. Garrett Westbrook (44)	Vice President and Controller	2020

None of the above officers are related and there are no arrangements or understandings between them and any other person pursuant to which any of them was elected as an officer, other than arrangements or understandings with directors or officers of the Corporation or Bank acting solely in their capacities as such.

The following is a brief description of the business experience of the principal executive officers of the Corporation and the Bank. Except as otherwise indicated, each principal executive officer has been engaged in their present or last employment, in the same or similar position, for more than five years.

Mr. Drew is a director of the Corporation and the Bank and was named President and Chief Executive Officer in May 2002. Previously, he served as President and Chief Operating Officer beginning in 2001 and Executive Vice President in 1999 of the Corporation and the Bank.

Ms. Lott became Chief Administrative Officer in 2018 and Executive Vice President of the Corporation and the Bank in 2017. She is also Cashier of the Bank. Previously, she served as Senior Vice President of the Bank since 2014. Prior to that, she served as Vice President of the Bank since 2008 and Assistant Vice President of the Bank since 2007.

Mr. Singley became Executive Vice President and Chief Credit Officer of the Bank in 2014. Previously, he was appointed President Moultrie Region and Senior Vice President of the Bank in 2011 and served as Senior Vice President of the Bank since 2008. Prior to that, he had been Vice President of the Bank since 2002.

Mr. Moritz became Executive Vice President of the Bank in 2018. Previously, he was appointed as Senior Vice President of the Bank and Valdosta Region President in 2011. Prior to that, he was employed by Park Avenue Bank in Valdosta, Georgia, for five years and Regions Bank for five years.

Mr. Dekle became Executive Vice President of the Bank in 2018. Previously, he was appointed Senior Vice President of the Bank and Moultrie Region President in 2014. Prior to that, he served as Vice President of the Bank since 2011 and, prior to that, Assistant Vice President of the Bank since 2007.

Mr. Costin became Senior Vice President of the Bank in 2015. Previously, he served as Vice President of the Bank since 2012 and, prior to that, Assistant Vice President of the Bank since 2011.

Ms. Yeager became Senior Vice President of the Bank in 2015. Previously, she was employed for 11 years with Commercial Banking Company in Valdosta, Georgia. Prior to that, she was employed for 18 years with First State Bank and Trust in Valdosta, Georgia.

Mr. Carpenter became Senior Vice President of the Bank and Tifton Region President in 2015. Previously, he was employed by BB&T in Tifton, Georgia, for 15 years where he most recently held the position of Area President for the communities of Tifton, Valdosta and Douglas.

Ms. Green became Senior Vice President of the Bank in 2018. Previously, she served as Vice President of the Bank since 2017. Prior to that, she was employed for 4 years with Thomas County Federal Savings and Loan in Thomasville, Georgia.

Mr. Westbrook became Vice President and Controller of the Corporation and the Bank in, 2020. Previously, he served as staff accountant of the Corporation and the Bank since 2018. He previously served as a tax manager for a local CPA firm.

Table 1 - Distribution of Assets, Liabilities, and Shareholders' Equity; Interest Rates and Interest Differentials

The following tables set forth, for the fiscal years ended December 31, 2019, 2018, and 2017, the daily average balances outstanding for the major categories of earning assets and interest-bearing liabilities and the average interest rate earned or paid thereon. Except for percentages, all data is in thousands of dollars.

Year Ended December 31, 2019

	Average Balance	Interest (Dollars in thousands)	Rate
ASSETS			
Cash and due from banks	\$ <u>12,428</u>	\$ <u>0</u>	- %
Earning assets:			
Interest-bearing deposits with banks	22,734	497	2.19%
Loans, net (a) (b) (c)	383,822	21,861	5.70%
Certificates of deposit in other banks	2,859	71	2.48%
Taxable investment securities held to maturity and available for sale	67,480	1,684	2.50%
Nontaxable investment securities held to maturity (c)	25,970	882	3.40%
Nontaxable investment securities available for sale (c)	6,339	223	3.52%
Other investment securities	<u>1,579</u>	<u>104</u>	6.59%
Total earning assets	<u>510,783</u>	\$ <u>25,322</u>	4.96%
Premises and equipment	14,292		
Other assets	<u>11,593</u>		
Total assets	\$ <u>549,095</u>		
LIABILITIES AND SHAREHOLDERS' EQUITY			
Noninterest-bearing demand deposits	\$ <u>114,983</u>	\$ <u>0</u>	- %
Interest-bearing liabilities:			
Interest bearing business checking	31,258	138	0.44%
NOW accounts	13,464	56	0.42%
Money market deposit accounts	177,154	1,555	0.88%
Savings deposits	33,276	118	0.35%
Time deposits	101,806	1,981	1.95%
Federal funds purchased	1	0	0.00%
Other borrowings	<u>26,797</u>	<u>605</u>	2.32%
Total interest-bearing liabilities	<u>383,756</u>	<u>4,453</u>	1.16%
Other liabilities	<u>3,332</u>		
Total liabilities	<u>502,071</u>		
Common stock	2,545		
Surplus	18,420		
Retained earnings	<u>26,059</u>		
Total shareholders' equity	<u>47,024</u>		
Total liabilities and shareholders' equity	\$ <u>549,095</u>		
Net interest income and margin		\$ <u>20,869</u>	<u>4.09%</u>

- (a) Average loans are shown net of unearned income and the allowance for loan losses. Nonperforming loans are included.
- (b) Interest income includes loan fees of approximately \$1,138 thousand.
- (c) Reflects taxable equivalent adjustments using a tax rate of 21%.

Year Ended December 31, 2018

	Average Balance	Interest (Dollars in thousands)	Rate
ASSETS			
Cash and due from banks	\$ <u>9,944</u>	\$ <u>0</u>	- %
Earning assets:			
Interest-bearing deposits with banks	25,951	485	1.87%
Loans, net (a) (b) (c)	346,761	18,782	5.42%
Certificates of deposit in other banks	2,019	48	2.38%
Taxable investment securities held to maturity and available for sale	54,088	1,363	2.52%
Nontaxable investment securities held to maturity (c)	36,364	1,204	3.31%
Nontaxable investment securities available for sale (c)	7,375	236	3.20%
Other investment securities	<u>2,356</u>	<u>144</u>	6.11%
Total earning assets	<u>474,914</u>	<u>\$ 22,262</u>	4.69%
Premises and equipment	13,763		
Other assets	<u>11,874</u>		
Total assets	\$ <u>510,495</u>		
LIABILITIES AND SHAREHOLDERS' EQUITY			
Noninterest-bearing demand deposits	\$ <u>112,768</u>	\$ <u>0</u>	- %
Interest-bearing liabilities:			
Interest bearing business checking	21,334	85	0.40%
NOW accounts	18,807	70	0.37%
Money market deposit accounts	147,395	1,030	0.70%
Savings deposits	32,082	124	0.39%
Time deposits	87,539	1,075	1.23%
Federal funds purchased	42	1	2.38%
Other borrowings	<u>44,654</u>	<u>937</u>	2.10%
Total interest-bearing liabilities	<u>351,853</u>	<u>3,322</u>	0.94%
Other liabilities	<u>3,795</u>		
Total liabilities	<u>468,416</u>		
Common stock	2,823		
Surplus	11,075		
Retained earnings	32,322		
Less treasury stock	<u>(4,141)</u>		
Total shareholders' equity	<u>42,079</u>		
Total liabilities and shareholders' equity	\$ <u>510,495</u>		
Net interest income and margin		\$ <u>18,940</u>	3.99%

- (a) Average loans are shown net of unearned income and the allowance for loan losses. Nonperforming loans are included.
- (b) Interest income includes loan fees of approximately \$1,062 thousand.
- (c) Reflects taxable equivalent adjustments using a tax rate of 21%.

	Year Ended December 31, 2017		
	Average Balance	Interest (Dollars in thousands)	Rate
ASSETS			
Cash and due from banks	\$ <u>8,701</u>	\$ <u>0</u>	- %
Earning assets:			
Interest-bearing deposits with banks	18,104	195	1.08%
Loans, net (a) (b) (c)	314,559	16,345	5.20%
Certificates of deposit in other banks	1,477	35	2.37%
Taxable investment securities held to maturity and available for sale	53,036	1,285	2.42%
Nontaxable investment securities held to maturity (c)	45,286	1,713	3.78%
Nontaxable investment securities available for sale (c)	7,260	287	3.95%
Other investment securities	<u>2,150</u>	<u>103</u>	4.79%
Total earning assets	<u>441,872</u>	\$ <u>19,963</u>	4.52%
Premises and equipment	11,835		
Other assets	<u>11,035</u>		
Total assets	\$ <u>473,443</u>		
LIABILITIES AND SHAREHOLDERS' EQUITY			
Noninterest-bearing demand deposits	\$ <u>130,252</u>	\$ <u>0</u>	- %
Interest-bearing liabilities:			
NOW accounts	20,606	40	0.19%
Money market deposit accounts	129,313	381	0.29%
Savings deposits	30,448	82	0.27%
Time deposits	79,832	652	0.82%
Federal funds purchased	80	1	1.25%
Other borrowings	<u>38,293</u>	<u>747</u>	1.95%
Total interest-bearing liabilities	<u>298,572</u>	<u>1,903</u>	0.64%
Other liabilities	<u>4,157</u>		
Total liabilities	<u>432,981</u>		
Common stock	4,294		
Surplus	31,702		
Retained earnings	30,587		
Less treasury stock	<u>(26,121)</u>		
Total shareholders' equity	<u>40,462</u>		
Total liabilities and shareholders' equity	\$ <u>473,443</u>		
Net interest income and margin		\$ <u>18,060</u>	4.09%

- (a) Average loans are shown net of unearned income and the allowance for loan losses. Nonperforming loans are included.
- (b) Interest income includes loan fees of approximately \$965 thousand.
- (c) Reflects taxable equivalent adjustments using a tax rate of 34%.

Table 2 – Rate/Volume Analysis

The following table sets forth, for the indicated years ended December 31, a summary of the changes in interest paid resulting from changes in volume and changes in rate. The change due to volume is calculated by multiplying the change in volume by the prior year's rate. The change due to rate is calculated by multiplying the change in rate by the prior year's volume. The change attributable to both volume and rate is calculated by multiplying the change in volume by the change in rate.

	2019	2018	Increase (Decrease)	Due To Changes In (a)	
				Volume	Rate
				(Dollars in thousands)	
Interest earned on:					
Interest-bearing deposits with banks	\$ 497	\$ 485	\$ 12	\$(33)	\$ 45
Loans, net (b)	21,861	18,782	3,079	2,077	1,002
Certificates of deposit in other banks	71	48	23	21	2
Taxable investment securities					
held to maturity and available for sale	1,684	1,363	321	334	(13)
Nontaxable investment securities					
held to maturity (b)	882	1,204	(322)	(354)	32
Nontaxable investment securities					
available for sale (b)	223	236	(13)	(43)	30
Other investment securities	<u>104</u>	<u>144</u>	<u>(40)</u>	<u>(52)</u>	<u>12</u>
Total interest income	<u>25,322</u>	<u>22,262</u>	<u>3,060</u>	<u>1,950</u>	<u>1,110</u>
Interest paid on:					
Interest bearing business checking	138	85	53	43	10
NOW accounts	56	70	(14)	(23)	9
Money market deposit accounts	1,555	1,030	525	231	294
Savings deposits	118	124	(6)	6	(12)
Time deposits	1,981	1,075	906	197	709
Federal funds purchased	0	1	(1)	(1)	0
Other borrowings	<u>605</u>	<u>937</u>	<u>(332)</u>	<u>(445)</u>	<u>112</u>
Total interest expense	<u>4,453</u>	<u>3,322</u>	<u>1,131</u>	<u>8</u>	<u>1,122</u>
Net interest earnings	<u>\$20,869</u>	<u>\$18,940</u>	<u>\$ 1,929</u>	<u>\$1,942</u>	<u>\$(12)</u>

- (a) Volume and rate components are in proportion to the relationship of the absolute dollar amounts of the change in each.
(b) Reflects taxable equivalent adjustments using a tax rate of 21% for 2019 and 2018 in adjusting interest on nontaxable loans and securities to a fully taxable basis.

	2018	2017	Increase (Decrease)	Due To Changes In (a)	
				Volume	Rate
				(Dollars in thousands)	
Interest earned on:					
Interest-bearing deposits with banks	\$ 485	\$ 195	\$ 290	\$ 108	\$ 182
Loans, net (b)	18,782	16,345	2,437	1,723	714
Certificates of deposit in other banks	48	35	13	13	0
Taxable investment securities					
held to maturity and available for sale	1,363	1,285	78	26	52
Nontaxable investment securities					
held to maturity (b)	1,204	1,713	(509)	(311)	(198)
Nontaxable investment securities					
available for sale (b)	236	287	(51)	5	(56)
Other investment securities	<u>144</u>	<u>103</u>	<u>41</u>	<u>11</u>	<u>30</u>
Total interest income	<u>22,262</u>	<u>19,963</u>	<u>2,299</u>	<u>1,575</u>	<u>724</u>
Interest paid on:					
Interest bearing business checking	85	0	85	67	18
NOW accounts	70	40	30	(3)	33
Money market deposit accounts	1,030	381	649	60	589
Savings deposits	124	82	42	4	38
Time deposits	1,075	652	423	68	355
Federal funds purchased	1	1	0	0	0
Other borrowings	<u>937</u>	<u>747</u>	<u>190</u>	<u>130</u>	<u>60</u>
Total interest expense	<u>3,322</u>	<u>1,903</u>	<u>1,419</u>	<u>326</u>	<u>1,093</u>
Net interest earnings	<u>\$18,940</u>	<u>\$18,060</u>	<u>\$ 880</u>	<u>\$1,249</u>	<u>\$(369)</u>

- (a) Volume and rate components are in proportion to the relationship of the absolute dollar amounts of the change in each.
(b) Reflects taxable equivalent adjustments using a tax rate of 21% for 2018 and 34% for 2017 in adjusting interest on nontaxable loans and securities to a fully taxable basis.

Table 3 - Investment Portfolio

The carrying values of investment securities for the indicated years are presented below:

	Year Ended December 31,		
	<u>2019</u>	<u>2018</u>	<u>2017</u>
	(Dollars in thousands)		
<u>Securities held to maturity:</u>			
State and municipal	\$ 20,443	\$ 30,583	\$ 41,447
Residential mortgage-backed	<u>5,044</u>	<u>6,244</u>	<u>3,144</u>
Total securities held to maturity	<u>\$ 25,487</u>	<u>\$ 36,827</u>	<u>\$ 44,591</u>
<u>Securities available for sale:</u>			
U.S. government treasuries	\$ 4,027	\$ 955	\$ 968
U.S. government agencies	38,498	45,207	43,860
State and municipal	4,534	7,378	7,574
Residential mortgage-backed	20,766	4,774	1,862
Corporate notes	<u>0</u>	<u>0</u>	<u>0</u>
Total securities available for sale	<u>\$ 67,825</u>	<u>\$ 58,314</u>	<u>\$ 54,264</u>

At December 31, 2019, the total investment portfolio decreased to \$93,312,824, down \$1,827,826, compared with \$95,140,650 at December 31, 2018. The decrease in the portfolio resulted in various maturities and calls totaling \$13,062,059, sales of \$9,358,503, and residential mortgage-backed securities principal paydowns of \$3,735,287. The sales were U.S. government agency and state and local municipal securities categorized as available for sale. These transactions resulted in a net gain of \$174,283. Partially offsetting these maturities, calls, and sales were purchases of \$23,291,052 of U.S. government agency securities, residential mortgage-backed securities, and municipal securities.

The following table shows the contractual maturities of debt securities at December 31, 2019, and the weighted average yields (for nontaxable obligations on a fully taxable basis assuming a 21% tax rate) of such securities. Mortgage-backed securities amortize in accordance with the terms of the underlying mortgages, including prepayments as a result of refinancing and other early payoffs.

	MATURITY							
	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years	
	<u>Amount</u>	<u>Yield</u>	<u>Amount</u>	<u>Yield</u>	<u>Amount</u>	<u>Yield</u>	<u>Amount</u>	<u>Yield</u>
	(Dollars in thousands)							
<u>Debt Securities:</u>								
U.S. government treasuries	\$ 0	0.00%	\$ 3,016	2.49%	\$ 1,011	2.25%	\$ 0	0.00%
U.S. government agencies	2,007	2.28%	26,857	2.62%	9,634	2.57%	0	0.00%
State and municipal	2,516	2.37%	10,047	2.78%	10,064	2.56%	2,350	2.53%
Residential mortgage-backed	<u>2</u>	<u>4.00%</u>	<u>893</u>	<u>2.94%</u>	<u>1,677</u>	<u>2.94%</u>	<u>23,239</u>	<u>2.74%</u>
Total	<u>\$ 4,525</u>	<u>2.33%</u>	<u>\$40,813</u>	<u>2.68%</u>	<u>\$22,386</u>	<u>2.58%</u>	<u>\$25,589</u>	<u>3.21%</u>

The calculation of weighted average yields is based on the carrying value and effective yields of each security weighted for the scheduled maturity of each security. At December 31, 2019 and 2018, securities carried at approximately \$62,931,401 and \$59,182,556, respectively, were pledged to secure public and trust deposits as required by law. At December 31, 2019, approximately \$25,000,827 was over pledged and could be released if necessary for liquidity needs. At December 31, 2019 and 2018, no securities were pledged to secure our Federal Home Loan Bank advances.

Table 4 - Loan Portfolio

The following table sets forth the amount of loans outstanding for the indicated years according to type of loan:

	Year Ended December 31,				
	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(Dollars in thousands)				
Commercial, financial and agricultural	\$ 87,441	\$ 88,403	\$ 73,146	\$ 70,999	\$ 58,173
Real estate:					
Construction loans	28,826	24,891	22,287	25,999	19,831
Commercial mortgage loans	143,022	123,477	106,458	91,733	85,777
Residential loans	102,240	103,348	99,160	83,271	67,969
Agricultural loans	31,459	31,562	25,374	16,580	15,620
Consumer & other	<u>5,094</u>	<u>5,086</u>	<u>3,767</u>	<u>3,961</u>	<u>3,435</u>
Total loans	398,082	376,767	330,192	292,543	250,805
Less:					
Unearned interest and discount	17	17	18	19	19
Allowance for loan losses	<u>3,604</u>	<u>3,429</u>	<u>3,044</u>	<u>3,124</u>	<u>3,032</u>
Net loans	<u>\$ 394,461</u>	<u>\$ 373,321</u>	<u>\$ 327,130</u>	<u>\$ 289,400</u>	<u>\$ 247,754</u>

The following table shows maturities of the commercial, financial, agricultural, and construction loan portfolio at December 31, 2019.

	Commercial, Financial, Agricultural and Construction (Dollars in thousands)
Distribution of loans which are due:	
In one year or less	\$ 36,921
After one year but within five years	54,478
After five years	<u>24,869</u>
Total	<u>\$ 116,268</u>

The following table shows, for such loans due after one year, the amounts which have predetermined interest rates and the amounts which have floating or adjustable interest rates at December 31, 2019.

	Loans With Predetermined Rates	Loans With Floating Rates (Dollars in thousands)	Total
Commercial, financial, agricultural and construction	<u>\$ 74,690</u>	<u>\$ 4,657</u>	<u>\$ 79,347</u>

The following table presents information concerning outstanding balances of nonaccrual, past-due, and restructured loans as well as foreclosed assets for the indicated years. Respectively, they are defined as: (a) loans accounted for on a nonaccrual basis (“nonaccruals”); (b) loans which are contractually past due 90 days or more as to interest or principal payments and still accruing (“past-dues”); and (c) loans past due 30 days or more for which the terms have been modified to provide a reduction or deferral of interest or principal because of a deterioration in the financial position of the borrower (“troubled debt restructured”). The Corporation’s nonaccrual policy is located in Note 3 of the Corporation’s Notes to Consolidated Financial Statements.

	Year Ended December 31,				
	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(Dollars in thousands)				
Average loans outstanding	<u>\$387,315</u>	<u>\$349,938</u>	<u>\$317,724</u>	<u>\$281,006</u>	<u>\$235,939</u>
Amount of allowance for loan losses at beginning of period	<u>\$ 3,429</u>	<u>\$ 3,044</u>	<u>\$ 3,124</u>	<u>\$ 3,032</u>	<u>\$ 3,114</u>
Amount of loans charged off during period:					
Commercial, financial and agricultural	179	548	113	103	264
Real estate:					
Construction	56	1	0	0	0
Commercial	275	43	169	0	0
Residential	227	7	60	4	33
Agricultural	0	0	94	0	0
Consumer & other	<u>14</u>	<u>7</u>	<u>12</u>	<u>9</u>	<u>22</u>
Total loans charged off	<u>751</u>	<u>606</u>	<u>448</u>	<u>116</u>	<u>319</u>
Amount of recoveries during period:					
Commercial, financial and agricultural	20	12	64	28	42
Real estate:					
Construction	0	0	0	0	0
Commercial	3	1	0	0	0
Residential	40	0	0	17	22
Agricultural	0	147	0	0	0
Consumer & other	<u>6</u>	<u>2</u>	<u>4</u>	<u>3</u>	<u>32</u>
Total loans recovered	<u>69</u>	<u>162</u>	<u>68</u>	<u>48</u>	<u>96</u>
Net loans charged off during period	<u>682</u>	<u>444</u>	<u>380</u>	<u>68</u>	<u>223</u>
Additions to allowance for loan losses charged to operating expense during period	<u>857</u>	<u>829</u>	<u>300</u>	<u>160</u>	<u>141</u>
Amount of allowance for loan losses at end of period	<u>\$ 3,604</u>	<u>\$ 3,429</u>	<u>\$ 3,044</u>	<u>\$ 3,124</u>	<u>\$ 3,032</u>
Ratio of net charge-offs during period to average loans outstanding for the period	<u>.18%</u>	<u>.13%</u>	<u>.12%</u>	<u>.02%</u>	<u>.09%</u>

The allowance is based upon management's analysis of the portfolio under current economic conditions. This analysis includes a study of loss experience, a review of delinquencies, and an estimate of the possibility of loss in view of the risk characteristics of the portfolio. Based on the above factors, management considers the current allowance to be adequate.

Allocation of Allowance for Loan Losses

Management has allocated the allowance for loan losses within the categories of loans set forth in the table below based on historical experience of net charge-offs. The allowance for loan losses allocated to each category is not necessarily indicative of future losses in any particular category and does not restrict the use of the allowance to absorb losses in other categories. The amount of the allowance applicable to each category and the percentage of loans in each category to total loans are presented below.

Category	December 31, 2019		December 31, 2018		December 31, 2017	
	Allocation	% of Total Loans	Allocation	% of Total Loans	Allocation	% of Total Loans
Commercial, financial and agricultural Real estate:	\$ 501	22.0%	\$ 402	23.5%	\$ 324	22.2%
Construction	1,035	7.2%	1,043	6.6%	1,043	6.8%
Commercial	1,359	35.9%	1,210	32.8%	1,057	32.2%
Residential	420	25.7%	459	27.4%	416	30.0%
Agricultural	77	7.9%	109	8.4%	12	7.7%
Consumer & other	212	1.3%	206	1.3%	192	1.1%
Total	<u>\$ 3,604</u>	<u>100.0%</u>	<u>\$ 3,429</u>	<u>100.0%</u>	<u>\$ 3,044</u>	<u>100.0%</u>

Category	December 31, 2016		December 31, 2015	
	Allocation	% of Total Loans	Allocation	% of Total Loans
Commercial, financial and agricultural Real estate:	\$ 191	24.3%	\$ 145	23.2%
Construction	1,043	8.9%	1,043	7.9%
Commercial	1,192	31.3%	1,192	34.2%
Residential	420	28.5%	382	27.1%
Agricultural	87	5.7%	86	6.2%
Consumer & other	191	1.3%	184	1.4%
Total	<u>\$ 3,124</u>	<u>100.0%</u>	<u>\$ 3,032</u>	<u>100.0%</u>

The calculation is based upon total loans including unearned interest and discount. Management believes that the portfolio is diversified and, to a large extent, secured without undue concentrations in any specific risk area. Control of loan quality is regularly monitored by management, the loan committee, and is reviewed by the Bank's Board of Directors which meets monthly. Independent external review of the loan portfolio is provided by examinations conducted by regulatory authorities. The amount of additions to the allowance for loan losses charged to operating expense for the periods indicated were based upon many factors, including actual charge-offs and evaluations of current economic conditions in the market area. Management believes the allowance for loan losses is adequate to cover any potential loan losses.

Table 5 - Deposits

The average amounts of deposits for the last three years are presented below.

	Year Ended December 31,		
	2019	2018	2017
	(Dollars in thousands)		
Noninterest-bearing demand deposits	<u>\$114,983</u>	<u>\$112,767</u>	<u>\$130,252</u>
Interest bearing business checking	31,258	21,335	0
NOW accounts	13,464	18,807	20,606
Money market deposit accounts	177,154	147,395	129,313
Savings	33,276	32,082	30,448
Time deposits	<u>101,806</u>	<u>87,539</u>	<u>79,832</u>
Total interest-bearing deposits	<u>356,958</u>	<u>307,158</u>	<u>260,199</u>
Total average deposits	<u>\$471,941</u>	<u>\$419,925</u>	<u>\$390,451</u>

The maturity of certificates of deposit of \$100,000 or more as of December 31, 2019, are presented below.

(Dollars in thousands)

3 months or less	\$ 11,107
Over 3 months through 6 months	8,894
Over 6 months through 12 months	14,327
Over 12 months	<u>18,908</u>
Total outstanding certificates of deposit of \$100,000 or more	<u>\$ 53,236</u>

Table 6 - Return on Equity and Assets

Certain financial ratios are presented below.

	Year Ended December 31,		
	<u>2019</u>	<u>2018</u>	<u>2017</u>
Return on average assets	0.96%	0.91%	0.80%
Return on average equity	11.25%	11.04%	9.41%
Dividend payout (dividends paid divided by net income)	23.09%	25.74%	29.44%
Average equity to average assets	8.57%	8.24%	8.55%

Table 7 – Short-Term Borrowings

Short-term borrowed funds consist of FHLB advances of \$5,814,286 with a weighted average interest rate of 1.78% as of December 31, 2019, and \$10,457,143 with a weighted average interest rate of 1.92% as of December 31, 2018. \$2.214 million of short-term borrowings are short-term portions of long-term principal reducing Federal Home Loan Bank advances.

Information concerning federal funds purchased and FHLB short-term advances are summarized as follows:

	<u>2019</u>	<u>2018</u>
Average balance during the year	\$ 6,545,280	\$17,305,184
Average interest rate during the year	1.89%	2.29%
Maximum month-end balance during the year	\$12,802,381	\$20,971,429

Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the federal securities laws. These forward-looking statements are intended to be covered by the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not statements of historical fact, and can be identified by the use of forward-looking terminology such as “believes”, “expects”, “may”, “will”, “could”, “should”, “projects”, “plans”, “goal”, “targets”, “potential”, “estimates”, “pro forma”, “seeks”, “intends”, or “anticipates” or the negative thereof or comparable terminology. Forward-looking statements include discussions of strategy, financial projections, guidance and estimates (including their underlying assumptions), statements regarding plans, objectives, expectations or consequences of various transactions, and statements about the future performance, operations, products and services of the Corporation and its subsidiaries. We caution our shareholders and other readers not to place undue reliance on such statements.

The Corporation cautions that there are various risks, uncertainties and other factors that could cause actual results and experience to differ materially from the anticipated results or other expectations expressed in any forward-looking statements; accordingly, there can be no assurance that such indicated results will be realized. These risks, uncertainties and other factors include, but are not limited to, risks related to:

- the conditions in the banking system, financial markets, and general economic conditions;
- the Corporation's ability to maintain profitability;
- the Corporation's ability to raise capital;
- the Corporation's ability to maintain liquidity or access other sources of funding;
- changes in the cost and availability of funding;
- the Corporation's construction and land development loans;
- asset quality;
- the adequacy of the allowance for loan losses;
- technology difficulties or failures;
- the Corporation's ability to execute its business strategy;
- the loss of key personnel;
- competition from financial institutions and other financial service providers;
- changes in technology;
- the impact of the Dodd-Frank Act and related regulations and other changes in financial services laws and regulations or failures to comply with such laws and regulations;
- changes in regulatory capital and other requirements;
- changes in monetary policy;
- losses due to fraudulent and negligent conduct of customers, third party service providers or employees;
- the costs and effects of litigation, examinations, investigations, or similar matters, or adverse facts and developments related thereto;
- possible regulatory or judicial proceedings, board resolutions, informal memorandums of understanding or formal enforcement actions imposed by regulators;
- the Corporation's reliance on third parties to provide key components of our business infrastructure and services required to operate our business;
- acquisitions or dispositions of assets or internal restructuring that may be pursued by the Corporation;
- deteriorating conditions in the stock market, the public debt market and other capital markets;
- changes in or application of environmental and other laws and regulations to which the Corporation is subject;
- political, legal and local economic conditions and developments;
- the Corporation's lack of geographic diversification;
- changes in commodity prices and interest rates, including the discontinuation of London Interbank Offered Rate ("LIBOR") as an interest rate benchmark;
- the Corporation's accounting and reporting policies;
- the Corporation's ability to maintain effective internal controls over financial reporting and disclosure controls and procedure;
- a cybersecurity incident involving the misappropriation, loss or unauthorized disclosure or use of confidential information of our customers;
- weather, natural disasters, and other catastrophic events;
- risks associated with the timing of the completion of the merger;
- the occurrence of any event, change or other circumstances that could give rise to the termination of the merger agreement, including a termination of the merger agreement under circumstances that could require the Corporation to pay a termination fee to First Bancshares;
- the inability to complete the merger contemplated by the merger agreement due to the failure to satisfy conditions necessary to close the merger;
- management time and effort may be diverted to the resolution of merger-related issues;
- the risk that the businesses of the Corporation and First Bancshares will not be integrated successfully, or such integration may be more difficult, time-consuming or costly than expected;
- First Bancshares' ability to achieve the synergies and value creation contemplated by the proposed merger with the Corporation;

- the expected growth opportunities or costs savings from the merger may not be fully realized or may take longer to realize than expected;
- revenues following the transaction may be lower than expected as a result of losses of customers or other reasons;
- potential deposit attrition, higher than expected costs, customer loss and business disruption associated with First Bancshares' integration of the Corporation, including, without limitation, potential difficulties in maintaining relationships with key personnel;
- the outcome of any legal proceedings that may be instituted against the Corporation or First Bancshares or their respective boards of directors;
- general economic conditions, either globally, nationally, in the States of Georgia or Mississippi, or in the specific markets in which the Corporation or First Bancshares operate;
- limitations placed on the ability of the Corporation and First Bancshares to operate their respective businesses by the merger agreement;
- the effect of the announcement of the merger on the Corporation and First Bancshares' business relationships, employees, customers, suppliers, vendors, other partners, standing with regulators, operating results and businesses generally;
- customer acceptance of the combined company's products and services;
- the amount of any costs, fees, expenses, impairments and charges related to the merger;
- fluctuations in the market price of First Bancshares common stock and the related effect on the market value of the merger consideration that the Corporation shareholders will receive upon completion of the merger;
- legislation, regulatory changes or changes in monetary or fiscal policy that adversely affect the businesses in which the Corporation and First Bancshares are engaged, including potential changes resulting from currently proposed legislation;
- liquidity risk affecting the Corporation or First Bancshares ability to meet their respective obligations when they become due;
- pandemics, terrorist activities and other risks that results in loss of consumer confidence and economic disruptions; and
- other factors discussed in the Corporation's other filings with the SEC.

The foregoing list of factors is not exclusive, and readers are cautioned not to place undue reliance on any forward-looking statements. The Corporation undertakes no obligation to update or revise any forward-looking statements. Additional information with respect to factors that may cause results to differ materially from those contemplated by such forward-looking statements is included in the Corporation's current and subsequent filings with the SEC.

ITEM 1A. RISK FACTORS

An investment in the Corporation's common stock and the Corporation's financial results are subject to a number of risks. Investors should carefully consider the risks described below and all other information contained in this Annual Report on Form 10-K and the documents incorporated by reference. Additional risks and uncertainties, including those generally affecting the industry in which the Corporation operates and risks that management currently deems immaterial, may arise or become material in the future and affect the Corporation's business.

Risks Related to the Corporation

As a bank holding company, adverse conditions in the general business or economic environment could have a material adverse effect on the Corporation's financial condition and results of operation.

Weaknesses or adverse changes in business and economic conditions generally or specifically in the markets in which the Corporation operates could adversely impact our business, including causing one or more of the following negative developments:

- a decrease in the demand for loans and other products and services offered by the Corporation;
- a decrease in the value of the Corporation's loans secured by consumer or commercial real estate;
- an impairment of the Corporation's assets, such as its intangible assets, goodwill, or deferred tax assets; or
- an increase in the number of customers or other counterparties who default on their loans or other obligations to the Corporation, which could result in a higher level of nonperforming assets, net charge-offs and provision for loan losses.

One or more negative developments resulting from adverse conditions in the general business or economic environment, some of which are described above, could have a material adverse effect on the Corporation's financial condition and results of operations.

The Corporation's ability to raise capital could be limited, affect its liquidity, and could be dilutive to existing shareholders.

The Corporation's ability to raise capital will depend on conditions in the capital markets, which are outside of our control, and on the Corporation's financial performance. Accordingly, there is no guarantee that the Corporation will be able to borrow funds or successfully raise additional capital at all or on terms that are favorable or otherwise not dilutive to existing shareholders.

Capital resources and liquidity are essential to the Corporation's businesses and it relies on external sources to finance a significant portion of its operations.

Liquidity is essential to the Corporation's businesses. We depend on access to a variety of sources of funding to provide us with sufficient capital resources and liquidity to meet our commitments and business needs, and to accommodate the transaction and cash management needs of our customers. Sources of funding available to us, and upon which we rely as regular components of our liquidity and funding management strategy, include traditional and brokered deposits, inter-bank borrowings, Federal Funds purchased, repurchase agreements and Federal Home Loan Bank advances. We may also raise funds from time to time in the form of either short-or long-term borrowings or equity issuances. The Corporation's capital resources and liquidity could be negatively impacted by disruptions in its ability to access these sources of funding. The cost of brokered and other out-of-market deposits and potential future regulatory limits on the interest rate we pay for brokered deposits could make them unattractive sources of funding. Further, factors that we cannot control, such as disruption of the financial markets or negative views about the financial services industry generally, could impair our ability to access sources of funds. Other financial institutions may be unwilling to extend credit to banks because of concerns about the banking industry and the economy generally and there may not be a viable market for raising short or long-term debt or equity capital. In addition, our ability to raise funding could be impaired if lenders develop a negative perception of our long-term or short-term financial prospects. Such negative perceptions could be developed if the Corporation is downgraded or put on (or remains on) negative watch by the rating agencies, suffers a decline in the level of its business activity or regulatory authorities take significant action against it, among other reasons.

Among other things, if we fail to remain "well-capitalized" for bank regulatory purposes, because we do not qualify under the minimum capital standards or the FDIC otherwise downgrades our capital category, it could affect customer confidence, our ability to grow, our costs of funds and FDIC insurance costs, our ability to pay dividends on common stock, and our ability to make acquisitions, and we would not be able to accept brokered deposits without prior FDIC approval. To be "well-capitalized", a bank must generally maintain a common equity Tier 1 capital ratio of 6.5%, Tier 1 leverage capital ratio of 5%, Tier 1 risk-based capital ratio of 8% and total risk-based capital ratio of 10%. In addition, our regulators may require us to maintain higher capital levels. Our failure to remain "well-capitalized" or to maintain any higher capital requirements imposed on us could negatively affect our business, results of operations and financial condition.

If the Corporation is unable to raise funding using the methods described above, it would likely need to finance or liquidate unencumbered assets to meet maturing liabilities. The Corporation may be unable to sell some of its assets, or it may have to sell assets at a discount from market value, either of which could adversely affect its results of operations and financial condition.

In addition, the Corporation is a legal entity separate and distinct from the Bank and depends on subsidiary service fees and dividends from the Bank to fund its payment of dividends to its shareholders and of interest and principal on its outstanding debt. The Bank is also subject to other laws that authorize regulatory authorities to prohibit or reduce the flow of funds from the Bank to the Corporation. Any inability of the Corporation to pay its obligations, or need to defer the payment of any such obligations, could have a material adverse effect on our business, operations, financial condition, and the value of our common stock.

The Corporation's construction and land development loans are subject to unique risks that could adversely affect earnings.

The Corporation's construction and land development loan portfolio was \$28.8 million at December 31, 2019, comprising 7.2% of total loans. Construction and land development loans are often riskier than home equity loans or residential mortgage loans to individuals. In the event of a general economic slowdown, they would represent higher risk due to slower sales and reduced cash flow that could impact the borrowers' ability to repay on a timely basis. As a result, these loans could represent higher risk due to slower sales and reduced cash flow that affect the borrowers' ability to repay on a timely basis which could result in a sharp increase in our total net charge-offs and require us to significantly increase our allowance for loan losses, any of which could have a material adverse effect on our financial condition or results of operations.

Recent performance may not be indicative of future performance.

Various factors, such as economic conditions, regulatory and legislative considerations, competition and the ability to find and retain talented people, may impede the Corporation's ability to remain profitable.

Deterioration in asset quality could have an adverse impact on the Corporation.

A significant source of risk for the Corporation arises from the possibility that losses will be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loans. With respect to secured loans, the collateral securing the repayment of these loans includes a wide variety of diverse real and personal property that may be affected by changes in prevailing economic, environmental and other conditions, including declines in the value of real estate, changes in interest rates, changes in monetary and fiscal policies of the federal government, environmental contamination and other external events. In addition, decreases in real estate property values due to the nature of the Bank's loan portfolio, over 75% of which is secured by real estate, could affect the ability of customers to repay their loans. The Bank's loan policies and procedures may not prevent unexpected losses that could have a material adverse effect on the Corporation's business, financial condition, results of operations, or liquidity.

Changes in prevailing interest rates may negatively affect the results of operations of the Corporation and the value of its assets.

The Corporation's earnings depend largely on the relationship between the yield on earning assets, primarily loans and investments, and the cost of funds, primarily deposits and borrowings. This relationship, known as the interest rate spread, is subject to fluctuation and is affected by economic and competitive factors which influence interest rates, the volume and mix of interest-earning assets and interest-bearing liabilities and the level of nonperforming assets. Fluctuations in interest rates affect the demand of customers for the Corporation's products and services. In addition, interest-bearing liabilities may re-price or mature more slowly or more rapidly or on a different basis than interest-earning assets. Significant fluctuations in interest rates could have a material adverse effect on the Corporation's business, financial condition, results of operations or liquidity. On March 3, 2020 the Federal Reserve lowered the target range for the federal funds rate to a range from 1.00 to 1.25 percent citing evolving risks to economic activity from the coronavirus ("COVID-19") (discussed elsewhere in these Risk Factors and in Part II, Item 7 under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations – Recent Developments"), and on March 15, 2020, the Federal Reserve further lowered the target range for the federal funds rate to a range from 0 to 0.25 percent citing related concerns about the disruption to economic activity and stress in the energy sector. A prolonged period of very low interest rates could reduce our net interest income and have a material adverse impact on our results of operations or financial condition.

In addition, the discontinuance of LIBOR as a reference rate, and the uncertainty related to such potential changes, may adversely affect the value of reference rate-linked debt securities that we hold or issue, which could further impact our interest rate spread and impact our financial condition or results of operations.

Changes in the level of interest rates may also negatively affect the value of the Corporation's assets and its ability to realize book value from the sale of those assets, all of which ultimately affect earnings.

The phase-out or the replacement of LIBOR with a different reference rate or modification of the method used to calculate LIBOR could adversely affect our financial condition and results of operations.

LIBOR is an interest rate benchmark used as a reference rate for a wide range of our financial instruments. In July 2017, the UK's Financial Conduct Authority, which regulates LIBOR, announced that it intends to stop compelling banks to submit LIBOR rates after 2021. It is unclear whether or not LIBOR will cease to exist at that time (and if so, what reference rate will replace it) or if new methods of calculating LIBOR will be established such that it continues to exist after 2021. The Alternative Reference Rates Committee (the "ARRC") has proposed that the Secured Overnight Financing Rate ("SOFR") is the rate that represents best practice as the alternative to LIBOR for use in contracts that are currently indexed to United States dollar LIBOR. The ARRC has proposed a paced market transition plan to SOFR from LIBOR and organizations are currently working on industry wide and company specific transition plans as it relates to financial and other derivative contracts exposed to LIBOR. Uncertainty exists as to the transition process and broad acceptance of SOFR as the primary alternative to LIBOR. LIBOR is the subject of recent national, international and other regulatory guidance and proposals for reform.

These reforms and other pressures may cause LIBOR to disappear entirely or to perform differently than in the past and could have adverse effects on our business, financial condition and results of operations. In particular, the disappearance of LIBOR and transition to a new method or benchmark could:

- adversely affect the interest rates paid or received on, and the revenue and expenses associated with, and the value of the Corporation's floating rate obligations, loans and other financial instruments tied to LIBOR, or other securities or financial arrangements given LIBOR's role in determining market interest rates globally;
- prompt inquiries or other actions from regulators in respect of our preparation and readiness for the replacement of LIBOR with an alternative benchmark rate;
- result in disputes, litigation or other actions with counterparties regarding the interpretation and enforceability of certain fallback language, or the absence of such language, in LIBOR-based securities and loans;
- result in customer uncertainty and disputes around how variable rates should be calculated in light of the foregoing, thereby damaging our reputation and resulting in a loss of customers and additional costs to us; and
- require the transition to or development of appropriate systems and analytics to effectively transition the Corporation's risk management processes from LIBOR-based products to those based on the applicable alternative pricing benchmark, such as SOFR.

The manner and impact of this transition, and the effect on the Corporation's funding costs, loan, and investment and trading securities portfolios, asset liability management and business is uncertain.

The Corporation's reported financial results depend on the accounting and reporting policies of the Corporation, the application of which requires significant assumptions, estimates and judgments.

The Corporation's accounting and reporting policies are fundamental to the methods by which we record and report our financial condition and results of operations. The Corporation's management must make significant assumptions and estimates and exercise significant judgment in selecting and applying many of these accounting and reporting policies so they comply with GAAP and reflect management's judgment of the most appropriate manner to report the Corporation's financial condition and results. In some cases, management must select a policy from two or more alternatives, any of which may be reasonable under the circumstances, which may result in the Corporation reporting materially different results than would have been reported under a different alternative.

If the Corporation's allowance for loan losses is not sufficient to cover actual loan losses, earnings would decrease.

The Bank's loan customers may not repay their loans according to their terms and the collateral securing the payment of these loans may be insufficient to assure repayment. The Bank may experience significant loan losses which would have a material adverse effect on the Corporation's operating results. Management makes various assumptions and judgments about the collectability of the loan portfolio, including the creditworthiness of borrowers and the value of the real estate and other assets serving as collateral for the repayment of loans. The Corporation maintains an allowance for loan losses in an attempt to cover any loan losses inherent in the portfolio. In determining the size of the allowance, management relies on an analysis of the loan portfolio based on historical loss experience, volume and types of loans, trends in classification, volume and trends in delinquencies and nonaccruals, national and local economic conditions and other pertinent information. As a result of these considerations, the Corporation has from time to time increased its allowance for loan losses. For the year ended December 31, 2019, the Corporation recorded an allowance for possible loan losses of \$3.60 million, compared with \$3.43 million for the year ended December 31, 2018. If these assumptions are incorrect, the allowance may not be sufficient to cover future loan losses and adjustments may be necessary to allow for different economic conditions or adverse developments in the loan portfolio. If we are required to materially increase our level of allowance for credit losses for any reason, such increase could adversely affect our business, financial condition and results of operations.

The Corporation may be subject to losses due to fraudulent and negligent conduct of the Bank's loan customers, third party service providers and employees.

When the Bank makes loans to individuals or entities, they rely upon information supplied by borrowers and other third parties, including information contained in the applicant's loan application, property appraisal reports, title information and the borrower's net worth, liquidity and cash flow information. While they attempt to verify information provided through available sources, they cannot be certain all such information is correct or complete. The Bank's reliance on incorrect or incomplete information could have a material adverse effect on the Corporation's profitability or financial condition.

We rely on third parties to provide key components of our business infrastructure.

Third parties provide key components of our business operations such as data processing, recording and monitoring transactions, online banking interfaces and services, internet connections and network access. While we have selected these third party vendors carefully, we do not control their actions. Any problems caused by these third parties, including those resulting from disruptions in communication services provided by a vendor, failure of a vendor to handle current or higher volumes, cyber-attacks and security breaches at a vendor, failure of a vendor to provide services for any reason or poor performance of services, could adversely affect our ability to deliver products and services to our customers and otherwise conduct our business. Financial or operational difficulties of a third party vendor could also hurt our operations if those difficulties interfere with the vendor's ability to serve us. Furthermore, our vendors could also be sources of operational and information security risk to us, including from breakdowns or failures of their own systems or capacity constraints. Replacing these third party vendors could also create significant delay and expense. Accordingly, use of such third parties creates an unavoidable inherent risk to our business operations.

Technology difficulties or failures or cyber security breaches of our network security could have a material adverse effect on the Corporation.

The Corporation depends upon data processing, software, and communication and information exchange on a variety of computing platforms and networks. The computer platforms and network infrastructure we use could be vulnerable to unforeseen hardware and cyber security issues. The Corporation cannot be certain that all of its systems are entirely free from vulnerability to cyber-attack or other technological difficulties or failures. The Corporation relies on the services of a variety of vendors to meet its data processing and communication needs. If information security is breached or other technology difficulties or failures occur, information may be lost or misappropriated, services and operations may be interrupted and the Corporation could subject us to additional regulatory scrutiny, damage our reputation, result in a loss of customers and expose us to claims from customers.

Any of these results could have a material adverse effect on the Corporation's business, financial condition, results of operations or liquidity. Although we have security measures designed to mitigate the possibility of break-ins, breaches and other disruptive problems, including firewalls and penetration testing, there can be no assurance that such security measures will be effective in preventing such problems.

The Corporation's business is subject to the success of the local economies and real estate markets in which it operates and susceptible to an economic downturn.

The Corporation's banking operations are located in southwest Georgia. Because of the geographic concentration of its operations, the Corporation's success depends largely upon economic conditions in this area, which include volatility in the agricultural market, influx and outflow of major employers in the area, and minimal population growth throughout the region. Deterioration in economic conditions in the communities in which the Corporation operates could adversely affect the quality of the Corporation's loan portfolio and the demand for its products and services, and accordingly, could have a material adverse effect on the Corporation's business, financial condition, results of operations or liquidity. The Corporation is less able than a larger institution to spread the risks of unfavorable local economic conditions across a large number of more diverse economies.

Moreover, if economic conditions were to worsen nationally, regionally or locally, then we could see a sharp increase in our total net charge-offs and also be required to significantly increase our allowance for credit losses. Furthermore, the demand for loans and our other products and services could decline. An increase in our non-performing assets and related increases in our provision for loan losses, coupled with a potential decrease in the demand for loans and our other products and services, could negatively affect our business and could have a material adverse effect on our capital, financial condition, results of operations and future growth. Our customers may also be adversely impacted by changes in regulatory, trade (including tariffs) and tax policies and laws, or a global health crisis or pandemic, all of which could reduce demand for loans and adversely impact our borrowers' ability to repay our loans. In addition, international economic uncertainty could also impact the U.S. financial markets by potentially suppressing stock prices, including ours, and adding to overall market volatility, which could adversely affect our business. The effects of any economic downturn could continue for many years after the downturn is considered to have ended.

The Corporation may face risks with respect to its ability to execute its business strategy.

The financial performance and profitability of the Corporation will depend on its ability to execute its strategic plan and manage its future growth. Moreover, the Corporation's future performance is subject to a number of factors beyond its control, including pending and future federal and state banking legislation, regulatory changes, unforeseen litigation outcomes, inflation, lending and deposit rate changes, interest rate fluctuations, increased competition and economic conditions. Accordingly, these issues could have a material adverse effect on the Corporation's business, financial condition, results of operations or liquidity. On March 3, 2020 the Federal Reserve lowered the target range for the federal funds rate to a range from 1.00 to 1.25 percent citing evolving risks to economic activity from the COVID-19 (discussed elsewhere in these Risk Factors and in Part II, Item 7 under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations – Recent Developments"), and on March 15, 2020, the Federal Reserve further lowered the target range for the federal funds rate to a range from 0 to 0.25 percent citing related concerns about the disruption to economic activity and stress in the energy sector. A prolonged period of very low interest rates could reduce our net interest income and have a material adverse impact on our results of operations or financial condition.

The Corporation depends on its key personnel, and the loss of any of them could adversely affect the Corporation.

The Corporation's success depends to a significant extent on the management skills of its existing executive officers and directors, many of whom have held officer and director positions with the Corporation for many years. The loss or unavailability of any of its key personnel, including DeWitt Drew, President and Chief Executive Officer; Donna S. Lott, Executive Vice President and Chief Administrative Officer; and Danny E. Singley, Executive Vice President & Chief Credit Officer, could have a material adverse effect on the Corporation's business, financial condition, and results of operations or liquidity.

Competition from financial institutions and other financial service providers may adversely affect the Corporation.

The banking business is highly competitive, and the Corporation experiences competition in its markets from other depository institutions and other financial service organizations, including brokers, finance companies, financial technology companies, mutual funds, savings and loan associations, credit unions and certain governmental agencies. The Corporation competes with these other financial institutions in attracting deposits and in making loans. Many of its competitors are well-established, larger financial institutions that are able to operate profitably with a narrower net interest margin and have a more diverse revenue base. The Corporation may face a competitive disadvantage as a result of its smaller size, lack of geographic diversification and inability to spread costs across broader markets. There can be no assurance that the Corporation will be able to compete effectively in its markets. Furthermore, developments increasing the nature or level of competition could have a material adverse effect on the Corporation's business, financial condition, results of operations or liquidity.

In addition, technology and other changes are allowing parties to complete financial transactions that historically have involved banks through alternative methods. For example, consumers can now maintain funds that would have historically been held as bank deposits in brokerage accounts or mutual funds. Consumers can also complete transactions such as paying bills and/or transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries could result in the loss of fee income, as well as the loss of customer deposits, which could have a material impact on our financial condition and results of operations.

The Corporation may not have the resources to effectively implement new technology, or we may experience operational challenges when implementing new technology.

The financial services industry is changing rapidly, and to remain competitive, we must continue to enhance and improve the functionality and features of our products, services and technologies. In addition to better serving our customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend, at least in part, upon our ability to respond to future technological changes and the ability to address the needs of our customers. We address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience as well as to create additional efficiencies in our operations as we continue to grow and expand our products and service offerings. We may experience operational challenges as we implement these new technology enhancements or products, which could result in our not fully realizing the anticipated benefits from such new technology or require us to incur significant costs to remedy any such challenges in a timely manner. In addition, complications during a conversion of our core technology platform or implementation or upgrade of any software could negatively impact the experiences or satisfaction of our customers, which could cause those customers to terminate their relationship with us or reduce the amount of business that they do with us, either of which could adversely affect our business, financial condition or results of operations.

Many of our larger competitors have substantially greater resources to invest in technological improvements. Third parties upon which we rely for our technology needs may not be able to cost-effectively develop systems that will enable us to keep pace with such developments. As a result, our competitors may be able to offer additional or superior products compared to those that we will be able to provide, which would put us at a competitive disadvantage. We may lose customers seeking new technology-driven products and services to the extent we are unable to provide such products and services. The inability to keep pace with technological change could adversely affect our business, financial condition and results of operations.

The short-term and long-term impact of the changing regulatory capital requirements is uncertain.

The Basel III Capital Rules established a common equity Tier 1 minimum capital requirement of 4.5%, a higher minimum Tier 1 capital to risk-weighted assets requirement of 6% and Total capital to risk-weighted assets of 8%. In addition, to be considered "well-capitalized", the rules include a common equity Tier 1 capital requirement of 6.5% or greater and a higher Tier 1 capital to risk-weighted assets requirement of 8% or greater. Moreover, the rules limit a banking organization's capital distributions and certain discretionary bonus payments if such banking organization does not hold a "capital conservation buffer" consisting of a 2.5% of common equity Tier 1 capital in addition to the 4.5% minimum common equity Tier 1 requirement and the other amounts necessary to meet the minimum risk-based capital requirements.

The application of the more stringent capital requirements described above could, among other things, result in lower returns on invested capital, require the raising of additional capital, and result in additional regulatory actions if we were to be unable to comply with such requirements. Implementation of changes to asset risk weightings for risk-based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could result in us modifying our business strategy and could restrict dividends.

We face a risk of noncompliance with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

The federal Bank Secrecy Act, USA Patriot Act of 2001 and other laws and regulations require financial institutions, among other duties, to institute and maintain effective anti-money laundering programs and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network, established by the Treasury to administer the Bank Secrecy Act, is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal bank regulatory agencies, as well as the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. Federal bank regulatory agencies and state bank regulators also have begun to focus on compliance with Bank Secrecy Act and anti-money laundering regulations. If our policies, procedures and systems are deemed deficient, we would be subject to liability, including fines and regulatory actions such as restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, which would negatively impact our business, financial condition and results of operations.

We could be subject to changes in tax laws, regulations and interpretations or challenges to our income tax provision.

We compute our income tax provision based on enacted tax rates in the jurisdictions in which we operate. Any change in enacted tax laws, rules or regulatory or judicial interpretations, any adverse outcome in connection with tax audits in any jurisdiction or any change in the pronouncements relating to accounting for income taxes could adversely affect our effective tax rate, tax payments and results of operations. In addition, changes in enacted tax laws, such as adoption of a lower income tax rate in any of the jurisdictions in which we operate, could impact our ability to obtain the future tax benefits represented by our deferred tax assets.

Changes in monetary policy, laws and regulations or failures to comply with such laws and regulations could adversely affect the Corporation.

Federal monetary policy, particularly as implemented through the Federal Reserve, significantly affects credit conditions for the Corporation, and any unfavorable change in these conditions could have a material adverse effect on the Corporation's business, financial condition, results of operations or liquidity. Further, the Corporation and the banking industry are subject to extensive regulation and supervision under federal and state laws and regulations. The restrictions imposed by such laws and regulations limit the manner in which the Corporation conducts its banking business, undertakes new investments and activities and obtains financing. These regulations are designed primarily for the protection of the deposit insurance funds and consumers and not to benefit holders of the Corporation's securities. Financial institution regulation has been the subject of significant legislation in recent years and may be the subject of further significant legislation in the future, none of which is in the control of the Corporation. Significant new laws or changes in, or repeals of, existing laws could have a material adverse effect on the Corporation's business, financial condition, results of operations or liquidity. See Part I, Item 1, "Supervision and Regulation."

In 2017, both chambers of Congress proposed comprehensive financial regulatory reform bills that would amend the Dodd-Frank Act and that could affect the banking industry as a whole, including our business and results of operations, in ways that are difficult to predict. In May 2018, certain provisions of these bills were signed into law as part of the Economic Growth Act and repealed or modified significant portions of the Dodd-Frank Act. Specifically, the Economic Growth Act delayed implementation of rules related to the Home Mortgage Disclosure Act, reformed and simplified certain Volcker Rule requirements, and raised the threshold for applying enhanced prudential standards to bank holding companies with total consolidated assets equal to or greater than \$50 billion to those with total consolidated assets equal to or greater than \$250 billion.

While recent federal legislation, including the Economic Growth Act, has scaled back portions of the Dodd-Frank Act, uncertainty about the timing and scope of such changes, as well as the cost of complying with a new regulatory regime, remains and enactment of any other regulatory relief is uncertain and none of which may lead to a meaningful reduction of our regulatory burden and attendant costs. See Part I, Item 1, “Supervision and Regulation.”

Federal and state regulators have the ability to impose or request that we consent to substantial sanctions, restrictions and requirements on the Bank if they determine, upon examination or otherwise, violations of laws, rules or regulations with which we or the Bank must comply, or weaknesses or failures with respect to general standards of safety and soundness. Such enforcement may be formal or informal and can include directors’ resolutions, memoranda of understanding, cease and desist or consent orders, civil money penalties and termination of deposit insurance and bank closures. Enforcement actions may be taken regardless of the capital level of the institution. In particular, institutions that are not sufficiently capitalized in accordance with regulatory standards may also face capital directives or prompt corrective action. Enforcement actions may require certain corrective steps (including staff additions or changes), impose limits on activities (such as lending, deposit taking, acquisitions or branching), prescribe lending parameters (such as loan types, volumes and terms) and require additional capital to be raised, any of which could adversely affect our financial condition and results of operations. Enforcement actions, including the imposition of monetary penalties, may have a material impact on our financial condition or results of operations, and damage to our reputation, and loss of our holding company status. In addition, compliance with any such action could distract management’s attention from our operations, cause us to incur significant expenses, restrict us from engaging in potentially profitable activities, and limit our ability to raise capital. Closure of the Bank would result in a total loss of shareholder investment.

The outbreak of the recent COVID-19, or an outbreak of another highly infectious or contagious disease, could adversely affect our business, financial condition and results of operations.

Our business is dependent upon the willingness and ability of our customers to conduct banking and other financial transactions. The spread of a highly infectious or contagious disease, such as COVID-19, could cause severe disruptions in the U.S. economy, which could in turn disrupt the business, activities, and operations of our customers, as well as our business and operations. Moreover, since the beginning of January 2020, the COVID-19 outbreak has caused significant disruption in the financial markets both globally and in the United States. The spread of COVID-19, or an outbreak of another highly infectious or contagious disease, including the time such outbreak takes to wane and the time it takes our markets to return to normal, may result in a significant decrease in business and/or cause our customers to be unable to meet existing payment or other obligations to us, particularly in the event of a spread of COVID-19 or an outbreak of an infectious disease in our market area. Although we maintain contingency plans for pandemic outbreaks, a spread of COVID-19, or an outbreak of another contagious disease could also negatively impact the availability of key personnel necessary to conduct our business activities. Such a spread or outbreak also negatively impact the business and operations of third-party service providers who perform critical services for us. The spread of COVID-19, or another highly infectious or contagious disease, or the failure to contain such spread could have a material adverse effect to our business, financial condition, and results of operations.

On March 11, 2020, the World Health Organization announced that infections of COVID-19 had become pandemic, and on March 13, the U.S. President announced a national emergency relating to the disease. There is a possibility of widespread infection in the United States and abroad, with the potential for catastrophic impact. National, state and local authorities have recommended social distancing and imposed or are considering quarantine and isolation measures on large portions of the population, including mandatory business closures. These measures, while intended to protect human life, are expected to have serious adverse impacts on domestic and foreign economies of uncertain severity and duration. The effectiveness of economic stabilization efforts, including proposed government payments to affected citizens and industries, is uncertain. Some economists are predicting the United States will soon enter a recession. Any of the foregoing factors, or other cascading effects of the pandemic that are not currently foreseeable, could materially affect our business, including our customers’ willingness to conduct banking transactions, their ability to pay on existing obligations and the availability of liquidity, which would negatively affect our financial condition and results of operations. The duration of any such impacts cannot be predicted.

Risks Related to the Merger

Because of the fixed exchange ratio and the fluctuation of the market price of First Bancshares common stock, our shareholders will not know the market value of the merger consideration until they will receive at the effective time of the merger.

Pursuant to the merger agreement, each share of the Corporation's common stock issued and outstanding immediately prior to the effective time of the merger will be converted into the right to receive 1.00 share of First Bancshares common stock.

The market value of the merger consideration may vary from the market value on the date we announced the merger until the date merger is completed and thereafter due to fluctuations in the market price of First Bancshares common stock. Any fluctuation in the market price of First Bancshares common stock will change the value of the shares of First Bancshares common stock that our shareholders may receive. Stock price changes may result from a variety of factors that are beyond our control, including but not limited to general market and economic conditions, changes in their respective businesses, operations and prospects and regulatory considerations.

Failure to complete the merger could negatively affect the value of our shares and the future business and financial results of the Corporation.

If the merger is not completed, the ongoing business of the Corporation could be adversely affected and we will be subject to a variety of risks associated with the failure to complete the merger, including the following:

- we may be required, under certain circumstances, to pay to First Bancshares a termination fee equal to \$3,750,000;
- we have incurred substantial costs in connection with the proposed merger, such as legal, accounting, financial advisor, printing and mailing fees;
- the loss of key employees and customers;
- the disruption of operations and business;
- deposit attrition, customer loss and revenue loss;
- unexpected problems with costs, operations, personnel, technology and credit;
- diversion of management focus and resources from operational matters and other strategic opportunities while working to implement the merger; and
- reputational harm due to the adverse perception of any failure to successfully complete the merger.

If the merger is not completed, these risks could materially affect the business, financial results and the value of the Corporation's common stock.

The Corporation will be subject to business uncertainties and contractual restrictions while the merger is pending.

Uncertainty about the effect of the merger on employees and customers may have an adverse effect on us. These uncertainties may impair our ability to attract, retain and motivate key personnel until the merger is completed, and could cause customers and others that deal with us to seek to change existing business relationships with us. Retention of certain employees may be challenging while the merger is pending, as certain employees may experience uncertainty about their future roles with us or the combined entity. If key employees depart because of issues relating to the uncertainty and difficulty of integration or a desire not to remain with us, our business or the business assumed by First Bancshares following the merger could be harmed. In addition, we have agreed to certain contractual restrictions on the operation of our business prior to closing which could materially affect the business, financial results and the value of the Corporation's common stock.

The merger agreement limits our ability to pursue an alternative acquisition proposal and requires us to pay a termination fee of \$3,750,000 under limited circumstances relating to alternative acquisition proposals.

Under the merger agreement, we have agreed not to initiate, solicit, induce or knowingly encourage, or take any action to facilitate any alternative business combination transaction or, subject to certain exceptions, participate in discussions or negotiations regarding, or furnish any non-public information relating to, any alternative business combination transaction. The merger agreement also provides that we will pay First Bancshares a termination fee in the amount of \$3,750,000 in the event that the merger agreement is terminated for certain reasons. These provisions could discourage a potential competing acquirer that might have an interest in acquiring the Corporation from considering or making a competing acquisition proposal, even if the potential competing acquirer was prepared to pay consideration with a higher per share cash value than the market value proposed to be received or realized in the merger, or might result in a potential competing acquirer proposing to pay a lower price than it might otherwise have proposed to pay because of the added expense of the termination fee that may become payable in certain circumstances under the merger agreement.

The merger agreement contains provisions granting both the Corporation and First Bancshares the right to terminate the merger agreement in certain circumstances.

The merger agreement contains certain termination rights, including the right, subject to certain exceptions, of either party to terminate the merger agreement if the merger is not completed on or prior to June 30, 2020 (subject to automatic extension to August 31, 2020 if the only outstanding condition to closing is the receipt of regulatory approvals), and the right of the Corporation to terminate the merger agreement, subject to certain conditions, to accept a business combination transaction deemed to be superior to the merger by our board of directors. Additionally, we may terminate the agreement if (i) the average closing price of First Bancshares common stock over the 10 trading days preceding the date that is five days prior to the closing date is less than \$26.86, and (ii) the decline in the price of First Bancshares common stock (as measured by the average closing price divided by \$33.58) is more than 20% greater than the decline in the KBW Regional Banking Index (KRX) (as measured by dividing the average closing price of the KBW Regional Banking Index over the 10 trading days preceding the date that is five days prior to the closing date by \$108.51); provided, however, that First Bancshares has the option, but not the obligation, to adjust the per share cash consideration or the per share stock consideration to prevent the termination of merger agreement.

If the merger is not completed, the ongoing business of the Corporation could be adversely affected and the Corporation will be subject to several risks, including the risks described elsewhere in this “Risk Factors” section.

The merger is subject to a number of conditions which, if not satisfied or waived in a timely manner, would delay the merger or adversely impact the companies’ ability to complete the transactions.

The completion of the merger is subject to certain conditions (some of which having been completed as of the date of this Annual Report on Form 10-K), including (1) approval of the merger agreement by the holders of at least a majority of the outstanding shares of the Corporation’s common stock entitled to vote at the special meeting of shareholders of the Corporation held March 27, 2020; (2) the receipt of all required regulatory approvals for the merger, without the imposition of any material on-going conditions or restrictions, and the expiration of all regulatory waiting periods; (3) the absence of any legal restraint (such as an injunction or restraining order) that would prevent the consummation of the merger; (4) the effectiveness of the registration statement filed by First Bancshares; (5) each party’s receipt of a tax opinion from its respective outside legal counsel, dated the closing date of the merger, confirming the merger qualifies as a “reorganization” within the meaning of Section 368(a) of the Code; (6) the Plan of Bank Merger in the form attached as Exhibit B to the merger agreement being executed and delivered; (7) the absence of the occurrence of a material adverse effect on SGB or First Bancshares; (8) the Corporation obtaining an actuarial analysis demonstrating that (i) the Corporation’s approximate total liability in respect of its pension plan on a termination basis will not materially exceed \$13.8 million and (ii) the difference between such liability and the market value of the assets of the pension plan will not be expected to materially exceed \$3.85 million, and (9) other customary closing conditions set forth in the merger agreement.

While it is currently anticipated that the merger will be completed during the second quarter of 2020, there can be no assurance that such conditions will be satisfied in a timely manner or at all, or that an effect, event, development or change will not transpire that could delay or prevent these conditions from being satisfied. Accordingly, there can be no guarantee with respect to the timing of the closing of the merger, whether the merger will be completed at all and when the Corporation shareholders will receive the merger consideration, if at all.

The merger may be completed even if the Corporation or First Bancshares experiences adverse changes in its business.

In general, either the Corporation or First Bancshares may refuse to complete the merger if the other party suffers a material adverse effect on its business prior to the closing of the merger. However, certain types of changes or occurrences with respect to the Corporation or First Bancshares would not prevent the merger from going forward, even if the change or occurrence would have adverse effects on the Corporation or First Bancshares, including the following:

- changes in laws and regulations affecting financial institutions and their holding companies generally, or interpretations thereof by courts or governmental entities, if such changes do not have a disproportionate impact on the affected company;
- changes in GAAP or regulatory accounting requirements generally applicable to financial institutions and their holding companies, if such changes do not have a disproportionate impact on the affected company;
- changes in global, national or regional political conditions including the outbreak of war or acts of terrorism, or in economic or market conditions affecting the financial services industry generally, if such changes do not have a disproportionate impact on the affected company;
- changes or effects from the announcement of the merger agreement and the transactions contemplated thereby, and compliance by the parties with the merger agreement on the business, financial condition or results of operations of the parties;
- any failure by the Corporation or First Bancshares to meet any internal or published industry analyst projections or forecasts or estimates of revenues or earnings for any period (but not including the underlying causes thereof);
- changes in the trading price or trading volume of First Bancshares common stock (but not including the underlying causes thereof unless otherwise specifically excluded); however, the Corporation may terminate the merger agreement if (i) the average closing price of First Bancshares common stock during a specified period prior to closing is less than \$26.86 and (ii) First Bancshares common stock underperforms the KBW Regional Banking Index by more than 20%, unless First Bancshares elects to make a compensating adjustment to the exchange ratio; and
- the impact of the merger agreement and the transactions contemplated thereby on relationships with customers or employees, including the loss of personnel subsequent to the date of the merger agreement.

Litigation in transactions of this type are sometimes filed against the board of directors of either party that could prevent or delay the completion of the merger or result in the payment of damages following completion of the merger.

In connection with the merger, it is possible that the Corporation shareholders may file putative class action lawsuits against the boards of directors of the Corporation and/or First Bancshares. Among other remedies, these shareholders could seek to enjoin the merger. The outcome of any such litigation would be uncertain. If a dismissal is not granted or a settlement is not reached, such potential lawsuits could prevent or delay completion of the merger and result in substantial costs to the Corporation or First Bancshares. The defense or settlement of any lawsuit or claim that remains unresolved at the time the merger is consummated may adversely affect the combined company's business, financial condition, results of operations, cash flows and market price.

On February 28, 2020, the Corporation received a letter on behalf of an alleged shareholder alleging that the Corporation and its directors violated their fiduciary duties including by issuing allegedly misleading disclosures in connection with the merger (the “Demand”). While the Corporation believed that the disclosures set forth in the definitive proxy statement/prospectus, dated February 18, 2020 (the “Proxy Statement”), which was filed by the Corporation with the SEC on February 20, 2020 and mailed on or about February 21, 2020 to the Corporation’s shareholders of record as of the close of business on February 12, 2020, fully complied with applicable law, to resolve the alleged shareholder’s claims and moot the disclosure claims, to avoid nuisance, potential expense, and delay and to provide additional information to the Corporation’s shareholders, the Corporation determined to voluntarily supplement the Proxy Statement with the additional disclosures. In light of the supplemental disclosures, the Demand was withdrawn. For additional information, see the Corporation’s Current Report on Form 8-K filed with the SEC on March 18, 2020.

The combined company expects to incur substantial expenses related to the merger.

The combined company expects to incur substantial expenses in connection with completing the merger and integrating the business and operations of the Corporation and First Bancshares. Although First Bancshares and the Corporation have assumed that a certain level of transaction and integration expenses would be incurred, there are a number of factors beyond their control that could affect the total amount or the timing of their integration expenses. Many of the expenses that will be incurred, by their nature, are difficult to estimate accurately at the present time. As a result, the transaction and integration expenses associated with the merger could, particularly in the near term, exceed the savings that the combined company expects to achieve from the integration of the businesses following the completion of the merger.

Following the merger, the combined company may be unable to integrate the Corporation’s business with First Bancshares successfully and realize the anticipated synergies and other benefits of the merger or do so within the anticipated timeframe.

The merger involves the combination of two companies that currently operate as independent companies, as well as the companies’ subsidiaries. Although the combined company is expected to benefit from certain synergies, including cost savings, the combined company may encounter potential difficulties in the integration process, including:

- the inability to successfully combine the Corporation’s business with First Bancshares in a manner that permits the combined company to achieve the cost savings anticipated to result from the merger, which would result in the anticipated benefits of the merger not being realized in the timeframe currently anticipated or at all;
- the risk of not realizing all of the anticipated operational efficiencies or other anticipated strategic and financial benefits of the merger within the expected timeframe or at all;
- potential unknown liabilities and unforeseen increased expenses, delays or regulatory conditions associated with the merger; and
- performance shortfalls as a result of the diversion of management’s attention caused by completing the merger and integrating the companies’ operations.

For all these reasons, you should be aware that it is possible that the integration process could result in the distraction of the combined company’s management, the disruption of the combined company’s ongoing business or inconsistencies in the combined company’s operations, any of which could adversely affect the ability of the combined company to maintain relationships with customers and employees or to achieve the anticipated benefits of the merger, or could otherwise adversely affect the business and financial results of the combined company.

While the merger is pending the Corporation and following the merger, the combined company, may be unable to retain key employees and customers.

Uncertainties about the effects of the merger may impair our ability to attract, retain and motivate key personnel until the merger is consummated and for a period of time thereafter for the combined company, and could cause customers and others who work with us to seek to change their existing business relationships with us. Employee retention may be particularly challenging during the pendency of the merger, as employees may experience uncertainty about their roles with the combined company following the merger. Uncertainties about the effects of the merger could cause customers and others who work with us to seek to change their existing business relationships with us. It is not unusual for competitors to use mergers as an opportunity to target the merging parties' customers and to hire certain of their employees.

The success of the combined company after the merger will depend in part upon its ability to retain key employees. Simultaneous with the execution of the merger agreement, First Bancshares entered into employment agreements with certain key employees of the Corporation, the effectiveness of which is conditioned upon the completion of the merger. However, key employees may depart either before or after the merger because of issues relating to the uncertainty and difficulty of integration or a desire not to remain with the combined company following the merger. Accordingly, no assurance can be given that the Corporation or, following the merger, the combined company will be able to retain key employees.

The voting power of the Corporation shareholders will be diluted by the merger.

The merger will result in the Corporation shareholders having an ownership stake in the combined company that is smaller than their current stake in the Corporation. Upon completion of the merger of the Corporation with First Bancshares, we estimate that the Corporation shareholders will own approximately 13.55% of the issued and outstanding shares of common stock of the combined company. Consequently, the Corporation shareholders, as a general matter, will have less influence over the management and policies of the combined company after the effective time of the merger than they currently exercise over the management and policies of the Corporation.

The market price of the combined company's common stock may decline as a result of the merger.

The market price of the combined company's common stock may decline as a result of the merger if the combined company does not achieve the perceived benefits of the merger or the effect of the merger on the combined company's financial results is not consistent with the expectations of financial or industry analysts. In addition, upon completion of the merger, the Corporation and First Bancshares shareholders will own interests in a combined company operating an expanded business with a different mix of assets, risks and liabilities. Current shareholders of the Corporation and First Bancshares may not wish to continue to invest in the combined company, or for other reasons may wish to dispose of some or all of their shares of the combined company.

ITEM 1B. UNRESOLVED STAFF COMMENTS

There are no unresolved comments from the SEC staff regarding the Corporation's periodic or current reports under the Exchange Act.

ITEM 2. PROPERTIES

The executive offices of the Corporation are located in the SGB Wealth Strategies office at 25 Second Avenue S.W. Moultrie, Georgia. The main banking office and operations center of the Bank are located in a 22,000 square foot facility at 201 First Street, S.E., Moultrie, Georgia. The Trust and Brokerage operations are located in the SGB Wealth Strategies office. The Bank's Administrative Services office is located across the street from the main office at 205 Second Street, S.E., Moultrie, Georgia. This building is also used for training and meeting rooms, record storage, and a drive-thru teller facility.

<u>Name</u>	<u>Address</u>	<u>Square Feet</u>
Main Office	201 First Street, SE, Moultrie, GA 31768	22,000
Old Operations Center	11 Second Avenue, SW, Moultrie, GA 31768	5,000
SGB Wealth Strategies Office	25 Second Avenue, SW, Moultrie, GA 31768	9,400
Administrative Services	205 Second Street, SE, Moultrie, GA 31768	15,000
Southwest Georgia Ins. Services	501 South Main Street, Moultrie, GA 31768	5,600
Baker County Branch	168 Georgia Highway 91, Newton, GA 39870	4,400
Sylvester Branch	300 North Main Street, Sylvester, GA 31791	12,000
North Valdosta Branch	3500 North Valdosta Road, Valdosta, GA 31602	5,900
Valdosta Commercial Banking Center	3520 North Valdosta Road, Valdosta, GA 31602	10,700
Baytree Branch	1404 Baytree Road, Valdosta, GA 31602	3,000
Tifton Branch	205 East Eighth Street, Tifton, GA 31794	9,000

All of the buildings and land, which include parking and drive-thru teller facilities, are owned by the Bank. Additionally, we have deployed nine In-Lobby teller machines throughout our footprint and replaced the traditional drive-up automated teller machines (ATM) with ATMs that will take deposits.

ITEM 3. LEGAL PROCEEDINGS

In the ordinary course of operations, the Corporation and the Bank are defendants in various legal proceedings. Additionally, in the ordinary course of business, the Corporation and the Bank are subject to regulatory examinations and investigations. In the opinion of management, there is no pending or threatened proceeding in which an adverse decision will result in a material adverse change in the consolidated financial condition or results of operations of the Corporation. No material proceedings terminated in the fourth quarter of 2019.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

The Corporation's common stock trades on the NYSE American LLC under the symbol "SGB". The closing price on December 31, 2019, was \$35.00. As of December 31, 2019, there were 374 record holders of the Corporation's common stock. Also, there were approximately 582 additional shareholders who held shares through trusts and brokerage firms.

Dividends

Cash dividends paid on the Corporation's common stock were \$0.48 per share in 2019 and \$0.47 per share in 2018. Our dividend policy objective is to pay out a portion of earnings in dividends to our shareholders in a consistent manner over time. However, no assurance can be given that dividends will be declared in the future. The amount and frequency of dividends is determined by the Corporation's Board of Directors after consideration of various factors, which include the Corporation's financial condition and results of operations, investment opportunities available to the Corporation, capital requirements, tax considerations and general economic conditions. The primary source of funds available to the parent company is the payment of dividends by its subsidiary bank. Federal and State banking laws restrict the amount of dividends that can be paid without regulatory approval. See Part I, Item 1, "Business – Payment of Dividends." The Corporation and its predecessors have paid cash dividends for the past ninety-two consecutive years.

Share Repurchases

The table below summarizes the number of shares of our common stock that were repurchased during the three months ended December 31, 2019 on behalf of the 2013 Omnibus Incentive Plan Restricted Stock Awards.

Month Ended	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Share Purchased as Part of Publicly Announced Plans	Maximum Number of Shares That May Still Be Purchased under the Plan
October 31, 2019	0	0	0	0
November 30, 2019	0	0	0	0
December 31, 2019	4,456	21.00	4,456	104,679
Total	4,456	21.00	4,456	104,679

⁽¹⁾ The 2013 Omnibus Incentive Plan was announced on December 18, 2013 for a maximum aggregate amount of 125,000 shares of common stock. The plan will expire December 18, 2023.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table presents information as of December 31, 2019, with respect to shares of common stock of the Corporation that may be issued under the Directors and Executive Officers Stock Purchase Plan and the 2013 Omnibus Incentive Plan. During 2019, 4,456 shares of restricted stock were issued under the 2013 Omnibus Incentive Plan.

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options	Weighted Average Exercise Price of Outstanding Options	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans
Equity compensation plans approved by shareholders ⁽¹⁾	0	\$0	364,739
Equity compensation plans not approved by shareholders ⁽²⁾	0	0	0
Total	0	\$0	364,739

⁽¹⁾ The Directors and Executive Officers Stock Purchase Plan and the 2013 Omnibus Incentive Plan.

⁽²⁾ Excludes shares issued under the 401(k) Plan.

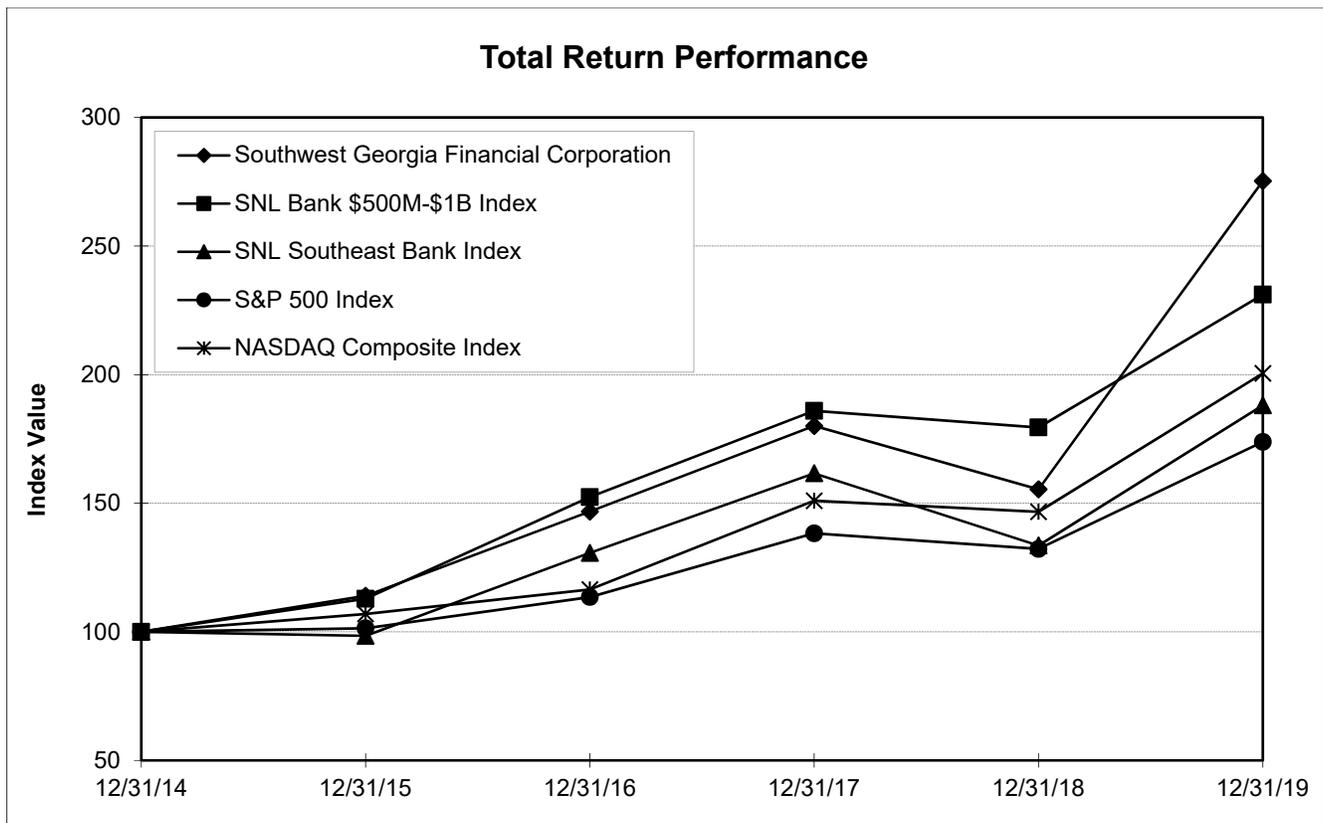
Sales of Unregistered Securities

The Corporation has not sold any unregistered securities in the past three years.

Performance Graph

The following graph compares the cumulative total shareholder return of the Corporation's common stock with SNL's Southeast Bank Index, SNL Bank \$500M - \$1B Index, the S&P 500 Index and the NASDAQ Composite Index. SNL's Southeast Bank Index is a compilation of the total return to shareholders over the past five years of a group of 74 banks located in the southeastern states of Alabama, Arkansas, Florida, Georgia, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, and West Virginia. The SNL Bank \$500M - \$1B Index is a compilation of the total return to shareholders over the past five years of a group of 36 banks in the United States with assets between \$500 million and \$1 billion. The comparison assumes \$100 was invested January 1, 2014, and that all semi-annual and quarterly dividends were reinvested each period. The comparison takes into consideration changes in stock price, cash dividends, stock dividends, and stock splits since December 31, 2013.

The comparisons in the graph are disclosed pursuant to Item 201(e), Regulation S-K promulgated under the Exchange Act and are not intended to forecast or be indicative of possible future performance of the Corporation's common stock.



<i>Index</i>	<i>Period Ending</i>					
	12/31/14	12/31/15	12/31/16	12/31/17	12/31/18	12/31/19
Southwest Georgia Financial Corporation	100.00	114.01	146.77	180.03	155.40	275.28
SNL Bank \$500M - \$1B Index	100.00	112.87	152.40	185.93	179.45	231.13
SNL Southeast Bank Index	100.00	98.44	130.68	161.65	133.56	188.08
S&P 500 Index	100.00	101.38	113.51	138.29	132.23	173.86
NASDAQ Composite Index	100.00	106.96	116.45	150.96	146.67	200.49

ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

The Corporation is a full-service community bank holding company headquartered in Moultrie, Georgia. The community of Moultrie has been served by the Bank since 1928. We provide comprehensive financial services to consumer, business and governmental customers, which, in addition to conventional banking products, include a full range of trust, retail brokerage and insurance services. Our primary market area incorporates Colquitt County, where we are headquartered, as well as Baker, Worth, Lowndes, and Tift Counties, each contiguous with Colquitt County, and the surrounding counties of southwest Georgia. We have six full service banking facilities each with a deposit automation teller machine, and nine In-Lobby teller machines throughout the six branches.

Our strategy is to:

- maintain the diversity of our revenue, including both interest and noninterest income through a broad base of business;
- strengthen our sales and marketing efforts while developing our employees to provide the best possible service to our customers;
- expand our market share where opportunity exists; and
- grow outside of our current geographic market either through de-novo branching or acquisitions into areas proximate to our current market area.

We believe that investing in sales and marketing in our markets and geographic expansion will provide us with a competitive advantage. To that end, about seven years ago, we began expanding geographically in Valdosta, Georgia, with two full-service banking centers, and added a commercial banking center in August 2014. Continuing to expand our geographic footprint, a loan production office was opened in the neighboring community of Tifton, Georgia, in January 2016. The loan production office was closed upon completion of a new full-service banking center in Tifton, Georgia, that was opened in August 2018. We focus on our customers and believe that our strategic positioning, strong balance sheet and capital levels position us to sustain our franchise, capture market share and build customer loyalty.

The Corporation's profitability, like most financial institutions, is dependent to a large extent upon net interest income, which is the difference between the interest received on earning assets and the interest paid on interest-bearing liabilities. The Corporation's earning assets are primarily loans, securities, and short-term interest-bearing deposits with banks, and the interest-bearing liabilities are principally customer deposits and borrowings. Net interest income is highly sensitive to fluctuations in interest rates. To address interest rate fluctuations, we manage our balance sheet in an effort to diminish the impact should interest rates suddenly change.

Broadening our revenue sources helps to reduce the risk and exposure of our financial results to the impact of changes in interest rates, which are outside of our control. Sources of noninterest income include our insurance agency, fees on customer accounts, and trust and retail brokerage services through our Wealth Strategies division. In 2019, noninterest income, at 19.2% of the Corporation's total revenue, increased mainly due higher income from insurance services, net gains on the sale of fixed assets, and net gains on the sale of securities when compared with 2018.

Our profitability is also impacted by operating expenses such as salaries, employee benefits, occupancy, and income taxes. Our lending activities are significantly influenced by regional and local factors such as changes in population, competition among lenders, interest rate conditions and prevailing market rates on competing uses of funds and investments, customer preferences and levels of personal income and savings in the Corporation's primary market area.

At the end of 2019, the Corporation's nonperforming assets decreased to \$515 thousand from \$1.33 million at December 31, 2018, due to decreases of \$964 thousand in nonaccrual loans and an increase of \$146 thousand in foreclosed assets when compared to the end of 2018.

Recent Developments

Pending Merger

On December 18, 2019, the Corporation entered into the merger agreement with First Bancshares, whereby the Corporation will be merged with and into the First Bancshares. Pursuant to and simultaneously with entering into the merger agreement, the Bank, and First Bancshares's wholly owned subsidiary bank, The First, entered into a Plan of Bank Merger whereby the Bank will be merged with and into The First immediately following the merger of the Corporation with and into First Bancshares. For additional information see Part I, Item 1, "Business – Recent Developments".

COVID-19 Pandemic

In December 2019, a novel strain of coronavirus—COVID-19—was reported in Wuhan, China. The World Health Organization has declared the outbreak to constitute a "Public Health Emergency of International Concern." In March 2020, infections of COVID-19 had become a pandemic with persons testing positive in all fifty states and the District of Columbia. On March 13, the U.S. President announced a national emergency relating to the pandemic. With the possibility of widespread infection in the United States and abroad, national, state and local authorities have recommended social distancing and imposed or are considering quarantine and isolation measures on large portions of the population, including mandatory business closures. On March 20, 2020, the Governor of the State of Georgia declared a state of emergency in response to the outbreak, however, as of the date of this Annual Report on Form 10-K, no order has been issued requiring us to close.

The COVID-19 outbreak is disrupting supply chains and affecting production and sales across a range of industries and may result in a significant decrease in business and/or cause our customers to be unable to meet existing payment or other obligations to us, particularly in the event of the spread of COVID-19 in our primary market areas. In response to these developments, the Federal Reserve has responded with a series of monetary policy adjustments in March 2020 including reductions to the targeted federal funds rate totaling 1.50 percent, an increase in its daily repurchase agreement offerings, announced purchases of U.S. Treasury securities and U.S. Agency mortgage-backed securities, and the establishment of the Commercial Paper Funding Facility, the Primary Dealer Credit Facility, and the Money Market Mutual Fund Liquidity Facility. The economic effects of the COVID-19 pandemic are difficult to predict and may adversely impact our business, financial condition or results of operations. The extent of the impact of COVID-19 pandemic on our business, financial condition and results of operations will depend on certain developments, including the duration and spread of the outbreak, impact on our customers, employees and vendors all of which are uncertain and cannot be predicted. See Part I, Item 1A under the heading "Risk Factors – Risks Related to the Corporation - The outbreak of the recent COVID-19, or an outbreak of another highly infectious or contagious disease, could adversely affect our business, financial condition and results of operations" for more information.

Critical Accounting Policies

In the course of the Corporation's normal business activity, management must select and apply many accounting policies and methodologies that lead to the financial results presented in the consolidated financial statements of the Corporation. Management considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy because of the uncertainty and subjectivity inherent in estimating the levels of allowance needed to cover probable credit losses within the loan portfolio and the material effect that these estimates have on the Corporation's results of operations. We believe that the allowance for loan losses as of December 31, 2019, is adequate; however, under adverse conditions or assumptions, future additions to the allowance may be necessary.

There have been no significant changes in the methods or assumptions used in our accounting policies that would have resulted in material estimates and assumptions changes. Note 1 to the Corporation's Consolidated Financial Statements provides a description of our significant accounting policies and contributes to the understanding of how our financial performance is reported.

Results of Operations

Performance Summary

For the year ended December 31, 2019, net income was \$5.29 million, up \$640 thousand from net income of \$4.65 million for 2018. The increase in net income is primarily due to an increase in net interest income and noninterest income. Net interest income for 2019 increased \$2.0 million to \$20.58 million due primarily to a \$3.08 million increase in interest income and fees on loans offset by a \$1.13 million increase in interest expense compared with last year. Noninterest income for 2019 increased \$610 thousand mainly due higher income from insurance services, net gains on the sale of fixed assets, and net gains on the sale of securities. These gains were partially offset by a \$1.47 million increase in noninterest expense due mostly to higher employee, equipment, data processing, professional fees, and postemployment benefits. Provision for income taxes increased \$478 thousand compared with last year, primarily due to a \$1.92 million reversal of deductible timing differences in tax basis depreciation expense. Net income was \$2.08 per diluted share for 2019 compared with a net income of \$1.83 per diluted share for 2018.

For the year ended December 31, 2018, net income was \$4.65 million, up \$840 thousand from net income of \$3.81 million for 2017. The increase in net income is primarily due to the lower income tax rates based on the enactment of the Tax Cuts and Jobs Act of 2017 (the “Tax Act”) resulting in a \$951 thousand decrease to the provision for income taxes. Net interest income for 2018 increased \$1.33 million to \$18.57 million due primarily to a \$2.46 million increase in interest income and fees on loans compared with last year. Growth in net interest income more than offset the \$804 thousand increase in noninterest expense due mostly to higher employee, advertising, telephone, and depreciation expenses related to the Tifton and Valdosta expansions. Provision for loan losses increased \$530 thousand when compared to 2017, which reflected our strong loan growth. Noninterest income also decreased \$106 thousand mainly due to lower income from mortgage banking services. Net income was \$1.83 per diluted share for 2018 compared with a net income of \$1.49 per diluted share for 2017

We measure our performance on selected key ratios, which are provided in the following table:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Return on average total assets	0.96%	0.91%	0.80%
Return on average shareholders' equity	11.01%	11.04%	9.41%
Average shareholders' equity to average total assets	8.76%	8.24%	8.55%
Net interest margin (tax equivalent)	4.09%	3.99%	4.09%

Net Interest Income

Net interest income after provision for loan losses increased \$1.98 thousand, or 11.2%, to \$19.73 million for 2019 when compared with 2018. Total interest income increased \$3.14 million, which more than offset an increase in total interest expense of \$1.13 million. The Corporation recognized a \$857 thousand provision for loan losses in 2019, a \$27 thousand increase compared with \$830 thousand in 2018. Interest income and fees on loans increased \$3.08 million when compared with 2018 resulting from growth in average loans of \$37.4 million. Also, interest income on investment securities increased by \$34 thousand mainly due to an increase in average investment securities volume of \$1.2 million compared with 2018. Interest on deposits in other banks also increased \$12 thousand compared with the same period last year. Partially offsetting these increases in net interest income, interest paid on deposits increased \$1.47 million to \$3.85 million and interest paid on total borrowings decreased by \$334 thousand when compared with the prior year. The average rate paid on average time deposits of \$92.7 million increased 72 basis points when compared with 2018. These rate increases were primarily driven by rising rates in our markets.

Net interest income after provision for loan losses increased \$798 thousand, or 4.71%, to \$17.74 million for 2018 when compared with 2017. Total interest income increased \$2.75 million which more than offset an increase in total interest expense of \$1.42 million. The Corporation recognized a \$830 thousand provision for loan losses in 2018, a \$530 thousand increase compared with \$300 thousand in 2017. Interest income and fees on loans increased \$2.46 million when compared with 2017 resulting from growth in average loans of \$32.2 million. Also, interest income on investment securities decreased by \$18 thousand mainly due to a decrease in average investment securities volume of \$7.5 million compared with 2017. Interest on deposits in other banks also increased \$290 thousand compared with the same period last year. Partially offsetting these increases in net interest income, interest paid on deposits increased \$1.23 million to \$2.38 million and interest paid on total borrowings increased by \$190 thousand when compared with the prior year. The average rate paid on average time deposits of \$87.5 million increased 41 basis points when compared with 2017. These rate increases were primarily driven by rising rates in our markets.

Net Interest Margin

Net interest margin, which is the net return on earning assets, is a key performance ratio for evaluating net interest income. It is computed by dividing net interest income by average total earning assets.

Net interest margin increased 10 basis points to 4.09% for 2019 when compared with 2018. The increase in net interest margin was attributed primarily to a 10.7% increase in average loan volume coupled with a 28 basis point rate increase in our loan portfolio. This increase was partially offset by an 8.9% increase in average interest bearing liabilities volume coupled with a 22 basis point rate increase in interest bearing liabilities. Net interest margin was 3.99% for 2018, a 10 basis point decrease from 4.09% in 2017.

Noninterest Income

Noninterest income is an important contributor to net earnings. The following table summarizes the changes in noninterest income during the past three years:

	2019		2018		2017	
	Amount	% Change	Amount	% Change	Amount	% Change
	(Dollars in thousands)					
Service charges on deposit accounts	\$ 929	(8.5)	\$ 1,015	1.0%	\$ 1,005	(7.5)%
Income from trust services	221	(6)	235	7.3	219	4.3
Income from retail brokerage services	360	(9.8)	399	10.2	362	5.9
Income from insurance services	1,741	8.5	1,604	5.3	1,523	3.0
Income from mortgage banking services	0	(100)	2	(98.7)	155	(56.2)
Gain (loss) on the sale or disposition of assets	288	NM	(80)	NM	(9)	NM
Gain (loss) on the sale of securities	174	NM	(165)	NM	187	10.7
Gain on extinguishment of debt	143	NM	318	NM	0	NM
Other income	<u>961</u>	9.3	<u>879</u>	1.0	<u>870</u>	11.3
Total noninterest income	<u>\$ 4,817</u>	14.5	<u>\$ 4,207</u>	(2.5)%	<u>\$ 4,312</u>	(3.3)%

*NM = not meaningful

For 2019, noninterest income was \$4.82 million, up from \$4.21 million in 2018. The increase was primarily attributed to increases in income from insurance services of \$137 thousand, net gains on the disposition of assets of \$368 thousand, net gains on the sale of investment securities of \$339 thousand, and other income of \$84 thousand when compared with 2018. These increases were offset by a \$175 thousand decrease in gain on the extinguishment of debt when compared with 2018. Other decreases included income from service charges on deposit accounts, income from trust services, and income from retail brokerage services of \$86 thousand, \$14 thousand, respectively, when compared with 2018.

For 2018, noninterest income was \$4.21 million, down from \$4.31 million in 2017. The decrease was primarily attributed to a decline in income from mortgage banking services of \$153 thousand compared with 2017. Commercial mortgage banking fees from Empire Financial Services, Inc. ceased as the entity was dissolved in late 2017. A loss on the disposition of assets of \$80 thousand was recognized in 2018 compared with a loss of \$9 thousand in 2017. A loss on the sale of securities of \$165 thousand was recognized in 2018 compared with a gain of \$187 thousand in 2017.

These decreases were offset by increases in income from insurance services, income from retail brokerage services, income from trust services, service charges on deposit accounts, and other income of \$80 thousand, \$37 thousand, \$16 thousand, \$10 thousand, and \$9 thousand, respectively, when compared with 2017. The Corporation also recognized a \$318 thousand gain on the extinguishment of debt in 2018 compared with a \$0 gain recognized in 2017.

Noninterest Expense

Noninterest expense includes all expenses of the Corporation other than interest expense, provision for loan losses and income tax expense. The following table summarizes the changes in the noninterest expenses for the past three years:

	2019		2018		2017	
	Amount	% Change	Amount	% Change	Amount	% Change
Salaries and employee benefits	\$ 10,247	5.4 %	\$ 9,725	5.1 %	\$ 9,251	5.5 %
Occupancy expense	1,260	5.4	1,195	6.3	1,124	(1.4)
Equipment expense	1,220	30.7	933	9.8	850	(1.3)
Data processing expense	1,649	14.1	1,445	(4.5)	1,513	10.6
Amortization of intangible assets	4	(75)	16	0.0	16	0.0
Other operating expenses	<u>3,727</u>	12.3	<u>3,320</u>	8.0	<u>3,075</u>	11.3
Total noninterest expense	\$ <u>18,106</u>	8.9 %	\$ <u>16,634</u>	5.1 %	\$ <u>15,829</u>	6.1 %

Noninterest expense increased \$1.47 million to \$18.11 million in 2019 compared with 2018. Salaries and employee benefits increased \$522 thousand, occupancy expense increased \$65 thousand, equipment expense increased \$287 thousand, and data processing expense increased \$204 thousand compared with 2018 as a result of expansion in the Tifton and Valdosta markets coupled with greater incentive based income. Other operating expense increased \$407 thousand compared with 2018 due primarily due to higher professional fees related to the upcoming merger with First Bancshares, postemployment benefits for employee separation agreements, and additional charitable contributions to the Hospital Authority of Colquitt County for community support.

For 2018, noninterest expense increased \$804 thousand to \$16.6 million compared with the same period in 2017. Salaries and employee benefits increased \$474 thousand when compared with 2017 as a result of staffing expansion in the Tifton and Valdosta markets and greater incentive based income. Other operating expense increased \$245 thousand compared with 2017 due primarily to higher telephone expense, advertising expense, and employee training expenses also related to expansion in the Tifton and Valdosta markets. Occupancy expense increased \$71 thousand and equipment expense increased \$83 thousand compared with 2017 primarily due to additional depreciation expense on the new bank building and equipment in Tifton. Data processing expense decreased \$68 thousand compared with 2017 largely related to the front-end core processor migration expenses incurred in 2017.

The efficiency ratio, (noninterest expense divided by total noninterest income plus tax equivalent net interest income), a measure of productivity, decreased to 70.5% for 2019 when compared with 71.9% for 2018 and 70.8% for year ending 2017. The efficiency ratio decreased slightly during 2019 due to a full-year of increased operating expenses due to the expansion into the Tifton, Georgia market, increased interest expense due to increased rates on interest bearing deposit accounts, and the tax equivalent adjustment on tax-free loans and investment securities declined due to the reduction in tax-free investment securities holdings. The improvement in the efficiency ratio for 2018 resulted from increased operating expenses as we expanded to the Tifton, Georgia market, increased interest expense as we paid higher rates on interest bearing deposit accounts, and the tax equivalent adjustment on tax-free loans and investment securities declined due to the reduction in the corporate income tax rate from 34% to 21% when compared with 2017.

Income Tax Expense

The Corporation had an expense of \$1.15 million for income taxes in 2019 compared with an expense of \$668 thousand in 2018 and \$1.62 million for the year ending December 31, 2017. These amounts resulted in an effective tax rate of 17.8%, 12.6%, and 29.8%, for 2019, 2018, and 2017, respectively. See Note 10 of the Corporation's Notes to Consolidated Financial Statements for further details of tax expense.

Uses and Sources of Funds

The Corporation, primarily through the Bank, acts as a financial intermediary. As such, our financial condition should be considered in terms of how we manage our sources and uses of funds. Our primary sources of funds are deposits and borrowings. We invest our funds in assets, and our earning assets are our primary source of income.

Total average assets increased \$38.1 million to \$548.6 million in 2019 compared with 2018. The increase in total average assets is primarily attributable to an increase in average loans of \$37.4 million. Average investment securities increased by \$1.2 million to \$101.4 million while interest-bearing deposits with other banks decreased by \$3.2 million. The Corporation's earning assets, which include loans, investment securities, certificates of deposit with other banks and interest-bearing deposits with banks, averaged \$510.8 million in 2019, a 7.6% increase from \$474.9 million in 2018. The average volume for total deposits increased \$52.0 million mostly due to an increase in average money market accounts of \$29.8 million resulting from the offering new premier money market accounts for individuals and businesses. In addition, interest-bearing business account deposits increased by \$9.9 million and time deposit accounts increased by \$14.3 million compared with the prior year. For 2019, average earning assets were comprised of 75.1% loans, 19.8% investment securities, and 5.0% deposit balances with banks. The ratio of average earning assets to average total assets increased slightly to 93.1% for 2019 compared with 93.0% for 2018.

Loans

Loans are one of the Corporation's largest earning assets and uses of funds. Because of the importance of loans, most of the other assets and liabilities are managed to accommodate the needs of the loan portfolio. During 2019, average net loans represented 75% of average earning assets and 70% of average total assets.

The composition of the Corporation's loan portfolio at December 31, 2019, 2018, and 2017 was as follows:

Category	2019		2018		2017	
	Amount	% Change	Amount	% Change	Amount	% Change
Commercial, financial, and agricultural	\$ 87,441	(1.1) %	\$ 88,403	20.9 %	\$ 73,146	3.0 %
Real estate:						
Construction	28,826	15.8	24,891	11.7	22,287	(14.3)
Commercial	143,022	15.8	123,477	16.0	106,458	16.1
Residential	102,240	(1.1)	103,348	4.2	99,160	19.1
Agricultural	31,459	(0.3)	31,562	24.4	25,374	53.0
Consumer & other	<u>5,094</u>	0.1	<u>5,086</u>	35.0	<u>3,767</u>	(4.9)
Total loans	\$398,082	5.7	\$376,767	14.1	\$330,192	12.9
Unearned interest and discount	(17)	(0.6)	(17)	(5.6)	(18)	5.3
Allowance for loan losses	<u>(3,604)</u>	5.1	<u>(3,429)</u>	12.6	<u>(3,044)</u>	2.6
Net loans	<u>\$394,461</u>	5.7 %	<u>\$373,321</u>	14.1 %	<u>\$327,130</u>	13.0 %

Total year-end balances of loans increased \$21.3 million while average total loans increased \$37.4 million in 2019 compared with 2018. Construction and commercial real estate loan categories as well as consumer and other loans experienced growth in 2019, while commercial, financial, agricultural loans as well as residential and agricultural real estate loans decreased slightly. The ratio of total loans to total deposits at year end increased to 84.1% in 2019 compared with 82.7% in 2018.

The loan portfolio mix at December 31, 2019 consisted of 7.2% loans secured by construction real estate, 35.9% loans secured by commercial real estate, 25.7% of loans secured by residential real estate, and 7.9% of loans secured by agricultural real estate. The loan portfolio also included other commercial, financial, and agricultural purposes of 22.0% and installment loans to individuals for consumer purposes of 1.3%.

Allowance and Provision for Possible Loan Losses

The allowance for loan losses represents our estimate of the amount required for probable loan losses in the Corporation's loan portfolio. Loans, or portions thereof, which are considered to be uncollectible are charged against this allowance and any subsequent recoveries are credited to the allowance. There can be no assurance that the Corporation will not sustain losses in future periods which could be substantial in relation to the size of the allowance for loan losses at December 31, 2019.

We have a loan review program in place which provides for the regular examination and evaluation of the risk elements within the loan portfolio. The adequacy of the allowance for loan losses is regularly evaluated based on the review of all significant loans with particular emphasis on non-accruing, past due, and other potentially impaired loans that have been identified as possible problems.

The allowance for loan losses was \$3.604 million, or 0.9% of total loans outstanding, as of December 31, 2019. This level represented an \$175 thousand increase from the corresponding 2018 year-end amount, which was also 0.9% of total loans outstanding.

The provision for loan losses was \$857 thousand in 2019 compared with provision for loan losses of \$830 thousand in 2018. See Part I, Item 1, "Table 4 – Loan Portfolio" for details of the changes in the allowance for loan losses.

Investment Securities

The investment portfolio serves several important functions for the Corporation. Investments in securities are used as a source of income for excess liquidity that is not needed for loan demand and to satisfy pledging requirements in the most profitable way possible. The investment portfolio is a source of liquidity when loan demand exceeds funding availability, and is a vehicle for adjusting balance sheet sensitivity to cushion against adverse rate movements. Our investment policy attempts to provide adequate liquidity by maintaining a portfolio with significant cash flow for reinvestment. The Corporation's investment securities represent 17.8% of our total assets. The portfolio includes 41.3% of U.S. government agency securities, 26.8% state, county and municipal securities, 27.7% of U.S. government sponsored pass-thru residential mortgage-backed securities, and 4.3% of U.S. government treasury securities.

The following table summarizes the contractual maturity of investment securities at their carrying values as of December 31, 2019:

<u>Amounts Maturing In:</u>	<u>Securities Available for Sale</u>	<u>Securities Held to Maturity</u> (Dollars in thousands)	<u>Total</u>
One year or less	\$ 2,009	\$ 2,516	\$ 4,525
After one through five years	31,325	9,488	40,813
After five through ten years	13,522	8,864	22,386
After ten years	<u>20,970</u>	<u>4,619</u>	<u>25,589</u>
Total investment securities	\$ <u>67,826</u>	\$ <u>25,487</u>	\$ <u>93,313</u>

At December 31, 2019, the total investment portfolio decreased \$1.8 million, down to \$93.3 million, compared with \$95.1 million at December 31, 2018. The decrease was mainly due to calls and maturities of \$14.6 million of municipal securities and U.S. government agency securities as well as residential mortgage-backed securities principal paydowns of \$2.2 million. Additionally, we sold \$9.4 million of available for sale U.S. government agency securities, while net amortization of bond premiums/discounts was \$341 thousand. Partially offsetting these increases were purchases of \$22.4 million of U.S. government agency securities, municipal securities, and residential mortgage-backed securities, net unrealized gains on available for sale securities of \$2.1 million, and realized net gains on available for sale securities of \$174 thousand.

We will continue to actively manage the size, components, and maturity structure of the investment securities portfolio. Future investment strategies will continue to be based on profit objectives, economic conditions, interest rate risk objectives, and balance sheet liquidity demands.

Nonperforming Assets

Nonperforming assets are defined as nonaccrual loans, loans that are 90 days past due and still accruing, other-than-temporarily impaired preferred stock, and property acquired by foreclosure. The level of nonperforming assets decreased \$818 thousand at December 31, 2019 compared with December 31, 2018. Nonaccrual loans decreased \$964 thousand compared with 2018, and foreclosed assets increased \$146 thousand compared with 2018. Nonperforming assets were approximately \$515 thousand, or 0.09% of total assets as of December 31, 2019, compared with \$1.3 million, or 0.25% of total assets at December 31, 2018.

Deposits and Other Interest-Bearing Liabilities

Our primary source of funds is deposits. The Corporation offers a variety of deposit accounts having a wide range of interest rates and terms. We rely primarily on competitive pricing policies and customer service to attract and retain these deposits.

In 2019, average deposits increased from \$419.9 million in 2018 to \$471.9 million. This average deposit growth occurred primarily from increases in new premier money market deposits of \$22.5 million, increases in noninterest-bearing accounts of \$10.2 million, and increases in savings accounts of \$1.7 million compared to 2018. These increases were offset by decreases in NOW accounts of \$11.6 million and decreases in total time deposits of \$4.8 million compared to 2018. As of December 31, 2019, the Corporation's balance of certificates of deposit of \$250,000 or more increased \$8.8 million to \$25.1 million from \$16.3 million at the end of 2018.

We have used borrowings from the Federal Home Loan Bank to support our residential mortgage lending activities. During 2019, the Corporation borrowed \$19 million in fixed rate credit advances, \$20 million in daily rate credit, and \$11 million in principal reducing credit advances. The Corporation repaid \$19 million of the fixed-rate and \$20 million of the daily rate advances. made annual installment payments of \$6.2 million on five principal reducing credit advances from the Federal Home Loan Bank. The Corporation also and made additional payments of \$12.7 million for the early retirement of two fixed rate credit advances and one principal reducing credit advance from the Federal Home Loan Bank and recognized a net gain of \$143 thousand.

During 2020, we expect to make annual installment payments totaling \$3.8 million on principal reducing credit advances and payoff a \$2 million fixed rate credit advance. Total long-term advances with the Federal Home Loan Bank were \$22.7 million at December 31, 2019. Details on the Federal Home Loan Bank advances are presented in Notes 7 and 8 of the Corporation's Consolidated Financial Statements.

Liquidity

Liquidity is managed to assume that the Bank can meet the cash flow requirements of customers who may be either depositors wanting to withdraw their funds or borrowers needing funds to meet their credit needs. Many factors affect the ability to accomplish liquidity objectives successfully. Those factors include the economic environment, our asset/liability mix and our overall reputation and credit standing in the marketplace. In the ordinary course of business, our cash flows are generated from deposits, interest and fee income, loan repayments and the maturity or sale of other earning assets.

The Corporation is a separate entity from the Bank and provides for its own liquidity. The Corporation is responsible for the payment of dividends declared for shareholders, and interest and principal on its outstanding debt. Substantially, all of the Corporation's liquidity is obtained from dividends from the Bank.

The Consolidated Statement of Cash Flows details the Corporation's cash flows from operating, investing, and financing activities. During 2019, operating and financing activities provided cash flows of \$19.8 million, while investing activities used \$17.7 million resulting in an increase in cash and cash equivalents balances of \$2.1 million.

Liability liquidity represents our ability to renew or replace our short-term borrowings and deposits as they mature or are withdrawn. The Bank's deposit mix includes a significant amount of core deposits. Core deposits are defined as total deposits less time deposits of \$250,000 or more. These funds are relatively stable because they are generally accounts of individual customers who are concerned not only with rates paid, but with the value of the services they receive, such as efficient operations performed by helpful personnel. Total core deposits were 94.7% of total deposits on December 31, 2019 and 96.4% of total deposits on December 31, 2018.

Asset liquidity is provided through ordinary business activity, such as cash received from interest and fee payments as well as from maturing loans and investments. Additional sources include marketable securities and short-term investments that are easily converted into cash without significant loss. The Bank had \$4.5 million of investment securities maturing within one year or less on December 31, 2019, which represented 4.8% of the investment debt securities portfolio. Also, the Bank has \$2.5 million of U.S. government agency securities callable at the option of the issuer within one year and approximately \$6.4 million of expected annual cash flow in principal reductions from payments of mortgage-backed securities.

During 2019 and 2018, no U.S. government agency securities with call features were called. We are not aware of any other known trends, events, or uncertainties that will have or that are reasonably likely to have a material adverse effect on the Corporation's liquidity or operations.

Contractual Obligations

The chart below shows the Corporation's contractual obligations and its scheduled future cash payments under those obligations as of December 31, 2019.

The majority of the Corporation's outstanding contractual obligations are long-term debt. The remaining contractual are comprised of purchase obligations for data processing services. We have no capital lease obligations.

	Payments Due by Period				
	(Dollars in thousands)				
	Total	Less than 1 Year	1-3 Years	3-5 Years	After 5 Years
<u>Contractual Obligations</u>					
Long-term debt	\$22,679	\$ 0	\$7,214	\$9,215	\$6,250
Operating leases	<u>5</u>	<u>5</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total contractual obligations	<u>\$22,684</u>	<u>\$ 5</u>	<u>\$7,214</u>	<u>\$9,215</u>	<u>\$6,250</u>

Off-Balance Sheet Arrangements

We are a party to financial instruments with off-balance-sheet risk which arise in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit in the form of loans or through letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the financial statements and are unconditionally cancelable. Since many of the commitments to extend credit and standby letters of credit are expected to expire without being drawn upon, the contractual amounts do not necessarily represent future cash requirements.

<u>Financial instruments whose contract amounts represent credit risk:</u>	<u>2019</u>	<u>2018</u>
	(Dollars in thousands)	
Commitments to extend credit	\$ 55,934	\$ 39,418
Standby letters of credit	\$ 1,255	\$ 4,343

The Corporation does not have any special purpose entities or off-balance sheet financing payment obligations.

Capital Resources and Dividends

Our average equity to average assets ratio was 8.76% in 2019 and 8.24% in 2018. At December 31, 2019, we were well in excess of all applicable minimum capital requirements under the guidelines with a common equity Tier 1 capital ratio of 12.35%, Tier I risk-based capital ratio of 12.35%, Total risk-based capital ratio of 13.27%, and a leverage ratio of 8.81%. To continue to conduct its business as currently conducted, the Corporation and the Bank will need to maintain capital well above the minimum levels.

The following table presents the risk-based capital and leverage ratios at December 31, 2019 and 2018 in comparison to both the minimum regulatory guidelines and the minimum for well capitalized:

<u>Risk-Based Capital Ratios</u>	<u>Corporation</u>		<u>Bank</u>		<u>Minimum Regulatory Guidelines</u>	<u>Minimum For Well-Capitalized</u>	<u>Minimum Plus Capital Conservation Buffer ⁽¹⁾</u>
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>			
Common Equity Tier 1	12.35%	11.97%	12.15%	11.44%	4.50%	≥ 6.50%	≥ 7.00%
Tier I capital	12.35%	11.97%	12.15%	11.44%	6.00%	≥ 8.00%	≥ 8.50%
Total risk-based capital	13.27%	12.87%	13.07%	12.34%	8.00%	≥ 10.00%	≥ 10.50%
Leverage	8.81%	8.62%	8.59%	8.24%	4.00%	≥ 5.00%	≥ 5.00%

⁽¹⁾ Not applicable to bank holding companies, like the Corporation, with less than \$1 billion in total consolidated assets that meet certain criteria

Interest Rate Sensitivity

The Corporation's most important element of asset/liability management is the monitoring of its sensitivity and exposure to interest rate movements which is the Corporation's primary market risk. We have no foreign currency exchange rate risk, commodity price risk, or any other material market risk. The Corporation has no trading investment portfolio, nor do we have any interest rate swaps or other derivative instruments.

Our primary source of earnings, net interest income, can fluctuate with significant interest rate movements. To lessen the impact of these movements, we seek to maximize net interest income while remaining within prudent ranges of risk by practicing sound interest rate sensitivity management. We attempt to accomplish this objective by structuring the balance sheet so that the differences in repricing opportunities between assets and liabilities are minimized. Interest rate sensitivity refers to the responsiveness of earning assets and interest-bearing liabilities to changes in market interest rates. The Corporation's interest rate risk management is carried out by the Asset/Liability Management Committee which operates under policies and guidelines established by the Bank's Board of Directors. The principal objective of asset/liability management is to manage the levels of interest-sensitive assets and liabilities to minimize net interest income fluctuations in times of fluctuating market interest rates. To effectively measure and manage interest rate risk, the Corporation uses computer simulations that determine the impact on net interest income of numerous interest rate scenarios, balance sheet trends and strategies. These simulations cover the following financial instruments: short-term financial instruments, investment securities, loans, deposits, and borrowings. These simulations incorporate assumptions about balance sheet dynamics, such as loan and deposit growth and pricing, changes in funding mix, and asset and liability repricing and maturity characteristics. Simulations are run under various interest rate scenarios to determine the impact on net income and capital. From these computer simulations, interest rate risk is quantified and appropriate strategies are developed and implemented. The Corporation also maintains an investment portfolio which receives monthly cash flows from mortgage-backed securities principal payments, and staggered maturities and provides flexibility over time in managing exposure to changes in interest rates. Any imbalances in the repricing opportunities at any point in time constitute a financial institution's interest rate sensitivity.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The information required by this item is filed herewith.



To the Shareholders and the Board of Directors of Southwest Georgia Financial Corporation

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Southwest Georgia Financial Corporation and Subsidiary (the Company) as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the three years then ended, and the related notes to the consolidated financial statements (collectively, 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, 2019 and 2018, and the results of its operations and its cash flows for the three years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

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 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. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

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.

TJS Deemer Dana LLP

We have served as the Company's auditor since 2002.

Dublin, GA
March 26, 2020

SOUTHWEST GEORGIA FINANCIAL CORPORATION
CONSOLIDATED BALANCE SHEETS
December 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
ASSETS		
Cash and due from banks	\$ 12,123,191	\$ 14,050,682
Interest-bearing deposits in other banks	<u>25,507,442</u>	<u>21,448,110</u>
Cash and cash equivalents	<u>37,630,633</u>	<u>35,498,792</u>
Certificates of deposit in other banks	2,730,000	2,732,000
Investment securities available for sale, at fair value	67,825,863	58,313,577
Investment securities to be held to maturity (fair value approximates \$26,117,580 and \$37,010,327)	25,486,961	36,827,073
Federal Home Loan Bank stock, at cost	1,714,600	1,820,300
Loans, net of allowance for loan losses of \$3,604,348 and \$3,428,869	394,460,827	373,321,368
Premises and equipment, net	13,847,369	14,573,974
Foreclosed assets, net	273,873	127,605
Intangible assets	0	3,907
Bank owned life insurance	6,913,103	6,779,242
Other assets	<u>4,253,039</u>	<u>4,835,329</u>
Total assets	<u>\$ 555,136,268</u>	<u>\$ 534,833,167</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Interest bearing business checking	\$ 27,897,114	\$ 28,070,871
NOW accounts	24,237,635	35,816,115
Money market	181,199,224	158,730,044
Savings	33,554,780	31,848,588
Certificates of deposit \$250,000 and over	25,082,708	16,264,681
Other time accounts	<u>67,580,453</u>	<u>81,214,376</u>
Total interest-bearing deposits	359,551,914	351,944,675
Noninterest-bearing deposits	<u>113,882,249</u>	<u>103,694,910</u>
Total deposits	<u>473,434,163</u>	<u>455,639,585</u>
Short-term borrowed funds	5,814,286	10,457,143
Long-term debt	22,678,571	21,171,429
Other liabilities	<u>2,718,271</u>	<u>3,946,066</u>
Total liabilities	<u>504,645,291</u>	<u>491,214,223</u>
Shareholders' equity:		
Common stock – \$1 par value, 5,000,000 shares authorized, 2,548,510 shares and 2,545,776 shares issued for 2019 and 2018	2,548,510	2,545,776
Additional paid-in capital	18,478,955	18,418,995
Retained earnings	28,910,043	24,841,569
Accumulated other comprehensive gain (loss)	<u>553,469</u>	<u>(2,187,396)</u>
Total shareholders' equity	<u>50,490,977</u>	<u>43,618,944</u>
Total liabilities and shareholders' equity	<u>\$ 555,136,268</u>	<u>\$ 534,833,167</u>

See accompanying notes to consolidated financial statements.

SOUTHWEST GEORGIA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
for the years ended December 31, 2019, 2018, and 2017

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Interest income:			
Interest and fees on loans	\$ 21,835,586	\$ 18,762,728	\$ 16,299,091
Interest on debt securities: Taxable	1,684,048	1,363,123	1,286,473
Interest on debt securities: Tax-exempt	843,575	1,090,871	1,228,479
Dividends	105,011	144,856	102,360
Interest on deposits in other banks	496,582	484,724	195,032
Interest on certificates of deposit in other banks	<u>71,482</u>	<u>47,870</u>	<u>34,879</u>
Total interest income	<u>25,036,284</u>	<u>21,894,172</u>	<u>19,146,314</u>
Interest expense:			
Deposits	3,848,800	2,383,524	1,153,609
Federal funds purchased	22	1,097	1,068
Other short-term borrowings	123,892	395,989	224,144
Long-term debt	<u>480,936</u>	<u>541,804</u>	<u>523,344</u>
Total interest expense	<u>4,453,650</u>	<u>3,322,414</u>	<u>1,902,165</u>
Net interest income	20,582,634	18,571,758	17,244,149
Provision for loan losses	<u>856,676</u>	<u>829,500</u>	<u>300,000</u>
Net interest income after provision for loan losses	<u>19,725,958</u>	<u>17,742,258</u>	<u>16,944,149</u>
Noninterest income:			
Service charges on deposit accounts	928,777	1,015,498	1,005,270
Income from trust services	221,006	234,649	218,657
Income from brokerage services	359,501	399,278	362,416
Income from insurance services	1,741,018	1,603,557	1,523,309
Income from mortgage banking services	0	2,475	155,053
Net gain (loss) on sale or disposition of assets	288,049	(79,529)	(9,022)
Net gain (loss) on sale of securities	174,283	(165,369)	186,610
Net gain on extinguishment of debt	143,031	317,832	0
Other income	<u>960,902</u>	<u>878,340</u>	<u>870,229</u>
Total noninterest income	<u>4,816,567</u>	<u>4,206,731</u>	<u>4,312,522</u>
Noninterest expense:			
Salaries and employee benefits	10,247,200	9,724,826	9,250,777
Occupancy expense	1,259,476	1,194,552	1,124,028
Equipment expense	1,219,682	933,485	850,376
Data processing expense	1,648,936	1,445,215	1,513,630
Amortization of intangible assets	3,907	15,625	15,625
Other operating expenses	<u>3,726,498</u>	<u>3,319,751</u>	<u>3,074,843</u>
Total noninterest expenses	<u>18,105,699</u>	<u>16,633,454</u>	<u>15,829,279</u>
Income before income taxes	6,436,826	5,315,535	5,427,392
Provision for income taxes	<u>1,146,586</u>	<u>668,416</u>	<u>1,619,900</u>
Net income	<u>\$ 5,290,240</u>	<u>\$ 4,647,119</u>	<u>\$ 3,807,492</u>
Basic earnings per share:			
Net income	\$ <u>2.08</u>	\$ <u>1.83</u>	\$ <u>1.49</u>
Weighted average shares outstanding	<u>2,545,672</u>	<u>2,545,565</u>	<u>2,547,421</u>
Diluted earnings per share:			
Net income	\$ <u>2.08</u>	\$ <u>1.83</u>	\$ <u>1.49</u>
Weighted average shares outstanding	<u>2,545,672</u>	<u>2,545,565</u>	<u>2,547,422</u>

See accompanying notes to consolidated financial statements.

SOUTHWEST GEORGIA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
for the years ended December 31, 2019, 2018, and 2017

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Net income	\$ 5,290,240	\$ 4,647,119	\$ 3,807,492
Other comprehensive income (loss), net of tax:			
Unrealized gain (loss) on securities available for sale	2,268,403	(830,815)	326,684
Reclassification adjustment for (gain) loss realized in income on securities available for sale	(174,283)	165,369	(186,610)
Unrealized gain (loss) on pension plan benefits	1,375,329	(40,601)	503,167
Federal income tax benefit (expense)	<u>728,584</u>	<u>(148,270)</u>	<u>486,869</u>
Other comprehensive income (loss), net of tax	<u>2,740,865</u>	<u>(557,777)</u>	<u>156,372</u>
Total comprehensive income	<u>\$ 8,031,105</u>	<u>\$ 4,089,342</u>	<u>\$ 3,963,864</u>

See accompanying notes to consolidated financial statements.

SOUTHWEST GEORGIA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
for the years ended December 31, 2019, 2018, and 2017

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Shareholders' Equity
Balance at Dec. 31, 2016	\$ 4,293,835	\$ 31,701,533	\$ 30,333,410	\$ (1,785,991)	\$ (26,120,453)	\$ 38,422,334
Net Income	-	-	3,807,492	-	-	3,807,492
Comprehensive income (loss):						
Changes in net gain on securities available for sale	-	-	-	93,675	-	93,675
Changes in net gain on pension plan benefits	-	-	-	62,697	-	62,697
Cash dividend declared						
\$.44 per share	-	-	(1,120,872)	-	-	(1,120,872)
Purchase of 5,932 shares of treasury stock	-	-	-	-	(122,340)	(122,340)
Balance at Dec. 31, 2017	\$ 4,293,835	\$ 31,701,533	\$ 33,020,030	\$ (1,629,619)	\$ (26,242,793)	\$ 41,142,986
Adjustment to correct immaterial misstatement of deferred compensation expense and cash surrender value in prior periods			(128,647)			(128,647)
Net Income	-	-	4,647,119	-	-	4,647,119
Comprehensive income (loss):						
Changes in net gain on securities available for sale	-	-	-	(525,702)	-	(525,702)
Changes in net gain on pension plan benefits	-	-	-	(32,075)	-	(32,075)
Cash dividend declared						
\$.47 per share	-	-	(1,196,332)	-	-	(1,196,332)
Purchase of 13,316 shares of treasury stock	-	-	-	-	(306,032)	(306,032)
Issue of restricted stock awards	-	(306,032)	-	-	306,032	-
Stock-based compensation	-	17,627	-	-	-	17,627
Retirement of treasury stock	(1,748,059)	(12,994,133)	(11,500,601)	-	26,242,793	-
Balance at Dec. 31, 2018	\$ 2,545,776	\$ 18,418,995	\$ 24,841,569	\$ (2,187,396)	\$ -	\$ 43,618,944
Net Income	-	-	5,290,240	-	-	5,290,240
Comprehensive income (loss):						
Changes in net gain on securities available for sale	-	-	-	1,654,355	-	1,654,355
Changes in net gain on pension plan benefits	-	-	-	1,086,510	-	1,086,510
Cash dividend declared						
\$.48 per share	-	-	(1,221,766)	-	-	(1,221,766)
Issue of restricted stock awards	4,456	(4,456)	-	-	-	-
Restricted stock awards sold to plan	-	(11,929)	-	-	-	(11,929)
Forfeitures of restricted awards	(1,722)	1,722	-	-	-	-
Stock-based compensation	-	74,623	-	-	-	74,623
Balance at Dec. 31, 2019	\$ 2,548,510	\$ 18,478,955	\$ 28,910,043	\$ 553,469	\$ -	\$ 50,490,977

See accompanying notes to consolidated financial statements.

SOUTHWEST GEORGIA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
for the years ended December 31, 2019, 2018, and 2017

Cash flows from operating activities:	<u>2019</u>	<u>2018</u>	<u>2017</u>
Net income	\$ 5,290,240	\$ 4,647,119	\$ 3,807,492
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	856,676	829,500	300,000
Depreciation	1,200,032	1,036,986	881,000
Net amortization of investment securities	340,934	356,101	396,899
Income on cash surrender value of bank owned life insurance	(133,861)	(147,824)	(133,398)
Amortization of intangibles	3,907	15,625	15,625
Disposal of fixed assets to charitable expense	0	0	13,045
Loss (gain) on sale/writedown of foreclosed assets	(37,589)	(17,974)	8,892
Net loss (gain) on disposal of fixed assets	(250,460)	753	1,594
Net loss (gain) on sale of securities	(174,283)	165,369	(186,610)
Net loss on disposal of bank property held for sale	0	96,750	0
Net gain on extinguishment of debt	(143,031)	(317,832)	0
Stock-based compensation	74,623	17,627	0
Change in:			
Other assets	(146,294)	71,733	489,903
Other liabilities	142,223	(193,157)	288,505
Net cash provided by operating activities	<u>7,023,117</u>	<u>6,560,776</u>	<u>5,882,947</u>
Cash flows from investing activities:			
Proceeds from calls, paydowns and maturities of securities HTM	11,298,080	12,252,434	10,070,453
Proceeds from calls, paydowns and maturities of securities AFS	5,499,264	795,028	635,818
Proceeds from Federal Home Loan Bank Stock repurchase	996,200	1,164,500	705,100
Proceeds from sale of securities available for sale	9,358,503	2,879,000	5,741,211
Proceeds from maturity of certificates of deposit in other banks	247,000	0	0
Purchase of securities held to maturity	0	(4,637,047)	(265,000)
Purchase of securities available for sale	(22,400,552)	(8,762,879)	(7,039,139)
Purchase of Federal Home Loan Bank Stock	(890,500)	(546,600)	(1,269,100)
Purchase certificates of deposit in other banks	(245,000)	(747,000)	(1,985,000)
Net change in loans	(22,638,586)	(47,511,765)	(38,895,975)
Purchase bank owned life insurance	0	0	(1,063,237)
Purchase of premises and equipment	(616,906)	(3,382,015)	(1,955,067)
Capitalized other real estate expenditures	(41,836)	0	0
Proceeds from sales of fixed assets and foreclosed assets	974,857	1,131,894	233,553
Proceeds from the sale of bank property held for sale	0	114,750	0
Net cash used by investing activities	<u>(18,459,476)</u>	<u>(47,249,700)</u>	<u>(35,086,383)</u>
Cash flows from financing activities:			
Net change in deposits	17,794,578	58,633,827	25,512,772
Payment of short-term portion of long-term debt	(41,490,744)	(22,971,429)	(13,447,619)
Payments for early retirement of long-term debt	(11,501,939)	(9,110,739)	0
Proceeds from issuance of short-term debt	32,214,286	8,000,000	7,857,143
Proceeds from issuance of long-term debt	17,785,714	9,000,000	18,142,857
Cash dividends paid	(1,221,766)	(1,196,332)	(1,120,872)
Payments for treasury stock	(11,929)	(306,032)	(122,340)
Net cash provided by financing activities	<u>13,568,200</u>	<u>42,049,295</u>	<u>36,821,941</u>
Increase in cash and cash equivalents	2,131,841	1,360,371	7,618,505
Cash and cash equivalents - beginning of period	35,498,792	34,138,421	26,519,916
Cash and cash equivalents - end of period	<u>\$ 37,630,633</u>	<u>\$ 35,498,792</u>	<u>\$ 34,138,421</u>

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS, continued

	<u>2019</u>	<u>2018</u>	<u>2017</u>
CASH PAID DURING THE YEAR FOR:			
Income taxes	\$ <u>1,080,000</u>	\$ <u>365,000</u>	\$ <u>895,000</u>
Interest paid	\$ <u>4,468,077</u>	\$ <u>3,246,847</u>	\$ <u>1,881,924</u>
NONCASH ITEMS:			
Increase in foreclosed properties and decrease in loans	\$ <u>850,851</u>	\$ <u>503,655</u>	\$ <u>903,842</u>
Unrealized gain (loss) on securities AFS	\$ <u>2,094,120</u>	\$ <u>(665,446)</u>	\$ <u>140,074</u>
Unrealized gain (loss) on pension plan benefits	\$ <u>1,375,329</u>	\$ <u>(40,601)</u>	\$ <u>503,167</u>
Net reclass between short and long-term debt	\$ <u>4,707,143</u>	\$ <u>7,457,143</u>	\$ <u>15,114,286</u>
Sale of fixed assets through loans	\$ <u>0</u>	\$ <u>13,000</u>	\$ <u>0</u>
Sale of foreclosed properties through loans	\$ <u>208,400</u>	\$ <u>0</u>	\$ <u>38,000</u>
Retirement of treasury stock	\$ <u>0</u>	\$ <u>26,242,793</u>	\$ <u>0</u>

See accompanying notes to consolidated financial statements.

SOUTHWEST GEORGIA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of Southwest Georgia Financial Corporation (the “Corporation”) and its direct and indirect subsidiaries, including its wholly-owned banking subsidiary, Southwest Georgia Bank (the “Bank”), conform to U.S. generally accepted accounting principles (“GAAP”) and to general practices within the banking industry. The following is a description of the more significant of those policies.

Principles of Consolidation

The consolidated financial statements include the accounts of the Corporation and its direct and indirect subsidiaries. All significant intercompany accounts and transactions have been eliminated in the consolidation.

Nature of Operations

The Corporation offers comprehensive financial services to consumer, business, and governmental entity customers through its banking offices in southwest Georgia. Its primary deposit products are money market, NOW, savings and certificates of deposit, and its primary lending products are consumer and commercial mortgage loans. In addition to conventional banking services, the Corporation provides investment planning and management, trust management, and commercial and individual insurance products. Insurance products and advice are provided by the Bank’s Southwest Georgia Insurance Services Division.

The Corporation’s primary business is providing banking services through the Bank to individuals and businesses principally in the counties of Colquitt, Baker, Worth, Lowndes, Tift and the surrounding counties of southwest Georgia. The Bank operates six branch offices in its trade area. Trust and retail brokerage services are offered at an office building located at 25 2nd Avenue SW in Moultrie, and lending services are offered in Valdosta at 3520 North Valdosta Road.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with these evaluations, management obtains independent appraisals for significant properties.

A substantial portion of the Corporation’s loans are secured by real estate located primarily in Georgia. Accordingly, the ultimate collection of these loans is susceptible to changes in the real estate market conditions of this market area.

Cash and Cash Equivalents and Statement of Cash Flows

For purposes of reporting cash flows, the Corporation considers cash and cash equivalents to include all cash on hand, deposit amounts due from banks, interest-bearing deposits in other banks, and federal funds sold.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

The Corporation maintains its cash balances in several financial institutions. Accounts at the financial institutions are secured by the Federal Deposit Insurance Corporation (the “FDIC”) up to \$250,000. The Corporation had uninsured deposits of \$137,883 at December 31, 2019.

The Corporation also maintains a cash balance in an account held with the Federal Home Loan Bank (FHLB). The FHLB is not a financial institution, and as a result, funds held are not subject to FDIC coverage. As of December 31, 2019, the Corporation had an outstanding balance of \$101,641 with the FHLB, which is entirely uninsured.

The Corporation also maintains a cash balance in an account held with the Federal Reserve Bank of Atlanta. Although funds held by this institution are not insured by the FDIC, funds are backed by the full faith and credit of the United States government. As of December 31, 2019, the Corporation had an outstanding balance of \$24,384,735 with the Federal Reserve Bank of Atlanta.

Investment Securities

Investment securities that management has the positive intent and ability to hold to maturity are classified as “held to maturity” and recorded at amortized cost. Securities not classified as held to maturity or trading are classified as available for sale and recorded at fair value with unrealized gains and losses (net of tax effect) reported in other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other-than-temporarily impaired are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Premises and Equipment

Premises and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation has been calculated primarily using the straight-line method for buildings and building improvements over the assets estimated useful lives. Equipment and furniture are depreciated using the modified accelerated recovery system method over the assets estimated useful lives for financial reporting and income tax purposes for assets purchased on or before December 31, 2003. For assets acquired after 2003, the Corporation used the straight-line method of depreciation. The following estimated useful lives are used for financial statement purposes:

Land improvements	5 – 31 years
Building and improvements	10 – 40 years
Machinery and equipment	5 – 10 years
Computer equipment	3 – 5 years
Office furniture and fixtures	5 – 10 years

All of the Corporation’s leases are operating leases and are not capitalized as assets for financial reporting purposes. Maintenance and repairs are charged to expense and betterments are capitalized.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

Long-lived assets are evaluated regularly for other-than-temporary impairment. If circumstances suggest that their value may be impaired and the write-down would be material, an assessment of recoverability is performed prior to any write-down of the asset. Impairment on intangibles is evaluated at each balance sheet date or whenever events or changes in circumstances indicate that the carrying amount should be assessed. Impairment, if any, is recognized through a valuation allowance with a corresponding charge recorded in the income statement.

Bank Property Held for Sale

In 2016, the Bank's former branch in Pavo, Georgia, was transferred from premises to bank property held for sale and depreciation was discontinued. The property was booked at the lower of cost or market value based on the current appraisal of \$211,500. On November 30, 2018, the Corporation sold this property and recorded a loss in the amount of \$96,750.

Loans and Allowances for Loan Losses

Loans are stated at principal amounts outstanding less unearned income and the allowance for loan losses. Interest income is credited to income based on the principal amount outstanding at the respective rate of interest except for interest on certain installment loans made on a discount basis which is recognized in a manner that results in a level-yield on the principal outstanding.

Accrual of interest income is discontinued on loans when, in the opinion of management, collection of such interest income becomes doubtful. Accrual of interest on such loans is resumed when, in management's judgment, the collection of interest and principal becomes probable.

Fees on loans and costs incurred in origination of most loans are recognized at the time the loan is placed on the books. Because loan fees are not significant, the results on operations are not materially different from the results which would be obtained by accounting for loan fees and costs as amortized over the term of the loan as an adjustment of the yield.

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

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer and residential loans for impairment disclosures.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes the collection of the principal is unlikely. The allowance is an amount which management believes will be adequate to absorb estimated losses on existing loans that may become uncollectible based on evaluation of the collectability of loans and prior loss experience. This evaluation takes into consideration such factors as changes in the nature and volume of the loan portfolios, current economic conditions that may affect the borrowers' ability to pay, overall portfolio quality, and review of specific problem loans.

Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based upon changes in economic conditions. Also, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize additions to the allowance based on their judgments of information available to them at the time of their examination.

Foreclosed Assets

In accordance with policy guidelines and regulations, properties acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at the fair market value less costs to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. A valuation allowance is established to record market value changes in foreclosed assets. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets. There was no valuation allowance for foreclosed asset losses at December 31, 2019. Foreclosed assets totaled \$273,873 at December 31, 2019, up from \$127,605 at December 31, 2018.

Intangible Assets

Intangible assets are amortized over a determined useful life using the straight-line basis. These assets are evaluated annually as to the recoverability of the carrying value. The remaining intangibles were fully amortized during the year ended December 31, 2019.

Credit Related Financial Instruments

In the ordinary course of business, the Corporation has entered into commitments to extend credit, including commitments under credit card arrangements, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded when they are funded.

Retirement Plans

The Corporation and its direct and indirect subsidiaries have post-retirement plans covering substantially all employees. The Corporation makes annual contributions to the plans in amounts not exceeding the regulatory requirements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

Bank Owned Life Insurance

The Bank owns life insurance policies on a group of employees. Banking laws and regulations allow the Bank to purchase life insurance policies on certain employees in order to help offset the Bank's overall employee compensation costs. The beneficial aspects of these life insurance policies are tax-free earnings and a tax-free death benefit, which are realized by the Bank as the owner of the policies. The cash surrender value of these policies is included as an asset on the balance sheet, and any increases in cash surrender value are recorded as noninterest income on the statement of income. At December 31, 2019 and 2018, the policies had a value of \$6,913,103 and \$6,779,242, respectively, and were 13.7% and 15.5%, respectively, of shareholders' equity. These values are within regulatory guidelines.

Income Taxes

The Corporation and its direct and indirect subsidiaries file a consolidated income tax return. Each subsidiary computes its income tax expense as if it filed an individual return except that it does not receive any portion of the surtax allocation. Any benefits or disadvantages of the consolidation are absorbed by the parent company. Each subsidiary pays its allocation of federal income taxes to the parent company or receives payment from the parent company to the extent that tax benefits are realized.

The Corporation reports income under the Financial Accounting Standards Board Accounting Standards Codification ("ASC") Topic 740, Income Taxes, which requires recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Recognition of deferred tax assets is based on management's belief that it is more likely than not that the tax benefit associated with certain temporary differences and tax credits will be realized.

The Corporation will recognize a tax position as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with an examination being presumed to occur. The amount recognized is the largest amount of a tax benefit that is greater than fifty percent likely of being realized on examination. No benefit is recorded for tax positions that do not meet the more than likely than not test.

The Corporation recognizes penalties related to income tax matters in income tax expense. The Corporation is subject to U.S. federal and Georgia state income tax audit for returns for the tax period ending December 31, 2017 and subsequent years.

Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) includes all changes in shareholders' equity during a period, except those resulting from transactions with shareholders. Besides net income, other components of the Corporation's accumulated other comprehensive income (loss) includes the after tax effect of changes in the net unrealized gain/loss on securities available for sale and the unrealized gain/loss on pension plan benefits.

Trust Department

Trust income is included in the accompanying consolidated financial statements on the cash basis in accordance with established industry practices. Reporting of such fees on the accrual basis would have no material effect on reported income.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

Advertising Costs

It is the policy of the Corporation to expense advertising costs as they are incurred. The Corporation does not engage in any direct-response advertising and accordingly has no advertising costs reported as assets on its balance sheet. Costs that were expensed during 2019, 2018, and 2017 were \$248,422, \$264,269, and \$192,016, respectively.

Regulatory Developments

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

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum Tier 1 leverage, Tier 1 risk-based capital and Total risk-based capital ratios. In July 2013, the Board of Governors of the Federal Reserve System published the Basel III Capital Rules. These rules establish a comprehensive capital framework applicable to all depository institutions, certain bank holding companies with total consolidated assets below a certain threshold and all and savings and loan holding companies except for those that are substantially engaged in insurance underwriting or commercial activities. These rules implement higher minimum capital requirements for banks and certain bank holding companies, include a new common equity Tier 1 capital requirement and establish criteria that instruments must meet to be considered common equity Tier 1 capital, additional Tier 1 capital or Tier 2 capital.

The Basel III Capital Rules became effective for the Bank on January 1, 2015, subject to a phase-in period, but are not applicable to bank holding companies, like the Corporation, with less than \$1 billion in total consolidated assets that meet certain criteria.

The minimum capital level requirements applicable to the Bank under the Basel III Capital Rules are: (i) a common equity Tier 1 risk-based capital ratio of 4.5%; (ii) a Tier 1 risk-based capital ratio of 6% (increased from 4%); (iii) a Total risk-based capital ratio of 8% (unchanged from the rules effective for the year ended December 31, 2014); and (iv) a Tier 1 leverage ratio of 4% for all institutions. Common equity Tier 1 capital will consist of retained earnings and common stock instruments, subject to certain adjustments.

The Basel III Capital Rules set forth changes in the methods of calculating certain risk-weighted assets, which in turn affect the calculation of risk-based ratios. The new risk weightings are more punitive for assets held by banks that are deemed to be of higher risk. These changes were also effective beginning January 1, 2015.

The Basel III Capital Rules also introduced a "capital conservation buffer" requiring an additional 2.50% common equity Tier 1 capital, which is in addition to each capital ratio and was phased-in over a three-year period beginning in January 2016.

As of December 31, 2019, the Bank is considered to be well-capitalized under the Basel III Capital Rules. There have been no conditions or events since December 31, 2019, that management believes has changed the Bank's status as "well-capitalized." The capital ratios of the Corporation and Bank are presented in Note 15 of the Corporation's Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

Adoption of New Accounting Standards

In March 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2018-05, Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118. The purpose of this ASU is to codify the SEC's guidance issued in Staff Accounting Bulletin 118. The amendments in this update were effective upon issuance. The adoption of ASU 2018-05 had no material impact on the Corporation's consolidated financial statements.

In March 2018, FASB issued ASU 2018-04, Investment - Debt Securities (Topic 320) and Regulated Operations (Topic 980): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 117 and SEC Release No. 33-9273. The purpose of this ASU is to codify the SEC's guidance issued in Staff Accounting Bulletin 117. The amendments in this update were effective upon issuance. The adoption of ASU 2018-04 had no material impact on the Corporation's consolidated financial statements.

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

In February 2018, the FASB issued ASU No. 2018-02, Income Statement – Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. ASU 2018-02 provides guidance on accounting for the effects of the Tax Cuts and Jobs Act, which was enacted in December, 2017. The guidance allows reclassification of the tax effects that were stranded in accumulated other comprehensive income as a result of the tax rate change from accumulated other comprehensive income to retained earnings. This guidance is effective for fiscal years beginning after December 15, 2018. The adoption of ASU 2018-02 had no material impact on the Corporation's consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, "Stock Compensation, Scope of Modification Accounting." This ASU clarifies when changes to the terms of conditions of a share-based payment award must be accounted for as modifications. Companies will apply the modification accounting guidance if the value, vesting conditions or classification of the award changes. The new guidance should reduce diversity in practice and result in fewer changes to the terms of an award being accounted for as modifications, as the guidance will allow companies to make certain non-substantive changes to awards without accounting for them as modifications. It does not change the accounting for modifications. ASU No. 2017-09 is effective for interim and annual reporting periods beginning after December 15, 2017; early adoption is permitted. The adoption of ASU 2017-09 had no material impact on the Corporation's consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

In March 2017, the FASB issued ASU No. 2017-08, Receivables – Nonrefundable Fees and Other Costs (Topic 310-20): Premium Amortization on Purchased Callable Debt Securities. This ASU shortens the amortization period for certain callable debt securities held at a premium. The premium on individual callable debt securities shall be amortized to the earliest call date. This guidance does not apply to securities for which prepayments are estimated on a large number of similar loans where prepayments are probable and reasonable estimable. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. This update should be adopted on a modified retrospective basis with a cumulative effect adjustment to retained earnings on the date of adoption. The adoption of ASU 2017-08 had no material impact on the Corporation's consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The updated accounting guidance requires changes to the presentation of the components of net periodic benefit cost on the income statement by requiring service cost to be presented with other employee compensation costs and other components of net periodic pension cost to be presented outside of any subtotal of operating income. This ASU also stipulates that only the service cost component of net benefit cost is eligible for capitalization. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The adoption of ASU 2017-07 had no material impact on the Corporation's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805), which provides a new framework for determining whether transactions should be accounted for as acquisitions or disposals of assets or businesses. This ASU is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2017. Early adoption will be permitted and should apply it to transactions that have not been reported in financial statements that have been issued or made available for issuance. The adoption of ASU 2017-01 had no material impact on the Corporation's consolidated financial statements.

Revenue Recognition

On January 1, 2018, the Corporation adopted ASC Topic 606, using the modified retrospective method. Disclosures of revenue from contracts with customers for periods beginning after January 1, 2018, are presented under ASC Topic 606 and have not materially changed from the prior year amounts. Noninterest income, within the scope of this guidance, is recognized as services are transferred to customers in an amount that reflects the considerations expected to be entitled to in exchange for those services. The Corporation's revenue streams that were in scope include service charges on deposit accounts, income from insurance services, income from trust services, Automated Teller Machine ("ATM") surcharge and other noninterest income.

Services Charges on Deposit Accounts - Service charges on deposit accounts primarily consist of monthly maintenance charges, analysis charges and Non-sufficient funds ("NSF") charges. The NSF charges and certain service charges are fixed and the performance obligation is typically satisfied at the time of the related transaction. The consideration for analysis charges and monthly maintenance charges are variable as the fee can be reduced if the customer meets certain qualifying metrics. The Corporation's performance obligations are satisfied either at the time of the transaction or over the course of a month.

Income from Insurance Services – Income from insurance services consists primarily of property and casualty insurance, life, health, and disability insurance. Property and casualty, life, health, and disability insurance includes the brokerage of both personal and commercial coverages. The placement of the policy is completion of the Corporation's performance obligation and revenue is recognized at that time. The Corporation's commission is primarily a percentage of the premium.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

Income from Trust Services – Income from Trust services consists of revenue generated from services provided for corporate, pension, and personal trusts, trustee services, and administrative services for employee benefit plans. The Corporation’s performance obligation and revenue is recognized once the service has been performed.

ATM Surcharge - ATM surcharge represents revenues earned from certain terminal activity. ATM surcharges primarily consist of charges assessed to our customers for using a non-Bank ATM or a non-Bank customer using our ATM. Such surcharges generally are recognized concurrently with the delivery of services on a daily basis.

Other - Other noninterest income primarily consists of transaction based revenue where the performance obligation is satisfied concurrent with the revenue recognition.

Recent Accounting Pronouncements

In December 2019, the FASB issued ASU No. 2019-12, Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes. ASU 2019-12 removes specific exceptions to the general principles in Topic 740. This update simplifies the accounting for income taxes by eliminating certain exceptions to the guidance in ASC 740 related to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period and the recognition for deferred tax liabilities for outside basis differences. The ASU also improves financial statement preparers’ application for income tax-related guidance, simplifies GAAP for franchise taxes and enacted changes in tax laws or rates, and clarifies the accounting for transactions that result in a step-up in the tax basis of goodwill. ASU 2019-12 will be effective on January 1, 2021 and is being reviewed for any material impact on the Corporation’s consolidated financial statements.

In March 2019, the FASB issued ASU No. 2019-01, Leases: Codification Improvements. ASU 2019-01 provides clarification to increase transparency and comparability among organizations by recognizing lease assets and liabilities on the balance sheet and disclosing essential information about leasing transactions. This ASU (1) allows the fair value of the underlying asset reported by lessors that are not manufacturers or dealers to continue to be its cost and not fair value as measured under the fair value definition, (2) allows for the payments received from sales-type and direct financing leases to continue to be presented as results from investing activities in the statement of cash flows, and (3) clarifies that entities do not have to disclose the effect of the lease standard on adoption year interim amounts. ASU 2019-01 will be effective on January 1, 2020 and is being reviewed for any material impact on the Corporation’s consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which is essentially the final rule on use of the “CECL” model, or current expected credit losses. Among other things, the amendments in this ASU require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For SEC filers, the amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with later effective dates for smaller reporting companies, like the Corporation, and non-SEC registrant public companies and other organizations. Early adoption will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. In December 2018, the federal bank regulatory agencies approved a final rule that modifies their regulatory capital rules and provides institutions the option to phase in over a three-year period any day-one regulatory capital effects of the new accounting standard. In October 2019, the FASB affirmed its previously proposed amendment to delay the effective date for small reporting companies to interim and annual reporting periods beginning after December 15, 2022, including interim

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

periods within those fiscal years. Early adoption is permitted. The adoption of ASU No. 2016-13 is being reviewed for any material impact on the Corporation's consolidated financial statements.

2. INVESTMENT SECURITIES

Investment securities have been classified in the consolidated balance sheets according to management's intent. The amortized costs of securities as shown in the consolidated balance sheets and their estimated fair values at December 31 were as follows:

Securities Available For Sale:

<u>December 31, 2019</u>	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Estimated Fair Value</u>
U.S. government treasury securities	\$ 3,972,502	\$ 54,688	\$ 0	\$ 4,027,190
U.S. government agency securities	37,508,686	1,014,199	24,759	38,498,126
State and municipal securities	4,352,782	181,538	0	4,534,320
Residential mortgage-backed securities	<u>20,553,780</u>	<u>226,155</u>	<u>13,708</u>	<u>20,766,227</u>
Total debt securities AFS	<u>\$ 66,387,750</u>	<u>\$ 1,476,580</u>	<u>\$ 38,467</u>	<u>\$ 67,825,863</u>

<u>December 31, 2018</u>	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Estimated Fair Value</u>
U.S. government treasury securities	\$ 982,044	\$ 0	\$ 27,474	\$ 954,570
U.S. government agency securities	45,823,595	264,567	881,157	45,207,005
State and municipal securities	7,394,278	30,579	46,922	7,377,935
Residential mortgage-backed securities	<u>4,769,668</u>	<u>21,579</u>	<u>17,180</u>	<u>4,774,067</u>
Total debt securities AFS	<u>\$ 58,969,585</u>	<u>\$ 316,725</u>	<u>\$ 972,733</u>	<u>\$ 58,313,577</u>

Securities Held to Maturity:

<u>December 31, 2019</u>	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Estimated Fair Value</u>
State and municipal securities	\$ 20,443,004	\$ 460,952	\$ 3,425	\$ 20,900,531
Residential mortgage-backed securities	<u>5,043,957</u>	<u>173,092</u>	<u>0</u>	<u>5,217,049</u>
Total securities HTM	<u>\$ 25,486,961</u>	<u>\$ 634,044</u>	<u>\$ 3,425</u>	<u>\$ 26,117,580</u>

<u>December 31, 2018</u>	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Estimated Fair Value</u>
State and municipal securities	\$ 30,582,785	\$ 208,480	\$ 67,434	\$ 30,723,831
Residential mortgage-backed securities	<u>6,244,288</u>	<u>49,490</u>	<u>7,282</u>	<u>6,286,496</u>
Total securities HTM	<u>\$ 36,827,073</u>	<u>\$ 257,970</u>	<u>\$ 74,716</u>	<u>\$ 37,010,327</u>

At December 31, 2019, securities with a carrying value of \$61,695,810 and a market value of \$63,183,218 were pledged as collateral for public deposits and other purposes as required by law. Of these amounts, approximately \$25,000,827 was over pledged and could be released if necessary for liquidity needs. At December 31, 2018, securities with a carrying value of \$59,182,556 and a market value of \$58,502,416 were pledged as collateral for public deposits and other purposes as required by law.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

At December 31, 2019 and 2018, we had both 1 – 4 family and multifamily mortgage loans pledged to secure Federal Home Loan Bank (“FHLB”) advances. The FHLB requires the Bank to hold a minimum investment of stock, based on membership and the level of activity. As of December 31, 2019, this stock investment was \$1,714,600.

There were no investments in obligations of any state or municipal subdivisions which exceeded 10% of the Corporation’s shareholders’ equity at December 31, 2019.

The amortized cost and estimated fair value of debt securities at December 31, 2019, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalties.

December 31, 2019

<u>Available for Sale:</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Amounts maturing in:		
One year or less	\$ 2,003,753	\$ 2,008,857
After one through five years	30,515,506	31,324,990
After five through ten years	13,117,995	13,522,004
After ten years	<u>20,750,496</u>	<u>20,970,012</u>
Total debt securities AFS	\$ <u>66,387,750</u>	\$ <u>67,825,863</u>

<u>Held to Maturity:</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Amounts maturing in:		
One year or less	\$ 2,515,949	\$ 2,522,936
After one through five years	9,487,983	9,704,341
After five through ten years	8,864,208	9,094,103
After ten years	<u>4,618,822</u>	<u>4,796,200</u>
Total debt securities HTM	\$ <u>25,486,961</u>	\$ <u>26,117,580</u>

The following tables summarize the activity of security sales by intention and year for years ending 2019, 2018, and 2017.

Securities Available For Sale:

<u>December 31,</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>
Proceeds of sales	<u>\$ 9,358,503</u>	<u>\$ 2,879,000</u>	<u>\$ 5,741,211</u>
Gross gains	\$ 174,283	\$ 0	\$ 186,610
Gross losses	<u>0</u>	<u>(165,369)</u>	<u>0</u>
Net gains (losses) on sales of available for sale securities	<u>\$ 174,283</u>	<u>\$ (165,369)</u>	<u>\$ 186,610</u>

Securities Held to Maturity:

No held to maturity securities were sold during the years ending 2019, 2018, and 2017.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

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

<u>December 31, 2019</u>	<u>Less Than Twelve Months</u>		<u>Twelve Months or More</u>	
	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<u>Securities Available for Sale</u>				
Temporarily impaired debt securities:				
U.S. government agency securities	\$ 24,760	975,240	\$ 0	\$ 0
State and municipal securities	0	0	0	0
Residential mortgage-backed securities	12,571	3,961,786	1,136	99,289
Total debt securities available for sale	<u>\$ 37,331</u>	<u>\$ 4,937,026</u>	<u>\$ 1,136</u>	<u>\$ 99,289</u>

Securities Held to Maturity

Temporarily impaired debt securities:				
Residential mortgage-backed securities	\$ 3,425	\$ 472,171	\$ 0	\$ 0
Total securities held to maturity	<u>\$ 3,425</u>	<u>\$ 472,171</u>	<u>\$ 0</u>	<u>\$ 0</u>

December 31, 2018

	<u>Less Than Twelve Months</u>		<u>Twelve Months or More</u>	
	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<u>Securities Available for Sale</u>				
Temporarily impaired debt securities:				
U.S. government treasury securities	\$ 0	\$ 0	\$ 27,474	\$ 954,570
U.S. government agency securities	33,077	6,073,337	848,080	20,015,052
State and municipal securities	3,209	306,792	43,713	1,813,173
Residential mortgage-backed securities	14,199	3,032,237	2,981	129,410
Total debt securities available for sale	<u>\$ 50,485</u>	<u>\$ 9,412,366</u>	<u>\$ 922,248</u>	<u>\$ 22,912,205</u>

Securities Held to Maturity

Temporarily impaired debt securities:				
State and municipal securities	\$ 20,209	\$ 7,359,536	\$ 47,225	\$ 2,782,627
Residential mortgage-backed securities	5,671	879,487	1,611	89,464
Total securities held to maturity	<u>\$ 25,880</u>	<u>\$ 8,239,023</u>	<u>\$ 48,836</u>	<u>\$ 2,872,091</u>

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

At December 31, 2019, four debt securities had unrealized losses with aggregate depreciation of .75% from the Corporation's amortized cost basis. At December 31, 2018, sixty-six securities had unrealized losses with aggregate depreciation of 2.35%. These unrealized losses relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government, its agencies, or other governments, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. Management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available for sale. Also, no declines in debt securities are deemed to be other-than-temporary.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

3. LOANS AND ALLOWANCE FOR LOAN LOSSES

The composition of the Corporation's loan portfolio at December 31, 2019 and 2018 was as follows:

	<u>2019</u>	<u>2018</u>
Commercial, financial and agricultural loans	\$ 87,441,489	\$ 88,403,215
Real estate		
Construction loans	28,826,099	24,890,536
Commercial mortgage loans	143,022,080	123,477,369
Residential loans	102,239,917	103,347,898
Agricultural loans	31,459,274	31,561,686
Consumer & other loans	<u>5,093,661</u>	<u>5,086,984</u>
Loans outstanding	398,082,520	376,767,688
Unearned interest and discount	(17,345)	(17,451)
Allowance for loan losses	<u>(3,604,348)</u>	<u>(3,428,869)</u>
Net loans	<u>\$ 394,460,827</u>	<u>\$ 373,321,368</u>

The Corporation's only significant concentration of credit at December 31, 2019, occurred in real estate loans which totaled approximately \$306 million. However, this amount was not concentrated in any specific segment within the market or geographic area.

At December 31, 2019, the lendable collateral value of the 1-4 family and multifamily mortgage loans that were pledged to FHLB to secure outstanding advances was \$67,746,577. FHLB has a blanket lien on the 1-4 family and multifamily portfolios, which totaled \$121,550,567.

Appraisal Policy

When a loan is first identified as a problem loan, the appraisal is reviewed to determine if the appraised value is still appropriate for the collateral. For the duration that a loan is considered a problem loan, the appraised value of the collateral is monitored on a quarterly basis. If significant changes occur in market conditions or in the condition of the collateral, a new appraisal will be obtained.

Nonaccrual Policy

The Corporation does not accrue interest on any loan (1) that is maintained on a cash basis due to the deteriorated financial condition of the borrower, (2) for which payment in full of principal or interest is not expected, or (3) upon which principal or interest has been past due for ninety days or more unless the loan is well secured and in the process of collection.

A loan subsequently placed on nonaccrual status may be returned to accrual status if (1) all past due interest and principal is paid with expectations of any remaining contractual principal and interest being repaid or (2) the loan becomes well secured and in the process of collection.

Loans placed on nonaccrual status amounted to \$241,078 and \$1,204,861 at December 31, 2019 and 2018, respectively. There was one past due credit card loan in the amount of \$2,571 over 90 days and still accruing at December 31, 2019. There were no past due loans over 90 days and still accruing at December 31, 2018. The accrual of interest is discontinued when the loan is placed on nonaccrual. Interest income that would have been recorded on these nonaccrual loans in accordance with their original terms totaled \$9,158 and \$64,015 as of December 31, 2019 and 2018, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

The following tables present an age analysis of past due loans and nonaccrual loans segregated by class of loans.

Age Analysis of Past Due Loans As of December 31, 2018						
	Current and < 30 Days Past Due	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due Loans	Total Loans
Commercial, financial and agricultural loans	\$ 84,952,610	\$ 675,714	\$ 1,685,289	\$ 127,876	\$ 2,488,879	\$ 87,441,489
Real estate:						
Construction loans	28,548,384	227,383	0	0	227,383	28,775,767
Commercial mortgage loans	138,646,493	3,962,070	209,234	1	4,171,305	142,817,798
Residential loans	100,302,023	1,404,806	248,516	115,772	1,769,094	102,071,117
Agricultural loans	30,877,028	457,246	125,000	0	582,246	31,459,274
Consumer & other loans	4,887,890	61,404	34,265	0	95,669	4,983,559
Total loans	\$ 388,214,428	\$ 6,788,623	\$ 2,302,304	\$ 243,649	\$ 9,334,576	\$ 397,549,004
Overdrafts, in-process, and suspense						533,516
						<u>\$398,082,520</u>

Age Analysis of Past Due Loans As of December 31, 2018						
	Current and < 30 Days Past Due	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due Loans	Total Loans
Commercial, financial and agricultural loans	\$ 88,119,660	\$ 222,516	\$ 247,397	\$ 36,157	\$ 283,555	\$ 88,403,215
Real estate:						
Construction loans	24,837,229	0	0	0	0	24,837,229
Commercial mortgage loans	122,454,819	0	0	1,022,550	1,022,550	123,477,369
Residential loans	101,630,920	1,424,282	1,560,913	146,154	146,153	103,337,986
Agricultural loans	31,240,367	321,319	321,319	0	0	31,561,686
Consumer & other loans	5,050,331	14,238	36,654	0	0	5,086,984
Total loans	\$ 373,333,325	\$ 1,982,355	\$ 2,166,283	\$ 1,204,861	\$ 3,371,144	\$ 376,704,469
Overdrafts, in-process, and suspense						63,219
						<u>\$376,767,688</u>

The following table presents nonaccrual loans segregated by class of loans.

	2019		2018	
	Nonaccrual	90 Days or More Still Accruing	Nonaccrual	90 Days or More Still Accruing
Commercial, financial and agricultural loans	\$ 125,305	\$ 2,571	\$ 36,157	\$ 0
Real estate:				
Construction loans	0	0	0	0
Commercial mortgage loans	1	0	1,022,550	0
Residential loans	115,772	0	146,154	0
Agricultural loans	0	0	0	0
Consumer & other loans	0	0	0	0
Total loans	\$ 241,078	\$ 2,571	\$ 1,204,861	\$ 0

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

Impaired Loans

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

At December 31, 2019 and 2018, impaired loans amounted to \$2,195,151 and \$4,356,381, respectively. A reserve amount of \$478,153 and \$518,230, respectively, was recorded in the allowance for loan losses for these impaired loans as of December 31, 2019 and 2018.

The following tables present impaired loans, segregated by class of loans as of December 31, 2019 and 2018:

<u>December 31, 2019</u>	Unpaid Principal Balance	Recorded Investment			Related Allowance	Year-to-date Average Recorded Investment	Interest Income Received During Impairment
		With No Allowance	With Allowance	Total			
Commercial, financial and agricultural loans	\$1,247,947	\$ 62,475	\$1,098,818	\$1,161,293	\$ 430,318	\$ 939,937	\$ 83,335
Real estate:							
Construction loans	63,708	63,708	0	63,708	0	63,708	4,533
Commercial mortgage loans	847,287	249,582	154,439	404,021	47,690	365,940	47,663
Residential loans	581,217	553,468	0	553,468	0	525,698	34,193
Agricultural loans	0	0	0	0	0	0	0
Consumer & other loans	<u>12,661</u>	<u>0</u>	<u>12,661</u>	<u>12,661</u>	<u>145</u>	<u>12,661</u>	<u>936</u>
Total loans	<u>\$2,752,820</u>	<u>\$ 929,233</u>	<u>\$1,265,918</u>	<u>\$2,195,151</u>	<u>\$478,153</u>	<u>\$1,907,944</u>	<u>\$170,660</u>

<u>December 31, 2018</u>	Unpaid Principal Balance	Recorded Investment			Related Allowance	Year-to-date Average Recorded Investment	Interest Income Received During Impairment
		With No Allowance	With Allowance	Total			
Commercial, financial and agricultural loans	\$ 184,899	\$ 87,525	\$ 568,816	\$ 656,341	\$ 276,392	\$ 370,038	\$ 52,411
Real estate:							
Construction loans	402,234	281,434	0	281,434	0	281,434	25,364
Commercial mortgage loans	1,787,305	1,277,611	333,892	1,611,503	51,854	1,544,299	45,403
Residential loans	1,801,002	1,027,647	752,443	1,780,090	188,368	1,594,390	127,806
Agricultural loans	12,526	12,526	0	12,526	0	12,526	5,530
Consumer & other loans	<u>0</u>	<u>0</u>	<u>14,487</u>	<u>14,487</u>	<u>1,616</u>	<u>14,487</u>	<u>820</u>
Total loans	<u>\$4,187,966</u>	<u>\$2,686,743</u>	<u>\$1,669,638</u>	<u>\$4,356,381</u>	<u>\$518,230</u>	<u>\$3,817,174</u>	<u>\$257,334</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

For the period ending December 31, 2017, the average recorded investment for impaired loans was \$3,789,822 and the interest income received during impairment was \$207,180.

At December 31, 2019 and 2018, included in impaired loans were \$3,384 and \$7,458, respectively, of troubled debt restructurings.

Troubled Debt Restructurings

Loans are considered to have been modified in a troubled debt restructuring, or TDR, when due to a borrower's financial difficulty the Corporation makes certain concessions to the borrower that it would not otherwise consider for new debt with similar risk characteristics. Modifications may include interest rate reductions, principal or interest forgiveness, forbearance, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of the collateral. Each potential loan modification is reviewed individually and the terms of the loan are modified to meet the borrower's specific circumstances at a point in time. Not all loan modifications are TDRs. However, performance prior to the modification, or significant events that coincide with the modification, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of loan modification or after a shorter performance period.

Loan modifications are reviewed and recommended by the Corporation's senior credit officer, who determines whether the loan meets the criteria for a TDR. Generally, the types of concessions granted to borrowers that are evaluated in determining whether the loan is classified as a TDR include:

- Interest rate reductions – Occur when the stated interest rate is reduced to a nonmarket rate or a rate the borrower would not be able to obtain elsewhere under similar circumstances.
- Amortization or maturity date changes – Result when the amortization period of the loan is extended beyond what is considered a normal amortization period for loans of similar type with similar collateral.
- Principal reductions – Arise when the Corporation charges off a portion of the principal that is not fully collateralized and collectability is uncertain; however, this portion of principal may be recovered in the future under certain circumstances.

The following tables present the amount of troubled debt restructuring by loan class, classified separately as accrual and nonaccrual at December 31, 2019 and 2018, as well as those currently paying under restructured terms and those that have defaulted under restructured terms as of December 31, 2019 and 2018. Loans modified in a troubled debt restructuring are considered to be in default once the loan becomes 30 or more days past due.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

December 31, 2019						
	Accruing	Non- accruing	#	Under restructured terms		
				Current	#	Default
Commercial, financial, and agricultural loans	\$ 3,384	\$ 0	1	\$ 3,384	0	\$ 0
Real estate:						
Construction loans	0	0	0	0	0	0
Commercial mortgage loans	0	0	0	0	0	0
Residential loans	0	0	1	0	0	0
Agricultural loans	0	0	0	0	0	0
Consumer & other loans	0	0	0	0	0	0
Total TDR's	\$ 3,384	\$ 0	1	\$ 3,384	0	\$ 0

December 31, 2018						
	Accruing	Non- accruing	#	Under restructured terms		
				Current	#	Default
Commercial, financial, and agricultural loans	\$ 5,570	\$ 0	1	\$ 5,570	0	\$ 0
Real estate:						
Construction loans	0	0	0	0	0	0
Commercial mortgage loans	0	0	0	0	0	0
Residential loans	1,888	0	1	1,888	0	0
Agricultural loans	0	0	0	0	0	0
Consumer & other loans	0	0	0	0	0	0
Total TDR's	\$ 7,458	\$ 0	2	\$ 7,458	0	\$ 0

The following table presents the amount of troubled debt restructurings by types of concessions made, classified separately as accrual and nonaccrual at December 31, 2019 and 2018.

Type of concession:	December 31, 2019				December 31, 2018			
	Accruing		Nonaccruing		Accruing		Nonaccruing	
	#	Balance	#	Balance	#	Balance	#	Balance
Payment modification	0	\$ 0	0	\$ 0	0	\$ 0	0	\$ 0
Rate reduction	0	0	0	0	0	0	0	0
Rate reduction, payment modification	0	0	0	0	1	1,888	0	0
Forbearance of interest	1	3,384	0	0	1	5,570	0	0
Total	1	\$ 3,384	0	\$ 0	2	\$ 7,458	0	\$ 0

As of December 31, 2019 and 2018, the Corporation had a balance of \$3,384 and \$7,458, respectively, in troubled debt restructurings. The Corporation had no charge-offs on such loans as of December 31, 2019, and no charge-offs as of December 31, 2018. The Corporation's balance in the allowance for loan losses allocated to such troubled debt restructurings was \$0 at both December 31, 2019 and 2018. The Corporation had no unfunded commitment to lend to a customer that has a troubled debt restructured loan as of December 31, 2019.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

Credit Risk Monitoring and Loan Grading

The Corporation employs several means to monitor the risk in the loan portfolio including volume and severity of loan delinquencies, nonaccrual loans, internal grading of loans, historical loss experience and economic conditions.

Loans are subject to an internal risk-grading system which indicates the risk and acceptability of that loan. The loan grades used by the Corporation are for internal risk identification purposes and do not directly correlate to regulatory classification categories or any financial reporting definitions.

The general characteristics of the risk grades are as follows:

Grade 1 – Exceptional – Loans graded 1 are characterized as having a very high credit quality, exhibit minimum risk to the Corporation and have low administrative cost. These loans are usually secured by highly liquid and marketable collateral and a strong primary and secondary source of repayment is available.

Grade 2 – Above Average – Loans graded 2 are basically sound credits secured by sound assets and/or backed by the financial strength of borrowers of integrity with a history of satisfactory payments of credit obligations.

Grade 3 – Acceptable – Loans graded 3 are secured by sound assets of sufficient value and/or supported by the sufficient financial strength of the borrower. The borrower will have experience in their business area or employed a reasonable amount of time at their current employment. The borrower will have a sound primary source of repayment, and preferably a secondary source, which will allow repayment in a prompt and reasonable period of time.

Grade 4 – Fair – Loans graded 4 are those which exhibit some weakness or downward trend in financial condition and although the repayment history is satisfactory, it requires supervision by bank personnel. The borrower may have little experience in their business area or employed only a short amount of time at their current employment. The loan may be secured by good collateral; however, it may require close supervision as to value and/or quality and may not have sufficient liquidation value to completely cover the loan.

Grade 5a – Watch – Loans graded 5a contain a discernible weakness; however, the weakness is not sufficiently pronounced so as to cause concern for the possible loss of interest or principal. Loans in this category may exhibit outward signs of stress, such as slowness in financial disclosures or recent payments. However, such signs are not of long duration or of sufficient severity that default appears imminent. Loans in this category are not so deficient as to cause alarm, but do require close monitoring for further deterioration and possible downgrade.

Grade 5b – Other Assets Especially Mentioned (OAEM) – Loans graded 5b may otherwise be classified more severely except that the loan is well secured by properly margined collateral, it is generally performing in accordance with the original contract or modification thereof and such performance has seasoned for a period of 90 days, or the ultimate collection of all principal and interest is reasonably expected. Loans in this grade are unsupported by sufficient evidence of the borrower's sound net worth or repayment capacity or may be subject to third party action that would cause concern for future prompt repayment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

Grade 6 – Substandard – Loans graded 6 contain clearly pronounced credit weaknesses that are below acceptable credit standards for the Corporation. Such weaknesses may be due to either collateral deficiencies or inherent financial weakness of the borrower, but in either case represents less than acceptable credit risk. Loans in this grade are unsupported by sufficient evidence of the borrower’s sound net worth, repayment capacity or acceptable collateral.

Grade 7 – Doubtful – Loans graded 7 have such pronounced credit weaknesses that the Corporation is clearly exposed to a significant degree of potential loss of principal or interest. These loan generally have a defined weakness which jeopardizes the ultimate repayment of the debt.

Grade 8 – Loss – Loans graded 8 are of such deteriorated credit quality that repayment of principal and interest can no longer be considered. These loans are of such little value that their continuance as an active bank asset is not warranted. As of December 31, 2019 and 2018, all Grade 8 loans have been charged-off.

The following tables present internal loan grading by class of loans at December 31, 2019 and 2018:

<u>December 31, 2019</u>	Commercial, Financial, and <u>Agricultural</u>	Construction <u>Real Estate</u>	Commercial <u>Real Estate</u>	Residential <u>Real Estate</u>	Agricultural <u>Real Estate</u>	Consumer and Other	<u>Total</u>
Rating:							
Grade 1- Exceptional	\$ 1,337,601	\$ 0	\$ 0	\$ 21,932	\$ 0	\$ 335,663	\$ 1,695,196
Grade 2- Above Avg.	1,000	485,000	892,053	184,901	1,352,739	29,220	2,944,913
Grade 3- Acceptable	23,863,615	4,863,194	36,268,643	27,923,193	16,118,982	1,307,088	110,344,716
Grade 4- Fair	59,884,319	23,272,247	102,519,640	68,280,386	13,535,352	3,393,268	270,885,212
Grade 5a- Watch	394,551	15,979	2,360,912	1,399,320	0	578	4,171,340
Grade 5b- OAEM	1,532	125,971	327,831	3,110,121	452,200	11,327	4,028,982
Grade 6- Substandard	1,730,710	63,708	653,001	1,293,986	0	16,517	3,757,922
Grade 7- Doubtful	228,161	0	0	26,078	0	0	254,239
Total loans	<u>\$87,441,489</u>	<u>\$28,826,099</u>	<u>\$143,022,080</u>	<u>\$102,239,917</u>	<u>\$31,459,274</u>	<u>\$5,093,661</u>	<u>\$398,082,520</u>

<u>December 31, 2018</u>	Commercial, Financial, and <u>Agricultural</u>	Construction <u>Real Estate</u>	Commercial <u>Real Estate</u>	Residential <u>Real Estate</u>	Agricultural <u>Real Estate</u>	Consumer and Other	<u>Total</u>
Rating:							
Grade 1- Exceptional	\$ 1,237,602	\$ 0	\$ 0	\$ 22,905	\$ 0	\$ 210,045	\$ 1,470,552
Grade 2- Above Avg.	0	0	0	0	0	43,711	43,711
Grade 3- Acceptable	23,821,846	1,860,003	30,398,565	25,839,646	16,863,356	1,151,239	99,934,655
Grade 4- Fair	58,753,931	22,749,099	88,122,957	73,114,310	14,698,330	3,657,108	261,095,735
Grade 5a- Watch	473,616	0	2,411,710	722,441	0	6,206	3,613,973
Grade 5b- OAEM	3,079,098	0	446,841	1,299,587	0	2,168	4,827,694
Grade 6- Substandard	787,309	281,434	2,097,296	2,349,009	0	16,507	5,531,555
Grade 7- Doubtful	249,813	0	0	0	0	0	249,813
Total loans	<u>\$88,403,215</u>	<u>\$24,890,536</u>	<u>\$123,477,369</u>	<u>\$103,347,898</u>	<u>\$31,561,686</u>	<u>\$5,086,984</u>	<u>\$376,767,688</u>

Allowance for Loan Losses Methodology

The allowance for loan losses (ALL) is determined by a calculation based on segmenting the loans into the following categories: (1) impaired loans and nonaccrual loans, (2) loans with a credit risk rating of 5b, 6, 7 or 8, (3) other outstanding loans, and (4) other commitments to lend. In addition, unallocated general reserves are estimated based on migration and economic analysis of the loan portfolio.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

The ALL is calculated by the addition of the estimated loss derived from each of the above categories. The impaired loans and nonaccrual loans are analyzed on an individual basis to determine if the future collateral value is sufficient to support the outstanding debt of the loan. If an estimated loss is calculated, it is included in the estimated ALL until it is charged to the loan loss reserve. The calculation for loan risk graded 5b, 6, 7 or 8, other outstanding loans and other commitments to lend is based on assigning an estimated loss factor based on a twelve quarter rolling historical weighted average net loss rate. The estimated requirement for unallocated general reserves from migration and economic analysis is determined by considering (1) trends in asset quality, (2) level and trends in charge-off experience, (3) macroeconomic trends and conditions, (4) microeconomic trends and conditions and (5) risk profile of lending activities. Within each of these categories, a risk factor percentage from a rating of excessive, high, moderate or low will be determined by management and applied to the loan portfolio. By adding the estimated value from the migration and economic analysis to the estimated reserve from the loan portfolio, a total estimated loss reserves is obtained. This amount is then compared to the actual amount in the loan loss reserve. The calculation of ALL is performed on a monthly basis and is presented to the Loan Committee and the Board of Directors.

Changes in the allowance for loan losses are as follows:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Balance, January 1	\$ 3,428,869	\$ 3,043,632	\$ 3,124,611
Provision charged to operations	856,677	829,500	300,000
Loans charged off	(750,757)	(606,345)	(447,747)
Recoveries	<u>69,559</u>	<u>162,082</u>	<u>66,768</u>
Balance, December 31	<u>\$ 3,604,348</u>	<u>\$ 3,428,869</u>	<u>\$ 3,043,632</u>

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

<u>December 31, 2019</u>	Commercial, Financial, and <u>Agricultural</u>	Construction <u>Real Estate</u>	Commercial <u>Real Estate</u>	Residential <u>Real Estate</u>	Agricultural <u>Real Estate</u>	Consumer and Other	<u>Total</u>
<u>Allowance for loan losses:</u>							
Beginning balance, December 31, 2018	\$ 402,251	\$ 1,043,027	\$ 1,210,302	\$ 458,871	\$ 108,878	\$ 205,540	\$ 3,428,869
Charge-offs	179,241	56,220	274,550	226,540	0	14,206	750,757
Recoveries	<u>20,029</u>	<u>0</u>	<u>3,368</u>	<u>39,812</u>	<u>0</u>	<u>6,350</u>	<u>69,559</u>
Net charge-offs	159,212	56,220	271,182	186,728	0	7,856	681,198
Provisions charged to operations	<u>258,307</u>	<u>48,417</u>	<u>420,195</u>	<u>147,666</u>	<u>(31,998)</u>	<u>14,090</u>	<u>856,677</u>
Balance at end of period, December 31, 2019	<u>\$ 501,346</u>	<u>\$ 1,035,224</u>	<u>\$ 1,359,315</u>	<u>\$ 419,809</u>	<u>\$ 76,880</u>	<u>\$ 211,774</u>	<u>\$ 3,604,348</u>
Individually evaluated for impairment	\$ 430,318	\$ 0	\$ 47,690	\$ 0	\$ 0	\$ 145	\$ 478,153
Collectively evaluated for impairment	<u>71,028</u>	<u>1,035,224</u>	<u>1,311,625</u>	<u>419,809</u>	<u>76,880</u>	<u>211,629</u>	<u>3,126,195</u>
Balance at end of period	<u>\$ 501,346</u>	<u>\$ 1,035,224</u>	<u>\$ 1,359,315</u>	<u>\$ 419,809</u>	<u>\$ 76,880</u>	<u>\$ 211,774</u>	<u>\$ 3,604,348</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

Loans :

Ending balance - Individually evaluated for impairment	\$ 1,161,293	\$ 63,708	\$ 404,021	\$ 553,468	\$ 0	\$ 12,661	\$ 2,195,151
Collectively evaluated for impairment	<u>86,280,196</u>	<u>28,762,391</u>	<u>142,618,059</u>	<u>101,686,449</u>	<u>31,459,274</u>	<u>5,081,000</u>	<u>395,887,369</u>
Balance at end of period	<u>\$87,441,489</u>	<u>\$28,826,099</u>	<u>\$143,022,080</u>	<u>\$102,239,917</u>	<u>\$31,459,274</u>	<u>\$5,093,661</u>	<u>\$398,082,520</u>

At December 31, 2019, of the \$2,195,151 loans that were individually evaluated for impairment, \$2,195,151 were deemed impaired.

	Commercial, Financial, and Agricultural	Construction Real Estate	Commercial Real Estate	Residential Real Estate	Agricultural Real Estate	Consumer and Other	Total
<u>December 31, 2018</u>							
<u>Allowance for loan losses:</u>							
Beginning balance, December 31, 2017	\$ 324,260	\$ 1,043,083	\$ 1,056,595	\$ 416,474	\$ 11,560	\$ 191,660	\$ 3,043,632
Charge-offs	548,460	783	43,349	6,909	0	6,844	606,345
Recoveries	<u>12,025</u>	<u>0</u>	<u>590</u>	<u>0</u>	<u>147,252</u>	<u>2,215</u>	<u>162,082</u>
Net charge-offs	536,435	783	42,759	6,909	(147,252)	4,629	444,263
Provisions charged to operations	<u>614,426</u>	<u>727</u>	<u>196,466</u>	<u>49,306</u>	<u>(49,934)</u>	<u>18,509</u>	<u>829,500</u>
Balance at end of period, December 31, 2018	<u>\$ 402,251</u>	<u>\$ 1,043,027</u>	<u>\$ 1,210,302</u>	<u>\$ 458,871</u>	<u>\$ 108,878</u>	<u>\$ 205,540</u>	<u>\$ 3,428,869</u>
Individually evaluated for impairment	\$ 276,392	\$ 0	\$ 51,854	\$ 188,368	\$ 0	\$ 1,616	\$ 518,230
Collectively evaluated for impairment	<u>125,859</u>	<u>1,043,027</u>	<u>1,158,448</u>	<u>270,503</u>	<u>108,878</u>	<u>203,924</u>	<u>2,910,639</u>
Balance at end of period	<u>\$ 402,251</u>	<u>\$ 1,043,027</u>	<u>\$ 1,210,302</u>	<u>\$ 458,871</u>	<u>\$ 108,878</u>	<u>\$ 205,540</u>	<u>\$ 3,428,869</u>

Loans :

Ending balance - Individually evaluated for impairment	\$ 656,341	\$ 281,434	\$ 1,611,503	\$ 1,929,214	\$ 12,526	\$ 14,487	\$ 4,505,505
Collectively evaluated for impairment	<u>87,746,874</u>	<u>24,609,102</u>	<u>121,865,866</u>	<u>101,418,684</u>	<u>31,549,160</u>	<u>5,072,497</u>	<u>372,262,183</u>
Balance at end of period	<u>\$88,403,215</u>	<u>\$24,890,536</u>	<u>\$123,477,369</u>	<u>\$103,347,898</u>	<u>\$31,561,686</u>	<u>\$5,086,984</u>	<u>\$376,767,688</u>

At December 31, 2018, of the \$4,505,505 loans that were individually evaluated for impairment, only \$4,356,381 were deemed impaired.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

The following table is a summary of amounts included in the ALL for the impaired loans with specific reserves and the recorded balance of the related loans.

	Year Ended December 31,		
	<u>2019</u>	<u>2018</u>	<u>2017</u>
Allowance for loss on impaired loans	\$ 478,153	\$ 518,230	\$ 331,779
Recorded balance of impaired loans	\$ 2,195,151	\$ 4,356,381	\$ 4,895,730

4. PREMISES AND EQUIPMENT

The amounts reported as bank premises and equipment at December 31, 2019 and 2018, are as follows:

	<u>2019</u>	<u>2018</u>
Land	\$ 3,715,432	\$ 3,842,146
Buildings	15,583,367	15,411,518
Furniture and equipment	11,155,784	10,767,592
Construction in process	<u>0</u>	<u>4,892</u>
	30,454,583	30,026,148
Less accumulated depreciation	(16,607,214)	(15,452,174)
Total	\$ <u>13,847,369</u>	\$ <u>14,573,974</u>

Depreciation of premises and equipment was \$1,200,032, \$1,036,986, and \$881,000 in 2019, 2018, and 2017, respectively. The Corporation depreciates its long-lived assets on various methods over their estimated productive lives, as more fully described in Note 1, Summary of Significant Accounting Policies.

5. INTANGIBLE ASSETS

The following table lists the Corporation's account relationship intangible assets at December 31, 2019 and 2018. These assets were fully amortized in March 2019.

	<u>2019</u>	<u>2018</u>
Amortizing intangible assets		
Account relationships	\$ <u>0</u>	\$ <u>3,907</u>
Total intangible assets	\$ <u>0</u>	\$ <u>3,907</u>

The intangible assets' carrying amount, accumulated amortization and amortization expense for December 31, 2019 are as follows:

	<u>2019</u>
Amortizing intangible assets	
Account relationships	
Gross carrying amount	\$ 125,000
Accumulated amortization	<u>125,000</u>
Net carrying amount	\$ 0
Amortization expense	\$ 3,907

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

6. DEPOSITS

At December 31, 2019, the scheduled maturities of certificates of deposit are as follows:

	<u>Amount</u>
2020	\$66,752,872
2021	16,345,763
2022	4,903,070
2023	4,630,440
2024 and thereafter	<u>31,016</u>
Total	<u>\$92,663,161</u>

The amount of overdraft deposits reclassified as loans were \$98,082 and \$70,003 for the years ended December 31, 2019 and 2018, respectively. At December 31, 2019, there were 41 certificates of deposit totaling \$23,582,708 that were at or above the FDIC insurance limit of \$250,000.

7. SHORT-TERM BORROWED FUNDS

Federal funds purchased generally mature within one to four days. On December 31, 2019, the Corporation did not have any federal funds purchased. The Corporation had approximately \$108,000,000 in unused federal funds and FHLB accommodations at December 31, 2019. The Corporation maintains a line of credit with the Federal Reserve Bank's Discount Window. The maximum amount that can be borrowed is dependent upon the amount of unpledged securities held by the Corporation as the amount of borrowings must be fully secured.

Other short-term borrowed funds consist of FHLB advances of \$5,814,286 with interest at 1.78% as of December 31, 2019, and \$10,457,143 with interest at 1.92% as of December 31, 2018. \$2.214 million and \$4.457 million of short-term borrowings are short-term portions of long-term principal reducing Federal Home Loan Bank advances as of December 31, 2019 and 2018, respectively.

Information concerning federal funds purchased and FHLB short-term advances are summarized as follows:

	<u>2019</u>	<u>2018</u>
Average balance during the year	\$ 6,545,280	\$17,305,184
Average interest rate during the year	1.89%	2.29%
Maximum month-end balance during the year	\$12,802,381	\$20,971,429

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

8. LONG-TERM DEBT

Long-term debt at December 31, 2019 and 2018, consisted of the following:

	<u>2019</u>	<u>2018</u>
Advance from FHLB with 1.25% fixed rate of interest with annual installment payments maturing September 30, 2020.	\$ 0	\$ 1,600,000
Advance from FHLB with 1.94% fixed rate of interest with annual installment payments maturing December 16, 2022.	0	2,571,429
Advance from FHLB with a 1.80% fixed rate of interest maturing July 10, 2020.	0	2,000,000
Advance from FHLB with a 1.93% fixed rate of interest with annual installment payments maturing September 28, 2022.	0	6,000,000
Advance from FHLB with a 3.018% fixed rate of interest maturing Sept. 17, 2021.	0	3,000,000
Advance from FHLB with a 3.192% fixed rate of interest maturing Sept. 20, 2023.	3,000,000	3,000,000
Advance from FHLB with a 3.400% fixed rate of interest maturing Sept. 20, 2025.	3,000,000	3,000,000
Advance from FHLB with a 1.836% fixed rate of interest maturing June 24, 2021.	5,000,000	0
Advance from FHLB with a 1.951% fixed rate of interest with quarterly installment payments maturing June 26, 2024.	3,500,000	0
Advance from FHLB with a 2.027% fixed rate of interest with quarterly installment payments maturing June 26, 2026.	3,928,571	0
Advance from FHLB with a 2.117% fixed rate of interest with quarterly installment payments maturing June 26, 2029.	<u>4,250,000</u>	<u>0</u>
Total long-term debt	<u>\$ 22,678,571</u>	<u>\$ 21,171,429</u>

The advances from FHLB are collateralized by the pledging of a combination of 1-4 family residential mortgages and multifamily loans. At December 31, 2019, 1-4 family residential mortgage loans and multifamily loans with a lendable collateral value of \$67,746,577 were pledged to secure these advances. At December 31, 2018, 1-4 family residential mortgage loans and multifamily loans with a lendable collateral value of \$61,443,772 were pledged to secure these advances. The amount of FHLB Stock held is based on membership and level of FHLB advances. At year end 2019 and 2018, the amount of stock held that is based on membership was \$480,100 and \$439,600, respectively, and the amount of stock held that is based on the level of FHLB advances was \$1,234,500 and \$1,380,700, respectively. At December 31, 2019, the Corporation had approximately \$108,000,000 of unused lines of credit with the FHLB.

The following are maturities of long-term debt for the next five years. At December 31, 2019, there was no floating rate long-term debt.

<u>Due in:</u>	<u>Fixed Rate Amount</u>
2020	\$ 0
2021	6,107,143
2022	1,107,143
2023	4,107,143
2024	4,607,142
Later years	<u>6,750,000</u>
Total long-term debt	<u>\$22,678,571</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

9. EMPLOYEE BENEFITS AND RETIREMENT PLANS

Pension Plan

The Corporation has a noncontributory defined benefit pension plan which covers most employees who have attained the age of 21 years and completed one year of continuous service. The Corporation is providing for the cost of this plan as benefits are accrued based upon actuarial determinations employing the aggregate funding method.

The table of actuarially computed benefit obligations and net assets and the related changes of the Plan at December 31, 2019, 2018, and 2017, is presented below.

	<u>2019</u>	<u>2018</u>	<u>2017</u>
<u>Change in Benefit Obligation</u>			
Benefit obligation at beginning of year	\$11,792,602	\$12,745,058	\$13,149,559
Service cost	0	0	0
Interest cost	639,233	657,845	712,228
Amendments	0	0	0
Settlement	(105,416)	(100,395)	(129,172)
Benefits paid	(1,162,037)	(1,097,859)	(1,116,643)
Other – net	<u>(114,386)</u>	<u>(412,047)</u>	<u>129,086</u>
Benefit obligation at end of year	<u>\$11,049,996</u>	<u>\$11,792,602</u>	<u>\$12,745,058</u>
<u>Change in Plan Assets</u>			
Fair value of plan assets at beginning of year	\$9,679,754	\$10,672,811	\$10,574,145
Actual return on plan assets	1,200,176	(254,803)	864,481
Employer contribution	700,000	460,000	480,000
Benefits paid	<u>(1,267,453)</u>	<u>(1,198,254)</u>	<u>(1,245,815)</u>
Fair value of plan assets at end of year	<u>\$ 10,312,477</u>	<u>\$ 9,679,754</u>	<u>\$10,672,811</u>
<u>Funded status</u>			
Funded status	<u>\$(737,519)</u>	<u>\$(2,112,848)</u>	<u>\$(2,072,247)</u>
Unrecognized net actuarial (gain)/loss	0	0	0
Unrecognized prior service cost	0	0	0
Pension liability included in other liabilities	<u>\$(737,519)</u>	<u>\$(2,112,848)</u>	<u>\$(2,072,247)</u>
Accumulated benefit obligation	<u>\$11,049,996</u>	<u>\$11,792,602</u>	<u>\$12,745,058</u>
<u>Amount recognized in consolidated balance sheet consist of the following:</u>			
Accrued Pension	<u>\$ 737,519</u>	<u>\$2,112,848</u>	<u>\$2,072,247</u>
Deferred tax assets	\$ 154,879	\$ 443,698	\$ 435,172
Accumulated other comprehensive income	<u>582,640</u>	<u>1,669,150</u>	<u>1,637,075</u>
Total	<u>\$ 737,519</u>	<u>\$2,112,848</u>	<u>\$2,072,247</u>
<u>Components of Pension Cost</u>			
Service cost	\$ 0	\$ 0	\$ 0
Interest cost on benefit obligation	639,233	657,845	712,228
Expected return on plan assets	(646,186)	(721,735)	(716,622)
Other - net	<u>580,372</u>	<u>482,679</u>	<u>587,821</u>
Net periodic pension cost	573,419	418,789	583,427
Partial recognition of loss due to settlement	<u>0</u>	<u>0</u>	<u>0</u>
Total	<u>\$ 573,419</u>	<u>\$ 418,789</u>	<u>\$ 583,427</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

Other changes in plan assets and benefit obligations recognized in comprehensive income:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Net loss (gain)	\$(1,248,748)	\$ 40,601	\$ (503,167)
Prior service costs	<u>0</u>	<u>0</u>	<u>0</u>
Total recognized in other comprehensive income (loss)	(1,248,748)	40,601	(503,167)
Net periodic pension cost	573,419	418,789	583,427
Partial recognition of loss due to settlement	<u>0</u>	<u>0</u>	<u>0</u>
Total recognized in net periodic pension cost and other comprehensive income	\$ <u>(675,329)</u>	\$ <u>459,390</u>	\$ <u>(80,260)</u>

After adopting ASC Topic 960, Employer’s Accounting for Defined Benefit Pension Plan and Other Postretirement Plans, and freezing its pension retirement plan, the Corporation decreased the accrued liability by \$1,375,329 in 2019 and increased \$40,601 in 2018. Also, changes were made to other comprehensive income (loss) of \$1,086,510 for 2019 and (\$32,075) for 2018 on an after-tax basis. During 2019, the fair value of the plan assets increased \$632,723.

At December 31, 2019, the plan assets included cash and cash equivalents, certificates of deposits with banks, U.S. government agency securities, corporate notes, and equity securities.

Assumptions used to determine the benefit obligation as of December 31, 2019 and 2018 respectively were:

<u>Weighted-Average Assumptions as of December 31</u>	<u>2019</u>	<u>2018</u>
Discount rate	5.70%	5.70%
Rate of compensation increase	N/A	N/A

For the years ended December 31, 2019, 2018, and 2017, the assumptions used to determine net periodic pension costs are as follows:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Discount rate	5.70%	5.70%	5.70%
Expected return on plan assets	7.00%	7.00%	7.00%
Rate of compensation increase	N/A	N/A	N/A

The expected rate of return represents the average rate of return to be earned on plan assets over the period the benefits included in the benefit obligation are to be paid. In determining the expected rate of return, the Corporation considers long-term compound annualized returns of historical market data as well as actual returns on the Corporation’s plan assets, and applies adjustments that reflect more recent capital market experience.

The Corporation’s pension plan investment objective is both security and long-term stability, with moderate growth. The investment strategies and policies employed provide for investments, other than “fixed-dollar” investments, to prevent erosion by inflation. Sufficient funds are held in a liquid nature (money market, short-term securities) to allow for the payment of plan benefits and expenses, without subjecting the funds to loss upon liquidation. In an effort to provide a higher return with lower risk, the fund assets are allocated between stocks, fixed income securities, and cash equivalents. All plan investments and transactions are in compliance with ERISA and any other law applicable to employee benefit plans. The targeted investment portfolio is allocated up to 45% in equities, 50% to 90% in fixed-income investments, and up to 20% in cash equivalent investments.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

All the Corporation's equity investments are in mutual funds with a Morningstar rating of 3 or higher, have at least \$300 million in investments, and have been in existence 5 years or more. Fixed income securities include issues of the U.S. government and its agencies and corporate notes. Any corporate note purchased has a rating (by Standard & Poor's or Moody's) of "A" or better. The average maturity of the fixed income portion of the portfolio does not exceed 10 years.

Pension Asset Allocation and Fair Value Measurement as of December 31

	2019			2018		
	<u>Fair Value</u>	<u>Level 1</u>	<u>%</u>	<u>Fair Value</u>	<u>Level 1</u>	<u>%</u>
Investment at fair value as determined by quoted market price:						
Equity	\$ 0	\$ 0	0%	\$ 3,482,765	\$ 3,482,765	36%
Fixed income	0	0	0%	1,096,033	1,096,033	11%
Total	\$ 0	\$ 0	0%	\$ 4,578,798	\$ 4,578,798	47%
Investment at estimated fair value:						
Certificates of deposit	\$ 4,967,299	\$ 4,967,299	48%	\$ 4,521,110	\$ 4,521,110	47%
Cash and cash equivalent	5,345,178	5,345,178	52%	579,846	579,846	6%
Total	\$10,312,477	\$10,312,477	100%	\$ 5,100,956	\$ 5,100,956	53%
Total	<u>\$10,312,477</u>	<u>\$10,312,477</u>	<u>100%</u>	<u>\$ 9,679,754</u>	<u>\$ 9,679,754</u>	<u>100%</u>

All of the pension plan's investments were reported as Level 1 assets and received Level 1 fair value measurement.

ASC Topic 820, Fair Value Measurements and Disclosures, establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy consists of three broad levels: Level 1 inputs consist of unadjusted quoted prices in active markets for identical assets and have the highest priority, and Level 3 inputs have the lowest priority. These levels are:

Level 1 - The fair values of mutual funds, preferred stock, corporate notes, and U.S. government agency securities were based on quoted market prices. Money market funds and certificates of deposit were reported at fair value.

Level 2 - Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that were not active, and model-based valuation techniques for which all significant assumptions were observable in the market.

Level 3 - Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

Estimated Contributions

The Corporation expects to contribute \$500,000 to its pension plan in 2020.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service and decrements as appropriate, are expected to be paid for fiscal years beginning:

2020	1,055,000
2021	1,031,000
2022	1,051,000
2023	1,021,000
2024	997,000
Years 2025 – 2029	4,484,000

The estimated amortization amount for 2020 is a net loss of \$504,825, no prior service cost or credit, and no net transition asset or obligation.

Southwest Georgia Bank 401(K) Plan

In place of the Corporation's frozen defined benefit pension retirement plan, the Corporation offers its employees a 401(K) Plan. This 401(K) plan is a qualified defined contribution plan as provided for under Section 401(K) of the Internal Revenue Code. This plan is a "safe-harbor" plan meaning that the Corporation will match contributions dollar for dollar for the first four percent of salary participants defer into the plan. The plan does allow for discretionary match in excess of the four percent and that the participants are allowed to defer the maximum amount of salary. The Corporation matched the employee participants for the first four percent of salary contributing to the plan \$206,731, \$219,006, and \$204,565 for the years ended December 31, 2019, 2018, and 2017, respectively.

Employee Stock Ownership Plan

The Corporation has a nondiscriminatory Employee Stock Ownership Plan and Trust (the "ESOP") administered by a trustee. The plan was established to purchase and hold Southwest Georgia Financial Corporation stock for all eligible employees. Contributions to the plan are made solely by the Corporation and are at the discretion of the Board of Directors. The annual amount of the contribution is determined by taking into consideration the financial conditions, profitability, and fiscal requirements of the Corporation. There were contributions of \$450,000, \$475,000, and \$425,000 for the years ended December 31, 2019, 2018, and 2017, respectively. Contributions to eligible participants are based on percentage of annual compensation. As of December 31, 2019, the ESOP holds 251,119 shares of the Corporation's outstanding common stock. There were 201,780 released shares allocated to the participants. The 49,339 unreleased shares are pledged as collateral for a \$911,718 debt incurred from repurchasing participants' shares. Dividends paid by the Corporation on ESOP shares are allocated to the participants based on shares held. ESOP shares are included in the Corporation's outstanding shares and earnings per share computation.

Directors Deferred Compensation Plan

The Corporation has a voluntary deferred compensation plan for the Board of Directors administered by an insurance company (the "Directors' Deferred Compensation Plan"). The plan stipulates that if a director participates in the Plan for four years, the Corporation will pay the director future monthly income for ten years beginning at normal retirement age, and the Corporation will make specified monthly payments to the director's beneficiaries in the event of his or her death prior to the completion of such payments. The plan is funded by life insurance policies with the Corporation as the named beneficiary. This plan is closed to new director enrollment and participation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *continued*

Directors and Executive Officers Stock Purchase Plan

The Corporation has adopted a stock purchase plan for the executive officers and directors of Southwest Georgia Financial Corporation. Under the plan, participants may elect to contribute up to \$900 monthly of salary or directors' fees and receive corporate common stock with an aggregate value of two times their contribution. The expense incurred during 2019, 2018, and 2017 on the part of the Corporation totaled \$248,780, \$248,800, and \$265,900, respectively.

Dividend Reinvestment and Share Purchase Plan

The Corporation maintains a dividend reinvestment and share purchase plan. The purpose of the plan is to provide shareholders of record of the Corporation's common stock, who elect to participate in the plan, with a simple and convenient method of investing cash dividends and voluntary cash contributions in shares of the common stock without payment of any brokerage commissions or other charges. Eligible participants may purchase common stock through automatic reinvestment of common stock dividends on all or partial shares and make additional voluntary cash payments of not less than \$5 nor more than \$5,000 per month.

The participant's price of common stock purchased with dividends or voluntary cash payments will be the average price of all shares purchased in the open market, or if issued from unissued shares or treasury stock the price will be the average of the high and low sales prices of the stock on the NYSE American LLC on the dividend payable date or other purchase date. During the years ended December 31, 2019, 2018, and 2017, shares issued through the plan were 5,986, 5,726, and 5,286, respectively, at an average price of \$20.96, \$22.63, and \$21.18, per share, respectively. These numbers of shares and average price per share are not adjusted by stock dividends.

Equity Incentive Award

The Corporation has a 2013 Omnibus Incentive Plan (the "Incentive Plan") that was approved by our shareholders at the Corporation's 2014 Annual Meeting. The Incentive Plan was established to attract, retain and motivate the Corporation's employees, consultants, advisors and directors, to promote the success of our business by linking their personal interests to those of our shareholders and to encourage stock ownership on the part of management. Under the Incentive Plan, the Corporation may issue a maximum aggregate amount of 125,000 shares of common stock pursuant to (i) stock options, which includes incentive stock options and non-qualified stock options, (ii) stock appreciation rights, (iii) restricted stock awards, (iv) restricted stock units, (v) incentive awards, (vi) other stock-based awards and (vii) dividend equivalents.

The Corporation may also grant cash-based awards under the Incentive Plan. During 2019, the Corporation granted 4,456 shares of restricted stock awards of which none are vested. The Corporation granted 13,316 shares of restricted stock awards during 2018 of which 2,606 vested and 1,163 were forfeited during 2019. The Corporation granted 4,271 shares of restricted stock awards during 2017 of which 714 vested and 559 were forfeited during 2019. In addition, participants sold 349 shares back to the plan during 2019.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

The following table summarizes the movements in the Corporation's outstanding restricted stock awards:

	Number of Shares	Amount
Non-vested balance, December 31, 2017	4,271	\$ 88,153
Granted	13,316	306,032
Vested	(854)	(17,627)
Non-vested balance, December 31, 2018	16,733	\$ 376,558
Granted	4,456	93,576
Vested	(3,320)	(74,622)
Repurchased from participants	349	11,928
Forfeited by participants	(1,722)	(38,266)
Non-vested balance, December 31, 2019	16,496	\$ 369,174

Awards are being amortized to expense over the five-year vesting period.

10. INCOME TAXES

Components of income tax expense for 2019, 2018, and 2017 are as follows:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Current expense	\$ 1,201,933	\$ 28,779	\$ 1,101,902
Deferred taxes (benefit)	<u>(55,347)</u>	<u>639,637</u>	<u>517,998</u>
Total income taxes	\$ <u>1,146,586</u>	\$ <u>668,416</u>	\$ <u>1,619,900</u>

The reasons for the difference between the federal income taxes in the consolidated statements of income and the amount and percentage computed by the applying the combine statutory federal and state income tax rate to income taxes are as follows:

	<u>2019</u>		<u>2018</u>		<u>2017</u>	
	Amount	%	Amount	%	Amount	%
Taxes at statutory income tax rate	\$ 1,351,733	21.0	\$ 1,116,262	21.0	\$ 1,845,313	34.0
Reductions in taxes resulting from exempt income	(209,892)	(3.3)	(272,486)	(5.1)	(524,347)	(9.7)
Other timing differences	<u>4,745</u>	<u>0.1</u>	<u>(175,360)</u>	<u>(3.3)</u>	<u>298,934</u>	<u>5.5</u>
Total income taxes	\$ <u>1,146,586</u>	<u>17.8</u>	\$ <u>668,416</u>	<u>12.6</u>	\$ <u>1,619,900</u>	<u>29.8</u>

The sources of timing differences for tax reporting purposes and the related deferred taxes recognized in 2019, 2018, and 2017 are summarized as follows:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Intangible asset amortization	\$ 0	\$ 0	\$ 172,816
Deferred gain on covered transaction	(1,115)	5,004	9,352
Nonaccrual loan interest	155	8,369	(6,896)
Recognition of AMT tax credit carryforward	0	332,776	0
Foreclosed assets expenses	4,760	41,530	(42,075)
Bad debt expense in excess of tax	(36,850)	(80,902)	423,203
Accretion of discounted bonds	10,546	16,805	14,772
Gain on disposition of discounted bonds	0	(4,188)	(28,215)
Book and tax depreciation difference	(43,664)	357,266	(24,959)
Other timing differences	<u>10,821</u>	<u>(37,023)</u>	<u>0</u>
Total deferred taxes	<u>\$ (55,347)</u>	<u>\$ 639,637</u>	<u>\$ 517,998</u>

ASC 740, Income Taxes, requires organizations to recognize the effect of a change in tax rates at the date of enactment by adjusting its deferred tax liabilities and assets to the new tax rate. With the Jobs and Tax Cut Act of 2017 being signed into law in December 2017, our deferred taxes were revalued resulting in additional income tax expense of \$419,359 at December 31, 2017, leaving \$98,639 as the actual current period timing difference.

	<u>December 31</u>	
	<u>2019</u>	<u>2018</u>
Deferred tax assets:		
Nonaccrual loan interest	\$ 319	\$ 474
Deferred gain on covered transaction	10,415	9,300
Foreclosed assets expenses	5,403	10,163
Intangible asset amortization	125,883	125,883
Bad debt expense in excess of tax	756,913	720,063
Realized loss on other-than-temporarily impaired equity securities	214,353	214,353
Deferred directors compensation	122,235	133,057
Capital loss carryforward	32,878	32,878
Pension plan	154,879	443,698
Unrealized losses on securities available for sale	<u>0</u>	<u>137,761</u>
Total deferred tax assets	<u>1,423,278</u>	<u>1,827,630</u>
Deferred tax liabilities:		
Accretion on bonds and gain on discounted bonds	78,853	68,307
Book and tax depreciation difference	532,235	575,899
Unrealized gains on securities available for sale	<u>302,004</u>	<u>0</u>
Total deferred tax liabilities	<u>913,092</u>	<u>644,206</u>
Net deferred tax assets	<u>\$ 510,186</u>	<u>\$ 1,183,424</u>

11. RELATED PARTY TRANSACTIONS

The ESOP held 251,119 shares of the Corporation's stock as of December 31, 2019, of which 49,339 shares have been pledged to secure the ESOP's debt to the Corporation. In the normal course of business, the Bank has made loans at prevailing interest rates and terms to directors and executive officers of the Corporation and its subsidiaries, and to their affiliates. The aggregate indebtedness to the Bank of these related parties approximated \$1,381,000 and \$1,567,000 at December 31, 2019 and 2018, respectively. During 2019, approximately \$346,000 of such loans were made, and repayments totaled approximately \$532,000. None of these above mentioned loans were restructured, nor were any related party loans charged off during 2019 or 2018. Also, during 2019 and 2018, directors and executive officers had approximately \$2,502,000 and \$2,015,000, respectively, in deposits with the Bank.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

12. COMMITMENTS, CONTINGENT LIABILITIES, AND FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

In the normal course of business, various claims and lawsuits may arise against the Corporation. Management, after reviewing with counsel all actions and proceedings, considers that the aggregate liability or loss, if any, will not be material.

The Corporation is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own risk exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit in the form of loans or through letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the Consolidated Balance Sheets. The contract or notional amounts of the instruments reflect the extent of involvement the Corporation has in particular classes of financial instruments.

Commitments to extend credit are contractual obligations to lend to a customer as long as all established contractual conditions are satisfied. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee by a customer.

Standby letters of credit and financial guarantees are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Standby letters of credit and financial guarantees are generally terminated through the performance of a specified condition or through the lapse of time.

The Corporation's exposure to credit loss in the event of nonperformance by the other party to commitments to extend credit and standby letters of credit is represented by the contractual or notional amounts of these instruments. As these off-balance sheet financial instruments have essentially the same credit risk involved in extending loans, the Corporation generally uses the same credit and collateral policies in making these commitments and conditional obligations as it does for on-balance sheet instruments. Since many of the commitments to extend credit and standby letters of credit are expected to expire without being drawn upon, the contractual or notional amounts do not represent future cash requirements.

The contractual or notional amounts of financial instruments having credit risk in excess of that reported in the Consolidated Balance Sheets are as follows:

	<u>Dec. 31, 2019</u>	<u>Dec. 31, 2018</u>
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	\$ <u>55,934,489</u>	\$ <u>39,418,110</u>
Standby letters of credit and financial guarantees	\$ <u>1,255,000</u>	\$ <u>4,342,849</u>

The Corporation has no lease obligations that require capitalization. The rental agreement for the loan production office in Tifton, Georgia ended July 31, 2018. The Corporation's remaining lease is an operating lease for postage services, which expires December 2020.

The following table shows scheduled future cash payments under this obligation as of December 31, 2019.

	<u>Payments Due by Period</u>				
	<u>Total</u>	Less than 1 <u>Year</u>	1-3 <u>Years</u>	4-5 <u>Years</u>	After 5 <u>Years</u>
Operating leases	\$5,148	\$5,148	\$ 0	\$ 0	\$ 0

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

Rental expenses were \$0, \$9,100, and \$15,600 for the years ended December 31, 2019, 2018, and 2017, respectively.

13. FAIR VALUE MEASUREMENTS AND DISCLOSURES

The Corporation utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available for sale are recorded at fair value on a recurring basis. From time to time, the Corporation may be required to record at fair value other assets on a nonrecurring basis, such as impaired loans and foreclosed real estate. Additionally, the Corporation is required to disclose, but not record, the fair value of other financial instruments.

Fair Value Hierarchy:

Under ASC Topic 820, the Corporation groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

- | | |
|---------|--|
| Level 1 | Valuation is based upon quoted prices for identical instruments traded in active markets. |
| Level 2 | Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market. |
| Level 3 | Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques. |

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

Cash and Cash Equivalents:

For disclosure purposes for cash and due from banks, interest bearing deposits in other banks and federal funds sold, the carrying amount is a reasonable estimate of fair value.

Certificates of Deposit in Other Banks:

For disclosure purposes for certificates of deposit in other banks, the carrying amount is a reasonable estimate of fair value.

Investment Securities Available for Sale:

Investment securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange and U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter market funds. Level 2 securities include mortgage-backed securities issued by government sponsored enterprises and state, county and municipal bonds. Other securities classified as available for sale are reported at fair value utilizing Level 2 inputs. Securities classified as Level 3 include asset-backed securities in less liquid markets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

Investment Securities Held to Maturity:

Investment securities held to maturity are not recorded at fair value on a recurring basis. For disclosure purposes, fair value measurement is based upon quoted prices, if available.

Federal Home Loan Bank Stock:

For disclosure purposes, the carrying value of other investments approximate fair value.

Loans:

The Corporation does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and a specific allocation is established within the allowance for loan losses. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC Topic 310, *Accounting by Creditors for Impairment of a Loan*. The fair value of impaired loans is estimated using one of three methods, including collateral value, market value of similar debt, and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. In accordance with ASC Topic 820, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation records the impaired loan as nonrecurring Level 3.

For disclosure purposes, the fair value of fixed rate loans which are not considered impaired, is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings. For unimpaired variable rate loans, the carrying amount is a reasonable estimate of fair value for disclosure purposes.

Foreclosed Assets:

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

Bank Owned Life Insurance:

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

Deposits:

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

FHLB Advances:

For disclosure purposes, the fair value of the FHLB fixed rate borrowing is estimated using discounted cash flows, based on the current incremental borrowing rates for similar types of borrowing arrangements.

Commitments to Extend Credit and Standby Letters of Credit:

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

Assets Recorded at Fair Value on a Recurring Basis:

The table below presents the recorded amount of assets measured at fair value on a recurring basis as of December 31, 2019 and 2018.

<u>December 31, 2019</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investment securities available for sale:				
U.S. government treasury securities	\$ 4,027,190	\$ 0	\$ 0	\$ 4,027,190
U.S. government agency securities	0	38,498,127	0	38,498,127
State and municipal securities	0	4,534,320	0	4,534,320
Residential mortgage-backed securities	<u>0</u>	<u>20,766,227</u>	<u>0</u>	<u>20,766,227</u>
Total	<u>\$ 4,027,190</u>	<u>\$ 63,798,674</u>	<u>\$ 0</u>	<u>\$ 67,825,864</u>
<u>December 31, 2018</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investment securities available for sale:				
U.S. government treasury securities	\$ 954,570	\$ 0	\$ 0	\$ 954,570
U.S. government agency securities	0	45,207,005	0	45,207,005
State and municipal securities	0	7,377,935	0	7,377,935
Residential mortgage-backed securities	<u>0</u>	<u>4,774,067</u>	<u>0</u>	<u>4,774,067</u>
Total	<u>\$ 954,570</u>	<u>\$ 57,359,007</u>	<u>\$ 0</u>	<u>\$ 58,313,577</u>

Assets Recorded at Fair Value on a Nonrecurring Basis:

The Corporation may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis are included in the table below as of December 31, 2019 and 2018.

<u>December 31, 2019</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Foreclosed assets	\$ 0	\$ 0	\$ 273,873	\$ 273,873
Impaired loans	<u>0</u>	<u>0</u>	<u>1,716,998</u>	<u>1,716,998</u>
Total assets at fair value	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 1,990,871</u>	<u>\$ 1,990,871</u>
<u>December 31, 2018</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Foreclosed assets	\$ 0	\$ 0	\$ 127,605	\$ 127,605
Impaired loans	<u>0</u>	<u>0</u>	<u>3,838,151</u>	<u>3,838,151</u>
Total assets at fair value	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 3,965,756</u>	<u>\$ 3,965,756</u>

Foreclosed properties that are included above as measured at fair value on a nonrecurring basis are those properties that resulted from a loan that had been foreclosed and charged down or have been written down subsequent to foreclosure. Foreclosed properties are generally recorded at the appraised value less estimated selling costs in the range of 15 – 20%. Loans that are reported above as being measured at fair value on a nonrecurring basis are generally impaired loans that have been either partially charged off or have specific

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

reserves assigned to them. Nonaccrual impaired loans that are collateral dependent are generally written down to a range of 80 – 85% of appraised value which considers the estimated costs to sell. Specific reserves are established for impaired loans based on appraised value of collateral or discounted cash flows.

The carrying amount and estimated fair values of the Corporation's assets and liabilities which are required to be either disclosed or recorded at fair value at December 31, 2019 and 2018, are as follows:

<u>December 31, 2019</u>	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>			
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
		(Dollars in thousands)			
Assets:					
Cash and cash equivalents	\$ 37,631	\$ 37,631	\$ 0	\$ 0	\$ 37,631
Certificates of deposit in other banks	2,730	2,730	0	0	2,730
Investment securities available for sale	67,826	4,027	63,799	0	67,826
Investment securities held to maturity	25,487	0	26,118	0	26,118
Federal Home Loan Bank stock	1,715	0	1,715	0	1,715
Loans, net	394,461	0	386,405	1,717	388,122
Bank owned life insurance	6,913	0	6,913	0	6,913
Liabilities:					
Deposits	473,434	0	458,402	0	458,402
Federal Home Loan Bank advances	28,493	0	28,780	0	28,780

<u>December 31, 2018</u>	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>			
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
		(Dollars in thousands)			
Assets:					
Cash and cash equivalents	\$ 35,499	\$ 35,499	\$ 0	\$ 0	\$ 35,499
Certificates of deposit in other banks	2,732	2,732	0	0	2,732
Investment securities available for sale	58,314	955	57,359	0	58,314
Investment securities held to maturity	36,827	0	37,010	0	37,010
Federal Home Loan Bank stock	1,820	0	1,820	0	1,820
Loans, net	373,321	0	362,373	3,838	366,211
Bank owned life insurance	6,779	0	6,779	0	6,779
Liabilities:					
Deposits	455,640	0	456,245	0	456,245
Federal Home Loan Bank advances	31,629	0	31,591	0	31,591

Limitations:

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial statement element. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates included herein are based on existing on- and off-balance-sheet financial instruments without attempting to estimate the value of anticipated future business and the fair value of assets and liabilities that are not required to be recorded or disclosed at fair value like premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

14. SUPPLEMENTAL FINANCIAL DATA

Components of other income and other operating expense in excess of one percent of gross interest income for the respective periods are as follows:

	Years Ended December 31		
	<u>2019</u>	<u>2018</u>	<u>2017</u>
Income:			
Bank card interchange fees	\$653,726	\$576,359	\$600,619
Gain on sale of fixed assets	\$250,460	\$(97,503)	\$ (1,594)
Expense:			
Other professional fees	\$499,797	\$287,273	\$317,147
Advertising & public relations	\$248,422	\$264,269	\$192,016
Director & board committee fees	\$301,842	\$241,523	\$278,821
FDIC insurance assessment	\$118,269	\$233,878	\$247,963
Telephone expense	\$309,012	\$284,586	\$180,559

15. SHAREHOLDERS' EQUITY / REGULATORY MATTERS

Dividends paid by the Bank subsidiary are the primary source of funds available to the parent company for payment of dividends to its shareholders and other needs. Banking regulations limit the amount of dividends that may be paid without prior approval of the Bank's regulatory agency. At December 31, 2019, approximately \$2,750,464 of the Bank's net assets were available for payment of dividends without prior approval from the regulatory authorities.

The Federal Reserve Board requires that banks maintain reserves based on their average deposits in the form of vault cash and average deposit balances at the Federal Reserve Banks. For the year ended December 31, 2019, the Bank had a total reserve requirement of \$0.

The Corporation (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by such agencies that, if undertaken, could have a direct material effect on the Corporation's and Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios (set forth in the following table) of Total, Common Equity Tier I, and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier I capital to average assets (as defined). As of December 31, 2019 and 2018, the Corporation met all capital adequacy requirements. As of December 31, 2019, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

To be categorized as well capitalized, an institution must maintain minimum Total risk-based, Common Equity Tier I risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the following tables. Under the Basel III rules, the Bank must hold a capital conservation buffer above the minimum regulatory risk-based capital ratios. The capital conservation buffer for 2019 is 2.50%. There are no conditions or events since the notification that management believes have changed the Bank's category. The Corporation's and the Bank's actual capital amounts and ratios as of December 31, 2019 and 2018, are also presented in the table.

As a result of regulatory limitations at December 31, 2019, approximately \$45,371,590 of the parent company's investments in net assets of the subsidiary bank of \$48,122,054, as shown in the accompanying condensed balance sheets in Note 16, was restricted from transfer by the subsidiary bank to the parent company in the form of cash dividends.

The Corporation's and the Bank's ratios under the above rules at December 31, 2019 and 2018, are set forth in the following tables.

<u>As of December 31, 2019</u>	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>Southwest Georgia Financial Corporation</u>						
Common equity Tier 1 (to risk-weighted assets)	\$48,412,803	12.35%	\$17,634,437	≥ 4.50%	N/A*	N/A*
Total capital (to risk-weighted assets)	\$52,017,151	13.27%	\$31,350,110	≥ 8.00%	N/A*	N/A*
Tier I capital (to risk-weighted assets)	\$48,412,803	12.35%	\$23,512,853	≥ 6.00%	N/A*	N/A*
Leverage (tier I capital to average assets)	\$48,412,803	8.81%	\$21,991,645	≥ 4.00%	N/A*	N/A*

<u>As of December 31, 2019</u>	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>Southwest Georgia Bank</u>						
Common equity Tier 1 (to risk-weighted assets)	\$47,568,585	12.15%	\$17,621,975	≥ 4.50% ⁽¹⁾	\$25,453,964	≥ 6.50%
Total capital (to risk-weighted assets)	\$51,172,933	13.07%	\$31,327,955	≥ 8.00% ⁽¹⁾	\$39,159,944	≥ 10.00%
Tier I capital (to risk-weighted assets)	\$47,568,585	12.15%	\$23,495,966	≥ 6.00% ⁽¹⁾	\$31,327,955	≥ 8.00%
Leverage (tier I capital to average assets)	\$47,568,585	8.59%	\$22,158,487	≥ 4.00%	\$27,698,109	≥ 5.00%

*N/A - As of December 31, 2019, the Corporation met the definition under the Basel III Capital Rules of a small bank holding company and, therefore, was exempt from consolidated risk-based and leverage capital adequacy guidelines for bank holding companies.

(1) Not including capital conservation buffer.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

<u>As of December 31, 2018</u>	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>Southwest Georgia Financial Corporation</u>						
Common equity Tier 1 (to risk-weighted assets)	\$45,802,434	11.97%	\$17,217,892	≥ 4.50%	N/A*	N/A*
Total capital (to risk-weighted assets)	\$49,231,303	12.87%	\$30,609,586	≥ 8.00%	N/A*	N/A*
Tier I capital (to risk-weighted assets)	\$45,802,434	11.97%	\$22,957,189	≥ 6.00%	N/A*	N/A*
Leverage (tier I capital to average assets)	\$45,802,434	8.62%	\$21,265,996	≥ 4.00%	N/A*	N/A*
<u>Southwest Georgia Bank</u>						
Common equity Tier 1 (to risk-weighted assets)	\$43,680,743	11.44%	\$17,180,290	≥ 4.50% ⁽¹⁾	\$24,815,974	≥ 6.50%
Total capital (to risk-weighted assets)	\$47,109,612	12.34%	\$30,542,738	≥ 8.00% ⁽¹⁾	\$38,178,422	≥ 10.00%
Tier I capital (to risk-weighted assets)	\$43,680,743	11.44%	\$22,907,053	≥ 6.00% ⁽¹⁾	\$30,542,738	≥ 8.00%
Leverage (tier I capital to average assets)	\$43,680,743	8.24%	\$21,206,909	≥ 4.00%	\$26,508,636	≥ 5.00%

*N/A - As of December 31, 2018, the Corporation met the definition under the Basel III Capital Rules of a small bank holding company and, therefore, was exempt from consolidated risk-based and leverage capital adequacy guidelines for bank holding companies.

(1) Not including capital conservation buffer.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

16. PARENT COMPANY FINANCIAL DATA

Southwest Georgia Financial Corporation's condensed balance sheets as of December 31, 2019 and 2018, and its related condensed statements of operations and cash flows for the years ended are as follows:

Condensed Balance Sheets as of December 31, 2019 and 2018 (Dollars in thousands)		
	<u>2019</u>	<u>2018</u>
ASSETS		
Cash	\$ 1,370	\$ 776
Investment in consolidated wholly-owned bank subsidiary, at equity	48,122	41,497
Loans	912	640
Other assets	<u>94</u>	<u>708</u>
Total assets	\$ <u>50,498</u>	\$ <u>43,621</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Total liabilities	\$ <u>7</u>	\$ <u>2</u>
Shareholders' equity:		
Common stock, \$1 par value, 5,000,000 shares authorized, 2,548,510 shares and 2,545,776 shares issued for 2019 & 2018	2,549	2,546
Additional paid-in capital	18,479	18,419
Retained earnings	28,910	24,841
Accumulated other comprehensive loss	<u>553</u>	<u>(2,187)</u>
Total shareholders' equity	<u>50,491</u>	<u>43,619</u>
Total liabilities and shareholders' equity	\$ <u>50,498</u>	\$ <u>43,621</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *continued*

16. PARENT COMPANY FINANCIAL DATA (continued)

Condensed Statements of Income and Expense
for the years ended December 31, 2019, 2018, and 2017
(Dollars in thousands)

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Income:			
Dividend received from bank subsidiary	\$ 2,245	\$ 1,200	\$ 2,000
Interest income	<u>80</u>	<u>45</u>	<u>26</u>
Total income	<u>2,325</u>	<u>1,245</u>	<u>2,026</u>
Expenses:			
Other	<u>373</u>	<u>189</u>	<u>172</u>
Income before income taxes and equity in Undistributed income of bank subsidiary	1,952	1,056	1,854
Income tax benefit – allocated from consolidated return	<u>82</u>	<u>40</u>	<u>88</u>
Income before equity in undistributed income of subsidiary	2,034	1,096	1,942
Equity in undistributed income of subsidiary	<u>3,256</u>	<u>3,551</u>	<u>1,865</u>
Net income	5,290	4,647	3,807
Retained earnings – beginning of year	24,841	33,020	30,334
Adjustment to correct immaterial misstatement of investment in bank subsidiary in prior periods	0	(129)	0
Cash dividend declared	(1,221)	(1,196)	(1,121)
Retirement of treasury stock	<u>0</u>	<u>(11,501)</u>	<u>0</u>
Retained earnings – end of year	\$ <u>28,910</u>	\$ <u>24,841</u>	\$ <u>33,020</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

16. PARENT COMPANY FINANCIAL DATA (continued)

Condensed Statements of Cash Flows
for the years ended December 31, 2019, 2018, and 2017
(Dollars in thousands)

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Cash flow from operating activities:			
Net income	\$ 5,290	\$ 4,647	\$ 3,807
Adjustments to reconcile net income to net cash used by operating activities:			
Equity in undistributed earnings of subsidiary	(3,256)	(3,551)	(1,865)
Stock-based compensation – restricted stock	75	18	0
Changes in:			
Other assets	(15)	3	(25)
Other liabilities	<u>5</u>	<u>2</u>	<u>0</u>
Net cash provided for operating activities	<u>2,099</u>	<u>1,119</u>	<u>1,917</u>
Cash flow from investing activities:			
Net change in loans	<u>(272)</u>	<u>(535)</u>	<u>80</u>
Net cash provided (used) for investing activities	<u>(272)</u>	<u>(535)</u>	<u>80</u>
Cash flow from financing activities:			
Cash dividend paid to shareholders	(1,221)	(1,196)	(1,121)
Payment to repurchase common stock	<u>(12)</u>	<u>(306)</u>	<u>(122)</u>
Net cash used for financing activities	<u>(1,233)</u>	<u>(1,502)</u>	<u>(1,243)</u>
Increase (decrease) in cash	594	(918)	754
Cash – beginning of year	<u>776</u>	<u>1,694</u>	<u>940</u>
Cash – end of year	\$ <u>1,370</u>	\$ <u>776</u>	\$ <u>1,694</u>

17. EARNINGS PER SHARE

Earnings per share are based on the weighted average number of common shares outstanding during the year.

	<u>December 31,</u>		
	<u>2019</u>	<u>2018</u>	<u>2017</u>
Net income	\$ <u>5,290,240</u>	\$ <u>4,647,119</u>	\$ <u>3,807,492</u>
Net income available to common shareholders	\$ <u>5,290,240</u>	\$ <u>4,647,119</u>	\$ <u>3,807,492</u>
Average number of common shares outstanding	2,545,672	2,545,565	2,547,421
Effect of dilutive restricted stock	<u>0</u>	<u>0</u>	<u>1</u>
Average number of common shares outstanding used to calculate diluted earnings per common share	<u>2,545,672</u>	<u>2,545,565</u>	<u>2,547,422</u>
Earnings per share - basic	\$ <u>2.08</u>	\$ <u>1.83</u>	\$ <u>1.49</u>
Earnings per share - diluted	\$ <u>2.08</u>	\$ <u>1.83</u>	\$ <u>1.49</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

18. QUARTERLY DATA

SOUTHWEST GEORGIA FINANCIAL CORPORATION
 QUARTERLY DATA
 (UNAUDITED)
 (Dollars in thousands)

	For the Year 2019			
	Fourth	Third	Second	First
Interest and dividend income	\$ 6,572	\$ 6,355	\$ 6,147	\$ 5,962
Interest expense	1,013	1,150	1,095	1,196
Net interest income	5,559	5,205	5,052	4,766
Provision for loan losses	112	379	250	116
Net interest income after provision for loan losses	5,447	4,826	4,802	4,650
Noninterest income	1,081	1,192	1,307	1,237
Noninterest expenses	4,918	4,221	4,550	4,416
Income before income taxes	1,610	1,797	1,559	1,471
Provision for income taxes	278	365	261	243
Net income	<u>\$ 1,332</u>	<u>\$ 1,432</u>	<u>\$ 1,298</u>	<u>\$ 1,228</u>
Earnings per share of common stock:				
Basic	<u>\$.53</u>	<u>\$.56</u>	<u>\$.51</u>	<u>\$.48</u>
Diluted	<u>\$.53</u>	<u>\$.56</u>	<u>\$.51</u>	<u>\$.48</u>

	For the Year 2018			
	Fourth	Third	Second	First
Interest and dividend income	\$ 5,900	\$ 5,640	\$ 5,292	\$ 5,062
Interest expense	1,116	867	725	614
Net interest income	4,784	4,773	4,567	4,448
Provision for loan losses	226	249	140	215
Net interest income after provision for loan losses	4,558	4,524	4,427	4,233
Noninterest income	1,175	978	1,060	994
Noninterest expenses	4,357	4,149	4,132	3,996
Income before income taxes	1,376	1,353	1,355	1,231
Provision for income taxes	253	209	207	(1)
Net income	<u>\$ 1,123</u>	<u>\$ 1,144</u>	<u>\$ 1,148</u>	<u>\$ 1,232</u>
Earnings per share of common stock:				
Basic	<u>\$.44</u>	<u>\$.45</u>	<u>\$.45</u>	<u>\$.48</u>
Diluted	<u>\$.44</u>	<u>\$.45</u>	<u>\$.45</u>	<u>\$.48</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *continued*

19. SEGMENT REPORTING

The Corporation operations are divided into four reportable business segments: The Retail and Commercial Banking Services, Insurance Services, Wealth Strategies Services, and Financial Management Services. These operating segments have been identified primarily based on the Corporation's organizational structure.

The Retail and Commercial Banking Services segment serves consumer and commercial customers by offering a variety of loan and deposit products, and other traditional banking services.

The Insurance Services segment offers clients a full spectrum of commercial and personal lines insurance products including life, health, property, and casualty insurance.

The Wealth Strategies Services segment provides personal trust administration, estate settlement, investment management, employee retirement benefit services, and the Individual Retirement Account (IRA) administration. Also, this segment offers full-service retail brokerage which includes the sale of retail investment products including stocks, bonds, mutual funds, and annuities.

The Financial Management Services segment is responsible for the management of the investment securities portfolio. It also is responsible for managing financial risks, including liquidity and interest rate risk.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Corporation evaluates performance based on profit or loss from operations after income taxes not including nonrecurring gains or losses.

The Corporation's reportable segments are strategic business units that offer different products and services. They are managed separately because each segment appeals to different markets and, accordingly, requires different technology and marketing strategies.

The Corporation allocates capital and funds used or funds provided for each reportable business segment. Also, each segment is credited or charged for the cost of funds provided or used. These credits and charges are reflected as net intersegment interest income (expense) in the table below. The Corporation does allocate income taxes to the segments. Other revenue represents noninterest income, exclusive of the net gain (loss) on disposition of assets and expenses associated with administrative activities which are not allocated to the segments. Those expenses include audit, compliance, investor relations, marketing, personnel, and other executive or parent company expenditures.

The Corporation does not have operating segments other than those reported. Parent Company and the Administrative Offices financial information is included in the "Other" category, and is deemed to represent an overhead function rather than an operating segment. The Administrative Offices include audit, marketing, information technology, personnel, and the executive office.

The Corporation does not have a single external customer from which it derives 10% or more of its revenue and operates in one geographical area.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

Information about reportable business segments, and reconciliation of such information to the consolidated financial statements for the years ended December 31, 2019, 2018, and 2017, are as follows:

	Segment Reporting For the year ended December 31, 2019						Totals
	Retail and Commercial Banking	Insurance Services	Wealth Strategies	Financial Management	Inter- segment Elimination	Other	
Net Interest Income (expense)							
external customers	\$ 18,365	\$ -	\$ (11)	\$ 2,170	\$ -	\$ 59	\$ 20,583
Net intersegment interest income (expense)	1,885	27	(1)	(1,932)	(17)	38	-
Net interest income	20,250	27	(12)	238	(17)	97	20,583
Provision for Loan Losses	857	-	-	-	-	-	857
Noninterest Income (expense)							
external customers	1,832	1,715	581	421	-	268	4,817
Intersegment noninterest Income (expense)	(26)	26	30	-	(30)	-	-
Total Noninterest Income	1,806	1,741	714	421	(30)	268	4,817
Noninterest Expenses:							
Depreciation	1,048	36	20	59	-	37	1,200
Amortization of intangibles	-	4	-	-	-	-	4
Other Noninterest expenses	11,607	1,286	635	800	-	2,574	16,902
Total Noninterest expenses	12,655	1,326	655	859	-	2,611	18,106
Pre-tax income	8,544	442	(56)	(200)	(47)	(2,246)	6,437
Provision for Income Taxes	1,545	81	(11)	(47)	-	(421)	1,147
Net Income	\$ 6,999	\$ 361	\$ (45)	\$ (153)	\$ (47)	\$ (1,825)	\$ 5,290
Assets	\$ 643,471	\$ 2,327	\$ 205	\$ 169,895	\$ (261,868)	\$ 1,106	\$ 555,136
Expenditures of Fixed Assets	\$ 578	\$ 6	\$ 17	\$ 16	\$ -	\$ -	\$ 617

Amounts included in the "Other" column are as follows:

	Other
Net interest Income:	
Parent Company	\$ 59
Executive Office	38
Noninterest Income:	
Executive office miscellaneous income	268
Noninterest Expenses:	
Parent Company corporate expenses	352
Executive office expenses not allocated to segments	2,259
Provision for Income taxes:	
Parent Company income taxes (benefit)	(82)
Executive office income taxes not allocated to segments	(339)
Net Income:	\$ (1,825)
Segment assets:	
Parent Company assets, after intercompany elimination	\$ 1,106

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

	Segment Reporting						Totals
	For the year ended December 31, 2018						
	Retail and Commercial Banking	Insurance Services	Wealth Strategies	Financial Management	Inter-segment Elimination	Other	
Net Interest Income (expense)							
external customers	\$ 16,334	\$ -	\$ -	\$ 2,193	\$ -	\$ 45	\$ 18,572
Net intersegment interest income (expense)	1,818	20	(7)	(1,831)	-	-	-
Net interest income	18,152	20	(7)	362	-	45	18,572
Provision for Loan Losses	830	-	-	-	-	-	830
Noninterest Income (expense)							
external customers	1,765	1,604	665	259	-	(86)	4,207
Intersegment noninterest Income (expense)	(20)	20	31	-	(31)	-	-
Total Noninterest Income	1,745	1,624	696	259	(31)	(86)	4,207
Noninterest Expenses:							
Depreciation	845	37	18	56	-	81	1,037
Amortization of intangibles	-	16	-	-	-	-	16
Other Noninterest expenses	10,974	1,158	624	752	-	2,073	15,581
Total Noninterest expenses	11,819	1,211	642	808	-	2,154	16,634
Pre-tax income	7,248	433	47	(187)	(31)	(2,195)	5,315
Provision for Income Taxes	1,184	68	3	(210)	-	(377)	668
Net Income	\$ 6,064	\$ 365	\$ 44	\$ 23	\$ (31)	\$ (1,818)	\$ 4,647
Assets	\$ 628,222	\$ 1,971	\$ 267	\$ 132,033	\$ (229,108)	\$ 1,448	\$ 534,833
Expenditures of Fixed Assets	\$ 3,321	\$ 2	\$ 8	\$ 57	\$ -	\$ -	\$ 3,388

Amounts included in the "Other" column are as follows:

	Other
Net interest Income:	
Parent Company	\$ 45
Noninterest Income:	
Executive office miscellaneous income	(86)
Noninterest Expenses:	
Parent Company corporate expenses	188
Executive office expenses not allocated to segments	1,966
Provision for Income taxes:	
Parent Company income taxes (benefit)	(40)
Executive office income taxes not allocated to segments	(337)
Net Income:	\$ (1,818)
Segment assets:	
Parent Company assets, after intercompany elimination	\$ 1,448

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

	Segment Reporting						Totals
	For the year ended December 31, 2017						
	Retail and Commercial Banking	Insurance Services	Wealth Strategies	Financial Management	Inter- segment Elimination	Other	
Net Interest Income (expense)							
external customers	\$ 15,119	\$ -	\$ -	\$ 2,099	\$ -	\$ 26	\$ 17,244
Net intersegment interest income (expense)	1,817	16	(6)	(1,827)	-	-	-
Net interest income	16,936	16	(6)	272	-	26	17,244
Provision for Loan Losses	300	-	-	-	-	-	300
Noninterest Income (expense)							
external customers	2,099	1,525	612	75	-	1	4,312
Intersegment noninterest Income (expense)	(16)	16	32	-	(32)	-	-
Total Noninterest Income	2,083	1,541	644	75	(32)	1	4,312
Noninterest Expenses:							
Depreciation	685	33	24	56	-	83	881
Amortization of intangibles	-	16	-	-	-	-	16
Other Noninterest expenses	10,328	1,119	592	780	-	2,113	14,932
Total Noninterest expenses	11,013	1,168	616	836	-	2,196	15,829
Pre-tax income	7,706	389	22	(489)	(32)	(2,169)	5,427
Provision for Income Taxes	1,784	86	(2)	306	-	(554)	1,620
Net Income	\$ 5,922	\$ 303	\$ 24	\$ (795)	\$ (32)	\$ (1,615)	\$ 3,807
Assets	\$ 567,723	\$ 1,687	\$ 177	\$ 138,598	\$ (219,840)	\$ 727	\$ 489,072
Expenditures of Fixed Assets	\$ 1,888	\$ 48	\$ 2	\$ 17	\$ -	\$ -	\$ 1,955

Amounts included in the "Other" column are as follows:

	Other
Net interest Income:	
Parent Company	\$ 26
Noninterest Income:	
Executive office miscellaneous income	1
Noninterest Expenses:	
Parent Company corporate expenses	172
Executive office expenses not allocated to segments	2,024
Provision for Income taxes:	
Parent Company income taxes (benefit)	(88)
Executive office income taxes not allocated to segments	(466)
Net Income:	\$ (1,615)
Segment assets:	
Parent Company assets, after intercompany elimination	\$ 727

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, continued

20. ADJUSTMENT TO RETAINED EARNINGS

During year-end processing for 2018, the Corporation discovered that its Directors' Deferred Compensation Plan accrual and the income related to the Cash Surrender Value of related policies to fund the plan had not been calculated properly for a number of years. Once discovered, the proper calculations were made and confirmed. The net effect on prior periods presented was determined to be immaterial and was therefore charged to 2018 Retained Earnings without restating prior periods. See the Consolidated Statements of Changes in Shareholders' Equity for the treatment of the correction. After this adjustment, the 2018 Consolidated Balance Sheets reflect the net present value of payments due under this plan and the 2018 Consolidated Statements of Income reflect the correct current year expense associated with changes in the net present value of payments due under this plan.

21. SUBSEQUENT EVENTS

On February 26, 2020, Southwest Georgia Financial Corporation declared a quarterly cash dividend of \$0.12 per common share. The dividend was paid on March 19, 2020, to shareholders of record on March 9, 2020.

In February 2020, the Corporation began the process of settlement of its defined benefit pension plan. As part of this process, an additional contribution was made. These transactions resulted in a charge of \$3.4 million to expense.

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

The Corporation performed an evaluation of subsequent events through March 26, 2020, the date upon which the Corporation's financial statements were available for issue. The Corporation has not evaluated subsequent events after this date.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

The Corporation did not change accountants nor have any disagreements with its accountants on any matters of accounting practices or principles or financial statement disclosure.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Corporation's management, including the Chief Executive Officer and Principal Financial Officer, supervised and participated in an evaluation of the effectiveness of the Corporation's disclosure controls and procedures (as defined in federal securities rules) as of December 31, 2019. Based on, and as of the date of, that evaluation, the Corporation's Chief Executive Officer and Principal Financial Officer have concluded that the Corporation's disclosure controls and procedures were effective in accumulating and communicating information to management, including the Chief Executive Officer and Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosures of that information under the SEC's rules and forms and that the Corporation's disclosure controls and procedures are designed to ensure that the information required to be disclosed in reports that are filed or submitted by the Corporation under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Management's Report on Internal Control over Financial Reporting

Management of the Corporation is responsible for establishing and maintaining effective internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

Under the supervision and with the participation of management, including the principal executive officer and principal financial officer, the Corporation conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in *Internal Control over Financial Reporting - Guidance for Smaller Public Companies* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation under the above framework, management of the Corporation has concluded the Corporation maintained effective internal control over financial reporting, as such term is defined in Securities Exchange Act of 1934 Rule 13a-15(f), as of December 31, 2019. Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting can also be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Management is also responsible for the preparation and fair presentation of the consolidated financial statements and other financial information contained in this report. The accompanying consolidated financial statements were prepared in conformity with GAAP and include, as necessary, best estimates and judgments by management.

/s/ DeWitt Drew

DeWitt Drew
President and Chief Executive Officer
(Principal Executive Officer)

/s/ T. Garrett Westbrook

T. Garrett Westbrook
Vice President and Controller
(Principal Financial Officer)

March 26, 2020

Changes in Internal Control Over Financial Reporting

No changes were made to the Corporation's internal control over financial reporting during the last fiscal quarter that materially affected or could reasonably likely to materially affect the Corporation's internal controls over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information regarding our directors, compliance with Section 16(a) reporting, code of ethics, audit committee and audit committee financial expert related to this item will be included in a definitive proxy statement or an amendment to this Annual Report on Form 10-K/A filed within 120 days after the end of our 2019 fiscal year and the information contained in Part I, Item 1 hereof under the heading "Business - Executive Officers of the Corporation and the Bank" regarding our executive officers is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information regarding executive and director compensation related to this item will be included in a definitive proxy statement or an amendment to this Annual Report on Form 10-K/A filed within 120 days after the end of our 2019 fiscal year.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

The information regarding security ownership of certain beneficial owners and management related to this item will be included in a definitive proxy statement or an amendment to this Annual Report on Form 10-K/A filed within 120 days after the end of our 2019 fiscal year and is incorporated herein by reference. The information contained in Part I, Item 1 hereof under the heading "Business – Recent Developments" and in Part II, Item 5 hereof under the heading "Securities Authorized for Issuance Under Equity Compensation Plans," is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information regarding security ownership and certain relationships and related transactions and director independence related to this item will be included in a definitive proxy statement or an amendment to this Annual Report on Form 10-K/A filed within 120 days after the end of our 2019 fiscal year and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information regarding principal accountant fees and services related to this item will be included in a definitive proxy statement or an amendment to this Annual Report on Form 10-K/A filed within 120 days after the end of our 2019 fiscal year and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Financial Statements

The following consolidated financial statements and supplementary information for the fiscal years ended December 31, 2019, 2018, and 2017 are included in Part II, Item 8 herein:

- (i) Report of Independent Auditors
- (ii) Consolidated Balance Sheets – December 31, 2019 and 2018
- (iii) Consolidated Statements of Income – Years ended December 31, 2019, 2018, and 2017
- (iv) Consolidated Statements of Comprehensive Income – Years ended December 31, 2019, 2018, and 2017
- (v) Consolidated Statements of Changes in Shareholders' Equity – Years ended December 31, 2019, 2018, and 2017
- (vi) Consolidated Statements of Cash Flows – Years ended December 31, 2019, 2018, and 2017
- (vii) Notes to Consolidated Financial Statements – December 31, 2019

(b) Financial Statement Schedules

All applicable financial statement schedules required have been included in the Notes to the Consolidated Financial Statements.

(c) Exhibits:

The exhibits filed as part of this registration statement are as follows:

<u>Exhibit Number</u>	<u>Description Of Exhibit</u>
2.1	Agreement and Plan of Merger, dated December 18, 2019, by and between The First Bancshares, Inc. and Southwest Georgia Financial Corporation (included as Exhibit 2.1 to the Corporation's Form 8-K dated December 18, 2019, previously filed with the SEC and incorporated herein by reference)
3.1	Articles of Incorporation of Southwest Georgia Financial Corporation, as amended and restated (included as Exhibit 3.1 to the Corporation's Form 10-KSB for the year ended December 31, 1996, previously filed with the SEC and incorporated herein by reference).
3.2	Bylaws of the Corporation, as amended.
4.1	Description of the Registrant's common stock, par value \$1.00 per share (the "Common Stock"), contained in the Registrant's registration on Form 8-A12B, Commission File No. 001-12053, which incorporates by reference the description of the Common Stock contained in the section entitled "Description of Securities" of the Registrant's registration statement on Form S-18, Commission File No. 33-327467-A, including all amendments and reports filed for the purpose of updating such description.
10.1	Agreement, dated December 18, 2019, by and between The First Bancshares, Inc., Southwest Georgia Financial Corporation and DeWitt Drew (included as Exhibit 2.1 to the Corporation's Form 8-K dated December 18, 2019, previously filed with the SEC and incorporated herein by reference)

- 10.2 Form of Directors' Deferred Compensation Plan of the Corporation (included as Exhibit 10.3 to the Corporation's Form S-18 dated January 23, 1990, previously filed with the SEC and incorporated herein by reference).*
- 10.3 Directors and Executive Officers Stock Purchase Plan of the Corporation dated August 22, 2012 (included as Exhibit 4 to the Corporation's Form S-8 dated October 11, 2012, previously filed with the SEC and incorporated herein by reference).*
- 10.4 Amendment No. 1 to Directors and Executive Officers Stock Purchase Plan of the Corporation dated March 23, 2016 (included as Exhibit 10.3 to the Corporation's Form 10-K for the year ended December 31, 2016, previously filed with the SEC and incorporated herein by reference).*
- 10.5 Supplemental Retirement Plan of the Corporation dated December 21, 1994 and Trust under the Corporation's Supplemental Retirement Plan dated December 21, 1994 (included as Exhibit 10.11 to the Corporation's Form 10-KSB for the year ended December 31, 1994, previously filed with the SEC and incorporated herein by reference).*
- 10.6 Amendment No. 1 to the Trust under the Corporation's Supplemental Retirement Plan, as amended (included as Exhibit 10.6b to the Corporation's Form 10-K for the year ended December 31, 1997, previously filed with the SEC and incorporated herein by reference).*
- 10.7 Dividend Reinvestment and Share Purchase Plan of the Corporation, as amended and restated by Amendment No. 1 (included as Exhibit 99 to the Corporation's Form S-3DPOS dated September 30, 1998, previously filed with the SEC and incorporated herein by reference).
- 10.8 Employment Agreement of DeWitt Drew (included as Exhibit 10.11 to the Corporation's Form S-4 dated January 6, 2004, previously filed with the SEC and incorporated herein by reference).*
- 10.9 2013 Omnibus Incentive Plan of the Corporation (included as Appendix I to the Corporation's Proxy Statement dated April 17, 2014, previously filed with the SEC and incorporated herein by reference).*
- 10.10 Employee Stock Ownership Plan and Trust of the Corporation, as amended and restated effective as of January 1, 2014 (included as Exhibit 10.10 to the Corporation's Form 10-K for the year ended December 31, 2016, previously filed with the SEC and incorporated herein by reference).*
- 10.11 Southwest Georgia Bank 401(k) Plan, as restated effective as of January 1, 2015 (included as Exhibit 10.11 to the Corporation's Form 10-K for the year ended December 31, 2016, previously filed with the SEC and incorporated herein by reference).*
- 10.12 Pension Retirement Plan of the Corporation, as amended and restated effective as of January 1, 2015; amended effective as of December 1, 2016 (included as Exhibit 10.12 to the Corporation's Form 10-K for the year ended December 31, 2016, previously filed with the SEC and incorporated herein by reference).*
- 10.13 Form of Restricted Stock Award Agreement (included as Exhibit 10.12 to the Corporation's Form 10-K for the year ended December 31, 2017, previously filed with the SEC and incorporated herein by reference).*
- 14 Code of Ethical Conduct dated February 27, 2008 (included as Exhibit 14 to the Corporation's Form 8-K dated February 27, 2008, previously filed with the SEC and incorporated herein by reference).

21	Subsidiaries of the Corporation
23.1	Consent of TJS Deemer Dana, LLP
31.1	Section 302 Certification of Periodic Financial Report by Chief Executive Officer.
31.2	Section 302 Certification of Periodic Financial Report by Principal Financial Officer.
32.1	Section 906 Certification of Periodic Financial Report by Chief Executive Officer.
32.2	Section 906 Certification of Periodic Financial Report by Principal Financial Officer.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* Management contract or compensatory plan or arrangement required to be filed as an exhibit to this form.

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

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

Southwest Georgia Financial Corporation
(Corporation)

Date: March 26, 2020

By: /s/ DeWitt Drew
DEWITT DREW
President and Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints DeWitt Drew and T. Garrett Westbrook and each of them, his or her true and lawful attorney(s)-in-fact and agent(s), with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign any or all amendments to this report and to file the same, with all exhibits and schedules thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney(s)-in-fact and agent(s) full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorney(s)-in-fact and agent(s), or their substitute(s), may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of Section 13 or 15(d) the Securities Exchange Act of 1934, as amended, this report has been signed by the following persons on behalf of the Corporation and in the capacities and on the dates indicated.

/s/ DeWitt Drew

Date: March 26, 2020

DEWITT DREW
President and Chief Executive Officer
(Principal Executive Officer)

/s/ T. Garrett Westbrook

Date: March 26, 2020

T. GARRETT WESTBROOK
Vice President and Controller
(Principal Financial Officer)

/s/ Roy Reeves

Date: March 26, 2020

ROY REEVES
Chairman

/s/ Cecil H. Barber

Date: March 26, 2020

CECIL H. BARBER
Vice Chairman

/s/ Richard L. Moss

Date: March 26, 2020

RICHARD L. MOSS
Director

/s/ Johnny R. Slocumb

Date: March 26, 2020

JOHNNY R. SLOCUMB
Director

/s/ M. Lane Wear

Date: March 26, 2020

M. LANE WEAR
Director

/s/ Marcus R. Wells

Date: March 26, 2020

MARCUS R. WELLS
Director