



LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

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, 2019 and 2018, 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, 2019 and 2018, 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 28, 2020

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

Consolidated Balance Sheets

December 31, 2019 and 2018

ASSETS

	<u>2019</u>	<u>2018</u>
Cash and due from banks	\$ 3,580,770	\$ 5,440,928
Interest-bearing deposits	<u>1,794,470</u>	<u>3,841,622</u>
Total cash and cash equivalents	5,375,240	9,282,550
Securities available-for-sale	135,827,462	138,074,738
Securities held-to-maturity	-	1,389,271
Nonmarketable equity securities	2,286,550	2,056,950
Loans held for sale	-	138,125
Loans receivable, net of allowance for loan losses of \$5,212,663 in 2019 and \$5,215,495 in 2018	320,377,870	305,905,218
Other real estate owned	17,970	-
Accrued interest receivable	1,871,905	1,810,309
Premises and equipment, net	17,412,923	9,773,467
Bank owned life insurance	11,207,646	10,954,385
Other assets	<u>6,013,439</u>	<u>8,677,292</u>
Total assets	<u>\$ 500,391,005</u>	<u>\$ 488,062,305</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

	<u>2019</u>	<u>2018</u>
Deposits		
Demand	\$ 118,991,555	\$ 107,577,224
NOW accounts	63,783,104	78,920,569
Money market accounts	125,846,962	144,698,316
Savings	43,886,618	41,114,351
Time deposits, other	36,199,319	32,153,320
Time, \$250,000 and over	<u>4,303,156</u>	<u>4,602,186</u>
Total deposits	393,010,714	409,065,966
Securities sold under agreements to repurchase	8,444,639	7,510,711
Advances from Federal Home Loan Bank (FHLB)	29,783,281	16,433,014
Accrued expenses and other liabilities	<u>13,017,942</u>	<u>6,559,708</u>
Total liabilities	<u>444,256,576</u>	<u>439,569,399</u>
Shareholders' equity		
Common stock, \$0.33 par value; 5,500,000 shares authorized, 3,384,370 and 3,352,738 shares issued, 3,265,475 and 3,228,532 shares outstanding at December 31, 2019 and 2018, respectively	1,128,123	1,117,579
Additional paid-in capital	13,134,232	12,457,437
Treasury stock, at cost; 118,895 and 124,206 shares at December 31, 2019 and 2018, respectively	(1,565,868)	(1,627,840)
Retained earnings	40,918,352	37,509,826
Accumulated other comprehensive income (loss)	<u>2,519,590</u>	<u>(964,096)</u>
Total shareholders' equity	<u>56,134,429</u>	<u>48,492,906</u>
Total liabilities and shareholders' equity	<u>\$ 500,391,005</u>	<u>\$ 488,062,305</u>

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

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

Consolidated Statements of Income

Years Ended December 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Interest and dividend income		
Interest and fees on loans	\$ 13,748,503	\$ 12,754,536
Investment securities	3,860,156	3,592,663
Other interest-earning assets	<u>297,923</u>	<u>308,895</u>
Total interest and dividend income	<u>17,906,582</u>	<u>16,656,094</u>
Interest expense		
Deposits	877,994	719,796
Borrowed funds	<u>953,932</u>	<u>452,168</u>
Total interest expense	<u>1,831,926</u>	<u>1,171,964</u>
Net interest income	16,074,656	15,484,130
Provision for loan losses	<u>-</u>	<u>-</u>
Net interest income after provision for loan losses	<u>16,074,656</u>	<u>15,484,130</u>
Noninterest income		
Ledyard Financial Advisors division income	10,887,002	10,511,630
Service fees	916,802	828,264
Net loss on sales of securities	(39,573)	-
Other	<u>926,632</u>	<u>854,452</u>
Total noninterest income	<u>12,690,863</u>	<u>12,194,346</u>
Noninterest expense		
Salaries and employee benefits	13,896,282	13,721,021
Occupancy and equipment	4,696,706	4,287,308
Federal Deposit Insurance Corporation (FDIC) insurance fees	24,502	141,593
Other general and administrative	<u>3,484,269</u>	<u>3,601,622</u>
Total noninterest expense	<u>22,101,759</u>	<u>21,751,544</u>
Income before income taxes	6,663,760	5,926,932
Income tax expense	<u>847,599</u>	<u>774,609</u>
Net income	<u>\$ 5,816,161</u>	<u>\$ 5,152,323</u>
Basic earnings per share	\$ 1.85	\$ 1.66
Diluted earnings per share	\$ 1.83	\$ 1.64
Weighted average numbers of shares outstanding	3,145,411	3,110,156

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, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Net income	\$ 5,816,161	\$ 5,152,323
Other comprehensive income (loss), net of tax		
Available-for-sale securities		
Changes in net unrealized gains (losses) on securities available-for-sale, net of income tax expense of \$(1,195,209) in 2019 and income tax benefit of \$574,998 in 2018	4,496,264	(2,163,089)
Reclassification adjustment for net losses on sales of securities available-for-sale, net of income tax benefit of \$(8,310) in 2019.	<u>31,263</u>	<u>-</u>
Total available-for-sale securities	<u>4,527,527</u>	<u>(2,163,089)</u>
Interest rate swaps		
Unrealized interest rate swap (liability) asset, net of income tax benefit of \$277,477 in 2019 and income tax expense of \$(124,067) in 2018	<u>(1,043,841)</u>	<u>466,727</u>
Total other comprehensive income (loss)	<u>3,483,686</u>	<u>(1,696,362)</u>
Total comprehensive income	<u>\$ 9,299,847</u>	<u>\$ 3,455,961</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, 2019 and 2018

	Common Stock	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2017	<u>\$1,106,307</u>	<u>\$11,910,643</u>	<u>\$(1,714,903)</u>	<u>\$ 34,608,234</u>	<u>\$ 732,266</u>	<u>\$ 46,642,547</u>
Net income	-	-	-	5,152,323	-	5,152,323
Other comprehensive loss, net of tax effect	-	-	-	-	(1,696,362)	(1,696,362)
Total comprehensive (loss) income	-	-	-	5,152,323	(1,696,362)	3,455,961
Cash dividends paid, \$0.70 per share	-	-	-	(2,250,731)	-	(2,250,731)
Stock awards issued from treasury (6,641 shares)	-	67,392	87,063	-	-	154,455
Stock-based compensation expense	-	780,285	-	-	-	780,285
Restricted stock issued, net of shares returned to cover taxes (33,816 shares)	11,272	(300,883)	-	-	-	(289,611)
Balance, December 31, 2018	<u>1,117,579</u>	<u>12,457,437</u>	<u>(1,627,840)</u>	<u>37,509,826</u>	<u>(964,096)</u>	<u>48,492,906</u>
Net income	-	-	-	5,816,161	-	5,816,161
Other comprehensive income, net of tax effect	-	-	-	-	3,483,686	3,483,686
Total comprehensive income	-	-	-	5,816,161	3,483,686	9,299,847
Cash dividends paid, \$0.74 per share	-	-	-	(2,407,635)	-	(2,407,635)
Stock awards issued from treasury (6,260 shares)	-	67,716	82,417	-	-	150,133
Stock-based compensation expense	-	905,429	-	-	-	905,429
Purchase of treasury stock (949 shares)	-	-	(20,445)	-	-	(20,445)
Restricted stock issued, net of shares returned to cover taxes (31,632 shares)	10,544	(296,350)	-	-	-	(285,806)
Balance, December 31, 2019	<u>\$1,128,123</u>	<u>\$13,134,232</u>	<u>\$(1,565,868)</u>	<u>\$ 40,918,352</u>	<u>\$ 2,519,590</u>	<u>\$ 56,134,429</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, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Cash flows from operating activities		
Net income	\$ 5,816,161	\$ 5,152,323
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization or accretion	1,431,453	1,448,284
Net loss on sales of securities	39,573	-
Deferred income tax (benefit) expense	(151,508)	121,155
Amortization of limited partnerships	572,099	547,777
Stock-based compensation	905,429	780,285
Fair value of stock awards issued from treasury stock	150,133	154,455
Increase in accrued interest receivable	(61,596)	(136,961)
Increase in other assets	(257,359)	(1,737,738)
Decrease in right-of-use assets	445,837	-
Decrease in operating lease liabilities	(443,044)	-
Net decrease (increase) in loans held for sale	138,125	(138,125)
Increase in accrued expenses and other liabilities	<u>864,274</u>	<u>1,961,894</u>
Net cash provided by operating activities	<u>9,449,577</u>	<u>8,153,349</u>
Cash flows from investing activities		
Proceeds from sales, calls, maturities and paydowns of securities available-for-sale	52,597,488	12,560,669
Proceeds from sales, calls, maturities and paydowns of securities held-to-maturity	1,379,093	160,560
Net purchase of FHLB stock	(229,600)	(397,244)
Purchase of securities available-for-sale	(45,331,845)	(17,081,473)
Low income housing investment	(993,154)	(78,415)
Net increase in loans to customers	(14,490,622)	(10,806,381)
Purchase of premises and equipment	<u>(1,803,304)</u>	<u>(858,715)</u>
Net cash used by investing activities	<u>(8,871,944)</u>	<u>(16,500,999)</u>
Cash flows from financing activities		
Net change in deposits	(16,055,252)	7,567,556
Net proceeds from short-term borrowings	20,350,267	2,467,167
Repayment of long-term FHLB borrowings	(7,000,000)	-
Net increase (decrease) in securities sold under agreements to repurchase	933,928	(2,414,751)
Purchase of treasury stock	(20,445)	-
Restricted stock issued, net of repurchase for tax withholdings and tax benefit	(285,806)	(289,611)
Cash dividends paid on common stock	<u>(2,407,635)</u>	<u>(2,250,731)</u>
Net cash (used) provided by financing activities	<u>(4,484,943)</u>	<u>5,079,630</u>
Net decrease in cash and cash equivalents	<u>(3,907,310)</u>	<u>(3,268,020)</u>
Cash and cash equivalents, beginning of year	<u>9,282,550</u>	<u>12,550,570</u>
Cash and cash equivalents, end of year	<u>\$ 5,375,240</u>	<u>\$ 9,282,550</u>
Supplementary cash flow information:		
Interest paid on deposits and borrowed funds	<u>\$ 1,796,176</u>	<u>\$ 1,167,616</u>
Income taxes paid	<u>\$ 157,131</u>	<u>\$ 135,614</u>
Non-cash transactions:		
Right-of-use lease asset	<u>\$ 7,030,158</u>	<u>\$ -</u>
Operating lease liability	<u>\$ (7,030,158)</u>	<u>\$ -</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, 2019 and 2018

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.

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Notes to Consolidated Financial Statements

December 31, 2019 and 2018

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.

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. Debt securities not classified as held-to-maturity are classified as available-for-sale and are carried at fair value. Nonmarketable equity securities, consisting of stock in the Federal Home Loan Bank (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.

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December 31, 2019 and 2018

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.

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

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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.

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 2019. 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.

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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.

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.

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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 TDRs 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.

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.

At the inception of a derivative contract, the Company designates the derivative as one of two types based on the Company's intentions and belief as to likely effectiveness as a hedge. These two types are (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value hedge"), or (2) a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow hedge"). For a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item, are recognized in current earnings as fair values change. For a cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. For both types of hedges, changes in the fair value of derivatives that are not highly effective in hedging the changes in fair value or expected cash flows of the hedged item are recognized immediately in current earnings. Changes in the fair value of derivatives that do not qualify for hedge accounting are reported currently in earnings, as non-interest income.

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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.

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.

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FASB Accounting Standards Codification (ASC) Topic 740, *Income Taxes*, defines the criteria that a 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, 2016 through 2018.

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.

Stock Based Compensation Plans

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. Ledyard Financial Advisors earns fees for its wealth management services, which are determined as a percentage of client assets under management, as of the last day of the month. As services are provided over time, the Company has determined the performance obligation to be satisfied over time and therefore, revenue is recognized as earned.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities and cash flow hedges, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

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Recently Issued Accounting Pronouncements

In February 2016, the 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 public companies for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company adopted this ASU on January 1, 2019. Implementation of the guidance resulted in the recording of right-of-use assets and lease liabilities on the consolidated balance sheet, however, it did not have a material impact on the consolidated statements of income. See Note 6 for additional disclosures relating to the Company's lease assets and liabilities.

In June 2016, the 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. In November 2019, the FASB issued ASU No. 2019-10, *Financial Instruments - Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*, which delays the effective date of ASU No. 2016-13 to fiscal years beginning after December 31, 2022, and interim periods within those fiscal years. Management is currently reviewing the ASU to assess its effect on the Company's consolidated financial condition and results of operations, which could be significant.

In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging (Topic 815)*. The amendments in this ASU improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition, this ASU makes certain targeted improvements to simplify the application of the hedge accounting guidance in current U.S. GAAP. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early application is permitted in any interim period after issuance of the ASU. Management has reviewed the guidance in the ASU and has determined it did not have a material effect on the Company's consolidated financial statements.

In August 2018, FASB issued ASU No. 2018-13, *Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement*. This ASU eliminates, adds and modifies certain disclosure requirements for fair value measurements. Among the changes, entities will no longer be required to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, but will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. This ASU is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption is permitted. Entities are also allowed to elect early adoption of the eliminated or modified disclosure requirements and delay adoption of the new disclosure requirements until their effective date. This ASU only revises disclosure requirements, and it will not have a material impact on the Company's consolidated financial statements.

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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, 2019</u>			
Net interest income	\$ 16,074,656	\$ -	\$ 16,074,656
Noninterest income	1,803,861	10,887,002	12,690,863
Noninterest expense	14,667,681	7,434,078	22,101,759
Income before income taxes	3,210,836	3,452,924	6,663,760
Income tax (benefit) expense	(109,552)	957,151	847,599
Net income	3,320,388	2,495,773	5,816,161

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<u>Year ended December 31, 2018</u>	<u>Banking</u>	<u>Wealth Advisory Services</u>	<u>Total Consolidated</u>
Net interest income	\$ 15,484,130	\$ -	\$15,484,130
Noninterest income	1,682,716	10,511,630	12,194,346
Noninterest expense	14,899,542	6,852,002	21,751,544
Income before income taxes	2,267,304	3,659,628	5,926,932
Income tax (benefit) expense	(239,840)	1,014,449	774,609
Net income	2,507,144	2,645,179	5,152,323

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 28, 2020, 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 \$325,000 and \$303,000 as of December 31, 2019 and 2018, respectively.

3. Investment Securities

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

	<u>2019</u>			
	<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	\$ 2,000,202	\$ -	\$ (250)	\$ 1,999,952
Mortgage-backed securities	47,371,289	840,151	(15,265)	48,196,175
State and municipal	78,777,861	2,858,675	(19,072)	81,617,464
Corporate bonds	<u>4,000,929</u>	<u>12,942</u>	<u>-</u>	<u>4,013,871</u>
Total securities available-for-sale	<u>\$132,150,281</u>	<u>\$ 3,711,768</u>	<u>\$ (34,587)</u>	<u>\$135,827,462</u>

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	<u>2018</u>			
	<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	\$ 13,289,565	\$ -	\$ (161,169)	\$ 13,128,396
Mortgage-backed securities	54,488,748	51,372	(1,500,008)	53,040,112
State and municipal	58,679,655	1,060,026	(1,360,819)	58,378,862
Corporate bonds	<u>13,670,636</u>	<u>2,744</u>	<u>(146,012)</u>	<u>13,527,368</u>
Total securities available-for-sale	\$ <u>140,128,604</u>	\$ <u>1,114,142</u>	\$ <u>(3,168,008)</u>	\$ <u>138,074,738</u>
<u>Securities held-to-maturity</u>				
Mortgage-backed securities	\$ 514,830	\$ 14,168	\$ -	\$ 528,998
State and municipal	<u>874,441</u>	<u>8,531</u>	<u>-</u>	<u>882,972</u>
Total securities held-to-maturity	\$ <u>1,389,271</u>	\$ <u>22,699</u>	\$ <u>-</u>	\$ <u>1,411,970</u>

At December 31, 2019 and 2018, securities with a carrying value of \$14,419,916 and \$22,481,614, 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, 2019 follow:

	<u>Available-for-Sale</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>
Within 1 year	\$ 5,233,754	\$ 5,237,312
Over 1 year through 5 years	6,342,194	6,591,606
After 5 years through 10 years	10,449,820	11,190,605
Over 10 years	62,753,224	64,611,764
Mortgage-backed securities	<u>47,371,289</u>	<u>48,196,175</u>
	\$ <u>132,150,281</u>	\$ <u>135,827,462</u>

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During 2019, proceeds from sales of securities available-for-sale were \$28,234,164 and gross losses on the sales of securities available-for-sale were \$42,094. There were no gross gains on sales of securities available-for-sale in 2019. There were no sales of securities available-for-sale in 2018. During 2019, sales of securities held-to-maturity were \$414,278 and gross gains on sales of securities held-to-maturity were \$2,521. There were no gross losses on sales of securities held-to-maturity in 2019. 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 2018.

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, 2019 and 2018:

2019						
	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	\$ -	\$ -	\$ 1,999,952	\$ (250)	\$ 1,999,952	\$ (250)
Mortgage-backed securities	2,956,218	(15,265)	-	-	2,956,218	(15,265)
State and municipal	2,539,930	(19,072)	-	-	2,539,930	(19,072)
Total	<u>\$ 5,496,148</u>	<u>\$ (34,337)</u>	<u>\$ 1,999,952</u>	<u>\$ (250)</u>	<u>\$ 7,496,100</u>	<u>\$ (34,587)</u>

2018						
	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	\$ 2,063,626	\$ (14,825)	\$ 11,064,770	\$ (146,344)	\$ 13,128,396	\$ (161,169)
Mortgage-backed securities	13,270,935	(220,772)	29,603,063	(1,279,236)	42,873,998	(1,500,008)
State and municipal	6,715,732	(148,010)	18,479,450	(1,212,809)	25,195,182	(1,360,819)
Corporate bonds	3,546,928	(20,104)	8,964,910	(125,908)	12,511,838	(146,012)
Total	<u>\$ 25,597,221</u>	<u>\$ (403,711)</u>	<u>\$ 68,112,193</u>	<u>\$ (2,764,297)</u>	<u>\$ 93,709,414</u>	<u>\$ (3,168,008)</u>

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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 at December 31 was as follows:

	<u>2019</u>	<u>2018</u>
Commercial	\$ 40,034,715	\$ 42,257,787
Commercial real estate	135,709,946	123,422,671
Construction	3,663,472	1,139,606
Residential real estate	133,179,563	131,418,109
Consumer	<u>12,680,192</u>	<u>12,537,707</u>
Subtotal	325,267,888	310,775,880
(Less) add:		
Allowance for loan losses	(5,212,663)	(5,215,495)
Net deferred loan costs	<u>322,645</u>	<u>344,833</u>
Loans, net	<u>\$320,377,870</u>	<u>\$305,905,218</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, 2019 and 2018, the Company was servicing loans for participants aggregating \$13,628,612 and \$12,674,480, respectively.

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An analysis of the allowance for loan losses follows for the year ended December 31, 2019:

	<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	\$ 1,242,098	\$ 2,411,012	\$ 14,999	\$ 691,661	\$ 105,759	\$ 749,966	\$ 5,215,495
Provision for (reduction in) loan losses	(157,170)	(266,144)	16,355	472,531	30,620	(96,192)	-
Loans charged off	-	-	-	(144,440)	(20,317)	-	(164,757)
Recoveries of loans previously charged off	116,272	-	-	31,466	14,187	-	161,925
Balance at end of year	<u>\$ 1,201,200</u>	<u>\$ 2,144,868</u>	<u>\$ 31,354</u>	<u>\$ 1,051,218</u>	<u>\$ 130,249</u>	<u>\$ 653,774</u>	<u>\$ 5,212,663</u>

An analysis of the allowance for loan losses follows for the year ended December 31, 2018:

	<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	\$ 1,083,047	\$ 2,943,851	\$ 41,371	\$ 689,441	\$ 107,562	\$ 644,242	\$ 5,509,514
Provision for (reduction in) loan losses	358,715	(532,839)	(26,372)	87,512	7,260	105,724	-
Loans charged off	(284,479)	-	-	(92,360)	(13,723)	-	(390,562)
Recoveries of loans previously charged off	84,815	-	-	7,068	4,660	-	96,543
Balance at end of year	<u>\$ 1,242,098</u>	<u>\$ 2,411,012</u>	<u>\$ 14,999</u>	<u>\$ 691,661</u>	<u>\$ 105,759</u>	<u>\$ 749,966</u>	<u>\$ 5,215,495</u>

The following table presents the allowance for loan losses and select loan information for the year ended December 31, 2019:

	<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>\$ 1,201,200</u>	<u>\$ 2,144,868</u>	<u>\$ 31,354</u>	<u>\$ 1,051,218</u>	<u>\$ 130,249</u>	<u>\$ 653,774</u>	<u>\$ 5,212,663</u>
Individually evaluated for impairment	<u>\$ -</u>	<u>\$ 22,825</u>	<u>\$ -</u>	<u>\$ 20,848</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 43,673</u>
Collectively evaluated for impairment	<u>\$ 1,201,200</u>	<u>\$ 2,122,043</u>	<u>\$ 31,354</u>	<u>\$ 1,030,370</u>	<u>\$ 130,249</u>	<u>\$ 653,774</u>	<u>\$ 5,168,990</u>
Loans							
Ending balance	<u>\$ 40,034,715</u>	<u>\$ 135,709,946</u>	<u>\$ 3,663,472</u>	<u>\$ 133,179,563</u>	<u>\$ 12,680,192</u>		<u>\$ 325,267,888</u>
Individually evaluated for impairment	<u>\$ -</u>	<u>\$ 458,191</u>	<u>\$ -</u>	<u>\$ 1,699,693</u>	<u>\$ -</u>		<u>\$ 2,157,884</u>
Collectively evaluated for impairment	<u>\$ 40,034,715</u>	<u>\$ 135,251,755</u>	<u>\$ 3,663,472</u>	<u>\$ 131,479,870</u>	<u>\$ 12,680,192</u>		<u>\$ 323,110,004</u>

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The following table presents the allowance for loan losses and select loan information for the year ended December 31, 2018:

	<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>1,242,098</u>	\$ <u>2,411,012</u>	\$ <u>14,999</u>	\$ <u>691,661</u>	\$ <u>105,759</u>	\$ <u>749,966</u>	\$ <u>5,215,495</u>
Individually evaluated for impairment	\$ <u>-</u>	\$ <u>135</u>	\$ <u>-</u>	\$ <u>24,786</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>24,921</u>
Collectively evaluated for impairment	\$ <u>1,242,098</u>	\$ <u>2,410,877</u>	\$ <u>14,999</u>	\$ <u>666,875</u>	\$ <u>105,759</u>	\$ <u>749,966</u>	\$ <u>5,190,574</u>
Loans							
Ending balance	\$ <u>42,257,787</u>	\$ <u>123,422,671</u>	\$ <u>1,139,606</u>	\$ <u>131,418,109</u>	\$ <u>12,537,707</u>		\$ <u>310,775,880</u>
Individually evaluated for impairment	\$ <u>1,608,398</u>	\$ <u>671,864</u>	\$ <u>73,592</u>	\$ <u>2,260,988</u>	\$ <u>-</u>		\$ <u>4,614,842</u>
Collectively evaluated for impairment	\$ <u>40,649,389</u>	\$ <u>122,750,807</u>	\$ <u>1,066,014</u>	\$ <u>129,157,121</u>	\$ <u>12,537,707</u>		\$ <u>306,161,038</u>

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

The Bank categorizes each loan category, with the exception of consumer loans, by credit risk exposure. The following tables present the credit risk profile by creditworthiness category as of December 31, 2019 and 2018.

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, 2019:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>
Pass	\$ 37,362,885	\$ 131,926,328	\$ 3,663,472	\$ 130,325,995
Special mention	520,697	581,257	-	373,596
Substandard	2,151,133	3,202,361	-	2,387,963
Doubtful	-	-	-	92,009
Total	<u>\$ 40,034,715</u>	<u>\$ 135,709,946</u>	<u>\$ 3,663,472</u>	<u>\$ 133,179,563</u>

The following table presents the ratings as of December 31, 2018:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>
Pass	\$ 36,126,698	\$ 115,642,712	\$ 1,066,014	\$ 128,194,246
Special mention	2,236,054	588,287	-	193,943
Substandard	3,895,035	7,191,672	73,592	2,875,461
Doubtful	-	-	-	154,459
Total	<u>\$ 42,257,787</u>	<u>\$ 123,422,671</u>	<u>\$ 1,139,606</u>	<u>\$ 131,418,109</u>

The following table presents an aging analysis of past due loans as of December 31, 2019:

	<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	\$ -	\$ -	\$ -	\$ -	\$ 40,034,715	\$ 40,034,715	\$ -
Commercial real estate	-	-	-	-	135,709,946	135,709,946	12,167
Construction	-	-	-	-	3,663,472	3,663,472	-
Residential real estate	523,090	635,758	102,383	1,261,231	131,918,332	133,179,563	1,053,870
Consumer	126,644	728	-	127,372	12,552,820	12,680,192	-
Total	<u>\$ 649,734</u>	<u>\$ 636,486</u>	<u>\$ 102,383</u>	<u>\$ 1,388,603</u>	<u>\$ 323,879,285</u>	<u>\$ 325,267,888</u>	<u>\$ 1,066,037</u>

The following table presents an aging analysis of past due loans as of December 31, 2018:

	<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	\$ 9,351	\$ -	\$ -	\$ 9,351	\$ 42,248,436	\$ 42,257,787	\$ 1,534,066
Commercial real estate	-	-	-	-	123,422,671	123,422,671	189,111
Construction	-	-	-	-	1,139,606	1,139,606	-
Residential real estate	1,009,701	442,079	198,651	1,650,431	129,767,678	131,418,109	1,590,308
Consumer	122,147	1,040	-	123,187	12,414,520	12,537,707	-
Total	<u>\$ 1,141,199</u>	<u>\$ 443,119</u>	<u>\$ 198,651</u>	<u>\$ 1,782,969</u>	<u>\$ 308,992,911</u>	<u>\$ 310,775,880</u>	<u>\$ 3,313,485</u>

At December 31, 2019 and 2018 there were no loans 90 days past due and still accruing interest.

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The following table presents a summary of information pertaining to impaired loans by loan category as of December 31, 2019:

	<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	\$ -	\$ -	\$ -	\$ 804,199	\$ 14,049	\$ 14,049
Commercial real estate	2,862	2,862	-	331,775	3,512	3,512
Construction	-	-	-	36,796	-	-
Residential real estate	993,045	993,045	-	1,330,403	52,601	52,601
With an allowance recorded						
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate	455,330	455,330	22,825	233,252	29,071	29,071
Residential real estate	706,648	706,648	20,848	649,937	30,898	30,898
Total						
Commercial	\$ -	\$ -	\$ -	\$ 804,199	\$ 14,049	\$ 14,049
Commercial real estate	458,192	458,192	22,825	565,027	32,583	32,583
Construction	-	-	-	36,796	-	-
Residential real estate	1,699,693	1,699,693	20,848	1,980,340	83,499	83,499

The following table presents a summary of information pertaining to impaired loans by loan category as of December 31, 2018:

	<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	\$ 1,608,398	\$ 1,608,398	\$ -	\$ 843,347	\$ 84,214	\$ 84,214
Commercial real estate	660,689	660,689	-	354,291	25,848	25,848
Construction	73,592	73,592	-	172,280	4,877	4,877
Residential real estate	1,667,761	1,667,761	-	1,625,986	66,221	66,221
With an allowance recorded						
Commercial	\$ -	\$ -	\$ -	\$ 152,352	\$ -	\$ -
Commercial real estate	11,175	11,175	135	5,588	-	-
Residential real estate	593,227	593,227	24,786	428,677	21,220	21,220
Total						
Commercial	\$ 1,608,398	\$ 1,608,398	\$ -	\$ 995,699	\$ 84,214	\$ 84,214
Commercial real estate	671,864	671,864	135	359,879	25,848	25,848
Construction	73,592	73,592	-	172,280	4,877	4,877
Residential real estate	2,260,988	2,260,988	24,786	2,054,663	87,441	87,441

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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.

The following tables present the recorded investment in troubled debt restructurings as of December 31, 2019 and 2018 based on payment performance status:

December 31, 2019	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>	<u>Total</u>
Performing	\$ -	\$ 446,021	\$ -	\$ 645,822	\$ 1,091,843
Non-performing	-	12,167	-	-	12,167
Total	\$ -	\$ 458,188	\$ -	\$ 645,822	\$ 1,104,010

December 31, 2018	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>	<u>Total</u>
Performing	\$ 74,333	\$ 482,753	\$ 73,592	\$ 670,679	\$ 1,301,357
Non-performing	-	28,522	-	260,149	288,671
Total	\$ 74,333	\$ 511,275	\$ 73,592	\$ 930,828	\$ 1,590,028

Troubled debt restructured loans are considered impaired and carry individual specific reserves. At December 31, 2019 and 2018 the specific reserve related to troubled debt restructured loans was \$39,798 and \$23,457. As of December 31, 2019 and 2018, there were no commitments to lend additional amounts to customers with outstanding loans that are classified as troubled debt restructurings.

There were no troubled debt restructurings that occurred during the year ended December 31, 2019.

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The following table summarizes troubled debt restructurings that occurred during the year ended December 31, 2018:

	<u>Number of Loans</u>	<u>Pre- Modification Outstanding Recorded Investment</u>	<u>Post- Modification Outstanding Recorded Investment</u>
Commercial	1	\$ 9,351	\$ 9,351
Commercial real estate	1	482,753	482,753
Residential real estate	<u>1</u>	<u>313,953</u>	<u>313,953</u>
Total	<u>3</u>	<u>\$ 806,057</u>	<u>\$ 806,057</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 previous twelve-months for which there was a payment default during the years ended December 31, 2019 and 2018.

5. Premises and Equipment

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

	<u>2019</u>	<u>2018</u>
Land and improvements	\$ 2,335,893	\$ 2,110,093
Buildings and improvements	18,784,368	10,526,298
Equipment	<u>7,883,014</u>	<u>7,979,260</u>
	29,003,275	20,615,651
Accumulated depreciation	<u>(11,590,352)</u>	<u>(10,842,184)</u>
	<u>\$ 17,412,923</u>	<u>\$ 9,773,467</u>

Depreciation, included in occupancy and equipment expense, amounted to \$748,168 and \$681,330 for the years ended December 31, 2019 and 2018, respectively.

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6. Leases

The Company adopted ASU No. 2016-02, *Leases*, on January 1, 2019 with no required adjustment to prior periods presented or cumulative-effect adjustment to retained earnings. The Company has operating leases pertaining to bank premises with remaining lease terms of four to 24 years, some of which include renewal options to extend which are reflected in the 24 years.

Leases are classified as operating or finance leases at the lease commencement date. The Company does not have any finance leases. Lease expense for operating leases are recognized on a straight-line basis over the lease term. Right-of-use assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent the Company's obligation to make lease payments arising from the lease. Right-of-use assets and lease liabilities are recognized at the lease commencement date based on the estimated present value of lease payments over the lease term.

The Company uses its incremental borrowing rate at lease commencement to calculate the present value of lease payments when the rate implicit in a lease is not known. The Company's incremental borrowing rate is based on the FHLB amortizing advance rate, adjusted for the lease term and other factors. The weighted-average discount rate for operating leases at December 31, 2019 was 2.5%.

Right-of-use assets and lease liabilities by lease type, and the associated balance sheet classifications as of December 31 were as follows:

		<u>2019</u>
<u>Balance Sheet Classification</u>		
Right-of-use assets:		
Operating leases	Premises and equipment, net	\$ <u>6,584,321</u>
Lease liabilities:		
Operating leases	Accrued expenses and other liabilities	\$ <u>6,587,117</u>

The components of lease expense were as follows for the year ended December 31:

	<u>2019</u>	<u>2018</u>
Operating lease cost	\$ <u>621,592</u>	\$ <u>827,882</u>

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The weighted-average remaining lease term for operating leases was 16.3 years at December 31, 2019.

Future lease payments for operating leases with initial terms of one year or more as of December 31, 2019 are as follows:

2020	\$ 618,794
2021	618,794
2022	579,746
2023	560,222
2024	560,222
Thereafter	<u>5,006,897</u>
Total undiscounted lease payments	7,944,675
Less: imputed interest	<u>1,357,558</u>
Net lease liability	<u>\$ 6,587,117</u>

7. Deposits

At December 31, 2019, the scheduled maturities of time deposits are as follows:

2020	\$ 26,181,902
2021	12,492,093
2022	978,843
2023	624,224
2024	<u>225,413</u>
	<u>\$ 40,502,475</u>

Deposit accounts with related parties were \$3,457,535 and \$3,680,543 at December 31, 2019 and 2018, respectively.

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8. 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 \$9,045,328 and a fair value of \$9,223,153 at December 31, 2019 and by mortgage-backed securities with a book value of \$11,388,960 and a fair value of \$10,928,273 at December 31, 2018. All securities collateralizing the repurchase agreements are under the Company's control. The maximum amount of repurchase agreements outstanding at any month-end during 2019 and 2018 was \$8,444,639 and \$7,925,926, respectively. The average amount of repurchase agreements outstanding during 2019 and 2018 was \$5,841,819 and \$7,131,617, respectively. The weighted average interest rate on repurchase agreements outstanding at December 31, 2019 and 2018 was 0.45% and 0.44%, respectively.

9. Advances from Federal Home Loan Bank and Other Borrowings

The Company has fixed-rate advances with the FHLB of \$29,783,281 and \$16,433,014 at December 31, 2019 and 2018. At December 31, 2019 and 2018 interest rates of fixed-rate advances ranged from 0.00% 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.

The contractual maturities of advances at December 31, 2019 were as follows:

2020	\$ 24,500,000
2021	3,000,000
2028	750,000
2029	633,100
2037	<u>900,181</u>
Total	<u>\$ 29,783,281</u>

The Bank has a long-term line of credit with the FHLB that does not expire in the amount of \$2,803,000. There were no amounts outstanding at December 31, 2019 or 2018. The Company, through the Bank, has the ability to borrow from the FRB Discount Window due to its pledge of \$2,080,141 and \$9,631,703 of state and municipal securities that it owned at December 31, 2019 and 2018. No amounts were outstanding at December 31, 2019 or 2018. The Company, through the Bank, has unsecured lines of credit at two correspondent banks totaling \$10,500,000. No amounts were outstanding on these lines of credit at December 31, 2019 or 2018.

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10. Income Taxes

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

	<u>2019</u>	<u>2018</u>
Current tax provision		
Federal	\$ 861,563	\$ 562,623
State	<u>137,544</u>	<u>90,831</u>
	<u>999,107</u>	<u>653,454</u>
Deferred tax (benefit) expense		
Federal	(88,964)	124,913
State	<u>(62,544)</u>	<u>(3,758)</u>
	<u>(151,508)</u>	<u>121,155</u>
	<u>\$ 847,599</u>	<u>\$ 774,609</u>

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

	<u>2019</u>	<u>2018</u>
Computed tax expense	\$ 1,399,390	\$ 1,245,072
Increase (reduction) in income taxes resulting from:		
Tax exempt income	(423,266)	(397,484)
Income from life insurance	(53,185)	(53,434)
Tax credits, net of amortization	(135,853)	(133,023)
State tax	129,858	85,852
Other	<u>(69,345)</u>	<u>27,626</u>
	<u>\$ 847,599</u>	<u>\$ 774,609</u>

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

	<u>2019</u>	<u>2018</u>
Deferred tax assets		
Allowance for loan losses	\$ 1,237,947	\$ 1,241,176
Employee benefit plan	977,979	935,468
Nonaccrual interest	44,371	36,576
Limited partnerships	244,046	187,272
Tax credit carryforward	-	219,024
Net unrealized loss on securities available-for-sale and interest rate swaps	-	256,279
Other	<u>4,039</u>	<u>4,617</u>
	<u>2,508,382</u>	<u>2,880,412</u>
Deferred tax liabilities		
Net unrealized gain on securities available-for-sale and interest rate swaps	669,763	-
Depreciation	539,969	774,492
Prepaid expenses	<u>125,057</u>	<u>157,793</u>
	<u>1,334,789</u>	<u>932,285</u>
Net deferred tax asset	<u>\$ 1,173,593</u>	<u>\$ 1,948,127</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, 2019 and 2018, the balance of the investment for qualified housing projects was \$3,895,140 and \$4,467,238, respectively. These balances are reflected in other assets on the consolidated balance sheets. New investments in qualified affordable housing projects are amortized using the proportional amortization method. All investments made before January 1, 2015 are amortized using the effective yield method. During the years ended December 31, 2019 and 2018, the Company recognized amortization expense of \$572,099 and \$547,777, respectively, which was included within income tax expense in the consolidated statements of income. Additionally, during the years ended December 31, 2019 and 2018, the Company recognized tax credits from its investments in affordable housing tax projects of \$599,731 and \$557,237, respectively.

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11. Earnings per Share

The following sets forth the computation of basic and diluted earnings per share for 2019 and 2018.

	<u>2019</u>	<u>2018</u>
Net income, as reported	\$ <u>5,816,161</u>	\$ <u>5,152,323</u>
Weighted-average shares outstanding	3,145,411	3,110,156
Effect of unvested stock grants	<u>32,014</u>	<u>40,153</u>
Adjusted weighted-average shares and assumed conversion	<u>3,177,425</u>	<u>3,150,309</u>
Basic earnings per share	\$ 1.85	\$ 1.66
Diluted earnings per share	\$ 1.83	\$ 1.64

12. 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.

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

At December 31, 2019 and 2018, the following financial instruments were outstanding whose contract amounts represent credit risk:

	<u>Contract Amount</u>	
	<u>2019</u>	<u>2018</u>
Commitments to grant loans	\$ <u>75,508,055</u>	\$ <u>63,409,606</u>
Commercial and standby letters-of-credit	\$ <u>541,435</u>	\$ <u>670,305</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.

13. 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.

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14. Minimum Regulatory Capital Requirements

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.

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, 2019, the Company and its bank subsidiary meet all capital requirements to which they are subject. As of December 31, 2019, 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 was being phased in from January 1, 2016 through January 1, 2019, when the full capital conservation buffer requirement was effective. As of December 31, 2019 and 2018, the Company and the Bank had a capital conservation buffer of 9.4% and 7.9%, respectively, which was in excess of the phased-in regulatory requirement of 2.50% and 1.875%, respectively.

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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, 2019</u>	(Dollar amounts in thousands)					
Total Capital to Risk Weighted Assets						
Company	\$ 57,776	17.4 %	\$ 26,512	8.0 %	\$ 33,140	10.0 %
Bank	\$ 52,570	15.9 %	\$ 26,400	8.0 %	\$ 33,000	10.0 %
Tier 1 Capital to Risk Weighted Assets						
Company	\$ 53,636	16.2 %	\$ 19,884	6.0 %	\$ 26,512	8.0 %
Bank	\$ 48,430	14.7 %	\$ 19,800	6.0 %	\$ 26,400	8.0 %
Common Equity Tier 1 Capital to Risk Weighted Assets						
Company	\$ 53,636	16.2 %	\$ 14,913	4.5 %	\$ 21,541	6.5 %
Bank	\$ 48,430	14.7 %	\$ 14,850	4.5 %	\$ 21,450	6.5 %
Tier 1 Capital to Average Assets						
Company	\$ 53,636	10.8 %	\$ 19,892	4.0 %	\$ 24,865	5.0 %
Bank	\$ 48,430	9.8 %	\$ 19,840	4.0 %	\$ 24,800	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, 2018</u>	(Dollar amounts in thousands)					
Total Capital to Risk Weighted Assets						
Company	\$ 53,473	16.7 %	\$ 25,625	8.0 %	\$ 32,032	10.0 %
Bank	\$ 49,296	15.4 %	\$ 25,598	8.0 %	\$ 31,997	10.0 %
Tier 1 Capital to Risk Weighted Assets						
Company	\$ 49,457	15.4 %	\$ 19,219	6.0 %	\$ 25,625	8.0 %
Bank	\$ 45,280	14.2 %	\$ 19,198	6.0 %	\$ 25,598	8.0 %
Common Equity Tier 1 Capital to Risk Weighted Assets						
Company	\$ 49,457	15.4 %	\$ 14,414	4.5 %	\$ 20,821	6.5 %
Bank	\$ 45,280	14.2 %	\$ 14,399	4.5 %	\$ 20,798	6.5 %
Tier 1 Capital to Average Assets						
Company	\$ 49,457	10.0 %	\$ 19,711	4.0 %	\$ 24,639	5.0 %
Bank	\$ 45,280	9.2 %	\$ 19,698	4.0 %	\$ 24,623	5.0 %

15. 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.

Interest rate swaps related to borrowings are cash flow hedges and interest rate swaps related to loans and municipal bonds are fair value hedges.

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At December 31, 2019 and 2018, the information pertaining to outstanding interest rate swap agreements used to hedge bonds, fixed-rate loans, and borrowings is as follows:

	<u>2019</u>	<u>2018</u>
Notional amount	\$40,190,031	\$30,642,660
Weighted average pay rate	3.29 %	3.30 %
Weighted average receive rate	2.24 %	2.83 %
Weighted average maturity in years	10.01	11.60

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 \$57,020 and \$118,050 during 2019 and 2018, respectively, and is reported as components of the applicable interest income or expense in the consolidated statements of income. Gains of \$34,310 and \$2,524 for the fair value of the hedges were recorded in earnings for the years ended December 31, 2019 and 2018, 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, 2019 and 2018:

	<u>2019</u>		<u>2018</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 borrowings	\$ 4,000,000	\$ 23,720	\$10,000,000	\$ 318,886
Interest rate swaps related to loans	13,332,444	78,066	2,040,540	150,506
Interest rate swaps related to municipal bonds	<u>485,000</u>	<u>1,057</u>	<u>12,680,000</u>	<u>534,054</u>
Total included in other assets	<u>\$17,817,444</u>	<u>\$ 102,843</u>	<u>\$24,720,540</u>	<u>\$ 1,003,446</u>
Included in other liabilities				
Interest rate swaps related to borrowings	\$ 6,000,000	\$ 156,227	\$ -	\$ -
Interest rate swaps related to municipal bonds	10,645,000	314,444	-	-
Interest rate swaps related to loans	<u>5,727,587</u>	<u>492,975</u>	<u>5,922,120</u>	<u>131,350</u>
Total included in other liabilities	<u>\$22,372,587</u>	<u>\$ 963,646</u>	<u>\$ 5,922,120</u>	<u>\$ 131,350</u>

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16. 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, 2019 and 2018, expense attributable to the plan amounted to \$536,960 and \$503,172, respectively.

Included in accrued expenses and other liabilities in the balance sheets at December 31, 2019 and 2018 are liabilities established pursuant to deferred compensation agreements with certain officers of the Company of \$2,674,243 and \$2,487,003, respectively. Deferred compensation expense related to these plans amounted to \$242,052 and \$283,235 for the years ended December 31, 2019 and 2018, respectively.

17. Stock-Based Compensation

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 150,000 shares. In May 2013, the shareholders voted to add 150,000 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, 2019 each vest over a period of one to four years.

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 \$905,429 and \$780,285 of compensation expense during the years ended December 31, 2019 and 2018, respectively. Total compensation expense related to nonvested awards not yet recognized is \$1,453,294 as of December 31, 2019 and is expected to be recognized over a weighted average period of 4.7 years.

During 2018, the Company's Board of Directors adopted the 2018 Stock Grant Plan (2018 Plan). Under the 2018 Plan, the maximum number of shares available for issuance is 150,000. During 2019, the Company issued 43,825 shares from the 2018 Plan. No shares were issued from the 2018 Plan during 2018.

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A summary of nonvested restricted stock awards as of December 31, 2019 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, 2018	102,491	\$ 19.54
Granted	47,290	21.04
Vested	(47,964)	18.75
Forfeited	<u>(783)</u>	21.51
Nonvested shares at December 31, 2019	<u>101,034</u>	20.61

18. 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>2019</u>	<u>2018</u>
Noninterest income		
Brokerage Commissions	\$ 363,731	\$ 170,814
Noninterest expense		
Professional fees	\$ 449,086	\$ 585,935
Printing, postage and stationery	427,478	323,261
Directors' fees	325,975	273,942
Advertising	624,267	639,545
ATM processing	310,964	247,991

19. 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 they 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 \$1,387,282 and \$7,468,397 at December 31, 2019 and 2018, respectively.

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20. Components of Other Comprehensive Income (Loss)

The following table presents the components of other comprehensive income (loss) for the years ended December 31, 2019 and 2018:

	<u>December 31, 2019</u>			<u>December 31, 2018</u>		
	<u>Before Tax</u>	<u>Tax Effect</u>	<u>Net of Tax</u>	<u>Before Tax</u>	<u>Tax Effect</u>	<u>Net of Tax</u>
Changes in net unrealized gains (losses) on securities available-for-sale	\$ 5,691,473	\$ 1,195,209	\$ 4,496,264	\$(2,738,087)	\$ (574,998)	\$(2,163,089)
Reclassification adjustment for net realized losses	39,573	8,310	31,263	-	-	-
Unrealized interest rate swap (liability) asset	<u>(1,321,318)</u>	<u>(277,477)</u>	<u>(1,043,841)</u>	<u>590,794</u>	<u>124,067</u>	<u>466,727</u>
Other comprehensive income (loss)	<u>\$ 4,409,728</u>	<u>\$ 926,042</u>	<u>\$ 3,483,686</u>	<u>\$(2,147,293)</u>	<u>\$ (450,931)</u>	<u>\$(1,696,362)</u>
			Unrealized Gains and Losses on Available-for-Sale Securities	Unrealized Gains and Losses on Cash Flow Hedges	Total	
Balance at December 31, 2017			\$ 540,536	\$ 191,730	\$ 732,266	
Other comprehensive (loss) income before reclassifications			<u>(2,163,089)</u>	<u>466,727</u>	<u>(1,696,362)</u>	
Balance at December 31, 2018			(1,622,553)	658,457	(964,096)	
Other comprehensive income (loss) before reclassifications			4,496,264	(1,043,841)	3,452,423	
Amounts reclassified from accumulated other comprehensive income			<u>31,263</u>	<u>-</u>	<u>31,263</u>	
Balance at December 31, 2019			<u>\$ 2,904,974</u>	<u>\$ (385,384)</u>	<u>\$ 2,519,590</u>	

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21. 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.

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.

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

Financial Instruments Recorded at Fair Value on a Recurring Basis

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.

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

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.

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

Fair Value Measurements at December 31, 2019, Using:

	<u>Total</u>	Quoted Prices In Active Markets for Identical Assets (<u>Level 1</u>)	Significant Other Observable Inputs (<u>Level 2</u>)
Assets (market approach)			
Securities available-for-sale			
U.S. Government sponsored enterprises	\$ 1,999,952	\$ -	\$ 1,999,952
Mortgage-backed securities	48,196,175	-	48,196,175
State and municipal	81,617,464	-	81,617,464
Corporate bonds	<u>4,013,871</u>	<u>-</u>	<u>4,013,871</u>
	<u>\$ 135,827,462</u>	<u>\$ -</u>	<u>\$ 135,827,462</u>
Interest rate swaps	<u>\$ 102,843</u>	<u>\$ -</u>	<u>\$ 102,843</u>
Liabilities (market approach)			
Interest rate swaps	<u>\$ 963,646</u>	<u>\$ -</u>	<u>\$ 963,646</u>

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Fair Value Measurements at December 31, 2018, Using:

	<u>Total</u>	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Assets (market approach)			
Securities available-for-sale			
U.S. Government sponsored enterprises	\$ 13,128,396	\$ -	\$ 13,128,396
Mortgage-backed securities	53,040,112	-	53,040,112
State and municipal	58,378,862	-	58,378,862
Corporate bonds	<u>13,527,368</u>	<u>-</u>	<u>13,527,368</u>
	<u>\$ 138,074,738</u>	<u>\$ -</u>	<u>\$ 138,074,738</u>
Loans held for sale	<u>\$ 138,125</u>	<u>\$ -</u>	<u>\$ 138,125</u>
Interest rate swaps	<u>\$ 1,003,446</u>	<u>\$ -</u>	<u>\$ 1,003,446</u>
Liabilities (market approach)			
Interest rate swaps	<u>\$ 131,350</u>	<u>\$ -</u>	<u>\$ 131,350</u>

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

Fair Value Measurements at December 31, 2019, Using

	<u>Total</u>	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Assets (market approach)			
Other real estate owned	<u>\$ 17,970</u>	<u>\$ -</u>	<u>\$ 17,970</u>

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The estimated fair values and related carrying amounts for assets and liabilities for which fair value is only disclosed 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, 2019</u>					
Financial assets					
Loans					
Commercial	\$ 38,753,047	\$ 41,997,864	\$ -	\$ -	\$ 41,997,864
Commercial real estate	133,292,307	139,309,384	-	-	139,309,384
Construction	3,624,755	3,663,462	-	-	3,663,462
Residential real estate	131,860,660	142,614,017	-	-	142,614,017
Consumer	12,524,456	13,134,217	-	-	13,134,217
Accrued interest receivable	1,871,905	1,871,905	-	1,871,905	-
Financial liabilities					
Deposits	393,010,714	393,321,656	-	393,321,656	-
Repurchase agreements	8,444,639	8,444,639	-	8,444,639	-
Advances from FHLB	29,783,281	29,545,346	-	29,545,346	-
Accrued interest payable	86,010	86,010	-	86,010	-
	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, 2018</u>					
Financial assets					
Securities held-to-maturity	\$ 1,389,271	\$ 1,411,970	\$ -	\$ 1,411,970	\$ -
Loans					
Commercial	40,913,712	36,923,362	-	-	36,923,362
Commercial real estate	120,713,815	98,134,034	-	-	98,134,034
Construction	1,121,857	911,575	-	-	911,575
Residential real estate	130,409,309	112,666,843	-	-	112,666,843
Consumer	12,401,692	11,333,787	-	-	11,333,787
Accrued interest receivable	1,810,309	1,810,309	-	1,810,309	-
Financial liabilities					
Deposits	409,065,966	408,786,660	-	408,786,660	-
Repurchase agreements	7,510,711	7,510,711	-	7,510,711	-
Advances from FHLB	16,433,014	16,072,946	-	16,072,946	-
Accrued interest payable	50,260	50,260	-	50,260	-

Excluded from the tables above were financial instruments measured at fair value on a recurring and nonrecurring basis, as previously described.