# 2020

# ANNUAL REPORT

THE SOUTHERN BANC COMPANY, INC.

THE SOUTHERN BANC
COMPANY, INC.
P.O. BOX 1130, GADSDEN, ALABAMA 35902
(256) 543-3860

Dear Fellow Shareholders,

All things considered, 2020 was not a bad year. We had lots of challenges and a few opportunities. Our interest margin narrowed due to declining interest rates and large loan repayments. The increased liquidity caused us to tilt our balance sheet more toward securities and less toward loans. While this transition did not provide the returns we were hoping for, things could have been much worse.

The actions of the Federal Government obscured the true impact of the economic shutdown, but the direct payments from the CARES Act mitigated the loan losses we would have endured otherwise. Our communities benefited from the cash payments, and perhaps most importantly, from the absence of predicted doom. While we should be grateful, the cost of these actions is unknown.

Nevertheless, our company performed well. The relentless effort and flexibility of our employees allowed the bank to continue business as usual, and maybe even a little better. We should be proud of our team, our customers and the resilience of all.

In 2021 there will still be business done, so we will carry on doing ours - helping you do yours. I appreciate the encouragement and thanks we get from many of you, and hope that the future months bring us all continued progress and stability.

Sincerely,

Gates Little
President

**THE SOUTHERN BANC COMPANY, INC.**

The Southern Banc Company, Inc. (the "Company") was incorporated at the direction of management of The Southern Bank Company (the "Bank"), formerly First Federal Savings and Loan Association of Gadsden, Alabama (the "Original Bank"), for the purpose of serving as the holding company of the Bank upon the acquisition of all of the capital stock issued by the Original Bank in its conversion from mutual to stock form in 1995. At June 30, 2020, the Company had total consolidated assets of approximately $103.3 million, deposits of $88.8 million and stockholders' equity of $12.3 million, or 11.95% of total consolidated assets.

The Original Bank was organized in 1936 as a federal savings association, at which time it also became a member of the Federal Home Loan Bank ("FHLB") System and obtained federal deposit insurance. On July 1, 2008, the Company announced that the Original Bank had converted its charter from a federal savings association to an Alabama state-chartered commercial bank. As a state-chartered bank, the Bank is regulated by the State of Alabama Banking Department (the "Banking Department") and the Federal Deposit Insurance Corporation ("FDIC"). As a bank holding company, the Company is regulated by the Board of Governors of the Federal Reserve System (the "Federal Reserve"). In 1999, the Bank adopted its current corporate title.

The Bank currently operates through four full-service banking offices located in Gadsden, Albertville, Guntersville and Centre, Alabama, and one commercial finance office located in Birmingham, Alabama. The Bank's business strategy has been to operate as a profitable and independent community-oriented financial institution dedicated to providing quality customer service. Generally, the Bank has sought to implement this strategy by using retail deposits as its sources of funds and maintaining most of its assets in loans secured by real estate properties located in the Bank's market area, consumer loans, commercial loans and leases, mortgage-backed securities issued by Federal Home Loan Mortgage Corporation ("Freddie Mac"), the Government National Mortgage Association ("GNMA") and Federal National Mortgage Association ("Fannie Mae"), U.S. government and agency securities, interest-earning deposits, and cash and equivalents.

In an effort to diversify the Company's loan and lease portfolio and to increase yield in the portfolio, the Company's management team and the Board of Directors developed and approved the Commercial Finance Division ("CFD") of The Southern Bank Company. This division was officially started in January 2011. The business of the CFD is to purchase accounts receivable. This business is also known as factoring. See Note 1 of Summary of Significant Accounting Policies.

The Bank's business strategy incorporates the following key elements: (1) remaining a community-oriented financial institution while maintaining a strong core customer base by providing quality service and offering customers the access to senior management and services that a community-based institution can offer; (2) attracting a retail deposit base from the communities served by the Bank's four banking offices; (3) maintaining asset quality by emphasizing investment in real estate loans, commercial loans, consumer loans, leases, mortgage-backed securities and other securities issued or guaranteed by the U.S. government or agencies thereof; and (4) maintaining liquidity and capital substantially in excess of regulatory requirements.

The lending activities and other investments of the Bank must comply with various regulatory requirements, and the Banking Department and FDIC periodically examine the Bank for compliance with various regulatory requirements. The Bank must file reports with the regulators describing its activities and financial condition. The Company and the Bank are also subject to certain reserve and capital requirements promulgated by the Federal Reserve.

The coronavirus 2019 disease (COVID-19) pandemic has created both a public health crisis and an economic crisis in the United States. The pandemic has disrupted lives, pushed the hospital system to its capacity, and created a global economic slowdown. The economic crisis is unprecedented in its scale: the pandemic has created a demand shock, a supply shock, and a financial shock all at once.

A return to pre-coronavirus conditions, including an increase in unemployment and/or continued negative developments in the domestic and international credit markets may significantly affect economic conditions in the market areas in which we do business, the value of our loans and investments, supply of and demand for deposits, and our ongoing operations, costs and profitability.

## MARKET FOR COMMON STOCK AND RELATED STOCKHOLDER MATTERS

At June 30, 2020, there were 806,086 shares of the Common Stock outstanding and approximately 130 stockholders of record. This total does not reflect the number of persons or entities who hold Common Stock in nominee or "street name" through various brokerage firms.

The Company's common stock trades in the over-the-counter market on the OTC Pink Marketplace® under the symbol "SRNN."

The payment of dividends on the Common Stock is subject to determination and declaration by the Board of Directors of the Company. In addition, from time to time, the Board of Directors may pay special cash dividends in addition to, or in lieu of, regular cash dividends. The payment of future dividends will be subject to the requirements of applicable law and the determination by the Board of Directors of the Company that the net income, capital and financial condition of the Company and the Bank, industry trends and general economic conditions, justify the payment of dividends. The Company is subject to certain restrictions on the amount of dividends that may be declared without prior regulatory approval.

Dividends paid by the Bank are a principal source of funds available to the Company for payment of dividends to its stockholders and for other needs. Applicable federal and state statutes and regulations impose restrictions on the amounts of dividends that may be declared by the subsidiary bank. At June 30, 2020, the Bank was able to pay dividends subject to regulatory approval. See Note 12 of Notes to Consolidated Financial Statements.

On April 21, 2009, the Company announced that to preserve capital it would suspend the payment of future dividends. The determination was made in the best judgment of the Board of Directors and management.

The following table sets forth information as to high and low sales prices of the Company's Common Stock for the calendar quarters indicated. The high and low sales prices of the Company's common stock shown below are based on information posted on the OTC Pink Marketplace by broker-dealers. These prices may include dealer mark-up, mark-down and/or commission and may not necessarily represent actual transactions.

| | Price Per Share | |
|---|---|---|
| | High | Low |
| **Fiscal 2019** | | |
| First Quarter | $11.50 | $9.66 |
| Second Quarter | $9.75 | $8.75 |
| Third Quarter | $9.70 | $8.75 |
| Fourth Quarter | $9.60 | $8.05 |
| **Fiscal 2020** | | |
| First Quarter | $8.60 | $8.30 |
| Second Quarter | $8.90 | $8.10 |
| Third Quarter | $9.10 | $8.90 |
| Fourth Quarter | $9.00 | $7.00 |

**SELECTED CONSOLIDATED FINANCIAL AND OTHER DATA**

| | Year Ended June 30, | | | | |
|---|---|---|---|---|---|
| | 2020 | 2019 | 2018 | 2017 | 2016 |
| | (In thousands, except per share data) | | | | |
| **INCOME STATEMENT DATA** | | | | | |
| Interest income | $ 5,377 | $ 5,483 | $ 5,378 | $ 4,217 | $ 3,931 |
| Interest expense | 1,118 | 918 | 807 | 740 | 807 |
| Net interest income | 4,259 | 4,565 | 4,571 | 3,477 | 3,124 |
| Provision for loan and lease losses | 44 | 20 | 773 | 1,208 | 1,859 |
| Net interest income after provision for loan and lease losses | 4,214 | 4,545 | 3,798 | 2,269 | 1,265 |
| Non-interest income | 395 | 170 | 157 | 136 | 273 |
| Non-interest expense | 4,180 | 4,081 | 3,801 | 3,684 | 3,743 |
| Income (loss) before income tax expense (benefit) | 429 | 634 | 154 | (1,279) | (2,205) |
| Income tax expense (benefit) | 115 | 169 | 719 | (487) | (847) |
| Net Income / (loss) | $ 314 | $ 465 | $ (565) | $ (792) | $ (1,358) |
| Earnings (loss) per share | | | | | |
| Basic | $ 0.41 | $ 0.61 | $ (0.74) | $ (1.03) | $ (1.76) |
| Diluted | $ 0.41 | $ 0.61 | $ (0.74) | $ (1.03) | $ (1.76) |

| | As of June 30, | | | | |
|---|---|---|---|---|---|
| | 2020 | 2019 | 2018 | 2017 | 2016 |
| | (In thousands) | | | | |
| **BALANCE SHEET DATA** | | | | | |
| Total assets | $ 103,302 | $ 97,705 | $ 94,081 | $ 96,542 | $ 97,887 |
| Loans and leases receivable, net | 49,105 | 58,874 | 67,218 | 61,309 | 57,121 |
| Securities: | | | | | |
| Available for sale | 25,874 | 18,567 | 19,599 | 28,775 | 36,103 |
| Federal Home Loan Bank stock | 174 | 177 | 429 | 340 | 388 |
| Deposits | 88,766 | 82,342 | 77,015 | 79,383 | 78,771 |
| FHLB advances & other borrowings | 0 | 2,000 | 6,000 | 5,000 | 5,190 |
| Stockholders' equity | 12,348 | 11,760 | 10,910 | 11,847 | 13,199 |

| | Year Ended June 30, | | | | |
|---|---|---|---|---|---|
| | 2020 | 2019 | 2018 | 2017 | 2016 |
| **KEY OPERATING DATA** | | | | | |
| Return on average assets | 0.32% | 0.49% | (0.57%) | (0.83%) | (1.38%) |
| Return on average equity | 2.73% | 4.34% | (5.22%) | (6.58%) | (9.61%) |
| Average equity to average assets | 11.79% | 11.38% | 10.98% | 12.64% | 14.40% |
| Dividend payout ratio | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| Number of full service offices | 4 | 4 | 4 | 4 | 4 |

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The following discussion and analysis is intended to assist you in understanding the consolidated financial condition and results of operations of The Southern Banc Company, Inc. and The Southern Bank Company (collectively, the "Company"), as of June 30, 2020 and June 30, 2019 and for the fiscal years ended June 30, 2020 and 2019. This discussion should be read in conjunction with the audited consolidated financial statements, accompanying footnotes and supplemental financial data included herein.*

### General

The principal business of the Bank consists of accepting deposits from the general public through the Bank's main and branch offices and investing those funds in loans secured by real estate properties and commercial and consumer loans located in the Bank's primary market area. In order to preserve liquidity, the Bank maintains a sizeable portfolio of investment and mortgage – backed securities. Substantially all of the Bank's mortgage-backed securities are guaranteed as to principal and interest by GNMA, Freddie Mac or Fannie Mae. The Bank's securities portfolio consists primarily of mortgage backed securities, government agency securities, including agency notes. See Note 2 of Notes to Consolidated Financial Statements. The Bank maintains a substantial amount in interest-bearing deposits in other banks, primarily interest-bearing accounts with the FHLB of Atlanta and BBVA Compass Bank, the Bank's correspondents.

In an effort to diversify the Company's loan and lease portfolio and to increase yield in the loan portfolio, the Company's management team and the Board of Directors developed and approved the Commercial Finance Division ("CFD") of The Southern Bank Company. This division was officially started in January 2011 and, along with the lease portfolio, generates significant revenues for the loan portfolio. The business of the CFD is to purchase accounts receivable, also known as factoring. See Note 1 Summary of Significant Accounting Policies and Note 3 Loans and Leases.

The Company's earnings are dependent primarily on the Bank's net interest income, which is the difference between interest income earned on its loans, securities portfolio, and income from factoring activities, and interest paid on customers' deposits and any other borrowings. See Note 1 of Summary of Significant Accounting Policies. The Company's earnings are also affected by the Bank's level of non-interest income, such as service charges on customers' deposit accounts, net gains or losses on the sale of securities, and other fees. In addition, earnings are affected by the level of non-interest expense, primarily consisting of compensation and employee benefit expense, data processing expense, professional service expense, office building and equipment expense, and other expenses.

The operations of the Company and the financial institution industry as a whole are significantly affected by prevailing economic conditions, competition and the monetary and fiscal policies of governmental agencies. Lending activities are influenced by the economy, the supply of housing, competition among lenders and the level of interest rates in the Bank's market area. The Bank's deposit flows and costs of funds are influenced by prevailing market rates of interest, primarily on competing investments, account maturities, and the levels of personal income and savings in the Bank's market area.

### Comparison of Financial Condition at June 30, 2020 and June 30, 2019

Total consolidated assets increased approximately $5.6 million, or 5.73%, from $97.7 million at June 30, 2019 to $103.3 million at June 30, 2020. During the year ended June 30, 2020, net loans decreased approximately $9.8 million, or 16.59%, from $58.9 million at June 30, 2019 to $49.1 million at June 30, 2020. The decrease in net loans was primarily attributable to pay-downs or payoffs of existing loans and leases coupled with fewer originations of new loans in 2020 due to the impact of COVID-19. Additionally, no new leases were acquired for the year ended June 30, 2020. For the fiscal year ended June 30, 2020, securities available for sale increased approximately $7.3 million, or 39.36%, from $18.6 million at June 30, 2019 to $25.9 million at June 30, 2020.

Cash and cash equivalents increased approximately $8.1 million, or 45.60%, from $17.7 million at June 30, 2019 to $25.8 million at June 30, 2020. The change in cash was primarily attributable to a decrease in loan and lease receivables of approximately $9.8 million, an increase in total deposits of approximately $6.4 million, offset in part by an increase in securities available for sale of approximately $7.3 million and a decrease in FHLB Advances of $2.0 million;

Accrued interest and dividends receivable increased approximately $31,000, or 16.15%, from approximately $193,000 at June 30, 2019 to $224,000 at June 30, 2020. This increase was primarily attributable to an increase in interest receivable in securities.

Total deposits increased approximately $6.4 million, or 7.80%, from approximately $82.3 million at June 30, 2019 to $88.7 million at June 30, 2020. FHLB advances decreased $2.0 million, or 100.00% from $2.0 million at June 30, 2019 to no FHLB advances at June 30, 2020. Other liabilities increased during the fiscal year ended June 30, 2020 by approximately $600,000, or 36.48%, from approximately $1.6 million at June 30, 2019 to $2.2 million at June 30, 2020. The increase in other liabilities was primarily attributable to an increase in factor client reserve.

Total consolidated equity increased approximately $588,000, or 5.00%, from approximately $11.8 million at June 30, 2019 to $12.3 million at June 30, 2020. This increase was primarily attributable to an increase in retained earnings of approximately $314,000 and accumulated other comprehensive income of approximately $302,000. No dividends were paid during the fiscal years ended June 30, 2010 and 2019.

**Results of Operation for the Years Ended June 30, 2020 and June 30, 2019**

The Company reported net income for the fiscal year ended June 30, 2020 of approximately $314,000 as compared to net income of approximately $465,000 for the fiscal year ended June 30, 2019. Net interest income after provision for loan and lease losses decreased approximately $331,000, or 7.28% for the fiscal year ended June 30, 2020 when compared to fiscal year 2019. This decrease was primarily attributable to a decrease in total interest income of approximately $106,000, or 1.93% and an increase in total interest expense of approximately $200,000 or 21.82%. During the fiscal year ended June 30, 2020, total interest and fees on loans decreased approximately $116,000 while total interest on deposits increased approximately $261,000, or 30.60%.

*Net Interest Income*. For the year ended June 30, 2020, net interest income before provision for loan and lease losses decreased approximately $306,000, or 6.70%, when compared to fiscal year ended 2019. This decrease was primarily attributable to an increase in the Bank's total interest expense of approximately $200,000, or 21.82% and a decrease in total interest income of approximately $106,000, or 1.93%. Interest income on securities available for sale decreased approximately $20,000, or 4.46% while other interest income increased approximately $30,000, or 14.64%. Total interest and fees on loans decreased approximately $116,000, or 2.40%.

*Provision for Loan and Lease Losses*. During the fiscal year ended June 30, 2020, the Company recorded a provision for loan and lease losses of approximately $44,000, as compared to approximately $20,000 for the fiscal year ended June 30, 2019. The provision increase was primarily attributable to an increase in impaired loans when compared to the prior year. The allowance for loan and lease losses is based on management's evaluation of possible loan and lease losses inherent in the Bank's loan portfolio. Management considers, among other factors, past loss experience, current economic conditions, volume, growth and composition of the loan portfolio, and other relevant factors.

*Other Income*. Other income increased approximately $225,000, or 132.30%, for the fiscal year ended June 30, 2020 when compared to fiscal year ended 2019. The increase in other income was primarily attributable to an increase in the sale of leased equipment of approximately $119,000, or 241.91% and an increase in net gains on the sale of securities available for sale of approximately $91,000.

*Other Expense*. Other expense increased approximately $98,000 or 2.41%, for the fiscal year ended June 30, 2020, when compared to fiscal year ended 2019. This increase was primarily attributable to increases in data processing expense of approximately $101,000, or 20.11%, offset by a decrease in other operating expense of approximately $30,000, or 5.55%.

*Provision (Benefit) for Income Taxes*. During the fiscal year ended June 30, 2020, the income tax provision decreased approximately $54,000, or 31.80%. This decrease was primarily attributable to the decrease in net income for the year. See Note 7 of Notes to Consolidated Financial Statements for reconciliation between the statutory tax rate and the effective tax rate.

**Asset/Liability Management**

Net interest income, the primary component of the Company's net income, is determined by the difference or "spread" between the yields earned on the Bank's interest-earning assets and the rates paid on its interest-bearing liabilities and the relative amounts of such assets and liabilities. Key components of a successful asset/liability strategy are the monitoring and managing of interest rate sensitivity on both the interest-earning assets and interest-bearing liabilities. The matching of the Bank's assets and liabilities may be analyzed by examining the extent to which its assets and liabilities are interest rate sensitive and by monitoring the expected effects of interest rate changes on an institution's net portfolio value.

An asset or liability is interest rate sensitive within a specific time period if it will mature or reprice within that time period. If the Bank's assets mature or reprice more quickly or to a greater extent than its liabilities, the Bank's net portfolio value and net interest income would tend to increase during periods of rising interest rates but decrease during periods of falling interest rates. If the Bank's assets mature or reprice more slowly or to a lesser extent than its liabilities, the Bank's net portfolio value and net interest income would tend to decrease during periods of rising interest rates but increase during periods of falling interest rates. The Bank's policy has been to seek to mitigate the interest rate risk inherent in business of originating long term loans funded by short term deposits by pursuing the following strategies: (i) the Bank has historically maintained substantial liquidity and capital levels to sustain unfavorable movements in market interest rates; and (ii) in order to minimize the adverse effect of interest rate risk on future operations, the Bank purchases adjustable- and fixed-rate securities with maturities of primarily 5 to 15 years and originates limited amounts of shorter term consumer loans.

The Bank measures its interest rate risk by computing estimated changes in the net interest income ("NII") of its cash flows from assets, liabilities and off-balance sheet items in the event of a range of assumed changes in market interest rates. These computations estimate the effect on the Bank's NII of sudden and sustained 100 basis point to 400 basis point increases and 100 basis point to 400 basis point decreases in market interest rates. The Bank's Board of Directors has adopted an interest rate risk policy which establishes maximum decreases in the Bank's estimated NII of 7.5%, 10%, 15% and 20% and maximum decreases of 7.5%, 10%, 15% and 20% in the event of 100, 200, 300 and 400 basis point increases and decreases in market interest rates, respectively. At June 30, 2020, based on the most recent available information, management estimated that the Bank's NII change from the base approximately 3.57%, 7.79%, 11.94%, and 16.20% in the event of an instantaneous and sustained 100, 200, 300 and 400 point increase and approximately 0.10%, (0.04%), (1.51%) and (2.88%) in the event of an instantaneous and sustained 100, 200, 300 and 400 point decrease.

These calculations indicate that the Bank's net interest income would increase in the event of an instantaneous and sustained rate increase whereas the economic value (long term sensitivity) of the Bank's equity would decrease in the event of instantaneous and sustained rate increases. These calculations indicate that the Bank's interest-earning assets would be expected to reprice more quickly than the Bank's interest-bearing liabilities.

Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates, prepayments and deposit run-offs and should not be relied upon as indicative of actual results. Certain shortcomings are inherent in such computations. Although certain assets and liabilities may have similar maturity or periods of repricing, they may react at different times and in different degrees to changes in the market interest rates. The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while rates on other types of assets and liabilities may lag behind changes in market interest rates. Certain assets, such as adjustable rate mortgages, generally have features which restrict changes in interest rates on a short-term basis and over the life of the asset. In the event of a change in interest rates, prepayments and early withdrawal levels could deviate significantly from those assumed in making calculations set forth above. Additionally, an increased credit risk may result, as the ability of many borrowers to service their debt may decrease in the event of an interest rate increase. Finally, virtually all of the adjustable rate loans in the Bank's portfolio contain conditions which restrict periodic changes in interest rates.

The Bank's Board of Directors is responsible for reviewing the Bank's asset and liability policies. On at least a quarterly basis, the Board reviews interest rate risk and trends, as well as liquidity and capital ratios and requirements. The Bank's management is responsible for administering the policies and determinations of the Board of Directors with respect to the Bank's asset and liability goals and strategies. Management expects that the Bank's asset and liability policies and strategies will continue as described above so long as competitive and regulatory conditions in the financial institution industry continue as they have in recent years.

**Contractual Obligations**

The following table sets forth the contractual obligations of the Bank as of June 30, 2020.

| | Less than One Year | One Year through Two Years | Two through Three Years | Over Three Years | Total |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| FHLB advances [1] | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 |
| Certificates of deposit [2] | 31,443 | 7,812 | 3,119 | 6,496 | 48,870 |
| Total | $ 31,443 | $ 7,812 | $ 3,119 | $ 6,496 | $ 48,870 |

(1) See Note 6 of Notes to Consolidated Financial Statements.
(2) See Note 5 of Notes to Consolidated Financial Statements.

## Average Balance, Interest and Average Yields and Rates

The following table sets forth certain information relating to the Company's average interest-earning assets and interest-bearing liabilities and reflects the average yield on assets and the average cost of liabilities for the periods and at the dates indicated. Such yields and costs are derived by dividing income or expense by the average monthly balance of assets or liabilities, respectively, for the periods indicated.

The table also presents information for the periods indicated with respect to the difference between the weighted average yield earned on interest-earning assets and the weighted average rate paid on interest-bearing liabilities, or "interest rate spread" which banks have traditionally used as an indicator of profitability. Another indicator of an institution's net interest income is its "net yield on interest-earning assets" which is its net interest income divided by the average balance of interest-earning assets. Net interest income is affected by the interest rate spread and by the relative amounts of interest-earning assets and interest-bearing liabilities. When interest-earning assets approximate or exceed interest-bearing liabilities, any positive interest rate spread will generate net interest income.

| | Years Ended June 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2020 | | | 2019 | | |
| | Average Balance | Interest | Average Yield/ Cost | Average Balance | Interest | Average Yield/ Cost |
| | (Dollars in thousands) | | | | | |
| Interest-earning assets: | | | | | | |
| Loans receivable | $ 58,721 | $ 4,715 | 8.03% | $ 65,231 | $ 4,831 | 7.41% |
| Securities | 18,624 | 427 | 2.29 | 18,792 | 447 | 2.38 |
| Other interest-earning assets | 18,042 | 234 | 1.30 | 8,296 | 204 | 2.46 |
| Total interest-earning assets | 95,388 | 5,376 | 5.64 | 92,319 | 5,482 | 5.94 |
| Non-interest-earning assets | 2,095 | | | 1,895 | | |
| Total assets | $ 97,483 | | | $ 94,214 | | |
| Interest-bearing liabilities: | | | | | | |
| Deposits | $ 75,595 | 1,114 | 1.47 | $ 71,398 | 853 | 1.19 |
| FHLB advances | 290 | 4 | 1.38 | 4,148 | 65 | 1.57 |
| Total interest-bearing liabilities | 75,885 | 1,118 | 1.47 | 75,546 | 918 | 1.22 |
| Non-interest-bearing liabilities | 10,109 | | | 7,944 | | |
| Total liabilities | 85,994 | | | 83,490 | | |
| Stockholders' equity | 11,489 | | | 10,724 | | |
| Total liabilities and equity | $ 97,483 | | | $ 94,214 | | |
| Net interest income | | $ 4,258 | | | $ 4,564 | |
| Interest rate spread | | | 4.16% | | | 4.72% |
| Net interest margin | | | 4.46% | | | 4.94% |
| Ratio of average interest-earning assets to average interest-bearing liabilities | | | 125.70% | | | 122.20% |

**Rate/Volume Analysis**

The table below sets forth certain information regarding changes in interest income and interest expense of the Company for the periods indicated. For each category of interest-earning asset and interest-bearing liability, information is provided on changes attributable to: (i) changes in volume (changes in volume multiplied by old rate) and (ii) changes in rates (changes in rate multiplied by old volume).

| | Year Ended June 30, 2020 vs. 2019 Increase (Decrease) Due to | | |
|---|---|---|---|
| | Rate | Volume | Total |
| | (In thousands) | | |
| Interest income | | | |
| Loans | $ 761 | $ (877) | $ (116) |
| Securities | 109 | (129) | (20) |
| Other interest-earning assets | 30 | 0 | 30 |
| Total interest-earning assets | 900 | (1006) | (106) |
| Interest expense | | | |
| Deposits | 196 | 65 | 261 |
| Interest on FHLB advances | 73 | (134) | (61) |
| Total interest-bearing liabilities | 269 | (69) | 200 |
| Change in net interest income | $ 631 | $ (937) | $ (306) |

**Liquidity and Capital Resources**

The Company conducts its business through its subsidiary, the Bank, which is required to maintain minimum levels of liquidity. The requirement, which varies from time to time depending upon economic conditions and deposit flows, is based upon a percentage of deposits and short-term borrowings. The Bank adjusts its liquidity levels in order to meet funding needs of deposit outflows, repayments of borrowings, and loan commitments. The Bank also adjusts liquidity as appropriate to meet its asset and liability management objectives.

The Bank's primary sources of funds are deposits, repayments of loans and mortgage-backed securities, maturities of investment securities and other investments. While scheduled principal repayments on loans and mortgage-backed securities are a relatively predictable source of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. The Bank invests, with the FHLB of Atlanta and other correspondent banks, in short-term interest-earning assets (e.g., Overnight Investments and Federal Funds Sold) that provide liquidity to meet lending requirements.

The Bank continues to maintain a high level of liquid assets in order to meet its funding requirements and compensating balance requirements of correspondent banks. At June 30, 2020, the Bank had approximately $42.0 million in on-balance sheet liquidity which represented 40.69% of total assets. The Bank's average liquidity ratio well exceeded the required minimum at and during the fiscal year ended June 30, 2020.

As of June 30, 2020, the Bank opted into the Community Bank Leverage Ratio ("CBLR") framework. At June 30, 2020, the Bank's CBLR ratio was 10.53% which exceeded all regulatory capital requirements under the CBLR framework and the Bank was considered to be "well-capitalized." See Note 12 of Notes to Consolidated Financial Statements.

**Commitments and Contingencies**

In the normal course of business, the Bank is a party to activities that contain credit, market and operational risks that are not reflected in the Company's Consolidated Financial Statements. The Bank provides customers with off-balance sheet credit support through loan commitments and lines of credit. Many of the commitments expire unused or are only partially used. Therefore, the total amount of commitments does not necessarily represent future cash demand requirements. The Company anticipates that the Bank will continue to have sufficient funds together with available borrowings to satisfy its commitments. As of June 30, 2020, the Bank had approximately $29.7 million of commitments to extend credit. See Note 10 of Notes to Consolidated Financial Statements.

## Critical Accounting Policy

The accounting principles followed by the Company and the methods of applying principles conform with accounting principles generally accepted in the United States and with general practices followed by the banking industry. The most critical accounting policy relates to the allowance for loan and lease losses.

The allowance for loan and lease losses is maintained at a level which management considers to be adequate to absorb losses inherent in the loan portfolio. Management's estimation of the amount of the allowance is based on a continuing evaluation of the loan portfolio and includes such factors as economic conditions, analysis of individual loans, overall portfolio characteristics, delinquencies and balance of any impaired loans (generally considered to be nonperforming loans, excluding residential mortgages and other homogeneous loans).

Management reviews the adequacy of the allowance for loan and lease losses on a continuous basis by assessing the quality of the loan portfolio and adjusting the allowance when appropriate. Management's evaluation of certain specifically identified loans includes a review of the financial condition and capacity of the borrower, the value of the collateral, current economic trends, historical losses, workout and collective arrangements, and possible concentrations of credit. The loan review process also includes a collective evaluation of credit quality within the mortgage and installment loan portfolios. In establishing the allowance, loss percentages are applied to groups of loans with similar risk characteristics. These loss percentages are determined by historical experience, portfolio mix, regulatory influence, and other economic factors. Each month this review is quantified in a report to management, which uses it to determine whether an appropriate allowance is being maintained. This report is then submitted to the Board of Directors monthly.

Changes in the allowance can result from changes in economic events or changes in the creditworthiness of borrowers. The effect of these changes is reflected when known. Though management believes the allowance for loan and lease losses to be adequate, ultimate losses may vary from estimations. Specific allowances for impaired loans are generally based on comparisons of the carrying values of the loans to the estimated fair value of the collateral. If our assumptions and judgments require modifications, our current allowance may not be sufficient, and adjustments may be necessary to allow for different economic conditions or adverse developments in our loan portfolio. Further, changes in market factors, such as interest rates or commodity prices, could lead to increases in the allowance. While management monitors these market dynamics carefully, adverse changes to these factors could be unforeseen by management and would result in higher levels of allowance and credit losses.

Impaired loans (generally considered to be nonperforming loans, excluding residential mortgages and other homogeneous loans) are measured based on the present value of expected future cash flows discounted at each loan's original effective interest rate. As a practical expedient, impairment is measured based on the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. When the measure of the impaired loan is less than the recorded investment of the loan, the impairment is recorded through a valuation allowance.

The Company ceases accrual of interest on a loan when payment on the loan is in excess of 90 days past due. Income is subsequently recognized only to the extent that cash payments are received until, in management's judgment, the borrower's ability to make periodic interest and principal payments has been reestablished, in which case the loan is returned to accrual status. In addition, bank regulators periodically review our allowance and may require us to increase our provision for credit losses or recognize further loan charge-offs.

## Forward-Looking Statements

Management's discussion and analysis includes certain forward-looking statements addressing, among other things, the impact of COVID-19 outbreak and measures taken in response, the Company's prospects for earnings, asset growth and net interest margin. Forward-looking statements are accompanied by, and identified with, such terms as "anticipates," "believes," "expects," "intends," and similar phrases. Management's expectations for the Company's future involve a number of assumptions and estimates. Factors that could cause actual results to differ from the expectations expressed herein include substantial changes in interest rates, changes in the general economy, and changes in the Bank's strategies for credit-risk management, interest-rate risk management and investment activities. Accordingly, any forward-looking statements included herein do not purport to be predictions of future events or circumstances and may not be realized.

## Risk Factors

In the course of conducting our business operations, we are exposed to a variety of risks, some of which are inherent in the financial services industry and others of which are more specific to our own businesses. Management considers a variety of risks together with other factors that might materially adversely affect our liquidity, cash flows, competitive position, business, reputation, results of operations or financial condition, including by materially increasing our expenses or decreasing our revenues. Additional factors that could affect our businesses, results of operations and financial condition are discussed herein. However, other factors could also adversely affect our businesses, results of operations and financial condition. Therefore, the risk factors identified should not be considered a complete list of potential risks that we may face.

# INDEPENDENT AUDITOR'S REPORT

**To the Board of Directors**
**The Southern Banc Company, Inc.**
**Gadsden, Alabama**

We have audited the accompanying consolidated financial statements of **The Southern Banc Company, Inc. and Subsidiaries**, which comprise the consolidated balance sheets as of June 30, 2020 and 2019, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated 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 accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of 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 auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 The Southern Banc Company, Inc. and Subsidiaries as of June 30, 2020 and 2019, and the results of their operations and their cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Mauldin & Jenkins, LLC

Birmingham, Alabama
October 9, 2020

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# THE SOUTHERN BANC COMPANY, INC.
# AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS
## JUNE 30, 2020 AND 2019

| Assets | 2020 | 2019 |
|---|---|---|
| Cash and due from banks | $ 2,730,922 | $ 2,485,171 |
| Interest-bearing deposits in banks | 20,625,220 | 14,800,917 |
| Federal funds sold | 2,410,000 | 410,000 |
| Total cash and cash equivalents | 25,766,142 | 17,696,088 |
| | | |
| Securities available for sale, at fair value | 25,874,339 | 18,566,761 |
| Federal Home Loan Bank stock | 174,000 | 176,600 |
| Loans and leases receivable, net of allowance for loan losses of $895,401 and $973,854, respectively | 49,105,437 | 58,874,068 |
| Accrued interest receivable | 223,583 | 192,493 |
| Property and equipment, net | 735,815 | 782,669 |
| Other assets | 1,422,779 | 1,415,991 |
| **Total assets** | $ 103,302,095 | $ 97,704,670 |
| **Liabilities and Stockholders' Equity** | | |
| Deposits | | |
| Noninterest-bearing | $ 10,402,407 | $ 7,232,436 |
| Interest-bearing | 78,363,627 | 75,109,234 |
| Total deposits | 88,766,034 | 82,341,670 |
| Other borrowings | - | 2,000,000 |
| Other liabilities | 2,187,913 | 1,603,050 |
| **Total liabilities** | 90,953,947 | 85,944,720 |
| | | |
| Commitments and contingencies | | |
| | | |
| Stockholders' equity | | |
| Preferred stock, par value $.01 per share, 500,000 shares authorized, no shares issued or outstanding | - | - |
| Common stock, par value $.01 per share, 3,500,000 shares authorized, 1,454,750 shares issued, 806,086 shares outstanding | 14,547 | 14,547 |
| Additional paid-in capital | 13,906,779 | 13,886,524 |
| Retained earnings | 7,591,830 | 7,277,810 |
| Shares held in trust, 44,506 and 39,260 shares at cost, respectively | (754,044) | (706,305) |
| Treasury stock, 648,664 shares at cost | (8,825,282) | (8,825,282) |
| Accumulated other comprehensive income | 414,318 | 112,656 |
| **Total stockholders' equity** | 12,348,148 | 11,759,950 |
| | | |
| **Total liabilities and stockholders' equity** | $ 103,302,095 | $ 97,704,670 |

**See Notes to Consolidated Financial Statements.**

# THE SOUTHERN BANC COMPANY, INC.
# AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS
## YEARS ENDED JUNE 30, 2020 AND 2019

| | 2020 | 2019 |
|---|---|---|
| **Interest income** | | |
| Loans, including fees | $ 4,715,493 | $ 4,831,228 |
| Securities available for sale | 427,132 | 447,050 |
| Other interest and dividends | 234,249 | 204,342 |
| **Total interest income** | 5,376,874 | 5,482,620 |
| **Interest expense** | | |
| Deposits | 1,113,808 | 852,812 |
| Other borrowings | 4,427 | 65,148 |
| **Total interest expense** | 1,118,235 | 917,960 |
| **Net interest income** | 4,258,639 | 4,564,660 |
| **Provision for loan losses** | 44,470 | 19,806 |
| **Net interest income after provision for loan losses** | 4,214,169 | 4,544,854 |
| **Other income** | | |
| Service charges and fees | 135,632 | 120,863 |
| Gain on sale of securities available for sale, net | 91,306 | - |
| Other income | 167,897 | 49,106 |
| **Total other income** | 394,835 | 169,969 |
| **Other expenses** | | |
| Salaries and employee benefits | 2,361,054 | 2,358,682 |
| Data processing | 604,814 | 503,540 |
| Professional services | 454,701 | 450,556 |
| Equipment and occupancy expenses | 253,577 | 233,205 |
| Other operating expenses | 505,496 | 535,221 |
| **Total other expenses** | 4,179,642 | 4,081,204 |
| **Income before income tax expense** | 429,362 | 633,619 |
| **Income tax expense** | 115,342 | 169,123 |
| **Net income** | $ 314,020 | $ 464,496 |
| **Income per share** | | |
| Basic | $ 0.41 | $ 0.61 |
| Diluted | $ 0.41 | $ 0.61 |
| **Average shares outstanding - basic and diluted** | 764,146 | 766,826 |

**See Notes to Consolidated Financial Statements.**

# THE SOUTHERN BANC COMPANY, INC.
# AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
## YEARS ENDED JUNE 30, 2020 AND 2019

| | 2020 | 2019 |
|---|---|---|
| **Net income** | **$ 314,020** | $ 464,496 |
| **Other comprehensive income:** | | |
| Unrealized holding gains on securities available for sale arising during period, net of tax of $129,729 and $135,608, respectively | **369,228** | 385,962 |
| Reclassification adjustment for gains included in net income, net of tax of $23,740 and $0, respectively | **(67,566)** | - |
| **Other comprehensive income** | **301,662** | 385,962 |
| **Comprehensive income** | **$ 615,682** | $ 850,458 |

**See Notes to Consolidated Financial Statements.**

# THE SOUTHERN BANC COMPANY, INC.
# AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
## YEARS ENDED JUNE 30, 2020 AND 2019

| | Common Stock | Additional Paid-in Capital | Retained Earnings | Shares Held in Trust | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| **Balance, June 30, 2018** | $ 14,547 | $ 13,886,524 | $ 6,813,314 | $ (706,305) | $ (8,825,282) | $ (273,306) | $ 10,909,492 |
| Net income | - | - | 464,496 | - | - | - | 464,496.00 |
| Other comprehensive income | - | - | - | - | - | 385,962 | 385,962 |
| **Balance, June 30, 2019** | 14,547 | 13,886,524 | 7,277,810 | (706,305) | (8,825,282) | 112,656 | 11,759,950 |
| Net income | - | - | 314,020 | - | - | - | 314,020 |
| Other comprehensive income | - | - | - | - | - | 301,662 | 301,662 |
| Stock option expense | - | 20,255 | - | - | - | - | 20,255 |
| Purchase of shares held in trust, $9.10 | - | - | - | (47,739) | - | - | (47,739) |
| **Balance, June 30, 2020** | $ 14,547 | $ 13,906,779 | $ 7,591,830 | $ (754,044) | $ (8,825,282) | $ 414,318 | $ 12,348,148 |

**See Notes to Consolidated Financial Statements.**

# THE SOUTHERN BANC COMPANY, INC.
# AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS
## YEARS ENDED JUNE 30, 2020 AND 2019

| | 2020 | 2019 |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| Net income | $ **314,020** | $ 464,496 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | **79,055** | 68,887 |
| Net amortization and accretion of securities | **68,711** | 56,069 |
| Provision for loan losses | **44,470** | 19,806 |
| Deferred income taxes | **115,342** | 169,123 |
| Stock option expense | **20,255** | - |
| Gain on sale of available for sale securities, net | **(91,306)** | - |
| Write down of other real estate owned | **-** | 4,518 |
| (Gain) loss on sale of other real estate owned | **5,288** | (1,310) |
| (Increase) decrease in interest receivable | **(31,090)** | 14,794 |
| Increase (decrease) in interest payable | **(1,960)** | 4,848 |
| Decrease in prepaid expenses | **19,468** | 51,955 |
| Net other operating activities | **480,834** | (459,410) |
| Net cash provided by operating activities | **1,023,087** | 393,776 |
| **INVESTING ACTIVITIES** | | |
| Purchase of securities available for sale | **(19,045,690)** | (1,371,878) |
| Proceeds from sales of securities available for sale | **6,830,329** | - |
| Proceeds from maturities and principal payments on securities available for sale | **5,338,030** | 2,869,735 |
| Redemption of Federal Home Loan Bank stock | **2,600** | 252,300 |
| Net decrease in loans and lease receivables | **9,570,272** | 10,089,947 |
| Proceeds from sales of other real estate owned | **7,002** | 64,510 |
| Purchase of property and equipment | **(32,201)** | (136,830) |
| Net cash provided by investing activities | **2,670,342** | 11,767,784 |
| **FINANCING ACTIVITIES** | | |
| Net increase in deposits | **6,424,364** | 5,326,985 |
| Repayment of other borrowings | **(2,000,000)** | (4,000,000) |
| Purchase of shares held in trust | **(47,739)** | - |
| Net cash provided by financing activities | **4,376,625** | 1,326,985 |
| Net increase in cash and cash equivalents | **8,070,054** | 13,488,545 |
| Cash and cash equivalents at beginning of year | **17,696,088** | 4,207,543 |
| Cash and cash equivalents at end of year | $ **25,766,142** | $ 17,696,088 |
| **SUPPLEMENTAL DISCLOSURE** | | |
| Cash paid during the year for: | | |
| Interest | $ **1,120,195** | $ 913,112 |
| **NONCASH TRANSACTIONS** | | |
| Transfer of loans to other real estate owned, net of internally financed sales | $ **153,888** | $ - |

**See Notes to Consolidated Financial Statements.**

## NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Nature of Business

The Southern Banc Company, Inc. (the "Company") was incorporated in the state of Delaware in May 1995 for the purpose of becoming a holding company to own all of the outstanding capital stock of The Southern Bank Company (the "Bank"), formerly First Federal Savings and Loan Association of Gadsden. Effective June 30, 2008, the Bank converted its charter from a federally chartered stock savings association to a commercial bank organized and existing under the laws of the state of Alabama.

The Bank is primarily engaged in the business of obtaining funds in the form of various deposit products and investing those funds in mortgage loans or single family real estate, commercial, and consumer loans. The Bank operates from its four offices in the northeast portion of Alabama and originates the majority of its loans in this market area. The Bank also operates a division that conducts accounts receivable management, or "factoring," of commercial accounts.

### Basis of Presentation and Accounting Estimates

The consolidated financial statements include the accounts of the Company and its two wholly-owned subsidiaries, the Bank and First Service Corporation. Significant intercompany transactions and balances have been eliminated in consolidation.

In preparing the financial statements in accordance with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the balance sheet date 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, the valuation of debt securities and deferred tax assets, other-than-temporary impairments of securities, and the fair value of financial instruments.

The Company has evaluated all transactions, events, and circumstances for consideration or disclosure through October 9, 2020, the date these financial statements were available to be issued, and has reflected or disclosed those items within the consolidated financial statements and related footnotes as deemed appropriate. As a result of the spread of the COVID-19 coronavirus, economic uncertainties have arisen which are likely to negatively impact the Company. The outbreak is disrupting supply chains and affecting production and sales across a range of industries. The extent of COVID-19's impact on the Company's operational and financial performance will depend on certain developments, including the duration and spread of the outbreak and the virus' impact on the Company's customers, employees and vendors. At this point, the extent to which COVID-19 may impact the Company's financial condition or results of operations remains uncertain.

### Cash and Cash Equivalents

For purposes of reporting consolidated cash flows, cash and cash equivalents include cash and balances due from banks, interest-bearing deposits in banks and federal funds sold. Cash flows from restricted equity securities, loans and lease receivables, and deposits are reported net.

The Bank maintains amounts due from banks which, at times, may exceed federally insured limits. The Bank has not experienced any losses in such accounts.

## NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Securities

All debt securities are classified as "available for sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the settlement date and are determined using the specific identification method.

The Company evaluates investment securities for other-than-temporary impairment ("OTTI") using relevant accounting guidance on a regular basis. 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 including an evaluation of credit ratings, (3) the impact of changes in market interest rates, (4) the intent of the Company to sell a security, and (5) whether it is more likely than not the Company will have to sell the security before recovery of its cost basis. If the Company intends to sell an impaired security, or if it is more likely than not the Company will have to sell the security before recovery of its cost basis, the Company records an other-than-temporary loss in an amount equal to the entire difference between fair value and amortized cost in earnings. Otherwise, only the credit portion of the estimated loss is recognized in earnings, with the other portion of the loss recognized in other comprehensive income.

### Restricted Equity Securities

The Company is required to maintain an investment in capital stock of the Federal Home Loan Bank of Atlanta (FHLB). Based on redemption provisions, the stock has no quoted market value and is carried at cost, which approximates fair value. At its discretion, the FHLB may declare dividends on the stock. Management reviews for impairment based on the ultimate recoverability of the cost basis in this stock.

### Loans and Leases Receivable

Loans and leases (collectively referred to as "loans") that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal balances less deferred fees and costs on originated loans and the allowance for loan losses. Interest income is accrued on the outstanding principal balance. Loan origination fees, net of certain direct origination costs, are deferred depending on the fee amount and/or the maturity of the loan, and recognized as an adjustment of the related loan yield over the life of the loan, using the straight line method without anticipating prepayments. Additionally, the Company engages in direct lease financing. The net investment in direct financing leases is the sum of all minimum lease payments and estimated residual values less unearned income.

The accrual of interest on loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due, or at the time the loan is 90 days past due, unless the loan is well-secured and in the process of collection. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal and interest is considered doubtful. All interest accrued but not collected for loans that are placed on nonaccrual is reversed against interest income and interest accrued on loans that are charged-off is reversed against interest income or charged to the allowance, unless management believes that the accrual of interest is recoverable through the liquidation of collateral. Interest income on nonaccrual loans is recognized on the cash basis, until the loans are returned to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and the loan has been performing according to the contractual terms generally for a period of not less than six months.

## NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Loans and Leases Receivable (Continued)

In an effort to diversify the Company's loan portfolio and to increase yield in the portfolio, the Company's management team and the Board of Directors developed and approved the Commercial Finance Division (CFD) of The Southern Bank Company. This division was officially started in January 2011. The business of the CFD is to purchase accounts receivable, a business also known as factoring. Factoring is a financial transaction whereby an outside company sells its accounts receivable to the Company, the factor, at a discount to obtain cash. The cash advance is a percentage of the invoice face value that the Company pays to the selling company upon submission. The Company records a reserve for the remainder of the total invoice amount held by the Company until the payment by the selling company's customer is made. Fees are the cost associated with the transaction that are deducted from the reserve prior to its being paid back to the seller. The interest charge fee is calculated based on the advanced amount outstanding multiplied by an agreed-upon interest rate.

### Allowance for Loan and Lease Losses

The allowance for loan and lease losses is established though a provision charged to earnings when losses are estimated to have occurred. Loan losses are charged against the allowance when the loss is recognized. Subsequent recoveries, if any, are credited to the allowance.

The allowance is an amount that management believes will be adequate to absorb estimated losses relating to specifically identified loans, as well as probable credit losses inherent in the balance of the loan portfolio. The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the uncollectibility of loans in light of historical experience, the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, current economic conditions that may affect the borrower's ability to pay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. This evaluation does not include the effects of expected losses on specific loans or groups of loans that are related to future events or expected changes in economic conditions. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses, and may require the Company to make changes to the allowance based on their judgment about information available to them at the time of their examinations.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established when the discounted cash flows, collateral value, or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. The qualitative factors considered by management include, among other factors, (1) changes in economic and business conditions; (2) changes in asset quality and foreclosure rates; (3) changes in loan portfolio volume; (4) the composition and concentrations of credit; (5) changes in collateral values in general; (6) the experience and ability of lending personnel and management; (7) effectiveness of the Company's loan policies, procedures and internal controls; and (8) the loan review system and oversight of the Board of Directors. An unallocated component may be maintained to cover uncertainties that could affect management's estimate of probable losses.

## NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Troubled Debt Restructurings

A loan is considered a troubled debt restructuring (TDR) based on individual facts and circumstances. The Company designates loan modifications as TDRs when for economic or legal reasons related to the borrower's financial difficulties, it grants a concession to the borrower that it would not otherwise consider. These concessions may include rate reductions, principal forgiveness, extension of maturity date and other actions intended to minimize potential losses.

In determining whether a borrower is experiencing financial difficulties, the Company considers if the borrower is in payment default or would be in payment default in the foreseeable future without the modification, the borrower declared or is in the process of declaring bankruptcy, the borrower's projected cash flows will not be sufficient to service any of its debt, or the borrower cannot obtain funds from sources other than the Company at a market rate for debt with similar risk characteristics.

In determining whether the Company has granted a concession, the Company assesses, if it does not expect to collect all amounts due, whether the current value of the collateral will satisfy the amounts owed, whether additional collateral or guarantees from the borrower will serve as adequate compensation for other terms of the restructuring, and whether the borrower otherwise has access to funds at a market rate for debt with similar risk characteristics.

### Property and Equipment

Land is carried at cost. Buildings and vault equipment are carried at cost less accumulated depreciation computed on the straight-line method over the estimated useful lives of the assets or the expected terms of the leases, if shorter. Expected terms include lease option periods to the extent that the exercise of such options is reasonably assured. Furniture, fixtures and other office equipment are carried at the cost less accumulated depreciation computed on either the straight-line or double-declining method over the estimated useful lives of the assets. Maintenance and repairs are expensed as incurred while major additions and improvements are capitalized. Gains and losses on dispositions are reflected in earnings/losses.

| Asset Category | Years |
|---|---|
| Buildings and improvements | 10-40 |
| Furniture and equipment | 5-20 |

### Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company - put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

## NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Other Real Estate Owned

Assets acquired through or in lieu of loan foreclosure are held for sale and are initially recorded at fair value less estimated costs to sell. Any write down to fair value at the time of transfer to other real estate owned is charged to the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less estimated costs to sell. Costs of improvements are capitalized, whereas costs relating to holding other real estate owned and any subsequent adjustments to the carrying value are expensed. The Company was carrying $141,598 and $0 in other real estate owned at June 30, 2020 and 2019, respectively. There was $0 of other real estate owned categorized as residential real estate at June 30, 2020 and 2019.

### Income Taxes

The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets may be reduced by deferred tax liabilities and a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

### Income Per Share

Basic income per share is computed by dividing net income by the weighted average number of shares of common stock outstanding. Common stock outstanding consists of issued shares less treasury stock and shares held in trust. Diluted income per share reflects additional potential common shares that would be outstanding if dilutive potential common shares are issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares consist of stock options. There are no dilutive shares of common stock at June 30, 2020 and 2019.

### Stock Compensation Plans

Stock compensation accounting guidance requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the grant date fair value of the equity or liability instruments issued. The stock compensation accounting guidance covers a wide range of share-based compensation arrangements including stock options and warrants, share appreciation rights, and employee share purchase plans.

The stock compensation accounting guidance requires that compensation cost for all stock awards be calculated and recognized over the employees' service period, generally defined as the vesting period. A Black-Scholes model is used to estimate the fair value of stock options.

## NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### 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, 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.

### Advertising Costs

Advertising costs consist of print and television media advertisements and promotional items and are expensed as incurred. Advertising costs totaled $119,489 and $102,614 during the years ended June 30, 2020 and 2019, respectively.

### Fair Value of Financial Instruments

Fair values of financial instruments are estimates using relevant market information and other assumptions, as more fully disclosed in Note 13. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

### Recent Accounting Pronouncements

Accounting Standards Codification (ASC) Topic 606, *Revenue from Contracts with Customers (ASC 606)*, provides guidance for reporting revenue from the Company's contracts to provide goods or services to customers. The guidance requires recognition of revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it expects to be entitled to receive in exchange for those goods or services recognized as performance obligations are satisfied.

The majority of revenue-generating transactions are excluded from the scope of ASC 606, including revenue generated from financial instruments, such as securities and loans. Revenue-generating transactions that are within the scope of ASC 606, classified within other income, are described as follows:

*Service Charges and Fees* – represent service fees for monthly activity and maintenance on customer accounts. Attributes can be transaction-based, item-based or time-based. Revenue is recognized when the Company's performance obligation is completed which is generally monthly for maintenance services or when a transaction is processed. Payment for such performance obligations are generally received at the time the performance obligations are satisfied.

*Gains and Losses from the Sale of Other Real Estate Owned* – the performance obligation in the sale of other real estate owned typically will be the delivery of control over the property to the buyer. If the Company is not providing the financing of the sale, the transaction price is typically identified in the purchase and sale agreement. However, if the Company provides seller financing, the Company must determine a transaction price, depending on if the sale contract is at market terms and taking into account the credit risk inherent in the arrangement.

The Company did not have an aggregate effect of modification resulting from adoption of ASC 606, and no financial statement line items were affected by this change in accounting standard.

## NOTE 2. SECURITIES

The amortized cost and fair value of securities are summarized as follows:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **Securities Available for Sale** | | | | |
| **June 30, 2020:** | | | | |
| **U.S. government agency securities** | **$ 1,149,345** | **$ 100,161** | **$ -** | **$ 1,249,506** |
| **Mortgage-backed securities** | **13,733,561** | **378,863** | **(11,053)** | **14,101,371** |
| **Corporate bonds** | **751,096** | **10,187** | **-** | **761,283** |
| **State and municipal securities** | **9,680,447** | **83,653** | **(1,921)** | **9,762,179** |
| | **$ 25,314,449** | **$ 572,864** | **$ (12,974)** | **$ 25,874,339** |
| June 30, 2019: | | | | |
| U.S. government agency securities | $ 2,298,620 | $ 57,737 | $ (1,217) | $ 2,355,140 |
| Mortgage-backed securities | 14,456,187 | 102,302 | (25,590) | 14,532,899 |
| Corporate bonds | 1,009,715 | 5,580 | (2,427) | 1,012,868 |
| State and municipal securities | 650,000 | 15,854 | - | 665,854 |
| | $ 18,414,522 | $ 181,473 | $ (29,234) | $ 18,566,761 |

The amortized cost and fair value of securities as of June 30, 2020 by contractual maturity are shown below. Actual maturities may differ from contractual maturities in mortgage-backed securities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Therefore, these securities are not presented by maturity category in the following summary:

| | Securities Available for Sale | |
|---|---|---|
| | Amortized Cost | Fair Value |
| Due in one year or less | $ 574,810 | $ 576,653 |
| Due from one to five years | 2,966,318 | 3,091,074 |
| Due from five to ten years | 7,034,791 | 7,099,081 |
| Due in over ten years | 1,004,969 | 1,006,160 |
| Mortgage-backed securities | 13,733,561 | 14,101,371 |
| | $ 25,314,449 | $ 25,874,339 |

Securities with a carrying value of $10,266,137 and $15,586,478 at June 30, 2020 and 2019, respectively, were pledged to secure public deposits and for other purposes as required or permitted by law.

Gains and losses on sales of securities consist of the following:

| | Years Ended June 30, | |
|---|---|---|
| | **2020** | 2019 |
| Gross gains | **$ 91,306** | $ - |
| Gross losses | **-** | - |
| Net realized gain | **$ 91,306** | $ - |

## NOTE 2. SECURITIES (Continued)

### Temporarily Impaired Securities

The following table shows the gross unrealized losses and fair value of the Company's securities with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2020 and 2019:

| | Less Than Twelve Months | | Over Twelve Months | | |
|---|---|---|---|---|---|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Total Unrealized Losses |
| **June 30, 2020:** | | | | | |
| **Mortgage-backed securities** | **$ 2,360,460** | **$ (11,053)** | **$ -** | **$ -** | **$ (11,053)** |
| **State and municipal securities** | **1,155,453** | **(1,921)** | **-** | **-** | **(1,921)** |
| **Total temporarily impaired securities** | **$ 3,515,913** | **$ (12,974)** | **$ -** | **$ -** | **$ (12,974)** |
| June 30, 2019: | | | | | |
| U.S. government agency securities | $ - | $ - | $ 998,783 | $ (1,217) | $ (1,217) |
| Mortgage-backed securities | - | - | 4,552,894 | (25,590) | (25,590) |
| Corporate bonds | - | - | 757,288 | (2,427) | (2,427) |
| Total temporarily impaired securities | $ - | $ - | $ 6,308,965 | $ (29,234) | $ (29,234) |

The unrealized losses on five investments were caused by interest rate changes. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at June 30, 2020.

### Other-Than-Temporary Impairment

Upon acquisition of a security, the Company evaluates for impairment under the accounting guidance for investments in debt and equity securities. The Company routinely conducts periodic reviews to identify and evaluate each investment security to determine whether an other-than-temporary impairment has occurred. Factors included in the evaluation process may include geographic concentrations, credit ratings, and other performance indicators of the underlying asset. As of June 30, 2020 and 2019, no securities within the Company's investment securities portfolio were considered other-than-temporarily impaired.

## NOTE 3. LOANS AND LEASES RECEIVABLES

### Portfolio Segments and Classes

The composition of loans and leases is summarized as follows:

| | June 30, 2020 | June 30, 2019 |
|---|---|---|
| Real estate mortgages: | | |
| Construction and development | **$ 4,113,179** | $ 6,249,383 |
| 1-4 family first mortgages | **7,104,201** | 8,031,719 |
| Commercial | **14,428,028** | 16,663,629 |
| Other | **7,621,603** | 5,861,342 |
| Commercial, financial, and agricultural | **11,155,235** | 13,816,012 |
| Commercial lease financing | **4,736,896** | 7,751,192 |
| Consumer and other | **899,168** | 1,493,757 |
| | **50,058,310** | 59,867,034 |
| Net deferred loan fees | **(57,472)** | (19,112) |
| Allowance for loan losses | **(895,401)** | (973,854) |
| Loans, net | **$ 49,105,437** | $ 58,874,068 |

For purposes of the disclosures required pursuant to ASC 310, the loan portfolio was disaggregated into segments and then further disaggregated into classes for certain disclosures. A portfolio segment is defined as the level at which an entity develops and documents a systematic method for determining its allowance for loan losses. There are three loan portfolio segments that include real estate, commercial, and consumer. A class is generally determined based on the initial measurement attribute, risk characteristic of the loan, and the Company's method for monitoring and assessing credit risk. Classes within the real estate portfolio segment include construction and development loans, 1-4 family first mortgages, commercial real estate loans, and other real estate loans. The classes of the commercial portfolio segment include non-real estate commercial, financial, and agricultural loans, along with commercial lease financing. Consumer loans have not been further segregated by class.

The following describe risk characteristics relevant to each of the portfolio segments and classes:

**Real estate** - As discussed below, the Company offers various types of real estate loan products. All loans within this portfolio segment are particularly sensitive to the valuation of real estate:

- Construction and development loans are repaid through cash flow related to the operations, sale or refinance of the underlying property. This portfolio class includes extensions of credit to real estate developers or investors where repayment is dependent on the sale of the real estate or income generated from the real estate collateral.
- 1-4 family first mortgage loans are repaid by various means such as a borrower's income, sale of the property, or rental income derived from the property.
- Commercial real estate mortgage loans include both owner-occupied commercial real estate loans and other commercial real estate loans such as commercial loans secured by income producing properties. Owner-occupied commercial real estate loans made to operating businesses are long-term financing of land and buildings and are repaid by cash flows generated from business operations. Real estate loans for income-producing properties such as office and industrial buildings and retail shopping centers are repaid from rent income derived from the properties.
- Other real estate mortgage loans include home equity lines of credit, loans secured by farmland and multi-family residential loans. These are repaid by various means such as a borrower's income, sale of the property, or rental income derived from the property.

## NOTE 3. LOANS AND LEASES RECEIVABLES (Continued)

### Portfolio Segments and Classes (Continued)

**Commercial** - The commercial loan portfolio segment includes commercial, financial, and agricultural loans. These loans include those loans to commercial customers for use in normal business operations to finance working capital needs, equipment purchases, or expansion projects. Loans are repaid by business cash flows. Collection risk in this portfolio is driven by the creditworthiness of the underlying borrower, particularly cash flows from the borrowers' business operations. Lease financing is also included in the commercial loan portfolio segment and is different in form from a loan; however, the basic considerations are similar: cash flow, capacity, credit history, management and projections of future operations.

**Consumer and other** - The consumer loan portfolio segment includes direct consumer installment loans, overdrafts and other revolving credit loans. Loans in this portfolio are sensitive to unemployment and other key consumer economic measures.

### Credit Risk Management

Senior management and loan officers are involved in the credit risk management process and assess the accuracy of risk ratings, the quality of the portfolio and the estimation of inherent credit losses in the loan portfolio. This comprehensive process also assists in the prompt identification of problem credits. The Company has taken a number of measures to manage the portfolios and reduce risk, particularly in the more problematic portfolios.

The Company employs a credit risk management process with defined policies, accountability and routine reporting to manage credit risk in the loan portfolio segments. Credit risk management is guided by a comprehensive Loan Policy that provides for a consistent and prudent approach to underwriting and approvals of credits. Within the Board approved Loan Policy, procedures exist that elevate the approval requirements as credits become larger and more complex. All loans are individually underwritten, risk-rated, approved, and monitored.

Responsibility and accountability for adherence to underwriting policies and accurate risk ratings lies in each portfolio segment. For the consumer portfolio segment, the risk management process focuses on managing customers who become delinquent in their payments. For the commercial and real estate portfolio segments, the risk management process focuses on underwriting new business and, on an ongoing basis, monitoring the credit quality of the portfolios. To ensure problem credits are identified on a timely basis, portfolio reviews are conducted to assess the larger adversely rated credits for proper risk rating and accrual status.

Credit quality and trends in the loan portfolio segments are measured and monitored regularly. Detailed reports, by product, collateral, accrual status, etc., are reviewed by the Chief Executive Officer, Officers Loan Committee, and Directors Loan Committee.

The following risk grade categories are utilized by management to analyze and manage the credit quality and risk of the loan portfolio:

- **Pass** - includes obligations where the probability of default is considered low.
- **Special Mention** - includes obligations that exhibit potential credit weaknesses or downward trends deserving management's close attention. If left uncorrected, these potential weaknesses may result in the deterioration of the repayment prospects or credit position at a future date. These loans are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification.

## NOTE 3. LOANS AND LEASES RECEIVABLES (Continued)

### Credit Risk Management (Continued)

- **Substandard** - includes obligations with defined weaknesses that jeopardize the orderly liquidation of debt. A substandard loan is inadequately protected by the current sound worth and paying capacity of the borrower or by the collateral pledged, if any. Normal repayment from the borrower is in jeopardy although no loss of principal is envisioned. There is a distinct possibility that a partial loss of interest and/or principal will occur if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual loans classified substandard.
- **Doubtful** - includes obligations with all the weaknesses found in substandard loans with the added provision that the weaknesses make collection of debt in full, based on current existing facts, conditions, and values, highly questionable and improbable. Serious problems exist to the point where partial loss of principal is likely. The possibility of loss is extremely high, but because of certain important, reasonably specific pending factors that may work to strengthen the loan, the classification of "Loss" is deferred until a more exact status may be determined.
- **Loss** - includes obligations incapable of repayment or unsecured debt. Such loans are considered uncollectible and of such little value, that continuance as an active asset is not warranted. Loans determined to be a loss are charged-off at the date of loss determination. There are no loans with a loss rating in the Company's portfolio as of June 30, 2020 and 2019.

The following tables summarize the risk categories, as defined above, of the Company's loan portfolio based upon the most recent analysis performed as of June 30, 2020 and 2019:

| | Pass | Special Mention | Substandard | Doubtful | Total |
|---|---|---|---|---|---|
| **June 30, 2020** | | | | | |
| **Real estate mortgages:** | | | | | |
| **Construction and development** | **$ 3,660,172** | **$ 321,000** | **$ 132,007** | **$ -** | **$ 4,113,179** |
| **1-4 family first mortgages** | **6,927,340** | **-** | **176,861** | **-** | **7,104,201** |
| **Commercial** | **13,746,909** | **377,852** | **303,267** | **-** | **14,428,028** |
| **Other** | **7,527,990** | **-** | **-** | **93,613** | **7,621,603** |
| **Commercial, financial, and agricultural** | **11,147,448** | **-** | **7,787** | **-** | **11,155,235** |
| **Commercial lease financing** | **4,736,896** | **-** | **-** | **-** | **4,736,896** |
| **Consumer and other** | **899,168** | **-** | **-** | **-** | **899,168** |
| **Total:** | **$ 48,645,923** | **$ 698,852** | **$ 619,922** | **$ 93,613** | **$ 50,058,310** |
| June 30, 2019 | | | | | |
| Real estate mortgages: | | | | | |
| Construction and development | $ 6,101,116 | $ - | $ 148,267 | $ - | $ 6,249,383 |
| 1-4 family first mortgages | 8,004,114 | - | 27,605 | - | 8,031,719 |
| Commercial | 15,900,184 | 386,701 | 376,744 | - | 16,663,629 |
| Other | 5,861,342 | - | - | - | 5,861,342 |
| Commercial, financial, and agricultural | 13,378,947 | 3,397 | 433,668 | - | 13,816,012 |
| Commercial lease financing | 7,751,192 | - | - | - | 7,751,192 |
| Consumer and other | 1,489,773 | 414 | 3,570 | - | 1,493,757 |
| Total: | $ 58,486,668 | $ 390,512 | $ 989,854 | $ - | $ 59,867,034 |

## NOTE 3. LOANS AND LEASES RECEIVABLES (Continued)

### Past Due Loans

A loan is considered past due if any required principal and interest payments have not been received as of the date such payments were required to be made under the terms of the loan agreement. Generally, the Company places loans on nonaccrual when there is a clear indication that the borrower's cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. The following tables present the aging of the recorded investment in loans and leases as of June 30, 2020 and 2019:

| | | Past Due Status (Accruing Loans and Leases) | | | | | |
|---|---|---|---|---|---|---|---|
| | **Current** | **30-59 Days** | **60-89 Days** | **90+ Days** | **Total Past Due** | **Nonaccrual** | **Total** |
| **June 30, 2020** | | | | | | | |
| **Real estate mortgages:** | | | | | | | |
| **Construction and development** | **$ 3,729,011** | **$ 321,000** | **$ -** | **$ -** | **$ 321,000** | **$ 63,168** | **$ 4,113,179** |
| **1-4 family first mortgages** | **6,918,862** | **-** | **8,478** | **-** | **8,478** | **176,861** | **7,104,201** |
| **Commercial** | **13,386,590** | **-** | **-** | **-** | **-** | **1,041,438** | **14,428,028** |
| **Other** | **7,527,990** | **-** | **-** | **-** | **-** | **93,613** | **7,621,603** |
| **Commercial, financial, and agricultural** | **10,004,248** | **1,143,200** | **-** | **-** | **1,143,200** | **7,787** | **11,155,235** |
| **Commercial lease financing** | **4,381,474** | **143,785** | **141,804** | **-** | **285,589** | **69,833** | **4,736,896** |
| **Consumer and other** | **897,662** | **1,506** | **-** | **-** | **1,506** | **-** | **899,168** |
| **Total:** | **$ 46,845,837** | **$ 1,609,491** | **$ 150,282** | **$ -** | **$ 1,759,773** | **$ 1,452,700** | **$ 50,058,310** |
| June 30, 2019 | | | | | | | |
| Real estate mortgages: | | | | | | | |
| Construction and development | $ 6,172,284 | $ - | $ - | $ - | $ - | $ 77,099 | $ 6,249,383 |
| 1-4 family first mortgages | 7,990,728 | 13,386 | - | - | 13,386 | 27,605 | 8,031,719 |
| Commercial | 15,715,131 | 92,438 | - | - | 92,438 | 856,060 | 16,663,629 |
| Other | 5,764,646 | 96,696 | - | - | 96,696 | - | 5,861,342 |
| Commercial, financial, and agricultural | 12,783,221 | 683,122 | - | - | 683,122 | 349,669 | 13,816,012 |
| Commercial lease financing | 7,739,327 | 4,200 | 7,665 | - | 11,865 | - | 7,751,192 |
| Consumer and other | 1,487,237 | 2,950 | - | - | 2,950 | 3,570 | 1,493,757 |
| Total: | $ 57,652,574 | $ 892,792 | $ 7,665 | $ - | $ 900,457 | $ 1,314,003 | $ 59,867,034 |

## NOTE 3. LOANS AND LEASES RECEIVABLES (Continued)

### Allowance for Loan and Lease Losses

The following tables detail activity in the allowance for loan and lease losses by portfolio segment for the years ended June 30, 2020 and 2019. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

| | Real Estate | Commercial | Consumer | Total |
|---|---|---|---|---|
| **June 30, 2020** | | | | |
| **Allowance for loan losses:** | | | | |
| **Beginning balance** | **$ 174,108** | **$ 790,327** | **$ 9,419** | **$ 973,854** |
| **Loans charged-off** | **-** | **(119,944)** | **(3,095)** | **(123,039)** |
| **Recoveries of loans previously charged-off** | **-** | **34** | **82** | **116** |
| **Provision (credit) for loan losses** | **194,711** | **(156,812)** | **6,571** | **44,470** |
| **Ending balance** | **$ 368,819** | **$ 513,605** | **$ 12,977** | **$ 895,401** |
| **Ending balance – individually evaluated for impairment** | **$ 74,971** | **$ 46,844** | **$ -** | **$ 121,815** |
| **Ending balance – collectively evaluated for impairment** | **293,848** | **466,761** | **12,977** | **773,586** |
| **Total ending balance** | **$ 368,819** | **$ 513,605** | **$ 12,977** | **$ 895,401** |
| **Loans:** | | | | |
| **Ending balance – individually evaluated for impairment** | **$ 612,327** | **$ 142,131** | **$ -** | **$ 754,458** |
| **Ending balance – collectively evaluated for impairment** | **32,654,684** | **15,750,000** | **899,168** | **49,303,852** |
| **Total ending balance** | **$ 33,267,011** | **$ 15,892,131** | **$ 899,168** | **$ 50,058,310** |
| June 30, 2019 | | | | |
| Allowance for loan losses: | | | | |
| Beginning balance | $ 235,921 | $ 840,252 | $ 17,214 | $ 1,093,387 |
| Loans charged-off | (4,518) | (134,672) | (5,090) | (144,280) |
| Recoveries of loans previously charged-off | - | 4,568 | 373 | 4,941 |
| Provision (credit) for loan losses | (57,295) | 80,179 | (3,078) | 19,806 |
| Ending balance | $ 174,108 | $ 790,327 | $ 9,419 | $ 973,854 |
| Ending balance – individually evaluated for impairment | $ 96,335 | $ 188,730 | $ - | $ 285,065 |
| Ending balance – collectively evaluated for impairment | 77,773 | 601,597 | 9,419 | 688,789 |
| Total ending balance | $ 174,108 | $ 790,327 | $ 9,419 | $ 973,854 |
| Loans: | | | | |
| Ending balance – individually evaluated for impairment | $ 1,104,717 | $ 720,962 | $ - | $ 1,825,679 |
| Ending balance – collectively evaluated for impairment | 35,701,356 | 20,846,242 | 1,493,757 | 58,041,355 |
| Total ending balance | $ 36,806,073 | $ 21,567,204 | $ 1,493,757 | $ 59,867,034 |

## NOTE 3. LOANS AND LEASES RECEIVABLES (Continued)

### Impaired Loans

A loan held for investment is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due (both principal and interest) according to the terms of the loan agreement. The following tables detail impaired loans, by portfolio class as of June 30, 2020 and 2019:

| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| **June 30, 2020** | | | | | |
| **With no related allowance recorded:** | | | | | |
| **Real estate mortgages:** | | | | | |
| **Construction and development** | **$ 68,839** | **$ 68,839** | **$ -** | **$ 69,225** | **$ 4,260** |
| **1-4 family first mortgages** | **-** | **-** | **-** | **-** | **-** |
| **Commercial** | **386,707** | **386,707** | **-** | **424,592** | **49,340** |
| **Other** | **-** | **-** | **-** | **-** | **-** |
| **Commercial, financial, and agricultural** | **7,787** | **7,787** | **-** | **25,061** | **3,274** |
| **Commercial lease financing** | **-** | **-** | **-** | **-** | **-** |
| **Consumer and other** | **-** | **-** | **-** | **-** | **-** |
| **Total with no related allowance recorded** | **463,333** | **463,333** | **-** | **518,879** | **56,874** |
| **With an allowance recorded:** | | | | | |
| **Real estate mortgages:** | | | | | |
| **Construction and development** | **63,168** | **63,168** | **19,168** | **67,699** | **8,243** |
| **1-4 family first mortgages** | **-** | **-** | **-** | **-** | **-** |
| **Commercial** | **-** | **-** | **-** | **-** | **-** |
| **Other** | **93,613** | **93,613** | **55,803** | **94,532** | **3,818** |
| **Commercial, financial, and agricultural** | **134,344** | **134,344** | **46,844** | **144,721** | **10,405** |
| **Commercial lease financing** | **-** | **-** | **-** | **-** | **-** |
| **Consumer and other** | **-** | **-** | **-** | **-** | **-** |
| **Total with an allowance recorded** | **291,125** | **291,125** | **121,815** | **306,952** | **22,466** |
| **Total impaired loans:** | **$ 754,458** | **$ 754,458** | **$ 121,815** | **$ 825,831** | **$ 79,340** |
| June 30, 2019 | | | | | |
| With no related allowance recorded: | | | | | |
| Real estate mortgages: | | | | | |
| Construction and development | $ 296,168 | $ 296,168 | $ - | $ 297,566 | $ 14,222 |
| 1-4 family first mortgages | - | - | - | - | - |
| Commercial | 571,754 | 571,754 | - | 611,744 | 57,710 |
| Other | - | - | - | - | - |
| Commercial, financial, and agricultural | 418,295 | 418,295 | - | 595,281 | 46,387 |
| Commercial lease financing | - | - | - | - | - |
| Consumer and other | - | - | - | - | - |
| Total with no related allowance recorded | 1,286,217 | 1,286,217 | - | 1,504,591 | 118,319 |
| With an allowance recorded: | | | | | |
| Real estate mortgages: | | | | | |
| Construction and development | 140,099 | 140,099 | 37,449 | 148,860 | 7,650 |
| 1-4 family first mortgages | - | - | - | - | - |
| Commercial | - | - | - | - | - |
| Other | 96,696 | 96,696 | 58,886 | 96,696 | 4,222 |
| Commercial, financial, and agricultural | 139,296 | 139,296 | 51,796 | 144,160 | 2,713 |
| Commercial lease financing | 163,371 | 163,371 | 136,934 | 169,690 | - |
| Consumer and other | - | - | - | - | - |
| Total with an allowance recorded | 539,462 | 539,462 | 285,065 | 559,406 | 14,585 |
| Total impaired loans: | $ 1,825,679 | $ 1,825,679 | $ 285,065 | $ 2,063,997 | $ 132,904 |

## NOTE 3. LOANS AND LEASES RECEIVABLES (Continued)

### Troubled Debt Restructurings

The restructuring of a loan is considered a troubled debt restructuring (TDR) if both (i) the borrower is experiencing financial difficulties and (ii) the Company has granted a concession. Concessions may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses. There was one real estate construction loan classified as a troubled debt restructuring in the amount of $77,099, which was restructured during the twelve months ended June 30, 2019. There were no new TDRs restructured during the twelve months ended June 30, 2020. At June 30, 2020 and 2019, the Company had TDRs totaling $70,955 and $145,726, respectively. There was one real estate construction loan classified as a TDR in the amount of $77,099 that defaulted on the modified terms during the twelve months ended June 30, 2019. No loans classified as TDR defaulted on the modified terms during the twelve months ended June 30, 2020.

### Related Party Loans

In the ordinary course of business, the Company has granted loans to certain related parties, including directors, executive officers and their affiliates. The interest rates on these loans were substantially the same as rates prevailing at the time of the transaction and repayment terms are customary for the type of loan. Changes in related party loans are as follows:

| | Years Ended June 30, | |
|---|---|---|
| | **2020** | 2019 |
| Balance, beginning of year | **$ 368,209** | $ 398,408 |
| Change in related | **(25,598)** | - |
| Advances | **204,008** | 168,934 |
| Repayments | **(122,732)** | (199,133) |
| Balance, end of year | **$ 423,887** | $ 368,209 |

## NOTE 4. PROPERTY AND EQUIPMENT

Premises and equipment are summarized as follows:

| | June 30, | |
|---|---|---|
| | **2020** | 2019 |
| Land | **$ 415,486** | $ 415,486 |
| Building and improvements | **1,091,977** | 1,073,998 |
| Furniture and equipment | **776,940** | 764,648 |
| | **2,284,403** | 2,254,132 |
| Accumulated depreciation | **(1,548,588)** | (1,471,463) |
| | **$ 735,815** | $ 782,669 |

## NOTE 4. PROPERTY AND EQUIPMENT (Continued)

### Leases

The Company leases its banking facility in Birmingham, Alabama under operating lease agreements from unrelated entities. The Birmingham office lease term is 3 years. Monthly payments will increase by 3% at each anniversary date.

Future minimum lease payments on the leases described above are summarized as follows:

| | |
|---|---|
| 2021 (time frame 7/01/20 – 6/30/21) | $ 5,457 |

Rental expense, which includes expenses for facilities and equipment, included in the statements of operations for the years ended June 30, 2020 and 2019 is $44,581 and $43,632, respectively.

## NOTE 5. DEPOSITS

The major classifications of deposits are as follows:

| | June 30, | |
|---|---|---|
| | **2020** | 2019 |
| Noninterest-bearing demand | **$ 10,402,407** | $ 7,232,436 |
| Interest-bearing demand | **25,170,226** | 21,726,979 |
| Savings | **4,323,889** | 3,632,614 |
| Time deposits of $250,000 or more | **9,868,239** | 9,480,282 |
| Other time deposits | **39,001,273** | 40,269,359 |
| | **$ 88,766,034** | $ 82,341,670 |

The scheduled maturities of time deposits at June 30, 2020 are as follows, (all maturities are presented on a fiscal year basis, i.e. 07/01/20 – 06/30/21 for 2021):

| | |
|---|---|
| 2021 | $ 31,442,615 |
| 2022 | 7,811,485 |
| 2023 | 3,119,338 |
| 2024 | 3,520,635 |
| 2025 | 2,975,439 |
| | $ 48,869,512 |

At June 30, 2020 and 2019, overdraft deposits reclassified to loans totaled $11,981 and $3,183, respectively. Deposits from related parties held by the Bank at June 30, 2020 and 2019 amounted to $647,396 and $1,813,351, respectively.

## NOTE 6. OTHER BORROWINGS

The Company owed the Federal Home Loan Bank of Atlanta on the following advances as of June 30, 2020 and 2019:

| Maturity Date | Interest rate | 2020 | 2019 |
|---|---|---|---|
| August 2019 | 1.57% | - | 2,000,000 |
| **Total** | | **$ -** | $ 2,000,000 |

The Federal Home Loan Bank advances were secured by pledged securities with a carrying value of $11,568,019 at June 30, 2019. Advances were paid off during 2019.

At June 30, 2020, the Company had accommodations which allow the purchase of federal funds from several correspondent banks on an overnight basis at prevailing overnight market rates. These accommodations are subject to various restrictions as to their term and availability, and in most cases, must be repaid in less than a month. At June 30, 2020 and 2019, the Company had $0 outstanding under these arrangements. The Company may borrow up to $4,000,000 under these arrangements as of June 30, 2020.

## NOTE 7. INCOME TAXES

Income tax expense consists of the following:

| | **Years Ended June 30,** | |
|---|---|---|
| | **2020** | 2019 |
| Current | **$ -** | $ - |
| Deferred | **115,342** | 169,123 |
| Income tax expense | **$ 115,342** | $ 169,123 |

The Company's income tax differs from the amounts computed by applying the federal income tax statutory rate to income before income taxes. A reconciliation of the differences is as follows:

| | **Years Ended June 30,** | |
|---|---|---|
| | **2020** | 2019 |
| Pretax income tax expense at federal statutory rate | **$ 90,166** | $ 133,060 |
| State income tax expense, net of federal tax benefits | **23,193** | 33,428 |
| Other, net | **1,983** | 2,635 |
| Income tax expense | **$ 115,342** | $ 169,123 |

## NOTE 7. INCOME TAXES (Continued)

The components of deferred income taxes are as follows:

| | June 30, 2020 | June 30, 2019 |
|---|---|---|
| Deferred income tax assets: | | |
| Allowance for loan losses | **$ 234,013** | $ 254,516 |
| Net operating loss (NOL) carryforward | **838,335** | 939,227 |
| Depreciation | **22,477** | 40,441 |
| Deferred loan fees and costs, net | **15,020** | 4,995 |
| Other | **5,294** | - |
| | **1,115,139** | 1,239,179 |
| Deferred income tax liabilities: | | |
| Accretion of discount on securities | **(26,715)** | (34,597) |
| Unrealized gain on securities for sale, net | **(145,571)** | (39,582) |
| Other | **-** | (816) |
| | **(172,286)** | (74,995) |
| Net deferred income tax assets | **$ 942,853** | $ 1,164,184 |

Realization of deferred tax assets association with the NOL carryforwards and reversal of other temporary differences is dependent upon generating sufficient taxable income prior to the expiration of the NOL carryforwards. Management believes that no valuation allowance is necessary at June 30, 2020 and 2019 given the current estimates of future taxable income. The gross federal net operating loss carryforwards totaled approximately $3,295,000 at June 30, 2020. The federal net operating loss carryforward will begin expiring in tax year 2033.

The Company and its subsidiaries are subject to U.S. federal income tax, as well as income tax within the State of Alabama. The Company is no longer subject to examination by taxing authorities for years before 2017.

## NOTE 8. EMPLOYEE RETIREMENT AND SAVINGS PLANS

### Employee Stock Ownership Plan

The Bank established an employee stock ownership plan ("ESOP") for eligible employees in 1995. The ESOP purchased 116,380 shares of the Company's common stock with the proceeds of a $1,163,800 note payable to the Bank and secured by the common stock owned by the ESOP. Principal payments under the note were due in equal annual installments through December 2005; interest was payable annually at a variable rate which was adjusted each January 1. The difference between the fair value of shares committed to be released and the cost of those shares to the ESOP (i.e., unearned compensation) was charged/credited to additional paid-in capital. Unearned compensation was amortized into compensation expense based on employee services rendered in relation to shares which were committed to be released based on the fair value of shares. Shares in the plan totaled 31,162 and 37,102 at June 30, 2020 and 2019, respectively. All shares had been allocated as of June 30, 2020 and 2019.

## NOTE 8. EMPLOYEE RETIREMENT AND SAVINGS PLANS (Continued)

### 401(k) Plan

The Company has a contributory, defined contribution plan which is qualified under Section 401(k) of the Internal Revenue Code. The plan is available to qualifying employees of the Company who have completed one year of service. The Company makes a contribution equal to three percent of the employee's salary under the Internal Revenue Code's Safe Harbor regulations. Additional matching contributions may be made at the discretion of the Company's Board of Directors and generally vest over five years. Contributions to the plan charged to expense totaled $103,320 and $101,480 for the years ended June 30, 2020 and 2019, respectively.

### Employment Agreements

The Company has a 36-month employment agreement with its President. This agreement provides that if employment under the agreement is terminated by the Company in connection with or within 12 months after any change in control of the Company, the employee will be paid approximately three times his salary.

## NOTE 9. STOCK BASED COMPENSATION PLAN

The Company has a stock option plan which provides for the grant of incentive stock options to employees and non-incentive stock options to non-employee directors. The Company may grant up to 145,745 option shares. There were no stock options outstanding at June 30, 2019.

The Company purchased shares in the open market to be issued upon exercise of stock options. Such shares are reflected at cost as shares held in trust in the accompanying consolidated balance sheets.

The fair value of each stock option award is estimated on the date of grant using a Black-Scholes-Merton valuation model that uses certain assumptions. Expected volatilities are based on an index of traded community banks. The Company considers historical data and peer group data to estimate option exercise and employee termination within the valuation model; separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. The expected term of options granted is based on the short-cut method and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

A summary of stock option activity under the plan as of June 30, 2020, and changes during the year then ended is presented below:

| | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| **Outstanding at July 1, 2019** | **-** | **$ -** | | |
| **Granted** | **20,000** | **8.35** | | |
| **Exercised** | **-** | **-** | | |
| **Forfeited** | **-** | **-** | | |
| **Cancelled** | **-** | **-** | | |
| **Outstanding at June 30, 2020** | **20,000** | **$ 8.35** | **7.55** | **$ 12,400** |
| **Vested at June 30, 2020** | **-** | **$ -** | **-** | **$ -** |

As of June 30, 2020, there is $44,037 of total unrecognized compensation cost related to nonvested share based compensation arrangements granted under the plan. The cost is expected to be recognized over a weighted-average period of 2.61 years.

## NOTE 10. COMMITMENTS AND CONTINGENCIES

### Loan Commitments

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. These financial instruments include commitments to extend credit. Such commitments involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amount recognized in the balance sheets. The majority of all commitments to extend credit are variable rate instruments.

The Company's exposure to credit loss is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments as it does for on-balance sheet instruments. A summary of the Company's commitments is as follows:

| | June 30, | |
|---|---|---|
| | **2020** | 2019 |
| Commitments to extend credit | **$ 29,661,402** | $ 24,855,797 |

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 amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies, but may include accounts receivable, inventory, property and equipment, residential real estate, and income-producing commercial properties.

### Contingencies

In the normal course of business, the Company is involved in various legal proceedings. In the opinion of management, any liability resulting from such proceedings would not have a material adverse effect on the Company's financial statements.

## NOTE 11. CONCENTRATIONS OF CREDIT

The Company originates primarily commercial, commercial real estate, residential real estate, and consumer loans to customers in Etowah, Marshall, and Cherokee Counties and the adjoining counties in northeast Alabama. The ability of the majority of the Company's customers to honor their contractual loan obligations is dependent on the economy in these areas.

Sixty-six percent of the Company's loan portfolio is concentrated in loans secured by real estate, of which a substantial portion is secured by real estate in the Company's primary market area. Accordingly, the ultimate collectibility of the loan portfolio and recovery of the carrying amount of other real estate owned, if any, is susceptible to changes in real estate conditions in the Company's primary market area. The other concentrations of credit by type of loan are set forth in Note 3.

The Company does not extend credit to any single borrower or group of related borrowers on a secured basis in excess of 20% of capital, as defined, or approximately $2,466,000, or on an unsecured basis in excess of 10% of capital, as defined, or approximately $1,233,000. However, these limits are waived when the extension of credit is made to a state or political subdivision located within the State of Alabama.

## NOTE 12. REGULATORY MATTERS

The Bank is subject to certain restrictions on the amount of dividends that may be declared without prior regulatory approval. At June 30, 2020, the payment of dividends is subject to regulatory approval.

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

Regulatory capital rules include a capital conservation buffer designed to absorb losses during periods of economic stress. On January 1, 2019, the capital conservation buffer of 2.5% was added on top of each of the minimum risk-based capital ratios. The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and was phased-in over a three-year period (increasing by that amount on each subsequent January 1, until it reached 2.5% on January 1, 2019) as presented in the following table. Banking institutions with a risk-based capital ratio above the minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

The minimum regulatory capital ratios, including the phase-in of the capital conservation buffer, for capital adequacy purposes are as follows:

| Year | Total Capital to Risk-Weighted Assets | Tier 1 Capital to Risk-Weighted Assets | CET1 Capital to Risk-Weighted Assets | Tier 1 Capital to Average Total Assets |
|---|---|---|---|---|
| 2016 | 8.625 % | 6.625 % | 5.125 % | 4.000 % |
| 2017 | 9.250 % | 7.250 % | 5.750 % | 4.000 % |
| 2018 | 9.875 % | 7.875 % | 6.375 % | 4.000 % |
| 2019 | 10.500 % | 8.500 % | 7.000 % | 4.000 % |
| 2020 | 10.500 % | 8.500 % | 7.000 % | 4.000 % |

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of Total, Tier 1 and CET1 capital to risk-weighted assets, as defined, and of Tier 1 capital to average total assets (leverage ratio), as defined. Management believes, as of June 30, 2020 and 2019, the Bank met all capital adequacy requirements to which it is subject.

As of June 30, 2020, the Bank opted into the Community Bank Leverage Ratio ("CBLR") framework. At June 30, 2020, the Bank's CBLR ratio was 10.53% which exceeded all regulatory capital requirements under the CBLR framework and the Bank was considered to be "well-capitalized."

## NOTE 12. REGULATORY MATTERS (Continued)

Banks and their bank holding companies that have less than $10 billion in total consolidated assets and meet other qualifying criteria, including a leverage ratio (equal to tier 1 capital divided by average total consolidated assets) of greater than 9%, are eligible to opt into the CBLR framework. Qualifying community banking organizations that elect to use the CBLR framework and that maintain a leverage ratio of greater than 9% will be considered to have satisfied the generally applicable risk-based and leverage capital requirements in the agencies' capital rules (generally applicable rule) and, if applicable, will be considered to have met the well-capitalized ratio requirements for purposes of section 38 of the Federal Deposit Insurance Act. Accordingly, a qualifying community banking organization that exceeds the 9% CBLR will be considered to have met: (i) the generally applicable risk-based and leverage capital requirements of the generally applicable capital rules; (ii) the capital ratio requirements in order to be considered well-capitalized under the prompt corrective action framework; and (iii) any other applicable capital or leverage requirements. A qualifying community banking organization that elects to be under the CBLR framework generally would be exempt from the current capital framework, including risk-based capital requirements and capital conservation buffer requirements. A banking organization meets the definition of a "qualifying community banking organization" if the organization has:

- A leverage ratio of greater than 9%;
- Total consolidated assets of less than $10 billion;
- Total off-balance sheet exposures (excluding derivatives other than sold credit derivatives and unconditionally cancellable commitments) of 25% or less of total consolidated assets; and
- Total trading assets plus trading liabilities of 5% or less of total consolidated assets.

Even though a banking organization meets the above-stated criteria, federal banking regulators have reserved the authority to disallow the use of the CBLR framework by a depository institution or depository institution holding company, based on the risk profile of the banking organization. On April 6, 2020, the federal banking regulators, implementing the applicable provisions of the CARES Act, issued interim rules which modified the CBLR framework so that: (i) beginning in the second quarter 2020 and until the end of the year, a banking organization that has a leverage ratio of 8% or greater and meets certain other criteria may elect to use the CBLR framework; and (ii) community banking organizations will have until January 1, 2022, before the CBLR requirement is reestablished at greater than 9%. Under the interim rules, the minimum CBLR will be 8% beginning in the second quarter and for the remainder of calendar year 2020, 8.5% for calendar year 2021, and 9% thereafter. The interim rules also maintain a two-quarter grace period for a qualifying community banking organization whose leverage ratio falls no more than 1% below the applicable community bank leverage ratio.

As of June 30, 2019, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum Total, Tier 1 and CET1 risk-based capital ratios and Tier 1 leverage capital ratios as set forth in the following table and not be subject to any formal enforcement action. There are no conditions or event since that notification that management believes have changed the Bank's category.

## NOTE 12. REGULATORY MATTERS (Continued)

The Bank and Company's actual capital amounts and ratios are presented in the following table.

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | | | *(Dollars in Thousands)* | | | |
| **June 30, 2020:** | | | | | | |
| **Community Bank Leverage Ratio** | | | | | | |
| **Consolidated** | **$ 11,591** | **11.56%** | **$ 4,012** | **4.00%** | **$ 5,015** | **5.00%** |
| **Southern Bank Company** | **$ 10,519** | **10.53%** | **$ 3,997** | **4.00%** | **$ 4,997** | **5.00%** |
| June 30, 2019: | | | | | | |
| Total Capital to Risk Weighted Assets | | | | | | |
| Consolidated | $ 12,378 | 19.53% | $ 6,654 | 10.50% | N/A | N/A |
| Southern Bank Company | $ 10,863 | 17.24% | $ 6,615 | 10.50% | $ 6,300 | 10.00% |
| Tier I Capital to Risk Weighted Assets | | | | | | |
| Consolidated | $ 11,588 | 18.29% | $ 5,387 | 8.50% | N/A | N/A |
| Southern Bank Company | $ 10,073 | 15.99% | $ 5,355 | 8.50% | $ 5,040 | 8.00% |
| CET1 Capital to Risk Weighted Assets | | | | | | |
| Consolidated | $ 11,588 | 18.29% | $ 4,436 | 7.00% | N/A | N/A |
| Southern Bank Company | $ 10,073 | 15.99% | $ 4,410 | 7.00% | $ 4,095 | 6.50% |
| Tier I Capital to Average Assets | | | | | | |
| Consolidated | $ 11,588 | 12.22% | $ 3,792 | 4.00% | N/A | N/A |
| Southern Bank Company | $ 10,073 | 10.67% | $ 3,777 | 4.00% | $ 4,721 | 5.00% |

## NOTE 13. FAIR VALUE OF ASSETS AND LIABILITIES

### Determination of Fair Value

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the *Fair Value Measurements and Disclosures* topic (FASB ASC 820), the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. 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 fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

## NOTE 13. FAIR VALUE OF ASSETS AND LIABILITIES (Continued)

### Assets Measured at Fair Value on a Recurring Basis

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such instruments pursuant to the valuation hierarchy.

The following tables present financial assets measured at fair value on a recurring basis:

| | | Fair Value Measurements Using | | |
|---|---|---|---|---|
| | Assets Measured at Fair Value | Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| **At June 30, 2020:** | | | | |
| **Securities available for sale** | **$ 25,874,339** | **$ -** | **$ 25,874,339** | **$ -** |
| At June 30, 2019: | | | | |
| Securities available for sale | $ 18,566,761 | $ - | $ 18,566,761 | $ - |

### Assets Measured at Fair Value on a Nonrecurring Basis

Under certain circumstances management makes adjustments to fair value for assets and liabilities although they are not measured at fair value on an ongoing basis. The following tables present the financial instruments carried on the consolidated balance sheet by caption and by level in the fair value hierarchy at June 30, 2020 and 2019, for which a nonrecurring change in fair value has been recorded:

| | Carrying Value at June 30, 2020 | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| **Impaired loans** | **$ 169,310** | **$ -** | **$ -** | **$ 169,310** |

| | Carrying Value at June 30, 2019 | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Impaired loans | $ 604,065 | $ - | $ - | $ 604,065 |

## NOTE 13. FAIR VALUE OF ASSETS AND LIABILITIES (Continued)

### Assets Measured at Fair Value on a Nonrecurring Basis (Continued)

*Impaired Loans*

Loans considered impaired under ASC 310-10-35, *Receivables*, are loans for which, based on current information and events, it is probable that the Company will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. Impaired loans can be measured based on the present value of expected payments using the loan's original effective rate as the discount rate, the loan's observable market price, or the fair value of the collateral less estimated selling costs if the loan is collateral dependent.

The fair value of impaired loans were primarily measured based on the value of the collateral securing these loans. Impaired loans are classified within Level 3 of the fair value hierarchy. Collateral may be real estate and/or business assets including equipment, inventory, and/or accounts receivable. The Company generally determines the value of real estate collateral based on independent appraisals performed by qualified licensed appraisers. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Appraised values are discounted for costs to sell and may be discounted further based on management's historical knowledge, changes in market conditions from the date of the most recent appraisal, and/or management's expertise and knowledge of the customer and the customer's business. Such discounts by management are subjective and are typically significant unobservable inputs for determining fair value. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors discussed above.

Impaired loans, which are usually measured for impairment using the fair value of collateral, had a carrying amount of $754,458 and $1,825,679, with a specific valuation allowance of $121,815 and $285,065, at June 30, 2020 and 2019, respectively. Of the $754,458 and $1,825,679 impaired loan portfolio, $291,125 and $889,131 were carried at fair value as a result of charge-offs and specific valuation allowances at June 30, 2020 and 2019, respectively. The remaining $463,333 and $936,548 were carried at cost, as the fair value of the collateral on these impaired loans exceeded the book value for each individual credit at June 30, 2020 and 2019, respectively. Charge-offs and changes in specific valuation allowances during 2020 and 2019 on impaired loans carried at fair value resulted in additional provision for loan losses of $121,815 and $140,947, respectively.

## NOTE 14. PARENT COMPANY FINANCIAL INFORMATION

The following information presents the condensed balance sheets of The Southern Banc Company, Inc. as of June 30, 2020 and 2019, and the condensed statements of operations and cash flows for the years then ended:

### CONDENSED BALANCE SHEETS

| | 2020 | 2019 |
|---|---|---|
| | (Dollars in Thousands) | |
| **Assets** | | |
| Cash and cash equivalents | **$ 122** | $ 128 |
| Investment in subsidiary | **11,851** | 11,257 |
| Other assets | **375** | 375 |
| **Total assets** | **$ 12,348** | $ 11,760 |
| **Liabilities and stockholders' equity** | | |
| Other liabilities | **$ -** | $ - |
| Stockholders' equity | | |
| Common stock | **14** | 14 |
| Additional paid-in capital | **13,907** | 13,886 |
| Retained earnings | **7,592** | 7,278 |
| Shares held in trust | **(754)** | (706) |
| Treasury stock | **(8,825)** | (8,825) |
| Accumulated other comprehensive income | **414** | 113 |
| **Total liabilities and stockholders' equity** | **$ 12,348** | $ 11,760 |

### CONDENSED STATEMENTS OF OPERATIONS

| | 2020 | 2019 |
|---|---|---|
| | (Dollars in Thousands) | |
| **Income** | **$ -** | $ - |
| **Expenses** | **(6)** | (6) |
| Loss before income taxes and equity in undistributed income of subsidiaries | **(6)** | (6) |
| **Income tax benefit** | **-** | - |
| **Loss before equity in undistributed income of subsidiaries** | **(6)** | (6) |
| **Equity in undistributed income of subsidiaries** | **320** | 471 |
| **Net income** | **$ 314** | $ 465 |

## NOTE 14. PARENT COMPANY FINANCIAL INFORMATION

### CONDENSED STATEMENTS OF CASH FLOWS

| | **2020** | 2019 |
|---|---|---|
| | *(Dollars in Thousands)* | |
| **OPERATING ACTIVITIES** | | |
| Net income | **$ 314** | $ 465 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Equity in undistributed income of subsidiaries | **(320)** | (471) |
| Net cash used in operating activities | **(6)** | (6) |
| Decrease in cash and cash equivalents | **(6)** | (6) |
| Cash and cash equivalents at beginning of year | **128** | 134 |
| Cash and cash equivalents at end of year | **$ 122** | $ 128 |

## CORPORATE INFORMATION

***Directors and Executive Officers of the Company:***

Gates Little
Chairman of the Board, President and Chief Executive Officer of the Company

Thomas F. Dowling, III
Retired
Sarrell Dental Center
Consultant

F. Michael Haney
Inzer, Haney, McWhorter, Haney & Skelton, LLC
Partner and Shareholder

James B. Little, III
New Capital Partners, LLC
Founder and Partner

Thomas Alan Ritchie, Jr.
Return Mail, Inc.
President

John E. Bell, III
HighFive Dental, LLC
Chief Financial Officer

***Executive Officers of the Bank:***

Gates Little
Chairman of the Board, President and Chief Executive Officer of the Bank

Teresa Elkins
Vice President of the Bank

***Main Office*:**

221 S. 6th Street
Gadsden, Alabama

***Branch Offices:***

625 East Main Street
Albertville, Alabama

2204 Henry Street
Guntersville, Alabama

390 W. Main Street
Centre, Alabama

***Independent Registered Public Accountants:***

Mauldin & Jenkins, LLC
Birmingham, Alabama

***General Counsel:***

Inzer, Haney, McWhorter, Haney & Skelton, LLC
Gadsden, Alabama

***Securities and Regulatory Counsel:***

Jones Walker LLP
Washington, D.C.

***Annual Stockholders Meeting:***

November 18, 2020 - 5:00 p.m.
The Southern Bank Company
221 S. 6th Street
Gadsden, Alabama
Record Date – October 5, 2020

**THE SOUTHERN BANC COMPANY, INC.**

221 SOUTH 6TH STREET • GADSDEN, ALABAMA 35901 • (256) 543-3860