2018 Annual Report

Eastern Michigan Financial Corporation

MISSION STATEMENT

To continue as a progressive and growing community bank, serving our communities by offering a wide range of competitive services for our customers, resulting in a profitable organization, enabling us to build capital, pay appropriate dividends to our stockholders and competitive salaries to our employees.

CORE VALUES

At Eastern Michigan Bank, we take great pride in being a community bank. At the center of our value system is our core commitment to provide value driven products and courteous service delivered by a caring and professional staff. After all, we're not just in the "banking business," we're in the business of financing people's lives and dreams - a responsibility we don't take lightly.

OUR PROMISE

We promise our customers they can rely on us to listen to their needs and try to provide solutions. We also promise to always practice discretion and tact when it comes to personal or professional financial issues and to treat our customers with respect, dignity and integrity, all while doing our best to help them reach their financial goals.

GENERAL INFORMATION

Eastern Michigan Financial Corporation is the holding company for Eastern Michigan Bank, a full service community bank with offices in Croswell, Deckerville, Fort Gratiot, Lakeport, Lexington, Marysville, Port Huron, Ruth and Sandusky.

INVESTOR RELATIONS CONTACT

Errin M. McMillan, Vice President, Chief Financial Officer
Eastern Michigan Financial Corporation
65 N. Howard Avenue
Croswell, Michigan 48422
810.398.5135

INDEPENDENT AUDITORS

Rehmann Robson
5800 Gratiot, Suite 201
Saginaw, Michigan 48638
989.799.9580

CORPORATE HEADQUARTERS

Eastern Michigan Financial Corporation
65 N. Howard Avenue
Croswell, Michigan 48422

TRANSFER AGENT AND REGISTRAR

Computershare Shareholder Services
P.O. Box 30170
College Station, Texas 77842-3170
800.368.5948

STOCK SYMBOL

Over-The-Counter Bulletin Board: EFIN

ANNUAL MEETING

The Eastern Michigan Financial Corporation annual meeting of company shareholders is scheduled for Tuesday, April 16, 2019 at 5:30 p.m. and will be held at Lakeview Hills Golf Resort, 6560 E. Peck Road, Lexington, Michigan 48450.

Annual Report

ADMINISTRATIVE OFFICES
65 N. Howard Avenue
Croswell, Michigan 48422
810.679.2500

LOAN CENTER
66 N. Howard Avenue
Croswell, Michigan 48422
810.679.2500

CROSWELL BRANCH
37 N. Howard Avenue
Croswell, Michigan 48422
810.679.3620

MARYSVILLE BRANCH
2970 Gratiot Boulevard
Marysville, Michigan 48040
810.364.4854

DECKERVILLE BRANCH
3636 Main Street
Deckerville, Michigan 48427
810.376.2015

PORT HURON BRANCH
600 Water Street
Port Huron, Michigan 48060
810.987.9777

FORT GRATIOT BRANCH
3061 Krafft Road
Fort Gratiot, Michigan 48059
810.966.2281

RUTH BRANCH
7004 E. Atwater Road
Ruth, Michigan 48470
989.864.3380

LAKEPORT BRANCH
7090 Lakeshore Road
Lakeport, Michigan 48059
810.385.3211

SANDUSKY BRANCH
324 S. Sandusky Road
Sandusky, Michigan 48471
810.648.3230

LEXINGTON BRANCH
5446 Main Street
Lexington, Michigan 48450
810.359.5353

CORPORATE WEBSITE
easternmichiganbank.com

BOARD OF DIRECTORS

Earl E. DesJardins, Chairman
Retired Civil Engineer
BMJ Engineers & Surveyors, Inc., Port Huron

Timothy M. Ward, Vice Chairman
Chief Executive Officer
Eastern Michigan Bank, Croswell

Bradley D. Apsey, Director
President
Apsey Funeral Home Inc., Deckerville

Karen S. Flanagan, Director
Farmer
Sandusky

William G. Oldford, Jr., Director
President
Eastern Michigan Bank, Croswell

Kathlene M. Partaka, Director
Retired EVP, Operations
Eastern Michigan Bank, Croswell

Ann Randall Kendrick, Director
Owner
Pollock Randall Funeral Home, Port Huron
Marysville Funeral Home, Marysville

Patricia W. Ryan, Director
Retired Partner
Frohm, Kelley, Butler & Ryan, P.C., Port Huron

John C. Williams, Director
Retired Superintendent
Electrical & Water Departments, Croswell

OFFICERS

EASTERN MICHIGAN FINANCIAL CORPORATION OFFICERS

Earl E. DesJardins, Chairman of the Board
Timothy M. Ward, Vice Chairman of the Board and Chief Executive Officer
William G. Oldford, Jr., President
Errin M. McMillan, Vice President, Chief Financial Officer

EASTERN MICHIGAN BANK SENIOR MANAGEMENT OFFICERS

Timothy M. Ward, Chief Executive Officer
William G. Oldford, Jr., President
Errin M. McMillan, Vice President, Chief Financial Officer

EASTERN MICHIGAN BANK VICE PRESIDENTS

Scott R. Badley, Commercial Loan Officer
Stacie L. Bales, Operations
Joseph L. Brown, Appraiser
Chad W. Deaner, Commercial Loan Manager
Christopher M. Flann, Commercial Loan Officer
Gerald D. Hepfer, Commercial Loan Officer
Jessica S. McLarty, Commercial Loan Officer
L. Michael O'Vell, Consumer Loan Manager and Security Officer
Kathleen M. Wurmlinger, Mortgage Manager

EASTERN MICHIGAN BANK ASSISTANT VICE PRESIDENTS

Stefanie M. Abbott, Lexington Branch Manager
Christi A. Agostino-Erd, Mortgage Loan Officer
Kimberly C. Bowman, Port Huron Branch Manager
Clariece C. Creguer, Deckerville Branch Manager
Kathi J. Jahn, Ruth Branch Manager
Audra L. Levitte, Human Resources Director
Tammy J. Williford, Marketing and Compliance Officer

EASTERN MICHIGAN BANK OFFICERS

Karen S. Biskey, IT Support and Vendor Management Specialist
Julie A. Chapdelaine, Bank Secrecy Act Officer
Trishette L. Davis, Croswell Branch Manager
Emily A. Dehring, Fort Gratiot Branch Manager
Rachel L. Galbraith, Commercial Loan Officer
Mary K. Heiden, Loan Processing Manager
Tracy L. Jackson-Wedge, Sandusky Branch Manager
Alexander J. Messing, Commercial Loan Officer
Cindy M. Mugridge, Lakeport Branch Manager
Amanda K. Rose, Marysville Branch Manager

RETIREMENTS

Catherine (Cathy) Fitz retired in late 2018 after twelve years of service to Eastern Michigan Bank and a forty-four year career in the banking industry. Ms. Fitz joined Eastern Michigan Bank as Branch Manager of our Marysville office in 2006 and was promoted to Assistant Vice President in September 2015.

During her time with the Bank, Ms. Fitz was very involved with her local community, serving as Vice Chair of the Port Huron division of the March of Dimes and Treasurer of the Marysville Rotary Club. She was also an active member of the Marysville Friends of the Arts and Women's Life Arc Angels, Chapter #820.

We thank Cathy for her service and wish her a long and happy retirement.

OFFICER PROMOTIONS AND NEW HIRES

OFFICER PROMOTIONS

Amanda K. Rose
Marysville
Branch Manager

Amanda Rose was promoted to Branch Manager of our Marysville office in September 2018. Amanda joined Eastern Michigan Bank's staff in February 2018 as Assistant Branch Manager of the Croswell office. Prior to coming to Eastern, she served as an Assistant Branch Manager at Huntington National Bank in Fort Gratiot.

Amanda holds an associate's degree from St. Clair County Community College in criminal justice and applied science. She currently resides in Fort Gratiot with her family.

NEW HIRES

Scott R. Badley
Vice President,
Commercial Loan Officer

Scott Badley joined Eastern Michigan Bank in September 2018 as Vice President, Commercial Loan Officer. He is based at our Marysville office where his responsibilities include servicing and growing the bank's diverse portfolio of business loan clients in Marysville and the surrounding area.

Scott comes to Eastern with twenty-six years of experience in the local banking industry, including extensive experience in the areas of commercial finance and compliance. Most recently he served as Senior Compliance Officer for Lakestone Bank & Trust and prior to that was a commercial lender for CSB Bank.

Scott holds a bachelor's degree in accounting from Eastern Michigan University and a master's degree in finance from Walsh College. He is the coach of both the men's and women's bowling teams at St. Clair County Community College, manager of the Port Huron Bowling Association and lives in Marysville with his wife, Cindy, and their family.

Emily A. Dehring
Fort Gratiot
Branch Manager

Emily L. Dehring joined Eastern Michigan Bank in December 2018 as Branch Manager of our Fort Gratiot location. Emily comes to Eastern with more than ten years' of banking experience, working as a Banker and Small Business Specialist and a Branch Manager for Chase Bank.

Emily holds a Bachelor of Business Administration degree in management from Northwood University. She lives in Fort Gratiot with her family and is an active member of the Port Huron Civic Theater as well as a volunteer for the Fort Gratiot Little League.

Jessica S. McClarty
Vice President,
Commercial Loan Officer

Jessica McLarty returned to Eastern Michigan Bank in January 2018 as Vice President, Commercial Loan Officer. Her responsibilities include originating both business and agricultural loans.

Jessica began her career at Eastern in 2000 as a teller and held various positions of increasing responsibility before being promoted to Assistant Vice President, Commercial Loan Officer in 2012. She left in 2013 to pursue other opportunities.

In addition to her banking experience, Jessica holds a Bachelor of Business Administration degree from Walsh College and is a graduate of the Perry School of Banking. She is currently Vice President of the Fort Gratiot Rotary and active with the National Association of Career Women (NACW), serving on the national board as well as the board of the Port Huron chapter. She is also the Membership Director for the Port Huron chapter of NACW.

BRANCH AND ADMINISTRATIVE STAFF

CROSWELL BRANCH
Skye Bolsby, Assistant Branch Manager
Amber Herzog-Solis, Head Teller
Gail Bourke, Teller
Colleen Newberry, Teller
Jillian Nichol, Teller
Talysha VanEenoo, Teller

DECKERVILLE BRANCH
Jennifer Sampier, Assistant Branch Manager
Scott Cameron, Teller, CSR
Debra Quick, Vault Teller

FORT GRATIOT BRANCH
Jennifer Briolat, Assistant Branch Manager
Diane Johnson, Head Teller
Kayleigh Bayliss, Teller
Katie Hurley, Teller

LAKEPORT BRANCH
Kathleen Saelens, Assistant Branch Manager
Donna Gentner, Head Teller
Karen Louks, Teller

LEXINGTON BRANCH
Krista Short, Assistant Branch Manager
Paula Mullen, Head Teller
Deborah Dickinson, Teller
Suzanne Hedges, Teller

MARYSVILLE BRANCH
Nancy Kulman, Assistant Branch Manager
Amanda Warner, Head Teller
Terri Herman, Teller

PORT HURON BRANCH
Elizabeth Symon, Assistant Branch Manager
Chelsea Grant, Head Teller
Stephanie Blake, Float Head Teller
Deanna Chen, Teller
Amanda Rennie, Teller

RUTH BRANCH
Anna-Marie Peresta, Assistant Branch Manager
Hannah Van Dyke, Head Teller
Cheryl Becker, Teller
Nicole Wolschleger, Teller

SANDUSKY BRANCH
Rita Berberich, Assistant Branch Manager
Megan Hartwick, Head Teller
Chelsea Spiegel, Float Head Teller
Mindy Fetting, Teller
Roxann Green, Teller

LOAN CENTER (CROSWELL)
Kathleen Breckner, Mortgage/Commercial Loan Clerk
Rebekah Delmedico, Credit Analyst
Ashley Foster, Loan Support Specialist
Amanda Mosher, Mortgage Specialist, Underwriter
Nicki Parker, Consumer Loan Documentation Specialist/Collections
Marian Romzek, Commercial Loan Clerk
Jasmine Williams, Senior Credit Analyst

ADMINISTRATIVE STAFF
Nikki Butler, Deposit Operations Manager
Chelsea DuPree, Human Resources Generalist
Melissa Gelinski, Accountant
Jamie Goline, Deposit Operations Specialist
Darlene Innes, Courier
Ashley Lindke, Deposit Operations Specialist
Dru Moran, Deposit Operations Specialist
Brett Nemeckay, Accounting Clerk
Mechel Smith, Deposit Operations Specialist

LETTER TO SHAREHOLDERS

We are pleased to report that 2018 was an outstanding year for Eastern Michigan Financial Corporation with net income for the year reaching $3.1 million. As a direct result of this increased performance, the Board of Directors was able to increase the quarterly dividend to $0.17 for the third and fourth quarters, up from $0.13 in the first two quarters. The Board also approved a bonus dividend of $0.13 in the fourth quarter, bringing the total dividend to our shareholders to $0.73 per share for the year, representing a 6% increase to our prior year's dividend.

Interest income rose significantly for 2018 and can be attributed to a number of factors:

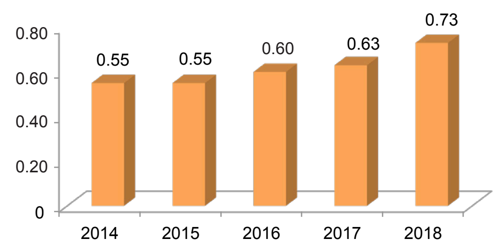
- Increase in loans outstanding. Outstanding loans increased year over year by over $5 million. The increase was primarily related to our consumer loan portfolio, led by our home equity loans and followed by our indirect auto loans. The consumer loan increase was fueled by opportunities generated by our branch managers, who focused their efforts on lending opportunities. Our commercial loan portfolio had balanced growth across all segments. The commercial lending development can be attributed to continued calling efforts by our lending team.
- Interest rate increases. Nearly all of our lines of credit that are extended for working capital purposes have a variable rate benchmarked to the prime lending rate. Over the course of 2018, the prime lending rate increased by 1%, which resulted in higher interest income on all our variable rate loans.
- Investment income increases. With excess deposits and capital not invested in loans, we purchased high quality bonds or invested our excess funds with the Federal Reserve Bank at the fed funds rate. As both investment yields and the fed funds rate increased over the course of 2018, and with deposit growth of nearly $24 million, we were able to capture more investment income over last year.

The increase in variable rates also caused an increase in interest expense, but as our cost of funds still remains exceptionally low versus our peers, we do not see a need to significantly increase deposit rates in the near future due to the our overall low loan to deposit ratio. While we continue to make every effort to grow our loan portfolio and improve our loan to deposit ratio, we are doing so prudently. Deposit growth has also come at a much faster rate than loan growth as the consolidation of local competitors has fostered discontent among some of their customers, resulting in new relationship opportunities for us.

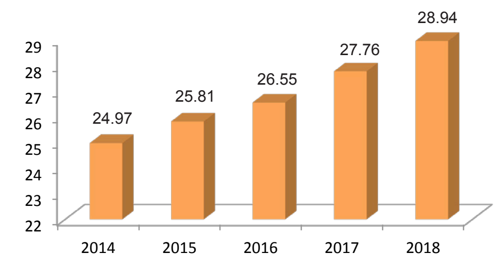
Activity continues to increase across all channels of our electronic delivery systems. In particular, we anticipate increased demand for person to person payments in the near term. To meet that demand we will be adding an enhanced product that will permit easier person to person payments, known as Zelle. Zelle is the banking industry's answer to non-bank competition from Pay Pal and Venmo. All of these electronic offerings are costly to offer and maintain, thus our expense for the product set increased in 2018 and is likely to increase more in the years moving forward.

Changes to the tax code effective January 1, 2018, have reduced our tax rate by one-third, significantly benefiting our net income for the year. In addition to the increase in our dividend already mentioned, we were also able to continue, and in some cases enhance, our incentive compensation for employees. Management feels strongly that incentivizing our employees to do the right thing for both our customers and the Bank results in higher profits and better returns for our shareholders.

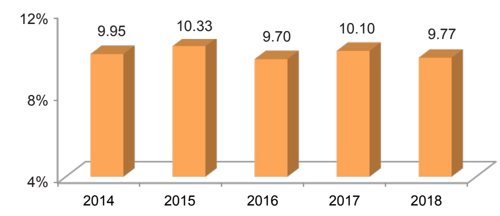
CASH DIVIDENDS PER SHARE



BOOK VALUE PER SHARE



CAPITAL RATIO



LETTER TO SHAREHOLDERS (CON'T)

As mentioned earlier in the year, a six-figure loss on a loan relationship we had for many years necessitated an increase in our loan loss reserve. Despite falling short of fully covering the loan balance, our collateral for this loan exceeded what was charged to the reserve. We also set aside reserves for two more six figure relationships that began showing signs of deterioration late in the year. We expect that these accounts will either improve or result in liquidation in the first half of 2019.

Management is proud of the hard work and dedication our employees have demonstrated over the last year. Both loans and deposits have grown over the course of the year and we have improved our financial and efficiency metrics across the board.

We also appreciate the trust and confidence our shareholders have placed with us. We look forward to seeing you at this year's annual shareholders' meeting on Tuesday, April 16, 2019, at 5:30 p.m. at Lakeview Hills in Lexington.

Sincerely,

Earl E. DesJardins
Chairman of the Board

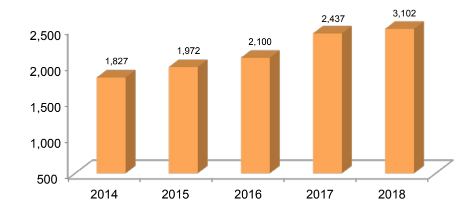
Timothy M. Ward
Vice Chairman of the Board,
Chief Executive Officer

2018 HIGHLIGHTS AND TEN YEAR FINANCIAL PROFILE

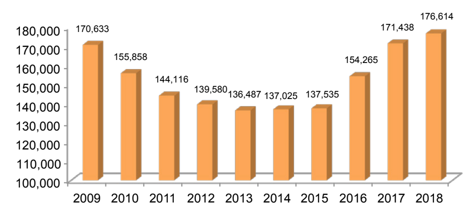
2018 HIGHLIGHTS

FOR THE YEAR (in thousands)	2018	2017	% Change
Net Interest Income	$ 10,582	$ 9,244	14.5%
Non-Interest Income	1,942	2,095	-7.3%
Non-Interest Expense	8,377	7,637	9.7%
Net Income	3,102	2,437	27.3%
YEAR END (in thousands)			
Total Assets	$ 355,073	$ 329,426	7.8%
Loans, Net of Unearned Interest	176,614	171,438	3.0%
Allowance for Loan Losses	1,551	1,330	16.6%
Deposits	319,584	295,923	8.0%
Shareholders' Equity	34,477	32,649	5.6%
PER SHARE			
Net Income	$ 2.61	$ 2.36	10.6%
Book Value	28.94	27.76	4.3%
Cash Dividends	0.73	0.63	15.9%
Number of Shares Outstanding	1,191,159	1,176,011	1.3%

NET INCOME
(in thousands)



TOTAL LOANS
(in thousands)



TEN YEAR FINANCIAL PROFILE

FOR THE YEAR (in thousands)	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009
Net Interest Income	$ 10,582	$ 9,244	$ 9,086	$ 8,306	$ 8,275	$ 8,175	$ 8,500	$ 8,674	$ 8,768	$ 8,369
Provision for Loan Losses	363	173	79	-144	69	283	406	933	1,066	2,294
Non-Interest Income	1,942	2,095	1,725	1,694	1,530	1,669	1,571	1,278	1,531	1,659
Non-Interest Expense	8,377	7,637	7,856	7,448	7,291	7,223	7,395	7,132	7,170	7,068
Income Before Income Taxes	3,784	3,529	2,876	2,696	2,445	2,338	2,270	1,887	2,063	666
Less: Income Taxes	682	1,092	776	724	618	518	497	404	495	16
Net Income	3,102	2,437	2,100	1,972	1,827	1,820	1,773	1,483	1,568	650
AT YEAR END (in thousands)										
Total Investment Securities	$ 89,065	$ 94,370	$ 106,504	$ 110,344	$ 118,054	$ 113,141	$ 85,452	$ 72,389	$ 64,855	$ 38,149
Restricted Investments	1,056	1,056	1,056	980	1,022	916	916	905	952	982
Federal Funds Sold	20,448	176	582	-	-	-	-	-	-	1,631
Total Loans	176,614	171,438	154,265	137,535	137,025	136,487	139,580	144,116	155,858	170,633
Allowance for Loan Losses	1,551	1,330	1,222	1,204	1,688	1,765	2,758	2,796	3,155	3,716
Total Assets	355,073	329,426	324,956	293,028	283,251	279,362	270,472	259,757	259,966	250,424
Total Deposits	319,584	295,923	293,079	262,124	253,998	252,086	242,897	233,578	234,907	224,277
Borrowed Funds	-	-	-	-	-	-	-	-	-	2,000
Shareholders' Equity	34,477	32,649	30,643	29,572	28,394	26,489	26,616	25,103	23,983	23,056
PER SHARE										
Net Income	$ 2.61	$ 2.36	$ 1.82	$ 1.73	$ 1.61	$ 1.60	$ 1.57	$ 1.31	$ 1.39	$ 0.58
Book Value	28.94	27.76	26.55	25.81	24.97	23.32	23.52	22.24	21.25	20.43
Cash Dividends	0.73	0.63	0.60	0.55	0.55	0.55	0.55	0.48	0.48	0.48
Number of Shares Outstanding	1,191,159	1,176,011	1,154,370	1,145,731	1,137,294	1,135,669	1,131,649	1,128,737	1,128,737	1,128,737
Return on Average Assets	0.91%	0.74%	0.67%	0.69%	0.65%	0.67%	0.68%	0.58%	0.61%	0.28%
Return on Average Equity	9.49%	7.70%	6.90%	6.64%	6.65%	6.83%	6.83%	5.94%	6.48%	2.83%
Capital Ratio	9.77%	10.10%	9.70%	10.33%	9.95%	9.75%	9.76%	9.68%	8.98%	9.33%

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands except per share data)

	December 31	
	2018	2017
Assets		
Cash and demand deposits due from banks	$ 7,704	$ 6,341
Interest bearing balances due from banks	37,306	19,440
Federal funds sold	20,448	176
Cash and cash equivalents	65,458	25,957
Certificates of deposit held in other banks	6,395	20,000
Equity securities	798	-
Debt securities		
Available-for-sale	79,146	83,178
Held-to-maturity	9,121	11,192
Restricted, at cost	1,056	1,056
Net loans	175,063	170,108
Accrued interest receivable	1,271	1,282
Premises and equipment, net	5,425	5,524
Foreclosed assets	-	91
Bank-owned life insurance	9,753	9,523
Other assets	1,587	1,515
Total assets	$ 355,073	$ 329,426
Liabilities and Shareholders' Equity		
Deposits		
Noninterest-bearing	$ 78,221	$ 80,697
Interest-bearing	241,363	215,226
Total deposits	319,584	295,923
Accrued interest payable and other liabilities	1,012	854
Total liabilities	320,596	296,777
Commitments and contingencies (Notes 12, 14, and 15)		
Shareholders' equity		
Common stock, $5 par value; 3,000,000 shares authorized, 1,191,159 (1,176,011 in 2017) shares issued and outstanding	5,955	5,880
Additional paid-in-capital	2,214	2,158
Retained earnings	27,497	25,291
Deferred compensation	2	-
Accumulated other comprehensive loss	(1,191)	(680)
Total shareholders' equity	34,477	32,649
Total liabilities and shareholders' equity	$ 355,073	$ 329,426

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

CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands except per share data)	Year Ended December 31	
	2018	2017
Interest and dividend income		
Loans (including fees)	$ 8,398	$ 7,343
Securities		
Taxable	1,441	1,330
Nontaxable	452	391
Other	104	99
Federal funds sold and deposits with banks	665	447
Total interest and dividend income	11,060	9,610
Interest expense	478	366
Net interest income	10,582	9,244
Provision for loan losses	363	173
Net interest income, after provision for loan losses	10,219	9,071
Noninterest income		
Service charges on deposit accounts	1,122	1,067
Other service charges and fees	257	240
Other	563	788
Total noninterest income	1,942	2,095
Noninterest expenses		
Compensation and benefits	4,711	4,358
Occupancy and equipment	854	846
Other	2,812	2,433
Total noninterest expenses	8,377	7,637
Income before federal income taxes	3,784	3,529
Federal income taxes	682	1,092
Net income	$ 3,102	$ 2,437
Net income per common share		
Basic	$ 2.61	$ 2.36
Diluted	$ 2.58	$ 2.31

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands except per share data)

	December 31	
	2018	2017
Other comprehensive (loss) income		
Unrealized holding (losses) gains on available-for-sale securities arising during the year	$ (647)	$ 150
Income tax benefit (expense) related to other comprehensive (loss) income	136	(51)
Other comprehensive (loss) income	(511)	99
Net income	3,102	2,437
Comprehensive income	$ 2,591	$ 2,536

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

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Dollars in thousands except per share data)

	Common Stock		Additional Paid-In-Capital	Retained Earnings	Deferred Compensation	Accumulated Other Comprehensive Loss	Total
	Shares	Amount					
Balances, January 1, 2017	1,154,370	$ 5,771	$ 1,999	$ 23,541	$ -	$ (668)	$ 30,643
Comprehensive income	-	-	-	2,437	-	99	2,536
Common stock options recognized	-	-	4	-	-	-	4
Issuance of restricted stock awards	4,876	24	(5)	-	-	-	19
Issuance of shares upon exercise of common stock options	20,118	102	160	-	-	-	262
Repurchase of common stock	(3,353)	(17)	-	(61)	-	-	(78)
Cash dividends paid ($0.63 per share)	-	-	-	(737)	-	-	(737)
Reclassification resulting from enactment of federal tax legislation	-	-	-	111	-	(111)	-
Balances, December 31, 2017	1,176,011	5,880	2,158	25,291	-	(680)	32,649
Comprehensive income	-	-	-	3,102	-	(511)	2,591
Common stock options recognized	-	-	6	-	-	-	6
Deferred compensation	80	-	-	-	2	-	2
Issuance of restricted stock awards	4,049	21	12	-	-	-	33
Issuance of shares upon exercise of common stock options	12,289	61	38	-	-	-	99
Repurchase of common stock	(1,270)	(7)	-	(27)	-	-	(34)
Cash dividends paid ($0.73 per share)	-	-	-	(869)	-	-	(869)
Balances, December 31, 2018	1,191,159	$ 5,955	$ 2,214	$ 27,497	$ 2	$ (1,191)	$ 34,477

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands except per share data)

	Year Ended December 31	
	2018	2017
Cash flows from operating activities		
Net income	$ 3,102	$ 2,437
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	363	173
Depreciation	323	304
Provision for foreclosed assets	10	47
Net amortization of investment securities premiums	558	771
Net unrealized loss on equity security	202	-
Share-based compensation	41	23
Net gain on sale of loans	(116)	(106)
Net gain on sale of foreclosed assets	(3)	(338)
Increase in cash value of bank-owned life insurance	(230)	(240)
Deferred income tax (benefit) expense	(24)	252
Origination of loans held for sale	(4,013)	(3,476)
Proceeds from loan sales	4,129	3,582
Changes in operating assets and liabilities which provided (used) cash		
Accrued interest receivable	11	(152)
Other assets	88	(169)
Accrued interest payable and other liabilities	158	(380)
Net cash provided by operating activities	4,599	2,728
Cash flows from investing activities		
Net change in certificates of deposit held in other banks	13,605	2,226
Activity in held-to-maturity securities		
Maturities, prepayments, and calls	1,990	2,872
Activity in available-for-sale securities		
Purchases	(37,769)	(11,836)
Maturities, prepayments, calls and sales	39,677	20,477
Loan principal originations, net	(5,486)	(17,799)
Purchases of premises and equipment	(224)	(139)
Proceeds from sale of foreclosed assets	252	1,684
Net cash provided by (used in) investing activities	12,045	(2,515)
Cash flows from financing activities		
Acceptances and withdrawals of deposits, net	23,661	2,844
Net proceeds from exercise of common stock options	99	262
Repurchase and retirement of common stock	(34)	(78)
Cash dividends paid	(869)	(737)
Net cash provided by financing activities	22,857	2,291
Net increase in cash and cash equivalents	39,501	2,504
Cash and cash equivalents, beginning of year	25,957	23,453
Cash and cash equivalents, end of year	$ 65,458	$ 25,957

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

(Dollars in thousands except per share data)

1. NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business and Consolidation

The accompanying consolidated financial statements include the accounts of ***Eastern Michigan Financial Corporation***, a registered bank holding company (the "Corporation"), and its wholly owned subsidiary, Eastern Michigan Bank (the "Bank"), and the Bank's wholly owned subsidiaries Eastern Michigan Properties, LLC; Eastern Michigan Financial Services, Inc.; Eastern Michigan Real Estate, Inc. and Eastern Michigan Exchange Services, LLC. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Corporation is independently owned and operates a community bank engaged in the business of retail and commercial banking services through its nine branches located in Sanilac, Huron, and St. Clair counties in Michigan. Active competition, principally from other commercial banks, savings banks and credit unions, exists in all of the Bank's primary markets. The Bank's results of operations can be significantly affected by changes in interest rates or changes in the automotive and agricultural industries which comprise a significant portion of the local economic environment.

Concentration Risks

The Bank's primary deposit products are interest- and noninterest-bearing checking accounts, savings accounts and time deposits and its primary lending products are real estate mortgages, commercial and consumer loans. The Bank does not have significant concentrations with respect to any one industry, customer, or depositor.

The Bank is a state chartered bank and a member of the Federal Deposit Insurance Corporation ("FDIC") Bank Insurance Fund. The Bank is subject to the regulations and supervision of the Federal Reserve Board and state regulators and undergoes periodic examinations by these regulatory authorities. The Corporation is also subject to regulations of the Federal Reserve Board governing bank holding companies.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and the reported amounts of income and expenses during the year. Actual results could differ from those estimates. Significant estimates include but are not limited to the determination of the allowance for loan losses and the fair value of equity securities.

Summary of Significant Accounting Policies

Accounting policies used in preparation of the accompanying consolidated financial statements are in conformity with accounting principles generally accepted in the United States of America. The principles which materially affect the determination of the consolidated financial position and results of operations of the Corporation and its subsidiaries are summarized below.

Cash and Cash Equivalents

For the purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, interest-bearing balances due from banks, short-term money market investments, and federal funds sold. Generally, federal funds are sold for a one-day period. The Bank maintains deposit accounts in various financial institutions which generally exceed the FDIC insured limits or are not insured. Management does not believe the Corporation is exposed to any significant interest, credit or other financial risk as a result of these deposits.

Certificates of Deposit Held in Other Banks

Certificates of deposit held in other banks mature within 3 years and are carried at cost.

Fair Value Measurements

Fair value refers to the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants in the market in which the reporting entity transacts such sales or transfers based on the assumptions market participants would use when pricing an asset or liability. Assumptions are developed based upon prioritizing information within a fair value hierarchy that gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable data, such as the reporting entity's own data (Level 3).

A description of each category in the fair value hierarchy is as follows:

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 the estimates of assumptions that market participants would use in pricing the asset or liability.

For a further discussion of Fair Value Measurements, refer to Note 2.

Investment Securities

Debt securities that management has the ability and positive intent to hold to maturity are classified as held-to-maturity and are recorded at amortized cost. Debt securities not classified as held-to-maturity are classified as available-for-sale and are recorded at fair value, with unrealized gains and losses, net of the effect of deferred income taxes, recorded in other comprehensive (loss) income. Equity securities are carried at fair value, with changes in fair value reported in net income. Equity securities without readily determinable fair values are carried at cost, minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Realized gains or losses on the sale of securities are recorded in investment income on the trade date and are determined using the specific identification method.

On January 1, 2018, the Company adopted a new accounting principle for Financial Instruments, which requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. The cumulative-effect adjustment to the balance sheet on January 1, 2018 was not considered significant.

Investment securities are reviewed at each reporting period for possible other-than-temporary impairment ("OTTI"). In determining whether an other-than-temporary impairment exists for debt securities, management must assert that: (a) it does not have the intent to sell the security; and (b) it is more likely than not the Corporation will not have to sell the security before recovery of its cost basis. If these conditions are not met, the Corporation must recognize an other-than-temporary impairment charge through earnings for the difference between the debt security's amortized cost basis and its fair value, and such amount is included in noninterest income. For these debt securities, the Corporation separates the total impairment into the credit loss component and the amount of the loss related to other factors. In order to determine the amount of the credit loss for a debt security, the Corporation calculates the recovery value by performing a discounted cash flow analysis based on the current cash flows and future cash flows management expects to recover. The amount of the total other-than-temporary impairment related to the credit risk is recognized in earnings and is included in noninterest income. The amount of the total other-than-temporary impairment related to other risk factors is recognized as a component of other comprehensive income. For debt securities that have recognized an other-than-temporary impairment through earnings, if through subsequent evaluation there is a significant increase in the cash flow expected, the difference between the amortized cost basis and the cash flows expected to be collected is accreted as interest income.

Equity securities are reviewed for other-than-temporary impairment at each reporting date. This evaluation considers a number of factors including, but not limited to, the length of time and extent to which the fair value has been less than cost, the financial condition and near term prospects of the issuer, and management's ability and intent to hold the securities until fair value recovers. If it is determined that management does not have the ability and intent to hold the securities until recovery or that there are conditions that indicate that a security may not recover in value, then the difference between the fair value and the cost of the security is recognized in earnings and is included in noninterest income. No such losses were recognized in 2018 or 2017.

Restricted Investments

The Bank is a member of the Federal Home Loan Bank System and is required to invest in capital stock of the Federal Home Loan Bank of Indianapolis ("FHLB"). The amount of the required investment is based upon the available balance of the Bank's outstanding home mortgage loans or advances from the FHLB and is carried at cost plus the value assigned to stock dividends.

The Bank is also a member of the Federal Reserve System and is required to invest in capital stock of the Federal Reserve Bank ("FRB"). The amount of the required investment is based upon the contributed capital of Eastern Michigan Bank and is carried at cost.

In addition, the Bank is a Farmer Mac I seller and is required to invest in capital stock of Farmer Mac. The amount of required investment is determined based upon the consolidated assets at the time of the initial stock purchase and is carried at cost.

Loans

Loans that management has the positive intent and ability to hold for the foreseeable future or until maturity or pay-off are generally reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct loan origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Consumer loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal and interest is considered doubtful.

All interest accrued in the current year but not collected for loans that are placed on nonaccrual or are charged off, is reversed against interest income while interest accrued but not collected in prior years is reversed against the allowance for loan losses. The interest on these loans is accounted for on the cash-basis until qualifying for return to accrual. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. For impaired loans not classified as nonaccrual, interest income is recognized daily as it is earned according to the terms of the loan agreement.

Nonperforming loans of the loan portfolio are comprised of those loans accounted for on a nonaccrual basis, accruing loans contractually past due 90 days or more as to interest or principal payments and loans modified under troubled debt restructurings (nonperforming originated loans).

Allowance for Loan Losses

The allowance for loan losses ("allowance") is an estimate of loan losses inherent in the Bank's loan portfolio. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the appropriateness of the total allowance after loan losses. Loan losses are charged off against the allowance when the Bank determines the loan balance to be uncollectible. Cash received on previously charged off amounts is recorded as a recovery to the allowance.

The allowance consists of two primary components, specific reserves related to impaired loans and general reserves. For such loans that are classified as impaired, a specific reserve is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of the loan. The general component covers non-impaired loans and is based on historical losses adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Bank over the most recent two years. This actual loss experience is adjusted for economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. These factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment.

Continued...

(Dollars in thousands except per share data)

A loan is considered impaired when, based on current information and events, it is probable that the Bank 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 by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loans obtained market price, or the fair value of the collateral, less costs to sell, if the loan is collateral dependent. A loan is collateral dependent if the repayment is expected to be provided solely by the underlying collateral.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer, home equity, and residential real estate loans for impairment disclosures, unless such loans are the subject of a restructuring agreement or in the process of foreclosure.

The Bank evaluates the credit quality of loans in the consumer loan portfolio, based primarily on the aging status of the loan and payment activity. Accordingly, nonaccrual loans, loans past due as to principal or interest 90 days or more and loans modified under troubled debt restructurings of the originated portfolio and acquired loans past due in accordance with the loans' original contractual terms are considered in a nonperforming status for purposes of credit quality evaluation.

Under certain circumstances, the Bank will provide borrowers relief through loan restructurings. A loan restructuring constitutes a troubled debt restructuring ("TDR") if for economic or legal reasons related to the borrower's financial difficulties the Bank grants a concession to the borrower that it would not otherwise consider. Restructured loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and are measured for impairment as described above.

The Bank assigns a risk rating to all loans except pools of homogeneous loans and periodically performs detailed internal reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by the Bank's regulators. During the internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which the borrowers operate and the fair values of collateral securing the loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into six major categories, defined as follows:

Pass: A pass loan is a credit with no existing or known potential weaknesses deserving of management's close attention.

Watch: Loans classified as watch have most of the characteristics of a pass loan; however, emerging weaknesses have been detected and warrant additional attention.

Special Mention: Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, this potential weakness may result in deterioration of the repayment prospects for the loan or of the Bank's credit position at some future date. Special mention loans are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

Substandard: Loans classified as substandard are not adequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the repayment of the debt. Well defined weaknesses include a borrower's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time, or the failure to fulfill economic expectations. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

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

Loss: Loans classified as loss are considered uncollectible and are charged off immediately.

The majority of the Bank's consumer and residential loan portfolios are comprised of secured loans that are evaluated at origination on a centralized basis against standardized underwriting criteria. The ongoing measurement of credit quality of the consumer, home equity, and residential real estate loan portfolios is largely done on an exception basis. If payments are made on schedule, as agreed, then no further monitoring is performed. However, if delinquency occurs, the delinquent loans are turned over to the Bank's collection department for resolution, which generally occurs fairly rapidly and often through repossession and foreclosure. Credit quality for the entire consumer, home equity, and residential real estate loan portfolio is measured by the periodic delinquency rate, nonaccrual amounts and actual losses incurred.

The Bank maintains a separate general valuation allowance for each portfolio segment. These portfolio segments include commercial and industrial, agricultural, real estate related industries, other commercial loans, residential real estate, consumer and other, and home equity with risk characteristics described as follows:

Commercial and Industrial: Commercial and industrial loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

Agricultural: The risk associated with agricultural loans depends on current market prices, weather conditions and other outside factors that are distinct to this segment. These loans, as with commercial and industrial loans, are generally underwritten to existing cash flows of operating businesses. Debt coverage, however, is influenced by different economic indicators than other commercial loans.

Real Estate Related Industries: These loans generally possess a higher inherent risk of loss than other loan portfolio segments. Adverse economic developments or an overbuilt market impact real estate projects and may result in troubled loans. Trends in vacancy rates of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for the properties to produce sufficient cash flow to service debt obligations.

Other Commercial: Other commercial loans are collateralized by real estate and are underwritten based upon existing cash flows of operating businesses. Because debt coverage is provided by business cash flows, trends in real estate values have less impact on this segment than other real estate segments and would be influenced more by unemployment rates and other key economic indicators.

Residential Real Estate: The degree of risk in residential mortgage lending depends primarily on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion. These loans generally possess a lower inherent risk of loss than other real estate portfolio segments. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Consumer and Other: The consumer and other loan portfolio is usually comprised of a large number of small loans, including automobile, personal loans, etc. Most loans are made directly for consumer purchases. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate the borrowers' capacity to repay their obligations may be deteriorating.

Home Equity: As with residential real estate, the degree of risk in home equity lending depends on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion but in addition depends on the value of any loan with a first lien interest. These loans generally possess a higher inherent risk of loss than residential real estate portfolio segments. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Although management believes the allowance to be appropriate, ultimate losses may vary from its periodic estimates. The Board of Directors reviews the appropriateness of the allowance monthly, including consideration of the relevant risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Bank's primary regulators review the appropriateness of the allowance. The regulatory agencies may require changes to the allowance based on their judgment about information available at the time of their examination.

Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value in the aggregate and are included in loans on the accompanying consolidated balance sheets, if any. Net unrealized losses, if any, are recognized through a valuation allowance of which the provision is accounted for in the consolidated statements of income.

Transfers of Financial Assets

Transfers of financial assets, including mortgage loans held for sale, are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when 1) the assets have been legally isolated from the Corporation, 2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and 3) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Other than servicing, as disclosed in Note 5, the Corporation has no substantive continuing involvement related to these loans. The Corporation sold to an unrelated third party residential mortgage loans with proceeds of $4,129 and $3,582 during 2018 and 2017, respectively, which resulted in a net gain of $116 and $106 for 2018 and 2017, respectively. Servicing fee income earned on such loans was $74 and $76 for 2018 and 2017, respectively, and is included in other noninterest income on the consolidated statements of income.

Servicing

Servicing assets are recognized as separate assets when rights are acquired through the purchase or sale of financial assets. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses.

Servicing assets or liabilities are amortized in proportion to and over the period of net servicing income or net servicing loss and are assessed for impairment or increased obligation based on the fair value of rights compared to amortized cost at each reporting date. Impairment is determined by stratifying rights into tranches based on predominant risk characteristics, such as interest rate, loan type, and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If the Bank later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income.

Servicing fee income is recorded for fees earned for servicing loans for others. The fees are based on a contractual percentage of the outstanding principal, or a fixed amount per loan and are recognized as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income, a component of other noninterest income.

Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value, less costs to sell, on the date of transfer, establishing a new cost basis. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of the carrying amount or fair value less costs to sell. Revenue and expenses from operations and changes in the valuation allowance are included in expenses from foreclosed assets, net, a component of other noninterest expenses in the consolidated statements of income.

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(Dollars in thousands except per share data)

Premises and Equipment

Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation which is computed principally by the straight-line method based upon the estimated useful lives of the related assets, which range from 3 to 40 years. Major improvements are capitalized and appropriately amortized based upon the useful lives of the related assets or the expected terms of the leases, if shorter, using the straight-line method. Maintenance, repairs and minor alterations are charged to current operations as expenditures occur. Management annually reviews these assets to determine whether carrying values have been impaired.

Share-Based Compensation Plans

Compensation cost relating to share-based payment transactions, including common stock option grants, restricted stock awards, and deferred compensation, are measured based on the estimated fair value of the equity or liability instruments issued on the grant dates and is recognized over the service period, which is generally the vesting period.

Bank-Owned Life Insurance

The Bank holds life insurance policies purchased on the lives of key officers. In the event of death of one of these individuals, the Bank, as beneficiary of the policies, would receive a specified cash payment equal to the face value of the policy. Such policies are recorded at their cash surrender value, or the amount that can be currently realized as of the balance sheet date. The change in cash surrender value is an adjustment of premiums paid in determining the net expense or income recognized under the contracts for the year and is included in other noninterest income.

Off-Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Bank has entered into commitments to extend credit, including commercial letters of credit and standby letters of credit. Such financial instruments are considered to be guarantees; however, as the amount of the liability related to such guarantees on the commitment date is considered insignificant, the commitments are generally recorded only when they are funded.

Business Acquisition Intangibles and Goodwill

A past business combination included identified amounts related to the valuation of customer deposit relationships (core deposit intangibles), which are being amortized on the straight line method over ten years, and residual goodwill, which is included in other assets. Such goodwill represents the purchase price in excess of identifiable assets and is not amortized but is evaluated by management for impairment at least annually, or at an interim basis if an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying value.

Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred income tax asset or liability is determined based on the federal income tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in federal income tax rates and laws. Valuation allowances are established, where necessary, to reduce deferred tax assets to the amount expected more likely than not to be realized. Income tax expense is the tax payable or refundable for the year plus or minus the change during the year in deferred tax assets and liabilities.

See Note 9 for a discussion of the impact of federal tax legislation (Tax Cuts and Jobs Act), which was enacted on December 22, 2017.

Net Income Per Share

Basic earnings per share represent income available to common shareholders divided by the weighted-average number of common shares outstanding less unvested restricted stock during the year. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustments to income that would result from the assumed issuance. Potential common shares that may be issued by the Corporation relate to outstanding common stock options and restricted stock awards, and are determined using the treasury stock method.

Subsequent Events

In preparing these consolidated financial statements, the Corporation has evaluated, for potential recognition or disclosure, significant events or transactions that occurred during the period subsequent to December 31, 2018, the most recent balance sheet presented herein, through February 11, 2019, the date these consolidated financial statements were available to be issued. No such events or transactions were identified.

New Accounting Pronouncements

ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, was issued in 2016 with the intention of improving financial reporting by requiring timelier recording of credit losses on loans and certain other financial instruments held by financial institutions.

The ASU requires that the measurement of all expected credit losses for financial assets that are measured at amortized cost at the reporting date be based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions will also use forward-looking information to develop their credit loss estimates.

The ASU requires enhanced disclosures to assist investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an institution's portfolio.

In addition, the ASU amends existing guidance on accounting for credit losses on available-for-sale debt securities, purchased financial assets with credit deterioration, and also applies to certain off-balance sheet credit exposures.

The ASU on credit losses will take effect for fiscal years beginning after December 15, 2020. Management is currently evaluating the provisions of ASU 2016-13 to determine the potential impact on the Corporation's consolidated financial statements.

ASU No. 2014-09, ***Revenue from Contracts with Customers***, as amended (collectively, "ASC 606") – On January 1, 2018, the Company adopted ASC 606, which creates a single framework for recognizing revenue from contracts with customers that are within its scope. The new guidance further revises when it's appropriate to recognize a gain or loss from the transfer of nonfinancial assets. The majority of the Company's revenues are derived from interest income, including loans and securities, and other sources, that are outside the scope of ASC 606. The Company's revenue sources that are within the scope of ASC 606, including service charges on deposits, interchange income, wealth management fees, investment brokerage fees, and the gains on the sale of OREO, are presented within noninterest income on the accompanying consolidated statements of income and are recognized as revenue as the Company satisfies its obligations to the customer. Refer to Note 17 for further discussion on the Corporation's accounting policies of revenue recognition within the scope of ASC 606.

The Corporation adopted ASC 606 using the modified retrospective method applied to all contracts not completed as of January 1, 2018. Results for 2018 are presented under ASC 606 while 2017 amounts continue to be reported in accordance with previous GAAP. The adoption of ASC 606 did not result in a change to the accounting for any of the in-scope revenue streams; therefore, no cumulative effect adjustment was recorded.

2. FAIR VALUE MEASUREMENTS

The Corporation utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Equity securities and available-for-sale debt securities are recorded at fair value on a recurring basis. Additionally, from time to time, the Corporation may be required to record at fair value other assets on a nonrecurring basis, such as debt securities held-to-maturity, loans, loans held for sale, foreclosed assets, mortgage servicing rights, goodwill and certain other assets and liabilities. These nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting or write downs of individual assets.

In connection with the adoption of the new accounting principle for Financial Instruments, as discussed in Note 1, the Corporation no longer discloses the methods and significant assumptions used to estimate fair value for financial instruments measured at amortized cost on the consolidated balance sheet. Additionally, the Corporation uses the exit price notion when measuring the fair value of financial instruments for disclosure purposes.

Following is a description of the valuation methodologies and key inputs used to measure financial assets and liabilities recorded at fair value, which includes an indication of the level of the fair value hierarchy in which the assets or liabilities are classified.

Investment Securities

Equity securities and available-for-sale debt securities 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 and liquidity assumptions.

Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, those that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 fair value measurement is based upon quoted prices for similar securities, 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 and liquidity assumptions. Level 2 securities include U.S. government and federal agency securities, mortgage-backed securities issued by government-sponsored entities, state and municipal bonds, corporate debt securities in active markets, and auction rate money market preferred securities. For Level 3 securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators. Securities classified as Level 3 include securities in less liquid markets.

Impaired Loans

The fair value of impaired loans is measured in accordance with accounting standards for subsequent measurement of receivables. The fair value of impaired loans is estimated using one of several methods, including collateral value, liquidation value 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.

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 a current 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.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Corporation believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

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(Dollars in thousands except per share data)

Assets Recorded at Fair Value on a Recurring Basis

The following tables set forth by level, within the fair value hierarchy, the recorded amount of assets and liabilities measured at fair value on a recurring basis as of December 31:

	Assets at Fair Value			
2018	**Level 1**	**Level 2**	**Level 3**	**Total**
Debt securities available-for-sale:				
U.S. treasury notes	$ 493	$ -	$ -	$ 493
U.S. government and federal agencies	-	19,356	-	19,356
Corporate bonds	-	7,215	-	7,215
Agency issued mortgage-backed securities	-	25,475	-	25,475
States and municipals	-	23,886	-	23,886
Other asset-backed securities		2,721		2,721
Equity securities	-	798	-	798
Total assets at fair value	$ 493	$ 79,451	$ -	$ 79,944

	Assets at Fair Value			
2017	**Level 1**	**Level 2**	**Level 3**	**Total**
Investment securities available-for-sale:				
U.S. treasury notes	$ 1,249	$ -	$ -	$ 1,249
U.S. government and federal agencies	-	21,253	-	21,253
Corporate bonds	-	2,171	-	2,171
Agency issued mortgage-backed securities	-	32,973	-	32,973
States and municipals	-	24,592	-	24,592
Money market preferred securities	-	940	-	940
Total assets at fair value	$ 1,249	$ 81,929	-	$ 83,178

Assets Recorded at Fair Value on a Nonrecurring Basis

The following tables set forth by level, within the fair value hierarchy, the recorded amount of assets and liabilities measured at fair value on a recurring basis as of December 31:

	Assets of Carrying Value			
2018	**Level 1**	**Level 2**	**Level 3**	**Total**
Impaired Loans (1)	$ -	$ -	$ 1,857	$ 1,857

	Assets of Carrying Value			
2017	**Level 1**	**Level 2**	**Level 3**	**Total**
Impaired Loans (1)	$ -	$ -	$ 2,149	$ 2,149

(1) Certain impaired loans were remeasured and reported at fair value through a specific valuation allowance. Impaired loans of $1,857 and $2,149 as of December 31, 2018 and 2017, respectively, were reduced by a specific valuation allowance totaling $290 and $264 as of those dates.

Quantitative information about Level 3 fair value measurements is as follows as of December 31, 2018:

	Level 3 Instruments			
Instrument	**Fair Value**	**Valuation Technique**	**Unobservable Input**	**Weighted Average and/or Range**
Impaired Loans	$ 1,857	Discounted Appraisal Value	Applied to Collateral Appraisal	2-95%

Quantitative information about Level 3 fair value measurements is as follows as of December 31, 2017:

	Level 3 Instruments			
Instrument	**Fair Value**	**Valuation Technique**	**Unobservable Input**	**Weighted Average and/or Range**
Impaired Loans	$ 2,149	Discounted Appraisal Value	Discount Applied to Collateral Appraisal	.002-41%

Estimated Fair Values of Financial Instruments Not Recorded at Fair Value in their Entirety on a Recurring Basis

Disclosure of the estimated fair values of financial instruments, which differ from carrying values, often requires the use of estimates. In cases where quoted market values in an active market are not available, the Corporation uses present value techniques and other valuation methods to estimate the fair values of its financial instruments. These valuation methods require considerable judgment and the resulting estimates of fair value can be significantly affected by the assumptions made and methods used. The methodologies for estimating fair value of financial assets and liabilities on a recurring and nonrecurring basis are discussed above.

The carrying amount and estimated fair value of financial instruments not recorded at fair value in their entirety on a recurring basis on the Corporation's consolidated balance sheets are as follows at December 31:

	2018		2017	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets				
Cash and cash equivalents	$ 65,458	$ 65,458	$ 25,957	$ 25,957
Certificates of deposit held in other banks	6,395	6,468	20,000	20,141
Investment securities held-to-maturity	9,121	8,808	11,192	10,987
Restricted investments	1,056	1,056	1,056	1,056
Net loans	175,063	172,982	170,108	169,661
Mortgage servicing rights	298	318	276	287
Accrued interest receivable	1,271	1,271	1,282	1,282
Liabilities				
Noninterest-bearing deposits	$ 78,221	$ 78,221	$ 80,697	$ 80,697
Interest-bearing deposits	241,363	241,512	215,226	215,387
Accrued interest payable	9	9	10	10

3. INVESTMENT SECURITIES

The amortized cost and fair value of non-trading investment securities, including gross unrealized gains and losses, are summarized as follows as of December 31:

2018	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Held-to-maturity				
Agency issued mortgage-backed securities	$ 6,752	$ -	$ 297	$ 6,455
States and municipals	2,369	-	16	2,353
Total held-to-maturity	9,121	-	313	8,808
Available-for-sale				
Debt securities				
U.S. treasury notes	509	-	16	493
U.S. government and federal agencies	19,410	-	54	19,356
Corporate bonds	7,441	-	226	7,215
Agency issued mortgage-backed securities	26,497	7	1,029	25,475
States and municipals	24,075	6	195	23,886
Other asset-backed securities	2,723	-	2	2,721
Total available-for-sale	80,655	13	1,522	79,146
Total debt securities	$ 89,776	$ 13	$ 1,835	$ 87,954

2017	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Held-to-maturity				
Agency issued mortgage-backed securities	$ 8,304	$ -	$ 196	$ 8,108
States and municipals	2,888	1	10	2,879
Total held-to-maturity	11,192	1	206	10,987
Available-for-sale				
Debt securities				
U.S. treasury notes	1,261	-	12	1,249
U.S. government and federal agencies	21,331	1	79	21,253
Corporate bonds	2,177	-	6	2,171
Agency issued mortgage-backed securities	33,550	16	593	32,973
States and municipals	24,721	15	144	24,592
Total debt securities	83,040	32	834	82,238
Money market preferred securities	1,000	-	60	940
Total available-for-sale	84,040	32	894	83,178
Total	$ 95,232	$ 33	$ 1,100	$ 94,165

Continued...

(Dollars in thousands except per share data)

Investment securities with carrying values of $3,988 and $4,486 at December 31, 2018 and 2017, respectively, were pledged to secure public deposits or for other purposes as permitted or required by law.

The amortized cost and fair value of held-to-maturity and available-for-sale debt securities grouped by contractual maturity at December 31, 2018, are summarized as follows:

	Maturing					
	Due in One Year or Less	Due After One Year Through Five Years	Due After Five Years Through Ten Years	Over Ten Years	Securities With Variable Monthly Payments or No Contractual Maturity	Total
Held-to-maturity						
Agency issued mortgage-backed securities	$ -	$ -	$ -	$ -	$ 6,752	$ 6,752
States and municipals	580	1,789	-	-	-	2,369
Total held-to-maturity	580	1,789	$ -	$ -	6,752	9,121
Available-for-sale						
U.S. treasury notes	$ -	$ 509	$ -	$ -	$ -	$ 509
U.S. government and federal agencies	17,875	1,535	-	-	-	19,410
Corporate bonds	2,000	2,500	2,941	-	-	7,441
Agency issued mortgage-backed securities	-	-	-	-	26,497	26,497
State and municipals	2,989	17,970	1,797	1,319	-	24,075
Other asset-backed securities	-	-	-	-	2,723	2,723
Total available-for-sale	$ 22,864	$ 22,514	$ 4,738	$ 1,319	$ 29,220	$ 80,655
Total amortized cost	$ 23,444	$ 24,303	$ 4,738	$ 1,319	$ 35,972	$ 89,776
Fair value	$ 23,394	$ 24,033	$ 4,553	$ 1,323	$ 34,651	$ 87,954

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

Because of their variable monthly payments, mortgage-backed securities are also not reported by a specific maturity group.

There were no sales of available-for-sale securities during 2018 or 2017; therefore were no gross realized gains or losses during these years.

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

	Less Than 12 Months		Over 12 Months			
2018	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Total Gross Unrealized Losses
Securities held-to-maturity						
Agency issued mortgage-backed securities	$ -	$ -	$ 6,454	$ 297	$ 6,454	$ 297
States and municipals	-	-	2,354	16	2,354	16
Total securities held-to-maturity	$ -	$ -	$ 8,808	$ 313	$ 8,808	$ 313
Securities available-for-sale						
Debt securities						
U.S. treasury notes	$ -	$ -	$ 493	$ 16	$ 493	$ 16
U.S. government and federal agencies	12,688	5	6,668	49	19,356	54
Corporate bonds	6,722	220	493	6	7,215	226
Agency issued mortgage-backed	-	-	25,305	1,029	25,305	1,029
States and municipals	5,578	21	15,127	174	20,705	195
Other asset-backed securities	2,721	2	-	-	2,721	2
Total securities available-for-sale	$ 27,709	$ 248	$ 48,086	$ 1,274	$ 75,795	$ 1,522

	Less Than 12 Months		Over 12 Months			
2017	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Total Gross Unrealized Losses
Securities held-to-maturity						
Agency issued mortgage-backed securities	$ -	$ -	$ 8,109	$ 196	$ 8,109	$ 196
States and municipals	2,378	10	-	-	2,378	10
Total securities held-to-maturity	$ 2,378	$ 10	$ 8,109	$ 196	$ 10,487	$ 206
Securities available-for-sale						
Debt securities						
U.S. treasury notes	$ -	$ -	$ 1,249	$ 12	$ 1,249	$ 12
U.S. government and federal agencies	13,815	46	5,440	33	19,255	79
Corporate bonds	497	3	1,674	3	2,171	6
Agency issued mortgage-backed	11,495	97	19,071	496	30,566	593
States and municipals	19,469	110	3,062	34	22,531	144
Total debt securities	45,276	256	30,496	578	75,772	834
Money market preferred securities	-	-	940	60	940	60
Total securities available-for-sale	$ 45,276	$ 256	$ 31,436	$ 638	$ 76,712	$ 894

As of December 31, 2018, the Corporation's investment security portfolio consisted of 211 securities, 173 of which were in an unrealized loss position. The unrealized losses are primarily related to the Corporation's corporate bonds, agency issued mortgage-backed securities, and states and municipal securities as discussed below.

As of December 31, 2018 and 2017, management conducted an analysis to determine whether all securities currently in an unrealized loss position, including auction rate money market preferred security, should be considered other-than-temporarily impaired. Such analyses considered, among other factors, the following criteria:

- Has the value of the investment declined more than what is deemed reasonable based on a risk and maturity adjusted discount rate?
- Is the investment credit rating below investment grade?
- Is it probable that the issuer will be unable to pay the amount when due?
- Is it more likely than not that the Corporation will not have to sell the security before recovery of its cost basis?
- Has the duration of the investment been extended for an unreasonable period of time?

Based on the Corporation's analysis using the above criteria, the fact that management has asserted that it does not have the intent to sell these securities in an unrealized loss position, and that it is more likely than not the Corporation will not be required to sell the securities before recovery of their cost basis, management does not believe that the values of any securities are other-than-temporarily impaired as of December 31, 2018 or 2017.

4. LOANS AND ALLOWANCE FOR LOAN LOSSES

The Bank grants commercial, consumer and residential mortgage loans to customers situated primarily in Sanilac, Huron and St. Clair counties in Michigan. The ability of the Bank's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area. Substantially all of the consumer and residential loans are secured by various items of property, while commercial loans are secured primarily by business assets and personal guarantees; a portion of loans are unsecured.

Loans are summarized as follows at December 31:

	2018	2017
Commercial and industrial	$ 31,042	$ 35,401
Agricultural	40,944	46,397
Real estate related industries	30,560	27,944
Other commercial	33,771	25,984
Residential real estate	22,540	23,568
Consumer and other	10,538	7,597
Home equity	7,219	4,547
Total loans	176,614	171,438
Allowance for loan losses	1,551	1,330
Loans, net	$ 175,063	$ 170,108

Continued...

(Dollars in thousands except per share data)

The allowance for loan losses and loans are as follows for the year ended December 31, 2018:

	Commercial and Industrial	Agricultural	Real Estate Related Industries	Other Commercial	Residential Real Estate	Consumer and Other	Home Equity	Total
Allowance for loan losses								
Balance at beginning of year	$ 196	$ 441	$ 257	$ 251	$ 113	$ 48	$ 24	$ 1,330
Provision for loan losses	130	(25)	(57)	291	(36)	47	13	363
Loans charged off	(121)	-	(153)	(68)	-	(59)	-	(401)
Recoveries of loans previously charged off	57	10	173	1	-	18	-	259
Balance at end of year	$ 262	$ 426	$ 220	$ 475	$ 77	$ 54	$ 37	$ 1,551
Allowance for loan losses attributable to loans								
Individually evaluated for impairment	$ -	$ 35	$ 59	$ 185	$ 4	$ 4	$ 3	$ 290
Collectively evaluated for impairment	262	391	161	290	73	50	34	1,261
Total allowance for loan losses	$ 262	$ 426	$ 220	$ 475	$ 77	$ 54	$ 37	$ 1,551
Loans								
Individually evaluated for impairment	$ 8	$ 1,481	$ 259	$ 1,129	$ 323	$ 28	$ 73	$ 3,301
Collectively evaluated for impairment	31,034	39,463	30,301	32,642	22,217	10,510	7,146	173,313
Total loans	$ 31,042	$ 40,944	$ 30,560	$ 33,771	$ 22,540	$ 10,538	$ 7,219	$ 176,614

The allowance for loan losses and loans are as follows for the year ended December 31, 2017:

	Commercial and Industrial	Agricultural	Real Estate Related Industries	Other Commercial	Residential Real Estate	Consumer and Other	Home Equity	Total
Allowance for loan losses								
Balance at beginning of year	$ 131	$ 429	$ 247	$ 253	$ 103	$ 26	$ 33	$ 1,222
Provision for loan losses	79	10	1	(3)	26	65	(5)	173
Loans charged off	(14)	-	-	-	(16)	(51)	(8)	(89)
Recoveries of loans previously charged off	-	2	9	1	-	8	4	24
Balance at end of year	$ 196	$ 441	$ 257	$ 251	$ 113	$ 48	$ 24	$ 1,330
Allowance for loan losses attributable to loans								
Individually evaluated for impairment	$ 41	$ 19	$ 155	$ 17	$ 27	$ -	$ 5	$ 264
Collectively evaluated for impairment	155	422	102	234	86	48	19	1,066
Total allowance for loan losses	$ 196	$ 441	$ 257	$ 251	$ 113	$ 48	$ 24	$ 1,330
Loans								
Individually evaluated for impairment	$ 772	$ 1,321	$ 473	$ 360	$ 278	$ 17	$ 93	$ 3,314
Collectively evaluated for impairment	34,629	45,076	27,471	25,624	23,290	7,580	4,454	168,124
Total loans	$ 35,401	$ 46,397	$ 27,944	$ 25,984	$ 23,568	$ 7,597	$ 4,547	$ 171,438

The following table shows the loans allocated by management's internal risk ratings at December 31, 2018:

	Commercial Credit Risk Profile by Risk Rating				
	Commercial and Industrial	Agricultural	Real Estate Related Industries	Other Commercial	Total
Risk Rating					
Pass	$ 31,034	$ 35,527	$ 29,126	$ 29,735	$ 125,422
Watch	8	3,414	-	3,218	6,640
Special mention	-	961	1,175	-	2,136
Substandard	-	1,042	259	818	2,119
Total	$ 31,042	$ 40,944	$ 30,560	$ 33,771	$ 136,317

The following table shows the homogeneous loans allocated by payment activity as of December 31, 2018:

	Consumer Credit Risk Profile by Risk Rating			
	Residential Real Estate	Consumer and Other	Home Equity	Total
Payment Activity				
Performing	$ 22,337	$ 10,510	$ 7,209	$ 40,056
Non-Performing	203	28	10	241
Total	$ 22,540	$ 10,538	$ 7,219	$ 40,297

The following table shows the loans allocated by management's internal risk ratings at December 31, 2017:

	Commercial Credit Risk Profile by Risk Rating				
	Commercial and Industrial	Agricultural	Real Estate Related Industries	Other Commercial	Total
Risk Rating					
Pass	$ 34,279	$ 43,686	$ 27,470	$ 25,385	$ 130,820
Watch	1,122	994	27	232	2,375
Special mention	-	757	-	-	757
Substandard	-	960	447	367	1,774
Total	$ 35,401	$ 46,397	$ 27,944	$ 25,984	$ 135,726

The following table shows the homogeneous loans allocated by payment activity as of December 31, 2017:

	Consumer Credit Risk Profile by Risk Rating			
	Residential Real Estate	Consumer and Other	Home Equity	Total
Payment Activity				
Performing	$ 23,212	$ 7,580	$ 4,526	$ 35,318
Non-Performing	356	17	21	394
Total	$ 23,568	$ 7,597	$ 4,547	$ 35,712

The following table shows an aging analysis of the loan portfolio by time past due as of December 31, 2018:

	Accruing Interest				
	Current	30 - 89 Days Past Due	More Than 90 Days Past Due	Total Nonaccrual	Total Loans
Commercial and industrial	$ 30,063	$ 706	$ -	$ 273	$ 31,042
Agricultural	39,902	-	-	1,042	40,944
Real estate related industries	30,527	-	-	33	30,560
Other commercial	33,735	-	-	36	33,771
Residential real estate	22,258	79	-	203	22,540
Consumer and other	10,451	59	-	28	10,538
Home equity	7,152	57	-	10	7,219
Total	$ 174,088	$ 901	$ -	$ 1,625	$ 176,614

The following table shows an aging analysis of the loan portfolio by time past due as of December 31, 2017:

	Accruing Interest				
	Current	30 - 89 Days Past Due	More Than 90 Days Past Due	Total Nonaccrual	Total Loans
Commercial and industrial	$ 35,401	$ -	$ -	$ -	$ 35,401
Agricultural	45,218	-	-	1,179	46,397
Real estate related industries	27,563	336	-	45	27,944
Other commercial	25,937	-	-	47	25,984
Residential real estate	23,102	111	-	355	23,568
Consumer and other	7,531	49	-	17	7,597
Home equity	4,504	22	-	21	4,547
Total	$ 169,256	$ 518	$ -	$ 1,664	$ 171,438

The following table presents information related to impaired loans as of December 31, 2018:

	Recorded Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded					
Commercial and industrial	$ 8	$ 8	$ -	$ 4	$ -
Agricultural	1,140	1,424	-	961	27
Real estate related industries	33	621	-	59	-
Other commercial	93	180	-	102	-
Residential real estate	146	351	-	150	-
Consumer and Other	13	22	-	15	-
Home equity	26	55	-	21	1

Continued...

(Dollars in thousands except per share data)

	Recorded Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with an allowance recorded					
Commercial and industrial	$ -	$ -	$ -	$ 386	$ -
Agricultural	341	565	35	439	12
Real estate related industries	226	226	59	307	3
Other commercial	1,036	1,036	185	642	70
Residential real estate	177	177	4	151	-
Consumer and Other	15	15	4	8	1
Home equity	47	47	3	62	2
Total impaired loans					
Commercial and industrial	$ 8	$ 8	$ -	$ 390	$ -
Agricultural	1,481	1,989	35	1,400	39
Real estate related industries	259	847	59	366	3
Other commercial	1,129	1,216	185	744	70
Residential real estate	323	528	4	301	-
Consumer and Other	28	37	4	23	1
Home equity	73	102	3	83	3
Total	$ 3,301	$ 4,727	$ 290	$ 3,307	$ 116

The following table presents information related to impaired loans as of December 31, 2017:

	Recorded Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded					
Commercial and industrial	$ -	$ -	$ -	$ 14	$ -
Agricultural	783	1,285	-	963	-
Real estate related industries	85	346	-	637	2
Other commercial	111	188	-	94	-
Residential real estate	153	633	-	203	-
Consumer and Other	17	25	-	8	1
Home equity	16	42	-	19	-
Loans with an allowance recorded					
Commercial and industrial	772	772	41	386	45
Agricultural	538	538	19	280	36
Real estate related industries	388	388	155	393	24
Other commercial	249	249	17	279	16
Residential real estate	125	129	27	62	4
Consumer and Other	-	-	-	-	-
Home equity	77	86	5	87	4
Total impaired loans					
Commercial and industrial	$ 772	$ 772	$ 41	$ 400	$ 45
Agricultural	1,321	1,823	19	1,243	36
Real estate related industries	473	734	155	1,030	26
Other commercial	360	437	17	373	16
Residential real estate	278	762	27	265	4
Consumer and Other	17	25	-	8	1
Home equity	93	128	5	106	4
Total	$ 3,314	$ 4,681	$ 264	$ 3,425	$ 132

A summary of loans that were modified in troubled debt restructurings during 2018 is as follows:

	Troubled Debt Restructurings		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Agricultural	1	$ 304	$ 300
Real Estate Related Industries	2	382	226
	3	$ 686	$ 526

The following table details the number of loans and the recorded investment in loans considered to be troubled debt restructurings ("TDRs") by type of modification during 2018:

	Total Modifications				
	Principal Deferrals		Interest Rate Reductions		
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment	Total Modifications
Agricultural	1	$ 304	-	$ -	$ 304
Real estate related industrial	1	153	1	229	382
	2	$ 457	1	$ 229	$ 686

A summary of loans that were modified in troubled debt restructurings during 2017 is as follows:

	Troubled Debt Restructurings		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Agricultural	1	$ 538	$ 538
Commercial and industrial	1	737	728
	2	$ 1,275	$ 1,266

The following table details the number of loans and the recorded investment in loans considered to be troubled debt restructurings ("TDRs") by type of modification during 2017:

	Total Modifications				
	Principal Deferrals		Interest Rate Reductions		
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment	Total Modifications
Agricultural	-	$ -	1	$ 538	$ 538
Commercial and industrial	1	737	-	-	737
	1	$ 737	1	$ 538	$ 1,275

There were no TDRs for which there was a payment default whereby the borrower was past due with respect to principal and/or interest for 90 days or more during the 12 months ended December 31, 2018 and 2017, that had been modified during the 12-month period prior to default.

5. SERVICING

The Bank services loans for others which generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors and taxing authorities, and processing foreclosures. Loans serviced as of December 31, 2018 and 2017, were $29,259 and $30,153, respectively; such loans are not included on the consolidated balance sheets.

The following summarizes the carrying value and the changes therein of mortgage servicing rights for the years ended December 31:

	2018	2017
Mortgage servicing rights		
Balance at beginning of year	$ 276	$ 295
Mortgage servicing rights capitalized	53	44
Mortgage servicing rights amortized	(32)	(63)
Balance at end of year	$ 297	$ 276

6. FORECLOSED ASSETS

Real estate owned activity was as follows for the years ended December 31:

	2018	2017
Beginning balance	$ 91	$ 923
Loans reclassified to real estate owned	168	561
Direct write-downs	(10)	(47)
Sales of real estate owned	(249)	(1,346)
End of year	$ -	$ 91

Continued...

(Dollars in thousands except per share data)

At December 31, 2017, real estate owned includes $71 of foreclosed residential real estate properties recorded as a result of obtaining physical possession of the property. There were no loans secured by residential real estate properties for which formal foreclosure proceeds were in process at December 31, 2018 or 2017.

Activity in the valuation allowance was as follows for the year ended December 31:

	2018	2017
Beginning balance	$ -	$ 209
Reductions from sales of real estate owned	(10)	(256)
Direct write-downs	10	47
End of year	$ -	$ -

(Income) expenses related to foreclosed assets include:

	2018	2017
Net gain on sales	$ (3)	$ (338)
Provision for unrealized losses	10	47
Operating expenses, net of rental income	(1)	(4)
Total expenses (income)	$ 6	$ (295)

7. PREMISES AND EQUIPMENT

Net premises and equipment consists of the following amounts at December 31:

	2018	2017
Bank premises and land	$ 8,624	$ 8,557
Furniture and equipment	4,359	4,304
Total	12,983	12,861
Less accumulated depreciation	7,558	7,337
Premises and equipment, net	$ 5,425	$ 5,524

Depreciation expense was $323 and $304 for 2018 and 2017, respectively.

8. DEPOSITS

The composition of deposits are summarized as follows as of December 31:

	2018	2017
Interest-bearing		
NOW accounts	$ 91,834	$ 52,729
Savings	67,076	67,007
Money market demand	47,984	56,806
Time, $250,000 and over	1,927	2,192
Other time	32,542	36,492
Total interest-bearing	241,363	215,226
Noninterest-bearing demand	78,221	80,697
Total deposits	$ 319,584	$ 295,923

Scheduled maturities of time deposits for each of the five years succeeding December 31, 2018 and thereafter, are summarized as follows:

Year	Amount
2019	17,259
2020	9,024
2021	4,842
2022	1,619
2023	1,722
After	3
Total	$ 34,469

9. FEDERAL INCOME TAXES

The provision for federal income taxes consists of the following components for the years ended December 31:

	2018	2017
Currently payable	$ 706	$ 840
Deferred (benefit) expense	(24)	252
Income taxes	$ 682	$ 1,092

The Tax Cuts and Jobs Act (the "Act") was enacted on December 22, 2017. The Act reduces the U.S. federal corporate tax rate from 35% to 21%, among other provisions. At that time, the Corporation remeasured certain deferred tax assets and liabilities based on the rates at which such amounts are expected to impact taxable income in the future, which is generally 21%, resulting in an immediate charge of approximately $147 in 2017.

A reconciliation between federal income tax expense reported and the amount computed by applying the statutory federal income tax rate to income before federal income taxes is as follows for the years ended December 31:

	2018	2017
Income tax provision at statutory rate	$ 795	$ 1,200
Effect of tax-exempt interest income	(118)	(154)
Remeasurement of deferred taxes due to changes in federal tax law	-	147
Other, net	5	(101)
Income taxes	$ 682	$ 1,092

The components of the net deferred income tax asset included within other assets in the accompanying consolidated balance sheets (measured at a 21% tax rate) resulted from the following temporary differences between the carrying amounts of assets and liabilities for federal income tax and financial reporting purposes as of December 31:

	2018	2017
Deferred tax assets		
Allowance for loan losses	$ 194	$ 135
Unrealized loss on available-for-sale securities	317	181
Nonaccrual loan interest	12	18
Deferred loan fees/costs	25	30
Other	51	48
Total deferred tax assets	599	412
Deferred tax liabilities		
Depreciation	99	90
Mortgage servicing rights	63	58
Other	40	28
Total deferred tax liabilities	202	176
Net deferred tax asset	$ 397	$ 236

The Corporation concluded that there are no significant uncertain tax positions requiring recognition in the Corporation's consolidated financial statements based on the evaluation performed for 2015 through 2018, the years which remain subject to examination by major tax jurisdictions as of December 31, 2018. The Corporation does not expect the total amount of unrecognized tax benefits ("UTB") (e.g. tax deductions, exclusions, or credits claimed or expected to be claimed) to significantly change in the next 12 months. The Corporation does not have any amounts accrued for interest and penalties related to UTBs at December 31, 2018 or 2017 and it is not aware of any claims for such amounts by federal or state income tax authorities.

10. RELATED PARTY TRANSACTIONS

Loans

In the ordinary course of business, the Bank grants loans to certain directors, executive officers and their affiliates. Such loans aggregated to $1,489 and $1,939 at December 31, 2018 and 2017, respectively.

Deposits

Deposits of Corporate directors, executive officers and their affiliates were $1,219 and $1,158 at December 31, 2018 and 2017, respectively.

11. OFF-BALANCE SHEET ACTIVITIES

The Bank is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The Bank's exposure to credit loss is represented by the contractual amount of these commitments. The Bank follows the same credit policy in making commitments, including requirements for collateral, as it does for on-balance-sheet instruments; no significant losses are anticipated as a result of these commitments.

At December 31, 2018 and 2017, the following financial instruments were outstanding whose contract amounts represent credit risk:

	Contract Amount	
	2018	2017
Unfunded commitments under lines of credit	$ 40,478	$ 35,088
Commitments to grant loans	3,056	5,271
Commercial and standby letters of credit	590	964

Unfunded commitments under commercial lines of credit, revolving home equity lines of credit and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. The commitments for equity lines of credit may expire without being drawn upon. These lines of credit are uncollateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Bank is committed. A majority of such commitments are at fixed rates of interest; a portion is unsecured.

Continued...

(Dollars in thousands except per share data)

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the customer.

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments, if deemed necessary. Guarantees that are not derivative contracts have been recorded on the Corporation's consolidated balance sheets at their fair value at inception. The Bank considers standby letters of credit to be guarantees; however, as the amount of the liability related to such guarantees on the commitment date is not significant, a liability related to such guarantees is not recorded at December 31, 2018 or 2017.

12. COMMON STOCK ACTIVITY, INCLUDING SHARE-BASED INCENTIVE PLANS

Common Stock Repurchases

During 2018 and 2017, the Corporation repurchased 1,270 and 3,353 shares of its common stock (see Note 16). The repurchase price in excess of the amounts identified with the original issuance of the common stock was charged entirely to retained earnings.

Share-Based Compensation

Common Stock Options

The fair value of each option award is estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted average assumptions for the year ended December 31, 2018:

Risk-free interest rate	2.88%
Expected term	10 years
Expected stock price volatility	18.51%
Dividend yield or expected	3.24%

Under the Corporation's 2012 Employee Stock Option Plan (the "Plan"), the Corporation may grant options to its directors, officers and employees for the purchase of up to 128,000 shares of common stock, which can be increased annually up to 3% of the shares outstanding at January 1, 2013, (1,131,649) or 33,949 shares. The exercise of each option equals the market price of the Corporation's stock on the date of grant and an option's maximum term is ten years. The options vest ratably over five years from date of grant. The Corporation also has options outstanding under a Plan established in 2000 and terminated in 2009. The terms of the 2000 Plan are essentially the same as the 2012 Plan. For the years ended December 31, 2018 and 2017, the Corporation recognized $6 and $4, respectively in compensation expense for stock options. As of December 31, 2018, unrecognized compensation costs related to nonvested awards amounted to $16 and will be recognized over a remaining weighted average period of approximately 5 years.

The expected volatility is based on historical volatility. The risk-free interest rates for periods within the contractual life of the awards are based on the U.S. Treasury yield curve in effect at the time of the grant. The expected life is based on historical exercise experience. The dividend yield assumption is based on the Corporation's history and expectation of dividend payouts.

In general, the Corporation's policy is to issue new shares upon the exercise of a stock option; however, the option holder has the option under the Plan to sell shares of stock owned by the holder to the Corporation to facilitate the exercise of options. A summary of the changes in the status of the Corporation's stock option plan is presented below:

	Common Shares Subject to Option	Weighted Average Exercise Price	Average Remaining Contractual Terms (Years)
Outstanding at January 1, 2017	137,211	$ 15.91	4.67
Granted	31,218	21.33	
Exercised	(26,948)	15.04	
Forfeited	(17,439)	18.80	
Outstanding at December 31, 2017	124,042	$ 17.05	5.46
Granted	34,234	22.92	
Exercised	(23,008)	18.05	
Forfeited	(12,330)	15.36	
Outstanding at December 31, 2018	122,938	$ 18.90	5.29

The fair value of options granted during 2018 and 2017 was $5 and $9, respectively.

As of December 31, 2018, 1,798 options under the 2009 plan are outstanding at an average exercise price of $10.10, all of which are exercisable. As of December 31, 2018, 121,140 options under the 2012 plan were outstanding at an average exercise price of $21.10 (range of $12.75 - $24.00) of which 56,682 are exercisable.

Shares granted in 2018 and 2017, include 10,719 and 6,830 shares received in connection with the exercise of a "reload" option whereby the grantee tendered shares to pay the exercise price of an option and received a new option to purchase the number of shares of common stock equal to the number of shares tendered to pay the exercise price.

Reload options have an exercise price equal to the estimated fair value as of the date of exercise of the underlying option. The date of grant of the reload option is the date of exercise of the underlying option. The reload option may be exercised one year after it is granted and expires on the date of expiration of the underlying option to which the reload options related.

Restricted Stock Awards

The Plan also authorizes the use of restricted stock awards, which were granted in 2018 and 2017. The fair value of restricted stock awards is estimated by the market price of the Corporation's common stock at the date of grant. Under the provisions of the plan, the Corporation cannot be obligated to "cash-settle" any of the restricted stock awards through redemption. The shares become vested over a 5-year service period. During the period the shares are not vested, the grantee may not sell, assign, transfer or pledge the shares but has all other rights of a shareholder, including the right to receive dividends and the right to vote such shares. Restricted stock is immediately forfeited when the employment of a grantee ceases. Restricted stock activity during 2018 and 2017, is summarized as follows:

	Number of Shares	Weighted-Average Grant - Date Fair Value per Share
Non-vested, January 1, 2017	-	$ -
Granted	4,876	21.30
Vested		-
Cancelled and forfeited	-	-
Non-vested, December 31, 2017	4,876	$ 21.30
Granted	4,700	22.55
Vested	(934)	21.30
Cancelled and forfeited	(516)	21.79
Non-vested, December 31, 2018	8,126	$ 21.99

Awards are being amortized to expense over the 5-year vesting period. Compensation cost related to restricted stock awards was $33 and $19 for 2018 and 2017, respectively. As of December 31, 2018, there was $146 of total remaining unrecognized compensation cost related to nonvested restricted stock awards granted under the Plan. The cost is expected to be recognized over the next 4 years.

There was an impact of $.03 and $.05 to diluted earnings per share resulting from such common stock equivalents in 2018 and 2017, respectively.

13. REGULATORY REQUIREMENTS

Capital Requirements

The Corporation (on a consolidated basis) and the Bank are subject to various regulatory capital requirements, including restrictions on dividends, administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation's 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, capital and certain off-balance-sheet items as defined in the regulations and 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.

Failure to meet capital requirements can initiate regulatory action. The final rules related to the implementation of the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III Rules) became effective for the Corporation on January 1, 2016, with full compliance of all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The capital conservation buffer as of December 31, 2018 and 2017 is 1.875% and 1.25%, respectively. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital.

Quantitative measurements 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). Management believes, as of December 31, 2018 and 2017, that the Corporation and the Bank met all capital adequacy requirements to which they are subject.

As of December 31, 2018 and 2017, the most recent notifications from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since the notification that management believes have changed the Bank's category. The Corporation's and the Bank's actual capital amounts and ratios as of December 31, 2018 and 2017 are also presented in the table.

Continued...

(Dollars in thousands except per share data)

December 31, 2018	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital to Risk Weighted Assets						
Consolidated	$ 37,219	18.59%	$ 19,775	9.875%	N/A	N/A
Bank	36,233	18.09	19,775	9.875	$ 20,025	10.00%
Tier 1 (Core) Capital To Risk Weighted Assets						
Consolidated	35,668	17.81	15,770	7.875	N/A	N/A
Bank	34,681	17.32	15,770	7.875	16,020	8.00
Common Tier 1 (CET1)						
Consolidated	35,668	17.81	12,766	6.375	N/A	N/A
Bank	34,681	17.32	12,766	6.375	13,016	6.50
Tier 1 (Core) Capital To Average Assets						
Consolidated	35,668	9.77	13,448	4.00	N/A	N/A
Bank	34,681	9.78	13,448	4.00	16,810	5.00

December 31, 2017	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital to Risk Weighted Assets						
Consolidated	$ 34,657	18.53%	$ 17,303	9.25%	N/A	N/A
Bank	33,645	17.99	17,303	9.25	$ 18,706	10.00%
Tier 1 (Core) Capital To Risk Weighted Assets						
Consolidated	33,327	17.82	13,562	7.25	N/A	N/A
Bank	32,315	17.28	13,562	7.25	14,964	8.00
Common Tier 1 (CET1)						
Consolidated	33,327	17.82	10,756	5.75	N/A	N/A
Bank	32,315	17.28	10,756	5.75	10,564	6.50
Tier 1 (Core) Capital To Average Assets						
Consolidated	33,327	10.10	13,194	4.00	N/A	N/A
Bank	32,315	9.81	13,175	4.00	16,469	5.00

Restrictions on Cash and Amounts Due from Banks

The Bank is required by regulatory agencies to maintain legal cash reserves based on the level of certain customer deposits. There was no required reserve balance at December 31, 2018 or 2017.

Restrictions on Dividends, Loans and Advances

Federal and state banking regulations place certain restrictions on the amount of loans or advances that can be extended to the Corporation by the Bank and dividends that can be paid to the Corporation by the Bank. The total amount of dividends which may be paid at any date is generally limited to the retained earnings of the Bank, and loans or advances are limited to 10% of the Bank's capital stock and surplus on a secured basis. In addition, dividends paid by the Bank to the Corporation would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements.

14. CONTINGENCIES

Litigation

The Corporation is party to litigation arising during the normal course of business. In the opinion of management, based on consultation with legal counsel, the resolution of such litigation is not expected to have a material effect on the consolidated financial statements.

Environmental Issues

As a result of acquiring real estate from foreclosure proceedings, the Corporation is subject to potential claims and possible legal proceedings involving environmental matters. No such claims have been asserted as of December 31, 2018.

15. OTHER EMPLOYEE BENEFIT PLANS

401(k) Plan

The Bank maintains a deferred compensation plan qualified under Section 401(k) of the Internal Revenue Code. Under this plan, eligible employees are permitted to contribute up to 25% of gross compensation into the retirement plan up to a maximum determined by the Internal Revenue Code; the Bank matches each employee contribution at a rate of up to 50% of the first 6% contributed by the employee. Expenses associated with the plan amounted to $76 and $74 in 2018 and 2017, respectively.

The 401(k) retirement plan also has a defined contribution profit sharing feature that covers substantially all of its employees. Contributions to the plan are based on an employee's earnings, as defined in the plan document. Expenses associated with the plan amounted to $219 and $200 in 2018 and 2017, respectively.

Deferred Compensation Plan

In 2018, the Corporation adopted a deferred compensation plan. Pursuant to the terms of the Deferred Compensation Plan, Bank Officers are permitted to defer all or a portion of any annual bonus and receive shares of the Corporation equal to the stock value based on the closing price on the day the bonus is issued. In addition, the participant's account will be credited with additional shares representing 25% bonus shares based on the number of shares credited from the deferral. Board members may also elect to defer any or all of their board fees and receive the same 25% bonus shares, subject to a 3-year vesting. The bonus shares for both deferred annual bonus amounts and deferred directors fees vest after three years of service, death, disability, or upon mandatory retirement from the board. The Deferred Compensation Plan does not allow for cash settlement.

The amounts deferred under the arrangements and invested in Corporation common stock are maintained in a grantor ("rabbi") trust. Assets of the rabbi trust are consolidated with the Corporation, and the value of the Corporation's common shares held in the rabbi trust is classified in shareholders' equity. The Corporation recognizes the original amount of deferred compensation as the basis for recognition in the rabbi trust. Changes in the fair value owed to employees are not recognized as the Deferred Compensation Plan does not permit diversification and must be settled only by the delivery of a fixed number of shares of the Corporation's common stock.

The Corporation recognized $2 of compensation expense in 2018 and has recorded a related obligation of $2 within shareholders' equity at December 31, 2018. As of December 31, 2018, a total of 80 shares are held in the rabbi trust of which 68 are vested and 12 remain unvested. The weighted average share price of shares held in the rabbi trust at December 31, 2018, is $24.43.

Bank-Owned Life Insurance

The Bank has invested in single premium, bank owned, whole life insurance policies on certain officers of the Bank. Bank owned life insurance is an alternative investment vehicle, generally non-liquid, which may produce additional earnings to offset, and later fund, various employee supplemental benefit expenses The earnings on the policies are not taxed unless withdrawn or surrendered prior to the death of the insured. The increase in cash surrender value of the policies, which was $231 and $240 in 2018 and 2017, respectively, is included in noninterest income in the consolidated statements of income.

The benefit promised by the Bank to the covered officers is established at one times the officer's salary at date of death; such benefit expires if the officers' employment is terminated for any reason other than death, including voluntary or involuntary termination or retirement. Based primarily on the ages of the covered officers, the Bank believes that the payment of such benefits is not probable; accordingly, the Bank has not recognized compensation expense for such benefits.

16. SUPPLEMENTAL CASH FLOWS INFORMATION

Other Cash Flows Information

Cash paid for interest and income taxes amounted to the following during the years ended December 31:

	2018	2017
Interest	$ 479	$ 370
Income taxes	$ 714	$ 1,111

Non-Cash Investing Activities

Collateral repossessed on real estate loans having carrying values in the amount of $168 and $561 on the date of transfer was reclassified to foreclosed assets in 2018 and 2017, respectively.

Non-Cash Financing Activities

During 2018 and 2017, options for the purchase of 6,176 and 20,118, respectively, common shares were exercised. In accordance with the Plan document, in 2017, 3,353 outstanding shares of common stock were repurchased by the Corporation to facilitate the exercise of 3,954 options. Total value assigned to the repurchased shares in 2017 was $78. No such shares were repurchased by the Corporation to facilitate the exercise of options in 2018.

Additionally, during 2018 and 2017, 16,832 and 9,686 common shares were exercised through a reload option whereby 10,719 and 6,830 common shares were tendered to pay the exercise price ("cashless exercise"). The issuance of shares upon exercise of common stock options has been recorded net of the tendered shares in the statement of shareholders' equity.

17. REVENUE FROM CONTRACTS WITH CUSTOMERS

The Corporation's primary revenue stream accounted for under ASC 606 relates to service charges on deposit accounts.

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

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End of Notes

Rehmann

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INDEPENDENT AUDITORS' REPORT

February 11, 2019

Shareholders and Board of Directors
Eastern Michigan Financial Corporation
Croswell, Michigan

We have audited the accompanying consolidated financial statements of ***Eastern Michigan Financial Corporation*** (the Corporation), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Independent Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on auditor judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Corporation's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of ***Eastern Michigan Financial Corporation*** as of December 31, 2018 and 2017, and the consolidated results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Rehmann Robson LLC

MILESTONES

Eastern Michigan Bank is proud to honor staff members who have celebrated milestone anniversaries with us in 2018. They are a valued part of our team and banking family, and we're grateful for their commitment and contributions.

30 YEAR AWARD

Cindy Mugridge, Branch Manager, Lakeport

15 YEAR AWARD

Stefanie Abbott, AVP, Branch Manager, Lexington
Amanda Mosher, Mortgage Specialist, Underwriter, Loan Center
Tammy Williford, AVP, Marketing and Compliance Officer, Administrative Offices

5 YEAR AWARD

(back)
Nicki Parker, Consumer Loan Documentation Specialist/Collections, Loan Center
Kathleen Breckner, Mortgage/Commercial Loan Clerk, Loan Center
Terri Herman, Teller, Marysville
Alicia Reinke, Head Teller, Sandusky
Chelsea DuPree, Human Resources Generalist, Administrative Offices

(front)
Anna-Marie Peresta, Assistant Branch Manager, Ruth
Dru Moran, Deposit Operations Specialist, Administrative Offices
Audra Levitte, AVP, Human Resources Director, Administrative Offices
Ashley Foster, Consumer/Commercial Loan Clerk
Krista Short, Assistant Branch Manager, Lexington

2018 Annual Report

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FDIC EQUAL HOUSING LENDER