



LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2016 and 2015

With Independent Auditor's Report



INDEPENDENT AUDITOR'S REPORT

Board of Directors and Shareholders
Ledyard Financial Group, Inc. and Subsidiary

We have audited the accompanying consolidated financial statements of Ledyard Financial Group, Inc. and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from 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 the auditor's 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 entity'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 entity'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 financial position of Ledyard Financial Group, Inc. and Subsidiary as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Berry Dunn McNeil & Parker, LLC

Portland, Maine
February 21, 2017

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY**Consolidated Balance Sheets****December 31, 2016 and 2015****ASSETS**

	<u>2016</u>	<u>2015</u>
Cash and due from banks	\$ 9,228,955	\$ 5,511,310
Interest-bearing deposits	<u>3,447,513</u>	<u>38,602,398</u>
Total cash and cash equivalents	12,676,468	44,113,708
Securities available-for-sale	142,127,100	98,292,616
Securities held-to-maturity	1,763,302	4,703,960
Nonmarketable equity securities	1,702,406	1,669,206
Loans held for sale	-	1,303,000
Loans receivable, net of allowance for loan losses of \$5,699,651 in 2016 and \$5,706,238 in 2015	289,166,831	269,664,025
Accrued interest receivable	1,653,251	1,380,645
Premises and equipment, net	7,690,328	7,806,583
Bank owned life insurance	10,441,900	10,176,998
Other assets	<u>9,084,742</u>	<u>6,959,021</u>
	<u>\$476,306,328</u>	<u>\$446,069,762</u>

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

LIABILITIES AND SHAREHOLDERS' EQUITY

	<u>2016</u>	<u>2015</u>
Deposits		
Demand	\$ 101,329,337	\$ 94,628,730
NOW accounts	74,825,098	72,043,118
Money market accounts	139,696,562	127,676,610
Savings	37,137,606	31,827,775
Time deposits, other	40,019,289	41,565,525
Time, \$250,000 and over	<u>8,975,762</u>	<u>5,195,212</u>
Total deposits	401,983,654	372,936,970
Securities sold under agreements to repurchase	6,878,829	11,167,789
Advances from Federal Home Loan Bank (FHLB)	20,000,000	14,000,000
Accrued expenses and other liabilities	<u>4,554,355</u>	<u>3,917,082</u>
Total liabilities	<u>433,416,838</u>	<u>402,021,841</u>
Shareholders' equity		
Common stock, \$1.00 par value; 5,500,000 shares authorized, 1,065,096 and 1,057,144 shares issued at December 31, 2016 and 2015, respectively	1,065,096	1,057,144
Additional paid-in capital	11,467,322	11,287,729
Treasury stock, at cost; 45,771 and 28,364 shares at December 31, 2016 and 2015, respectively	(1,799,630)	(967,154)
Retained earnings	32,946,852	30,831,251
Accumulated other comprehensive (loss) income	<u>(790,150)</u>	<u>1,838,951</u>
Total shareholders' equity	<u>42,889,490</u>	<u>44,047,921</u>
	<u>\$476,306,328</u>	<u>\$446,069,762</u>

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

Consolidated Statements of Income

Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Interest and dividend income		
Interest and fees on loans	\$ 10,922,894	\$ 10,771,664
Investment securities	2,971,292	2,757,602
Other interest-earning assets	<u>235,050</u>	<u>148,535</u>
Total interest and dividend income	<u>14,129,236</u>	<u>13,677,801</u>
Interest expense		
Deposits	593,728	569,961
Borrowed funds	<u>278,547</u>	<u>280,790</u>
Total interest expense	<u>872,275</u>	<u>850,751</u>
Net interest income	13,256,961	12,827,050
Provision for loan losses	<u>-</u>	<u>-</u>
Net interest income after provision for loan losses	<u>13,256,961</u>	<u>12,827,050</u>
Noninterest income		
Ledyard Financial Advisors division income	8,314,869	8,437,281
Service fees	833,058	838,866
Net gain on sales of securities	449,907	51,688
Other	<u>755,202</u>	<u>831,425</u>
Total noninterest income	<u>10,353,036</u>	<u>10,159,260</u>
Noninterest expense		
Salaries and employee benefits	11,625,439	11,104,178
Occupancy and equipment	3,450,441	3,413,740
Federal Deposit Insurance Corporation (FDIC) insurance fees	190,000	239,500
Other general and administrative	<u>3,208,467</u>	<u>3,054,078</u>
Total noninterest expense	<u>18,474,347</u>	<u>17,811,496</u>
Income before income taxes	5,135,650	5,174,814
Income tax expense	<u>1,007,232</u>	<u>1,113,476</u>
Net income	<u>\$ 4,128,418</u>	<u>\$ 4,061,338</u>
Basic earnings per share	\$ 3.98	\$ 3.96
Diluted earnings per share	\$ 3.87	\$ 3.85
Weighted average numbers of shares outstanding	1,038,284	1,024,334

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

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY**Consolidated Statements of Comprehensive Income****Years Ended December 31, 2016 and 2015**

	<u>2016</u>	<u>2015</u>
Net income	\$ 4,128,418	\$ 4,061,338
Other comprehensive loss, net of tax		
Available-for-sale securities		
Net unrealized holding losses on securities available-for-sale	(3,941,811)	(443,448)
Reclassification adjustment for net realized gains on securities available-for-sale included in net income	(449,907)	(51,688)
Tax effect	<u>1,493,184</u>	<u>168,346</u>
Net of tax amount	(2,898,534)	(326,790)
Interest rate swaps		
Unrealized interest rate swap asset (liability)	408,232	(27,744)
Tax effect	<u>(138,799)</u>	<u>9,433</u>
Net of tax amount	269,433	(18,311)
Other comprehensive loss, net of tax	<u>(2,629,101)</u>	<u>(345,101)</u>
Total comprehensive income	<u>\$ 1,499,317</u>	<u>\$ 3,716,237</u>

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

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

Consolidated Statements of Changes in Shareholders' Equity

Years Ended December 31, 2016 and 2015

	Common Stock	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total
Balance, December 31, 2014	<u>\$1,048,940</u>	<u>\$10,960,879</u>	<u>\$ (959,688)</u>	<u>\$ 28,778,060</u>	<u>\$ 2,184,052</u>	<u>\$ 42,012,243</u>
Net income	-	-	-	4,061,338	-	4,061,338
Other comprehensive loss, net of tax effect	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(345,101)</u>	<u>(345,101)</u>
Total comprehensive income	<u>-</u>	<u>-</u>	<u>-</u>	<u>4,061,338</u>	<u>(345,101)</u>	<u>3,716,237</u>
Cash dividends paid, \$1.92 per share	-	-	-	(2,008,147)	-	(2,008,147)
Stock repurchase (2,100 shares)	-	-	(102,255)	-	-	(102,255)
Stock awards issued (2,788 shares)	-	39,975	94,789	-	-	134,764
Stock-based compensation expense	-	533,000	-	-	-	533,000
Restricted stock issued, net (8,204 shares)	<u>8,204</u>	<u>(246,125)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(237,921)</u>
Balance, December 31, 2015	<u>1,057,144</u>	<u>11,287,729</u>	<u>(967,154)</u>	<u>30,831,251</u>	<u>1,838,951</u>	<u>44,047,921</u>
Net income	-	-	-	4,128,418	-	4,128,418
Other comprehensive loss, net of tax effect	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(2,629,101)</u>	<u>(2,629,101)</u>
Total comprehensive income	<u>-</u>	<u>-</u>	<u>-</u>	<u>4,128,418</u>	<u>(2,629,101)</u>	<u>1,499,317</u>
Cash dividends paid, \$1.92 per share	-	-	-	(2,012,817)	-	(2,012,817)
Stock repurchase (19,789 shares)	-	-	(925,995)	-	-	(925,995)
Stock awards issued (2,382 shares)	-	29,682	93,519	-	-	123,201
Stock-based compensation expense	-	425,500	-	-	-	425,500
Restricted stock issued, net (7,952 shares)	<u>7,952</u>	<u>(275,589)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(267,637)</u>
Balance, December 31, 2016	<u><u>\$1,065,096</u></u>	<u><u>\$11,467,322</u></u>	<u><u>\$ (1,799,630)</u></u>	<u><u>\$ 32,946,852</u></u>	<u><u>\$ (790,150)</u></u>	<u><u>\$ 42,889,490</u></u>

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

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

Consolidated Statements of Cash Flows

Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities		
Net income	\$ 4,128,418	\$ 4,061,338
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization or accretion	1,283,516	1,271,189
Net gain on sales of securities	(449,907)	(51,688)
Net gain on sales other real estate owned	(40,406)	-
Deferred income tax (benefit) expense	(98,556)	17,768
Amortization of limited partnerships	656,847	478,188
Fair value of stock awards vested during the year	425,500	533,000
Fair value of stock awards issued from treasury stock	123,201	134,764
(Increase) decrease in accrued interest receivable	(272,606)	25,708
Increase in other assets	(566,520)	(1,191,541)
Net decrease in loans held for sale	1,303,000	1,429,400
Increase in accrued expenses and other liabilities	<u>944,728</u>	<u>398,877</u>
Net cash provided by operating activities	<u>7,437,215</u>	<u>7,107,003</u>
Cash flows from investing activities		
Proceeds from sales, calls, maturities and paydowns of securities available-for-sale	18,031,432	20,339,351
Proceeds from sales, calls, maturities and paydowns of securities held-to-maturity	3,158,329	2,437,054
Net (purchase) redemption of FHLB stock	(33,200)	791,244
Purchase of securities available-for-sale	(66,804,926)	(18,059,378)
Low income housing investment	(886,826)	(826,403)
Net increase in loans to customers	(19,502,806)	(3,854,531)
Purchase of premises and equipment	<u>(387,733)</u>	<u>(384,243)</u>
Net cash (used) provided by investing activities	<u>(66,425,730)</u>	<u>443,094</u>
Cash flows from financing activities		
Net increase in deposits	29,046,684	7,255,022
Proceeds from short-term borrowings	6,000,000	-
Net (decrease) increase in securities sold under agreements to repurchase	(4,288,960)	2,379,287
Purchase of treasury stock	(925,995)	(102,255)
Restricted stock redeemed	(267,637)	(237,921)
Cash dividends paid on common stock	<u>(2,012,817)</u>	<u>(2,008,147)</u>
Net cash provided by financing activities	<u>27,551,275</u>	<u>7,285,986</u>
Net (decrease) increase in cash and cash equivalents	<u>(31,437,240)</u>	<u>14,836,083</u>
Cash and cash equivalents, beginning of year	<u>44,113,708</u>	<u>29,277,625</u>
Cash and cash equivalents, end of year	<u>\$ 12,676,468</u>	<u>\$ 44,113,708</u>
Supplementary cash flow information:		
Interest paid on deposits and borrowed funds	<u>\$ 867,885</u>	<u>\$ 848,228</u>
Income taxes paid	<u>\$ 231,000</u>	<u>\$ 1,049,083</u>

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

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

Nature of Business

Ledyard Financial Group, Inc. (the Company) is headquartered in Hanover, New Hampshire and, as a bank holding company, it provides financial services to its customers through its wholly-owned bank subsidiary, Ledyard National Bank (the Bank). The Bank provides retail and commercial banking and wealth advisory services through its office locations in Central New Hampshire and Vermont.

1. Summary of Significant Accounting Policies

The accounting policies of the Company are in conformity with U.S. generally accepted accounting principles (U.S. GAAP) and general practices within the banking industry. The following is a description of the more significant policies.

Basis of Presentation

The Company follows accounting standards as set by the Financial Accounting Standards Board (FASB). FASB sets U.S. GAAP that management follows to consistently report the Company's financial condition, results of operations and cash flows.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned bank subsidiary. All intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

In preparing financial statements in conformity with U.S. GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of other real estate owned. In connection with the determination of the allowance and the carrying value of other real estate owned, management obtains independent appraisals for significant properties and collateral securing significant loans. Accordingly, the ultimate collectability of a substantial portion of the Company's loan portfolio is susceptible to changes in local market conditions.

While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's loan portfolio. Such agencies may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

Significant Group Concentrations of Credit Risk

The Company's operations are affected by various risk factors, including interest rate risk, credit risk, and risk from geographic concentration of lending activities. Management attempts to manage interest rate risk through various asset/liability management techniques designed to match maturities of assets and liabilities. Loan policies and administration are designed to provide assurance that loans will only be granted to creditworthy borrowers, although credit losses are expected to occur because of subjective factors beyond the control of the Company. Although the Company has a diversified loan portfolio and economic conditions are stable, most of its lending activities are conducted within the geographic area where it is located. As a result, the Company and its borrowers may be especially vulnerable to the consequences of changes in the local economy. In addition, a substantial portion of the Company's loans are secured by real estate.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents include cash and due from banks, and interest-bearing deposits.

The Company's due from bank accounts and interest-bearing deposits, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant risk on cash and cash equivalents.

Investment Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as held-to-maturity and carried at cost, adjusted for amortization of premiums and accretion of discounts over the period to call or maturity using methods approximating the interest method. Securities not classified as held-to-maturity, including equity securities with readily determinable fair values, are classified as available-for-sale and are carried at fair value. Nonmarketable equity securities, consisting of stock in the FHLB and Federal Reserve Bank (FRB), are carried at cost and evaluated for impairment. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Unrealized gains and losses on securities available-for-sale are reported as a net amount in other comprehensive income, net of tax.

For declines in the fair value of individual debt securities available-for-sale below their cost that are deemed to be other-than-temporary, where the Company does not intend to sell the security and it is more likely than not that the Company will not be required to sell the security before recovery of its amortized cost basis, the other-than-temporary decline in the fair value of the debt security related to 1) credit loss is recognized in earnings, and 2) other factors, is recognized in other comprehensive income or loss. Credit loss is deemed to exist if the present value of expected future cash flows using the effective rate at acquisition is less than the amortized cost basis of the debt security. For individual debt securities where the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the security's cost basis and its fair value at the balance sheet date.

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

In estimating other-than-temporary impairment losses, management considers 1) the length of time and the extent to which the fair value has been less than cost, 2) the financial condition and near-term prospects of the issuer, and 3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are stated at the amount of unpaid principal, increased by deferred loan costs and reduced by an allowance for loan losses.

Loans past due 30 days or more are considered delinquent. Management is responsible to initiate immediate collection efforts to minimize delinquency and any eventual adverse impact on the Company.

In general, consumer loans will be charged off if the loan is delinquent for 120 consecutive days. Commercial and real estate loans are charged off in part or in full if they are considered uncollectible.

Loan interest income is accrued daily on the outstanding balances. Accrual of interest is discontinued when a loan is specifically determined to be impaired or management believes, after considering collection efforts and other factors, that the borrower's financial condition is such that collection of interest is doubtful. Any unpaid interest previously accrued on those loans is reversed from income. Interest income is generally not recognized on specific impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are generally applied as a reduction of the loan principal balance. Interest income on other nonaccrual loans is recognized only to the extent of interest payments received. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loan origination and commitment fees and certain direct origination costs are being deferred and the net amount amortized as an adjustment of the related loan's yield. The Company is generally amortizing these amounts over the contractual life of the loan.

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Notes to Consolidated Financial Statements

December 31, 2016 and 2015

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The allowance for loan losses is evaluated on a regular basis by management. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance consists of general, allocated and unallocated components, as further described below.

General Component

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by the following loan segments: residential real estate, commercial real estate, construction, commercial and consumer. Management uses an average of historical losses based on a time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels/trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and changes in lending policies, experience, ability, depth of lending management and staff; and national and local economic conditions. There were no changes in the Company's policies or methodology pertaining to the general component for loan losses during 2016. Management follows a similar process to estimate its liability for off-balance-sheet commitments to extend credit.

The qualitative factors are determined based on the various risk characteristics of each loan segment. Risk characteristics relevant to each portfolio segment are as follows:

Residential real estate: All loans in this segment are collateralized by 1-4 family residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality of this segment.

Commercial real estate: Loans in this segment are primarily income-producing properties or properties occupied by businesses. The underlying cash flows generated by the properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates or a general slowdown in business which, in turn, will have an effect on the credit quality of this segment. Management obtains rent rolls and business financial statements on an annual basis and continually monitors the cash flows of these loans.

Construction: Loans in this segment include real estate development loans for which payment is derived from sale of the property. Credit risk is affected by cost overruns, time to sell at an adequate price, and market conditions.

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Commercial: Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer spending, will have an effect on the credit quality in this segment.

Consumer: Repayment of loans in this segment is generally dependent on the credit quality of the individual borrower.

Allocated Component

The allocated component relates to loans that are classified as impaired. Impairment is measured on a loan-by-loan basis for commercial, commercial real estate, construction and residential real estate loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan. Large groups of smaller balance homogenous loans are collectively evaluated for impairment, and the allowance resulting therefrom is reported as the general component, as described above.

A loan is considered impaired when, based on current information and events, it is probable that the Company 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.

The Company periodically may agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring (TDR). All TDR's are classified as impaired.

Unallocated Component

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general reserves in the portfolio.

Credit Related Financial Instruments

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

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

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December 31, 2016 and 2015

Derivative Financial Instruments

Fair values for interest rate swap agreements are based upon the amounts required to settle the contracts.

The Company utilizes interest rate swap agreements to provide an effective hedge against changes in the London Interbank Offered Rates (LIBOR) swap curve. Interest rate swaps are contracts in which a series of interest rate flows are exchanged over a prescribed period. The notional amount on which the interest payments are based is not exchanged.

The Company assesses, both at the hedge's inception and on an ongoing basis, whether the derivative instruments that are used are highly effective in offsetting changes in fair values or cash flows of the hedged items. The effective portion of the gain or loss on a derivative designated and qualifying as a cash flow hedging instrument is initially reported as a component of other comprehensive income and subsequently reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of the gain or loss on the derivative instrument, if any, is recognized currently in earnings.

Interest rate derivative financial instruments receive hedge accounting treatment only if they are designated as a hedge and are expected to be, and are, effective in substantially reducing interest rate risk arising from the assets and liabilities identified as exposing the Company to risk. Those derivative financial instruments that do not meet the hedging criteria discussed below would be classified as trading activities and would be recorded at fair value with changes in fair value recorded in income. Derivative hedge contracts must meet specific effectiveness tests (i.e., over time the change in their fair values due to the designated hedge risk must be within 80 to 125 percent of the opposite change in the fair values of the hedged assets or liabilities). Changes in fair value of the derivative financial instruments must be effective at offsetting changes in the fair value of the hedged items due to the designated hedge risk during the term of the hedge. Further, if the underlying financial instrument differs from the hedged asset or liability, there must be a clear economic relationship between the prices of the two financial instruments. If periodic assessment indicates derivatives no longer provide an effective hedge, the derivatives contracts would be closed out and settled or classified as a trading activity.

Cash flows resulting from the derivative financial instruments that are accounted for as hedges of assets and liabilities are classified in the cash flow statement in the same category as the cash flows of the items being hedged.

For derivatives designated in a fair value hedge accounting relationship, changes in fair value associated with the hedged exposure are recorded in current earnings, while changes in the derivatives unhedged risk remain in AOCI.

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Other Real Estate Owned

Real estate properties acquired through or in lieu of loan foreclosure are initially recorded at fair value less estimated selling cost at the date of foreclosure. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses.

After foreclosure, these assets are carried at the lower of their new cost basis or fair value less cost to sell. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. Valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of its cost or fair value less cost to sell.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost, less accumulated depreciation. The provision for depreciation is computed over the estimated useful life of the related asset, principally by the straight-line method. Improvements to leased property are amortized over the lesser of the term of the lease or life of the improvements.

Income Taxes

The Company recognizes income taxes under the asset and liability method. Under this method, deferred tax assets and liabilities are established for the temporary differences between the book bases and the tax bases of the Company's assets and liabilities at enacted tax rates expected to be in effect when the amounts related to such temporary differences are realized or settled. Adjustments to the Company's deferred tax assets are recognized as deferred income tax expense or benefit based on management's judgment relating to the realizability of such assets.

FASB Accounting Standards Codification (ASC) Topic 740, *Income Taxes*, defines the criteria that an individual's tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. Topic 740 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service and State tax authorities for the years ended December 31, 2013 through 2015.

Earnings per Share

Basic earnings per share data is computed based on the weighted average number of the Company's common shares outstanding during the year. Potential common stock is considered in the calculation of weighted average shares outstanding for diluted earnings per share, and is determined using the treasury stock method.

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

Stock Based Compensation Plans

FASB ASC Topic 718, *Compensation-Stock Compensation*, requires entities issuing stock options in exchange for services to measure the fair value of the options at the grant date and to recognize the fair value of those options as expense, generally over the period in which they vest.

Restricted stock awards are measured at the fair value of the stock at the grant date and recognized as expense over the period in which they vest.

Ledyard Financial Advisors Assets and Fees

Assets held by Ledyard Financial Advisors (a division of Ledyard National Bank) for its customers, other than trust cash on deposit at the Bank, are not included in these financial statements because they are not assets of the Bank. Fees that Ledyard Financial Advisors earns are recorded on the accrual basis.

Recently Issued Accounting Pronouncements

In January 2016, FASB issued Accounting Standards Update (ASU) No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This guidance changes how entities account for equity investments that do not result in consolidation and are not accounted for under the equity method of accounting. This guidance also changes certain disclosure requirements and other aspects of current US GAAP. Public businesses must use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. This guidance is effective for fiscal years beginning after December 15, 2017, including interim periods within the fiscal year. The Company is currently evaluating the impact of the adoption of ASU 2016-01 on its consolidated financial statements.

In February 2016, FASB issued ASU No. 2016-02, *Leases (Topic 842)*. The ASU was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The ASU is effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Management is reviewing the guidance in the ASU to determine whether it will have a material effect on the Company's consolidated financial condition and results of operations.

In June 2016, FASB issued ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*. The ASU requires entities to measure credit losses on loans receivable using a current expected credit loss model, instead of the incurred loss model used in current accounting principles. The ASU is effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. Management is currently reviewing the ASU to assess its effect on the Company's consolidated financial condition and results of operations.

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Business Segments

U.S. GAAP requires public companies to report (i) certain financial and descriptive information about “reportable operating segments,” as defined, and (ii) certain enterprise-wide financial information. Operating segment information is reported using a “management approach” that is based on the way management organizes the segments for purposes of making operating decisions and assessing performance.

The Company’s two primary business segments are banking and wealth advisory services.

Banking consists principally of lending to commercial and consumer customers, as well as deposit gathering activities.

Wealth advisory services includes, as its principal business lines, financial planning services, investment management services, personal tax services, trustee services and estate planning.

The Company’s business segment disclosure is based on information generated by an internal profitability reporting system, which generates information by business segment based on the needs of management responsible for managing those segments. Allocations between the business segments can be subjective in nature and are reviewed and refined as circumstances warrant. Any allocations that may affect the reported results of any business segment will not affect the consolidated financial position or results of operations of the Company as a whole. The Company does not allocate assets by segment.

The following tables provide selected financial information for the Company’s business segments:

	<u>Banking</u>	<u>Wealth Advisory Services</u>	<u>Total Consolidated</u>
<u>Year ended December 31, 2016</u>			
Net interest income	\$ 13,256,961	\$ -	\$ 13,256,961
Noninterest income	2,038,167	8,314,869	10,353,036
Noninterest expense	12,745,165	5,729,182	18,474,347
Income before income taxes	2,549,963	2,585,687	5,135,650
Income tax (benefit) expense	(16,959)	1,024,191	1,007,232
Net income	2,566,922	1,561,496	4,128,418

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY**Notes to Consolidated Financial Statements****December 31, 2016 and 2015**

	<u>Banking</u>	<u>Wealth Advisory Services</u>	<u>Total Consolidated</u>
<u>Year ended December 31, 2015</u>			
Net interest income	\$ 12,827,050	\$ -	\$12,827,050
Noninterest income	1,721,979	8,437,281	10,159,260
Noninterest expense	12,418,641	5,392,855	17,811,496
Income before income taxes	2,130,388	3,044,426	5,174,814
Income tax (benefit) expense	(92,421)	1,205,897	1,113,476
Net income	2,222,809	1,838,529	4,061,338

Subsequent Events

For the purposes of the presentation of these financial statements in conformity with U.S. GAAP, management has considered transactions or events occurring through February 21, 2017, which is the date that the financial statements are available to be issued. Management has not evaluated subsequent events after that date for inclusion in the financial statements.

2. Cash and Due from Banks

The Bank is required to maintain certain reserves of vault cash or deposits with the FRB. The amount of this reserve requirement, included in cash and due from banks, was approximately \$122,000 and \$53,000 as of December 31, 2016 and 2015, respectively.

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

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3. Investment Securities

The amortized cost and fair value of securities, with gross unrealized gains and losses, follow:

	2016			
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<u>Securities available-for-sale</u>				
U.S. Government sponsored enterprises	\$ 9,569,452	\$ -	\$ (80,730)	\$ 9,488,722
Mortgage-backed securities	51,562,395	16,467	(1,098,087)	50,480,775
Collateralized mortgage obligations	61,930	2,083	-	64,013
State and municipal	63,446,624	1,557,137	(1,999,889)	63,003,872
Corporate bonds	<u>19,064,383</u>	<u>75,868</u>	<u>(50,533)</u>	<u>19,089,718</u>
Total securities available-for-sale	<u>\$143,704,784</u>	<u>\$ 1,651,555</u>	<u>\$ (3,229,239)</u>	<u>\$ 142,127,100</u>
<u>Securities held-to-maturity</u>				
Mortgage-backed securities	\$ 843,536	\$ 25,428	\$ -	\$ 868,964
Collateralized mortgage obligations	32,003	551	-	32,554
State and municipal	<u>887,763</u>	<u>38,622</u>	<u>-</u>	<u>926,385</u>
Total securities held-to-maturity	<u>\$ 1,763,302</u>	<u>\$ 64,601</u>	<u>\$ -</u>	<u>\$ 1,827,903</u>

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

	2015			
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<u>Securities available-for-sale</u>				
U.S. Government sponsored enterprises	\$ 2,500,000	\$ -	\$ (42,208)	\$ 2,457,792
Mortgage-backed securities	20,988,836	298,240	-	21,287,076
Collateralized mortgage obligations	121,636	6,857	-	128,493
State and municipal	48,137,817	2,777,707	(17,068)	50,898,456
Corporate bonds	<u>23,730,293</u>	<u>86,695</u>	<u>(296,189)</u>	<u>23,520,799</u>
Total securities available-for-sale	<u>\$ 95,478,582</u>	<u>\$ 3,169,499</u>	<u>\$ (355,465)</u>	<u>\$ 98,292,616</u>

Securities held-to-maturity

Mortgage-backed securities	\$ 3,696,516	\$ 304,383	\$ -	\$ 4,000,899
Collateralized mortgage obligations	113,020	3,569	-	116,589
State and municipal	<u>894,424</u>	<u>59,061</u>	<u>-</u>	<u>953,485</u>
Total securities held-to-maturity	<u>\$ 4,703,960</u>	<u>\$ 367,013</u>	<u>\$ -</u>	<u>\$ 5,070,973</u>

At December 31, 2016 and 2015, securities with a carrying value of \$33,077,817 and \$40,773,928, respectively, were pledged to secure public deposits and for other purposes required or permitted by law.

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2016 follow:

	<u>Available-for-Sale</u>		<u>Held-to-Maturity</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
Within 1 year	\$ 3,089,031	\$ 3,099,002	\$ -	\$ -
Over 1 year through 5 years	32,602,529	32,738,387	887,763	926,385
After 5 years through 10 years	19,763,553	20,675,550	-	-
Over 10 years	36,625,346	35,069,373	-	-
Collateralized mortgage obligations and mortgage-backed securities	<u>51,624,325</u>	<u>50,544,788</u>	<u>875,539</u>	<u>901,518</u>
	<u>\$143,704,784</u>	<u>\$ 142,127,100</u>	<u>\$ 1,763,302</u>	<u>\$ 1,827,903</u>

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Notes to Consolidated Financial Statements

December 31, 2016 and 2015

During 2016 and 2015, proceeds from sales of securities available-for-sale were \$5,534,700 and \$1,400,094, respectively. Gross gains on sales of securities available-for-sale in 2016 and 2015 were \$221,540 and \$64,158, respectively. Gross losses on sales of securities available-for-sale in 2015 were \$12,470. During 2016, proceeds from sales of securities held-to-maturity were \$2,619,870. Gross gains on sales of securities held-to-maturity in 2016 were \$228,367. The sales of securities held-to-maturity met the exemption for holding securities to maturity under FASB ASC Topic 320, *Investments - Debt and Equity Securities*. The remaining principal balance of the securities was less than 15% of the principal balance at acquisition. There were no sales of securities held-to-maturity in 2015.

The following table presents information pertaining to securities with gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous loss position at December 31, 2016 and 2015:

	2016					
	Less Than 12 Months		Greater Than 12 Months		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. Government sponsored enterprises	\$ 9,488,722	\$ (80,730)	\$ -	\$ -	\$ 9,488,722	\$ (80,730)
Mortgage-backed securities	47,964,665	(1,098,087)	-	-	47,964,665	(1,098,087)
State and municipal	27,781,372	(1,999,889)	-	-	27,781,372	(1,999,889)
Corporate bonds	8,044,033	(50,533)	-	-	8,044,033	(50,533)
Total	<u>\$93,278,792</u>	<u>\$ (3,229,239)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$93,278,792</u>	<u>\$ (3,229,239)</u>

	2015					
	Less Than 12 Months		Greater Than 12 Months		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. Government sponsored enterprises	\$ -	\$ -	\$ 2,457,792	\$ (42,208)	\$ 2,457,792	\$ (42,208)
State and municipal	1,086,942	(17,068)	-	-	1,086,942	(17,068)
Corporate bonds	5,982,122	(150,767)	1,022,452	(145,422)	7,004,574	(296,189)
Total	<u>\$ 7,069,064</u>	<u>\$ (167,835)</u>	<u>\$ 3,480,244</u>	<u>\$ (187,630)</u>	<u>\$10,549,308</u>	<u>\$ (355,465)</u>

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Notes to Consolidated Financial Statements

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

These unrealized losses related principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other-than-temporary.

4. Loans

The composition of net loans, including loans held for sale, at December 31 was as follows:

	<u>2016</u>	<u>2015</u>
Commercial	\$ 26,184,750	\$ 22,421,245
Commercial real estate	125,198,517	117,851,532
Construction	3,391,998	4,043,724
Residential real estate	123,986,487	116,664,901
Consumer	<u>15,773,150</u>	<u>14,128,736</u>
Subtotal	294,534,902	275,110,138
(Less) add:		
Loans held for sale	-	1,303,000
Allowance for loan losses	(5,699,651)	(5,706,238)
Net deferred loan costs	<u>331,580</u>	<u>260,125</u>
Loans, net	<u>\$289,166,831</u>	<u>\$270,967,025</u>

The Company has transferred a portion of its originated commercial and commercial real estate loans to participating lenders. The amounts transferred have been accounted for as sales and are therefore not included in the Company's accompanying consolidated balance sheets. The Company and participating lenders share ratably in any gains or losses that may result from a borrower's lack of compliance with contractual terms of the loan. The Company continues to service the loans on behalf of the participating lenders and, as such, collects cash payments from the borrowers and remits payments (net of servicing fees) to participating lenders. At December 31, 2016 and 2015, the Company was servicing loans for participants aggregating \$12,341,792 and \$17,310,770, respectively.

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Notes to Consolidated Financial Statements

December 31, 2016 and 2015

An analysis of the allowance for loan losses follows for the year ended December 31, 2016:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
Balance at beginning of year	\$ 711,043	\$ 2,927,821	\$ 62,185	\$ 1,552,600	\$ 211,110	\$ 241,479	\$ 5,706,238
Provision for (reduction in) loan losses	(122,343)	(140,662)	16,373	8,280	(9,044)	247,396	-
Loans charged off	-	-	-	(39,115)	(28,338)	-	(67,453)
Recoveries of loans previously charged off	19,838	11,400	-	18,600	11,028	-	60,866
Balance at end of year	<u>\$ 608,538</u>	<u>\$ 2,798,559</u>	<u>\$ 78,558</u>	<u>\$ 1,540,365</u>	<u>\$ 184,756</u>	<u>\$ 488,875</u>	<u>\$ 5,699,651</u>

An analysis of the allowance for loan losses follows for the year ended December 31, 2015:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
Balance at beginning of year	\$ 545,235	\$ 2,902,388	\$ 99,187	\$ 1,526,158	\$ 192,529	\$ 478,076	\$ 5,743,573
Provision for (reduction in) loan losses	46,663	25,433	(37,002)	194,824	6,679	(236,597)	-
Loans charged off	(11)	-	-	(175,612)	(14,052)	-	(189,675)
Recoveries of loans previously charged off	119,156	-	-	7,230	25,954	-	152,340
Balance at end of year	<u>\$ 711,043</u>	<u>\$ 2,927,821</u>	<u>\$ 62,185</u>	<u>\$ 1,552,600</u>	<u>\$ 211,110</u>	<u>\$ 241,479</u>	<u>\$ 5,706,238</u>

The following table presents the allowance for loan losses and select loan information for the year ended December 31, 2016:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
Allowance for loan losses							
Ending balance	<u>\$ 608,538</u>	<u>\$ 2,798,559</u>	<u>\$ 78,558</u>	<u>\$ 1,540,365</u>	<u>\$ 184,756</u>	<u>\$ 488,875</u>	<u>\$ 5,699,651</u>
Individually evaluated for impairment	<u>\$ 175,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 251,001</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 426,001</u>
Collectively evaluated for impairment	<u>\$ 433,538</u>	<u>\$ 2,798,559</u>	<u>\$ 78,558</u>	<u>\$ 1,289,364</u>	<u>\$ 184,756</u>	<u>\$ 488,875</u>	<u>\$ 5,273,650</u>
Loans							
Ending balance	<u>\$ 26,184,750</u>	<u>\$ 125,198,517</u>	<u>\$ 3,391,998</u>	<u>\$ 123,986,487</u>	<u>\$ 15,773,150</u>		<u>\$ 294,534,902</u>
Individually evaluated for impairment	<u>\$ 447,769</u>	<u>\$ 65,229</u>	<u>\$ 279,533</u>	<u>\$ 2,342,768</u>	<u>\$ -</u>		<u>\$ 3,135,299</u>
Collectively evaluated for impairment	<u>\$ 25,736,981</u>	<u>\$ 125,133,288</u>	<u>\$ 3,112,465</u>	<u>\$ 121,643,719</u>	<u>\$ 15,773,150</u>		<u>\$ 291,399,603</u>

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The following table presents the allowance for loan losses and select loan information for the year ended December 31, 2015:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
Allowance for loan losses							
Ending balance	\$ <u>711,043</u>	\$ <u>2,927,821</u>	\$ <u>62,185</u>	\$ <u>1,552,600</u>	\$ <u>211,110</u>	\$ <u>241,479</u>	\$ <u>5,706,238</u>
Individually evaluated for impairment	\$ <u>20,052</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>79,800</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>99,852</u>
Collectively evaluated for impairment	\$ <u>690,991</u>	\$ <u>2,927,821</u>	\$ <u>62,185</u>	\$ <u>1,472,800</u>	\$ <u>211,110</u>	\$ <u>241,479</u>	\$ <u>5,606,386</u>
Loans							
Ending balance	\$ <u>22,421,245</u>	\$ <u>117,851,532</u>	\$ <u>4,043,724</u>	\$ <u>116,664,901</u>	\$ <u>14,128,736</u>		\$ <u>275,110,138</u>
Individually evaluated for impairment	\$ <u>642,249</u>	\$ <u>199,781</u>	\$ <u>116,774</u>	\$ <u>2,353,293</u>	\$ <u>-</u>		\$ <u>3,312,097</u>
Collectively evaluated for impairment	\$ <u>21,778,996</u>	\$ <u>117,651,751</u>	\$ <u>3,926,950</u>	\$ <u>114,311,608</u>	\$ <u>14,128,736</u>		\$ <u>271,798,041</u>

All of the following tables are presented net of third-party guarantees.

The Bank categorizes each loan category by credit risk exposure. The following tables present the credit risk profile by creditworthiness category as of December 31, 2016 and 2015.

Loans in the "pass" category are considered to be low to average risk.

Loans in the "special mention" category are starting to show signs of potential weakness and are being closely monitored by management.

Loans in the "substandard" category are inadequately protected by the current net worth and paying capacity of the borrowers and/or the collateral pledged, thus there is an increased possibility that the Company will sustain some loss if the weakness is not corrected.

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

Loans in the "loss" category are considered uncollectible and of such little value that their continuance as loans is not warranted.

On an annual basis, or more often if needed, the Company formally reviews the ratings on all commercial, commercial real estate, construction and residential real estate loans. Semi-annually, the Company engages an independent third-party to review a significant portion of loans within these segments. Management uses the results of these reviews as part of its annual review process.

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The following table presents the ratings as of December 31, 2016:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>
Pass	\$ 25,605,070	\$ 121,125,149	\$ 3,012,517	\$ 119,837,243
Special mention	72,702	598,360	87,010	212,411
Substandard	155,223	3,475,008	292,471	3,674,345
Doubtful	<u>351,755</u>	<u>-</u>	<u>-</u>	<u>262,488</u>
Total	<u>\$ 26,184,750</u>	<u>\$ 125,198,517</u>	<u>\$ 3,391,998</u>	<u>\$ 123,986,487</u>

The following table presents the ratings as of December 31, 2015:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>
Pass	\$ 18,245,995	\$ 112,338,531	\$ 3,812,889	\$ 111,631,597
Special mention	3,417,573	1,537,785	220,520	1,018,433
Substandard	<u>757,677</u>	<u>3,975,216</u>	<u>10,315</u>	<u>4,014,871</u>
Total	<u>\$ 22,421,245</u>	<u>\$ 117,851,532</u>	<u>\$ 4,043,724</u>	<u>\$ 116,664,901</u>

The following table presents an aging analysis of past due loans as of December 31, 2016:

	<u>30-59 Days Past Due</u>	<u>60-89 Days Past Due</u>	<u>90 Days and Greater</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans</u>	<u>Loans on Nonaccrual</u>
Commercial	\$ 89,118	\$ -	\$ 66,105	\$ 155,223	\$ 26,029,527	\$ 26,184,750	\$ 427,768
Commercial real estate	154,988	-	-	154,988	125,043,529	125,198,517	65,229
Construction	-	-	-	-	3,391,998	3,391,998	-
Residential real estate	1,721,325	517,649	1,122,532	3,361,506	120,624,981	123,986,487	1,970,393
Consumer	<u>902</u>	<u>-</u>	<u>-</u>	<u>902</u>	<u>15,772,248</u>	<u>15,773,150</u>	<u>-</u>
Total	<u>\$ 1,966,333</u>	<u>\$ 517,649</u>	<u>\$ 1,188,637</u>	<u>\$ 3,672,619</u>	<u>\$ 290,862,283</u>	<u>\$ 294,534,902</u>	<u>\$ 2,463,390</u>

The following table presents an aging analysis of past due loans as of December 31, 2015:

	<u>30-59 Days Past Due</u>	<u>60-89 Days Past Due</u>	<u>90 Days and Greater</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loans</u>	<u>Loans on Nonaccrual</u>
Commercial	\$ -	\$ 20,052	\$ -	\$ 20,052	\$ 22,401,193	\$ 22,421,245	\$ 20,052
Commercial real estate	116,962	65,547	-	182,509	117,669,023	117,851,532	199,780
Construction	-	-	-	-	4,043,724	4,043,724	-
Residential real estate	1,303,067	428,829	764,206	2,496,102	114,168,799	116,664,901	2,089,712
Consumer	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>14,128,736</u>	<u>14,128,736</u>	<u>-</u>
Total	<u>\$ 1,420,029</u>	<u>\$ 514,428</u>	<u>\$ 764,206</u>	<u>\$ 2,698,663</u>	<u>\$ 272,411,475</u>	<u>\$ 275,110,138</u>	<u>\$ 2,309,544</u>

At December 31, 2016 and 2015, there were no loans 90 days past due and still accruing interest.

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Notes to Consolidated Financial Statements

December 31, 2016 and 2015

The following table presents a summary of information pertaining to impaired loans by loan category as of December 31, 2016:

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Investment</u>	<u>Interest Income Recognized</u>	<u>Interest Income Recognized on a Cash Basis</u>
With no related allowance						
Commercial	\$ 96,014	\$ 96,014	\$ -	\$ 359,106	\$ 3,003	\$ 3,003
Commercial real estate	65,229	65,229	-	132,505	-	-
Construction	279,533	279,533	-	198,154	20,220	20,220
Residential real estate	<u>1,817,253</u>	<u>1,817,253</u>	<u>-</u>	<u>1,877,024</u>	<u>68,126</u>	<u>68,126</u>
	<u>\$ 2,258,029</u>	<u>\$ 2,258,029</u>	<u>\$ -</u>	<u>\$ 2,566,789</u>	<u>\$ 91,349</u>	<u>\$ 91,349</u>
With an allowance recorded						
Commercial	\$ 351,755	\$ 351,755	\$ 175,000	\$ 185,903	\$ 17,512	\$ 17,512
Commercial real estate	-	-	-	-	-	-
Construction	-	-	-	-	-	-
Residential real estate	<u>525,515</u>	<u>525,515</u>	<u>251,001</u>	<u>471,006</u>	<u>2,402</u>	<u>2,402</u>
	<u>\$ 877,270</u>	<u>\$ 877,270</u>	<u>\$ 426,001</u>	<u>\$ 656,909</u>	<u>\$ 19,914</u>	<u>\$ 19,914</u>
Total						
Commercial	\$ 447,769	\$ 447,769	\$ 175,000	\$ 545,009	\$ 20,515	\$ 20,515
Commercial real estate	65,229	65,229	-	132,505	-	-
Construction	279,533	279,533	-	198,154	20,220	20,220
Residential real estate	<u>2,342,768</u>	<u>2,342,768</u>	<u>251,001</u>	<u>2,348,030</u>	<u>70,528</u>	<u>70,528</u>
	<u>\$ 3,135,299</u>	<u>\$ 3,135,299</u>	<u>\$ 426,001</u>	<u>\$ 3,223,698</u>	<u>\$ 111,263</u>	<u>\$ 111,263</u>

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The following table presents a summary of information pertaining to impaired loans by loan category as of December 31, 2015:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Investment	Interest Income Recognized	Interest Income Recognized on a Cash Basis
With no related allowance						
Commercial	\$ 622,197	\$ 622,197	\$ -	\$ 1,176,853	\$ 76,829	\$ 76,829
Commercial real estate	199,781	199,781	-	402,974	-	-
Construction	116,774	116,774	-	148,512	-	-
Residential real estate	<u>1,936,796</u>	<u>1,936,796</u>	<u>-</u>	<u>1,559,996</u>	<u>77,578</u>	<u>77,578</u>
	<u>\$ 2,875,548</u>	<u>\$ 2,875,548</u>	<u>\$ -</u>	<u>\$ 3,288,335</u>	<u>\$ 154,407</u>	<u>\$ 154,407</u>
With an allowance recorded						
Commercial	\$ 20,052	\$ 20,052	\$ 20,052	\$ 77,715	\$ -	\$ -
Commercial real estate	-	-	-	-	-	-
Construction	-	-	-	-	-	-
Residential real estate	<u>416,497</u>	<u>416,497</u>	<u>79,800</u>	<u>386,436</u>	<u>3,162</u>	<u>3,162</u>
	<u>\$ 436,549</u>	<u>\$ 436,549</u>	<u>\$ 99,852</u>	<u>\$ 464,151</u>	<u>\$ 3,162</u>	<u>\$ 3,162</u>
Total						
Commercial	\$ 642,249	\$ 642,249	\$ 20,052	\$ 1,254,568	\$ 76,829	\$ 76,829
Commercial real estate	199,781	199,781	-	402,974	-	-
Construction	116,774	116,774	-	148,512	-	-
Residential real estate	<u>2,353,293</u>	<u>2,353,293</u>	<u>79,800</u>	<u>1,946,432</u>	<u>80,740</u>	<u>80,740</u>
	<u>\$ 3,312,097</u>	<u>\$ 3,312,097</u>	<u>\$ 99,852</u>	<u>\$ 3,752,486</u>	<u>\$ 157,569</u>	<u>\$ 157,569</u>

Troubled Debt Restructurings

A loan modification constitutes a troubled debt restructuring if the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. To determine whether or not a loan should be classified as a troubled debt restructuring, management evaluates a loan based upon the following criteria:

- The borrower demonstrates financial difficulty; common indicators include past due status with bank obligations, substandard credit bureau reports, or an inability to refinance with another lender, and,
- The Company has granted a concession; common concessions include maturity date extension, interest rate adjustments to below market pricing, reduction of principal and deferment of payments.

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December 31, 2016 and 2015

The following tables present the recorded investment in troubled debt restructurings as of December 31, 2016 and 2015 based on payment performance status:

December 31, 2016	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>	<u>Total</u>
Performing	\$ 371,755	\$ -	\$ 279,533	\$ 372,375	\$ 1,023,663
Non-performing	<u>9,909</u>	<u>65,229</u>	<u>-</u>	<u>-</u>	<u>75,138</u>
Total	<u>\$ 381,664</u>	<u>\$ 65,229</u>	<u>\$ 279,533</u>	<u>\$ 372,375</u>	<u>\$ 1,098,801</u>

December 31, 2015	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>	<u>Total</u>
Performing	\$ 622,196	\$ -	\$ 116,774	\$ 351,046	\$ 1,090,016
Non-performing	<u>20,052</u>	<u>82,819</u>	<u>-</u>	<u>26,222</u>	<u>129,093</u>
Total	<u>\$ 642,248</u>	<u>\$ 82,819</u>	<u>\$ 116,774</u>	<u>\$ 377,268</u>	<u>\$ 1,219,109</u>

Troubled debt restructured loans are considered impaired and carry individual specific reserves. At December 31, 2016 the specific reserve related to troubled debt restructured loans was \$175,000. There was no specific reserve related to troubled debt restructured loans at December 31, 2015. As of December 31, 2016, the Company was contractually committed to lend up to \$120,000 in additional funds to one customer with an outstanding line of credit that is classified as a troubled debt restructuring. As of December 31, 2015, there were no commitments to lend additional amounts to customers with outstanding loans that are classified as troubled debt restructurings.

The following tables summarize troubled debt restructurings that occurred during the periods indicated:

<u>During the Year Ended December 31, 2016</u>			
	<u>Number of Loans</u>	<u>Pre- Modification Outstanding Recorded Investment</u>	<u>Post- Modification Outstanding Recorded Investment</u>
Commercial	2	\$ 371,755	\$ 371,755
Residential real estate	<u>1</u>	<u>324,251</u>	<u>324,251</u>
Total	<u>3</u>	<u>\$ 696,006</u>	<u>\$ 696,006</u>

A loan is considered to be in payment default once it is greater than 30 days contractually past due under the modified terms. There were no troubled debt restructurings modified within the twelve-month period ended 2016, for which there was a payment default during the period.

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During the year ended 2015, there were no loan modifications executed which constituted troubled debt restructurings.

5. Premises and Equipment

A summary of the cost and accumulated depreciation of premises and equipment follows:

	<u>2016</u>	<u>2015</u>
Land and improvements	\$ 1,922,993	\$ 1,922,993
Buildings and improvements	8,532,254	8,398,514
Equipment	<u>6,878,394</u>	<u>6,624,522</u>
	17,333,641	16,946,029
Accumulated depreciation	<u>(9,643,313)</u>	<u>(9,139,446)</u>
	<u>\$ 7,690,328</u>	<u>\$ 7,806,583</u>

Depreciation, included in occupancy and equipment expense, amounted to \$503,988 and \$508,449 for the years ended December 31, 2016 and 2015, respectively.

Pursuant to the terms of noncancelable lease agreements in effect at December 31, 2016, pertaining to premises and equipment, future minimum rent commitments under various operating leases are as follows:

2017	\$ 711,910
2018	272,660
2019	188,732
2020	180,487
2021	135,044
Thereafter	<u>45,947</u>
	<u>\$ 1,534,780</u>

The leases contain options to extend for periods from three to ten years. The cost of such extensions is not included above. Total rent expense for the years ended December 31, 2016 and 2015 amounted to \$730,969 and \$761,894, respectively.

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Notes to Consolidated Financial Statements

December 31, 2016 and 2015

6. Deposits

At December 31, 2016, the scheduled maturities of time deposits are as follows:

2017	\$ 33,842,098
2018	12,523,193
2019	467,914
2020	960,663
2021	1,190,444
Thereafter	<u>10,739</u>
	<u>\$ 48,995,051</u>

Deposit accounts with related parties were \$4,002,844 and \$2,647,503 at December 31, 2016 and 2015, respectively.

7. Securities Sold Under Agreements to Repurchase

Securities sold under repurchase agreements mature within twelve months and are collateralized by mortgage-backed securities with a book value of \$15,934,689 and a fair value of \$15,634,844 at December 31, 2016 and by mortgage-backed securities with a book value of \$21,663,534 and a fair value of \$22,127,837 at December 31, 2015. All securities collateralizing the repurchase agreements are under the Company's control. The maximum amount of repurchase agreements outstanding at any month-end during 2016 and 2015 was \$19,450,155 and \$15,306,948, respectively. The average amount of repurchase agreements outstanding during 2016 and 2015 was \$12,453,740 and \$12,979,388, respectively. The weighted average interest rate on repurchase agreements outstanding at December 31, 2016 and 2015 was 0.08% and 0.11%, respectively.

8. Advances from Federal Home Loan Bank and Other Borrowings

The Company has fixed-rate advances with the FHLB of \$20,000,000 and \$14,000,000 at December 31, 2016 and 2015. At December 31, 2016 and 2015 interest rates of fixed-rate advances ranged from 0.83% to 2.65%.

Outstanding FHLB borrowings are secured by a blanket lien on qualified collateral consisting primarily of loans with first mortgages secured by one to four family properties, certain unencumbered investment securities, and other qualified assets.

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December 31, 2016 and 2015

The contractual maturities of advances at December 31, 2016 were as follows:

2017	\$ 10,000,000
2019	7,000,000
2021	<u>3,000,000</u>
Total	\$ <u>20,000,000</u>

The Bank has a long-term line of credit with the FHLB that does not expire, in the amount of \$2,800,000. There were no amounts outstanding at December 31, 2016 or 2015. The Company, through the Bank, has the ability to borrow from the FRB Discount Window due to its pledge of \$15,502,580 and \$18,430,581 of state and municipal securities that it owned at December 31, 2016 and 2015. No amounts were outstanding at December 31, 2016 or 2015. The Company, through the Bank, has unsecured lines of credit at two correspondent banks totaling \$5,500,000. No amounts were outstanding on these lines of credit at December 31, 2016 or 2015.

9. Income Taxes

Allocation of federal and state income taxes between current and deferred portions was as follows:

	<u>2016</u>	<u>2015</u>
Current tax provision		
Federal	\$ 997,462	\$ 976,556
State	<u>108,326</u>	<u>119,152</u>
	<u>1,105,788</u>	<u>1,095,708</u>
Deferred tax (benefit) expense		
Federal	(84,415)	55,920
State	<u>(14,141)</u>	<u>(38,152)</u>
	<u>(98,556)</u>	<u>17,768</u>
	<u>\$ 1,007,232</u>	<u>\$ 1,113,476</u>

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December 31, 2016 and 2015

The income tax provision differs from the expense that would result from applying federal statutory rates to income before income taxes, as follows:

	<u>2016</u>	<u>2015</u>
Computed tax expense	\$ 1,746,121	\$ 1,759,437
Increase (reduction) in income taxes resulting from:		
Tax exempt income	(704,595)	(560,721)
Income from life insurance	(104,901)	(105,777)
Tax credits, net of amortization	(25,001)	(2,600)
State tax	60,392	83,160
Other	<u>35,216</u>	<u>(60,023)</u>
	<u>\$ 1,007,232</u>	<u>\$ 1,113,476</u>

The components of the net deferred tax asset were as follows:

	<u>2016</u>	<u>2015</u>
Deferred tax assets		
Allowance for loan losses	\$ 1,855,534	\$ 1,855,566
Employee benefit plan	1,036,147	978,490
Nonaccrual interest	79,319	75,661
Limited partnerships	93,669	10,365
Other	<u>10,753</u>	<u>17,650</u>
	<u>3,075,422</u>	<u>2,937,732</u>
Deferred tax liabilities		
Net unrealized (loss) gain on securities available-for-sale and interest rate swaps	(407,046)	947,339
Depreciation	449,349	404,232
Deferred rent	<u>6,728</u>	<u>12,710</u>
	<u>49,031</u>	<u>1,364,281</u>
Net deferred tax asset	<u>\$ 3,026,391</u>	<u>\$ 1,573,451</u>

No valuation allowance is deemed necessary for the deferred income tax asset. The net deferred tax asset is included with other assets in the consolidated balance sheet.

The Company invests in qualified affordable housing projects. At December 31, 2016 and 2015, the balance of the investment for qualified housing projects was \$4,030,905 and \$3,687,751, respectively. These balances are reflected in other assets on the consolidated balance sheets. During the years ended December 31, 2016 and 2015, the Company recognized amortization expense of \$656,847 and \$478,188, respectively, which was included within income tax expense on the consolidated statements of income. Additionally, during the years ended December 31, 2016 and 2015, the Company recognized tax credits from its investments in affordable housing tax projects of \$692,894 and \$513,576, respectively.

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10. Earnings per Share

The following sets forth the computation of basic and diluted earnings per share for 2016 and 2015.

	<u>2016</u>	<u>2015</u>
Net income, as reported	\$ <u>4,128,418</u>	\$ <u>4,061,338</u>
Weighted-average shares outstanding	1,038,284	1,024,334
Effect of unvested stock grants	28,421	29,335
Effect of dilutive stock options	<u>217</u>	<u>423</u>
Adjusted weighted-average shares and assumed conversion	<u>1,066,922</u>	<u>1,054,092</u>
Basic earnings per share	\$ 3.98	\$ 3.96
Diluted earnings per share	\$ 3.87	\$ 3.85

Employee stock options are excluded from the computation of dilutive earnings per share for 2016 and 2015, since inclusion of these common stock equivalents would be anti-dilutive.

11. Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, standby and commercial letters-of-credit, and interest rate caps and floors written on adjustable rate loans. Such instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters-of-credit is represented by the contractual notional amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. For interest rate caps and floors written on adjustable rate loans, the contract or notional amounts do not represent exposure to credit losses.

The Company generally requires collateral or other security to support financial instruments with credit risk.

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December 31, 2016 and 2015

At December 31, 2016 and 2015, the following financial instruments were outstanding whose contract amounts represent credit risk:

	<u>Contract Amount</u>	
	<u>2016</u>	<u>2015</u>
Commitments to grant loans	\$ <u>55,947,208</u>	\$ <u>56,285,119</u>
Commercial and standby letters-of-credit	\$ <u>3,221,981</u>	\$ <u>2,868,350</u>

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.

Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial property.

Standby letters-of-credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. The credit risk involved in issuing letters-of-credit is essentially the same as that involved in extending loan facilities to customers.

At times, the Company places interest rate caps and floors on loans written by the Company to enable customers to transfer, modify, or reduce their interest rate risk.

12. Legal Contingencies

Various legal claims arise from time-to-time in the normal course of business which, in the opinion of management, will have no material effect on the Company's financial statements.

13. Shareholders' Equity and Regulatory Matters

The Company and its bank subsidiary are subject to various regulatory capital requirements administered by the Office of the Comptroller of the Currency (OCC). Failure to meet minimum capital requirements can result in mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements.

These capital requirements represent quantitative measures of the Company's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's capital amounts and classification are also subject to qualitative judgments by its regulators about components, risk weightings and other factors.

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Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios of total and Tier 1 capital, and Common Equity Tier 1 (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital to average assets (as defined). Management believes that, as of December 31, 2016, the Company and its bank subsidiary meet all capital requirements to which they are subject. As of December 31, 2016, the most recent notification from the OCC categorized the banking subsidiary as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, a financial institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category. Prompt corrective action provisions are not applicable to bank holding companies.

The ability of the Company to pay cash dividends depends on the receipt of dividends from its banking subsidiary. The Company, as the sole shareholder of the banking subsidiary, is entitled to dividends from legally available funds when and as declared by the banking subsidiary's Board of Directors.

Regulatory capital requirements limit a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% above its minimum risk-based capital requirements. The final Basel III capital rule became effective for the Bank on January 1, 2015. The capital conservation buffer requirement is being phased in from January 1, 2016 through January 1, 2019, when the full capital conservation buffer requirement will be effective. As of December 31, 2016, the Company and the Bank had a capital conservation buffer in excess of the phased-in regulatory requirement of 0.625%.

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The actual capital amounts and ratios for the Company and the Bank are presented below.

	<u>Actual</u>		<u>Minimum Capital Requirement</u>		<u>Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>December 31, 2016</u>	(Dollar amounts in thousands)					
Total Capital to Risk Weighted Assets						
Company	\$ 47,926	14.2 %	\$ 27,074	8.0 %	\$ 33,842	10.0 %
Bank	\$ 45,316	13.4 %	\$ 27,049	8.0 %	\$ 33,811	10.0 %
Tier 1 Capital to Risk Weighted Assets						
Company	\$ 43,680	12.9 %	\$ 20,305	6.0 %	\$ 27,074	8.0 %
Bank	\$ 41,070	12.1 %	\$ 20,287	6.0 %	\$ 27,049	8.0 %
Common Equity Tier 1 Capital to Risk Weighted Assets						
Company	\$ 43,680	12.9 %	\$ 15,229	4.5 %	\$ 21,998	6.5 %
Bank	\$ 41,070	12.1 %	\$ 15,215	4.5 %	\$ 21,977	6.5 %
Tier 1 Capital to Average Assets						
Company	\$ 43,680	9.3 %	\$ 18,719	4.0 %	\$ 23,398	5.0 %
Bank	\$ 41,070	8.8 %	\$ 18,706	4.0 %	\$ 23,382	5.0 %

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	<u>Actual</u>		<u>Minimum Capital Requirement</u>		<u>Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>December 31, 2015</u>	(Dollar amounts in thousands)					
Total Capital to Risk Weighted Assets						
Company	\$ 45,919	15.6 %	\$ 23,601	8.0 %	\$ 44,664	10.0 %
Bank	\$ 42,957	14.6 %	\$ 23,575	8.0 %	\$ 29,469	10.0 %
Tier 1 Capital to Risk Weighted Assets						
Company	\$ 42,209	14.3 %	\$ 17,701	6.0 %	\$ 23,601	8.0 %
Bank	\$ 39,247	13.3 %	\$ 17,681	6.0 %	\$ 23,575	8.0 %
Common Equity Tier 1 Capital to Risk Weighted Assets						
Company	\$ 42,209	14.3 %	\$ 13,276	4.5 %	\$ 19,176	6.5 %
Bank	\$ 39,247	13.3 %	\$ 13,261	4.5 %	\$ 19,155	6.5 %
Tier 1 Capital to Average Assets						
Company	\$ 42,209	9.5 %	\$ 17,866	4.0 %	\$ 22,332	5.0 %
Bank	\$ 39,247	8.8 %	\$ 17,852	4.0 %	\$ 22,316	5.0 %

14. Derivative Financial Instruments

The Company uses interest rate swap agreements for asset/liability management purposes, to hedge various exposures or to modify interest rate characteristics of various balance sheet accounts. Such derivatives are used as part of the asset/liability management process and are linked to specific assets or liabilities, and have high correlation between the contract and the underlying item being hedged, both at inception and throughout the hedge period. The notional amount of the interest rate swaps does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest rate swaps.

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At December 31, 2016 and 2015, the information pertaining to outstanding interest rate swap agreements used to hedge bonds, fixed-rate loans, and borrowings is as follows:

	<u>2016</u>	<u>2015</u>
Notional amount	\$18,850,000	\$ 9,835,000
Weighted average pay rate	3.41 %	3.47 %
Weighted average receive rate	0.62 %	0.73 %
Weighted average maturity in years	16.29	20.77
Unrealized gain (loss)	\$ 380,487	\$ (30,137)

These agreements provide for the Company to make payments at a fixed-rate in exchange for receiving payments at a floating-rate, determined by a specified index. Interest expense recorded on these swap transactions totaled \$250,637 during 2016 and is reported as components of the applicable interest income or expense in the consolidated statements of income. There was no interest expense recorded in 2015. Gains of \$12,635 and losses of \$2,392 for the ineffective portion of the hedges were recorded in earnings for the years ended December 31, 2016 and 2015, respectively. The Company expects the hedges to remain highly effective during the remaining terms of the swaps.

The following table reflects the fair value and cash flow hedges included in the consolidated balance sheets as of December 31, 2016 and 2015:

	<u>2016</u>		<u>2015</u>	
	<u>Notional Value</u>	<u>Fair Value</u>	<u>Notional Value</u>	<u>Fair Value</u>
Included in other assets				
Interest rate swaps related to debt	\$ 4,000,000	\$ 256,090	\$ -	\$ -
Interest rate swaps related to loans	<u>2,170,000</u>	<u>135,245</u>	-	-
Total included in other assets	<u>\$ 6,170,000</u>	<u>\$ 391,335</u>	<u>\$ -</u>	<u>\$ -</u>
Included in other liabilities				
Interest rate swaps related to municipal bonds	<u>\$12,680,000</u>	<u>\$ 605</u>	<u>\$ 9,835,000</u>	<u>\$ 30,137</u>

15. Employee Benefits

The Company sponsors a 401(k) profit sharing plan which covers all employees who are at least 18 years of age and who have completed one year of employment. Eligible employees contribute a percentage of their annual compensation to the 401(k) plan and the Company makes a flat contribution to all eligible employees, regardless of the amount contributed by the employee. In addition, the Company may make discretionary contributions on behalf of employees under the plan. For the years ended December 31, 2016 and 2015, expense attributable to the plan amounted to \$420,764 and \$436,194, respectively.

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Included in accrued expenses and other liabilities in the balance sheets at December 31, 2016 and 2015 are liabilities established pursuant to deferred compensation agreements with certain officers of the Company of \$2,064,194 and \$1,890,217, respectively. Deferred compensation expense related to these plans amounted to \$228,788 and \$284,387 for the years ended December 31, 2016 and 2015, respectively.

16. Stock-Based Compensation

Warrants to purchase shares of the Company's common stock at various exercise prices have been granted to certain members of the organizing group, key management, and employees of the Company prior to April 2006. The warrants vest in three years and expire ten years from the date the warrant was granted.

On April 19, 2006, the shareholders of the Company approved the 2006 Stock Option and Incentive Plan (the current plan). The maximum number of shares of stock reserved and available for issuance under this Plan is 50,000 shares. In May 2013, the shareholders voted to add 50,000 new shares. Awards may be granted in the form of incentive stock options and restricted stock, or any combinations of the preceding, and the exercise price shall not be less than 100% of the fair market value on the date of grant. No stock options are exercisable more than ten years after the date the stock option is granted. The stock options vest over a three-year period. The restricted stock awards granted through December 31, 2016 each vest over a three or four-year period.

On January 1, 2006, the Company adopted FASB guidance for the incentive stock option and restricted stock grants relating to the current plan and previous plans. In accordance with that guidance, the Company recorded \$425,500 and \$533,000 of compensation expense during the years ended December 31, 2016 and 2015, respectively. Total compensation expense related to nonvested awards not yet recognized is \$672,430 as of December 31, 2016 and is expected to be recognized over a weighted average period of 2.2 years.

A summary of nonvested restricted stock awards as of December 31, 2016 and changes during the year then ended are presented below:

	<u>Shares</u>	<u>Weighted Average Grant-Date Fair Value</u>
Nonvested shares at December 31, 2015	29,335	\$ 44.17
Granted	14,790	46.32
Vested	(8,416)	38.46
Forfeited	<u>(7,288)</u>	42.46
Nonvested shares at December 31, 2016	<u>28,421</u>	46.51

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At December 31, 2016 and December 31, 2015 there were 1,300 and 2,300 stock option shares outstanding and exercisable with a weighted average exercise price of \$40.51 and \$40.29. The weighted average remaining contractual life and aggregate intrinsic value was 0.91 and \$18,083 at December 31, 2016. There were no stock options granted, exercised, or expired during 2016. There were 1,000 stock options forfeited during 2016 with a weighted average exercise price of \$40.00.

The remaining number of stock options and shares of restricted stock available to be granted was 39,394 and 46,896 at December 31, 2016 and 2015, respectively.

17. Other Noninterest Income and Expense

The components of other noninterest income and expense which are in excess of 1% of total revenues (total interest and dividend income and noninterest income) and not shown separately in the statements of income are as follows for the years ended December 31:

	<u>2016</u>	<u>2015</u>
Noninterest income		
Bank owned life insurance	\$ 264,902	\$ 267,114
Gain on sale of loans	159,741	295,525
Noninterest expense		
Professional fees	\$ 432,995	\$ 375,185
Printing, postage and stationery	352,169	361,436
Directors' fees	257,316	259,038
Advertising	517,047	446,205
ATM processing	257,465	241,668

18. Related Party Transactions

The Company has had, and may be expected to have in the future, transactions in the ordinary course of business with directors, principal officers, their immediate families and affiliated companies in which are principal shareholders (commonly referred to as related parties), all of which have been, in the opinion of management, on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. Loans granted to related parties amounted to \$1,664,762 and \$3,065,077 at December 31, 2016 and 2015, respectively.

During January 2007, the Bank entered into a long-term lease with a company whose sole owner is a director and shareholder of the Company. This lease is for space that is the headquarters for the Bank's Ledyard Financial Advisors division. The lease has an initial term of 10 years. The lease has three five-year options to renew. Lease payments to the related party were \$357,061 and \$354,976 in 2016 and 2015, respectively. Future minimum rent commitments and rent expense related to this related party lease are included in Note 5.

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19. Fair Value

U.S. GAAP defines fair value, establishes a framework for measuring fair value, and requires certain disclosures about fair value measurements.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. U.S. GAAP also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three levels of inputs that may be used to measure fair value are:

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

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

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

Assets and liabilities measured at fair value on a recurring basis are summarized below:

	<u>Fair Value Measurements at December 31, 2016, Using</u>		
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
	<u>Total</u>		
Assets (market approach)			
Securities available-for-sale			
U.S. Government sponsored enterprises	\$ 9,488,722	\$ -	\$ 9,488,722
Mortgage-backed securities	50,480,775	-	50,480,775
Collateralized mortgage obligations	64,013	-	64,013
State and municipal	63,003,872	-	63,003,872
Corporate bonds	19,089,718	-	19,089,718
	<u>\$ 142,127,100</u>	<u>\$ -</u>	<u>\$ 142,127,100</u>
Interest rate swaps	<u>\$ 391,335</u>	<u>\$ -</u>	<u>\$ 391,335</u>
Liabilities (market approach)			
Interest rate swaps	<u>\$ 605</u>	<u>\$ -</u>	<u>\$ 605</u>

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<u>Fair Value Measurements at December 31, 2015, Using</u>			
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
	<u>Total</u>		
Assets (market approach)			
Securities available-for-sale			
U.S. Government sponsored enterprises	\$ 2,457,792	\$ -	\$ 2,457,792
Mortgage-backed securities	21,287,076	-	21,287,076
Collateralized mortgage obligations	128,493	-	128,493
State and municipal	50,898,456	-	50,898,456
Corporate bonds	<u>23,520,799</u>	<u>-</u>	<u>23,520,799</u>
	<u>\$ 98,292,616</u>	<u>\$ -</u>	<u>\$ 98,292,616</u>
Liabilities (market approach)			
Interest rate swaps	<u>\$ 30,137</u>	<u>\$ -</u>	<u>\$ 30,137</u>

Assets and liabilities measured at fair value on a nonrecurring basis are summarized below:

<u>Fair Value Measurements at December 31, 2016, Using</u>			
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
	<u>Total</u>		
Assets (market approach)			
Impaired loans	\$ 451,269	\$ -	\$ 451,269

<u>Fair Value Measurements at December 31, 2015, Using</u>			
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
	<u>Total</u>		
Assets (market approach)			
Impaired loans	\$ 336,697	\$ -	\$ 336,697

Certain impaired loans were written down to their fair value of \$451,269 and \$336,697 at December 31, 2016 and 2015, respectively, resulting in an impairment charge through the provision for loan losses, which was included in earnings for the period.

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

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Certain financial and nonfinancial instruments are excluded from disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

Cash and cash equivalents: The carrying amounts of cash and short-term instruments approximate fair values.

Investment securities: Fair values for securities are determined by obtaining quoted market prices on nationally recognized securities exchanges or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities.

Nonmarketable equity securities: The carrying value of nonmarketable equity securities, comprised of FHLB stock and FRB stock, approximates fair value based on the redemption provisions of the FHLB and FRB.

Loans held for sale: Fair values of loans held for sale are based on commitments on hand from investors or prevailing market prices.

Loans receivable: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Deposit liabilities: The fair values disclosed for demand deposits (e.g., interest and noninterest checking, passbook savings, and certain types of money market and NOW accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregate expected monthly maturities on time deposits.

Securities sold under agreements to repurchase: The carrying amounts of borrowings under repurchase agreements maturing within ninety days approximate their fair values.

Advances from Federal Home Loan Bank: The fair values of these borrowings are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Accrued interest: The carrying amounts of accrued interest approximate fair value.

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Interest rate swaps: The fair value measurements utilize a discounted cash flow model that incorporates and considers observable data that may include publicly available third party market quotes in developing the curve utilized for discounting future cash flows.

Off-balance-sheet instruments: The Company's off-balance sheet instruments consist of loan commitments. Fair values for loan commitments have not been presented as the future revenue derived from such financial instruments is not significant.

The estimated fair values, and related carrying amounts, of the Company's financial instruments are as follows:

	Carrying Amount	Estimated Fair Value	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<u>December 31, 2016</u>					
Financial assets					
Cash and due from banks	\$ 9,228,955	\$ 9,228,955	\$ 9,228,955	\$ -	\$ -
Interest-bearing deposits in banks	3,447,513	3,447,513	3,447,513	-	-
Securities available-for-sale	142,127,100	142,127,100	-	142,127,100	-
Securities held-to-maturity	1,763,302	1,763,302	-	1,763,302	-
Nonmarketable equity securities	1,702,406	1,702,406	-	-	1,702,406
Loans					
Commercial	25,532,750	22,293,800	-	272,769	22,021,031
Commercial real estate	122,192,151	98,253,102	-	65,229	98,187,873
Construction	3,307,810	3,207,900	-	279,533	2,928,367
Residential real estate	122,240,326	107,972,840	-	2,091,767	105,881,073
Consumer	15,562,213	14,538,253	-	-	14,538,253
Interest rate swaps	391,335	391,335	-	391,335	-
Financial liabilities					
Deposits	401,983,654	401,630,746	-	-	401,630,746
Repurchase agreements	6,878,829	6,878,829	-	-	6,878,829
Advances from Federal Home Loan Bank	20,000,000	19,792,467	-	-	19,792,467
Accrued interest payable	44,239	44,239	-	-	44,239
Interest rate swaps	605	605	-	605	-

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<u>December 31, 2015</u>	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>	<u>Quoted Prices In Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Financial assets					
Cash and due from banks	\$ 5,511,310	\$ 5,511,310	\$ 5,511,310	\$ -	\$ -
Interest-bearing deposits in banks	38,602,398	38,602,398	38,602,398	-	-
Securities available-for-sale	98,292,616	98,292,616	-	98,292,616	-
Securities held-to-maturity	4,703,960	5,070,973	-	5,070,973	-
Nonmarketable equity securities	1,669,206	1,669,206	-	-	1,669,206
Loans held for sale	1,303,000	1,315,888	-	1,315,888	-
Loans					
Commercial	21,690,522	22,222,385	-	622,197	21,600,188
Commercial real estate	114,820,266	117,747,517	-	199,781	117,547,736
Construction	3,977,990	4,058,092	-	116,774	3,941,318
Residential real estate	115,009,898	117,581,532	-	2,273,493	115,308,039
Consumer	13,905,225	14,087,723	-	-	14,087,723
Accrued interest receivable	1,380,645	1,380,645	-	-	1,380,645
Financial liabilities					
Deposits	372,936,970	372,915,599	-	-	372,915,599
Repurchase agreements	11,167,789	11,167,789	-	-	11,167,789
Advances from Federal Home Loan Bank	14,000,000	14,166,628	-	-	14,166,628
Accrued interest payable	39,849	39,849	-	-	39,849
Interest rate swaps	30,137	30,137	-	30,137	-