

Annual Report



Community Engagement



Habitat for Humanity | Edina



WSU Welcome to Winona Fair | Winona



Bundle Up Drive | Winona



Golf Outing Sponsor | Northfield



Operation Joy | Northfield



10 Days of Giving | Hastings



Bundle Up Drive | St. Charles



Teach Children to Save | St. Charles



Toys for Tots | Rochester



Chili Cook Off | Cannon Falls



School Supply Donation Drive | Hastings



We're proud to share photos of teammates living out our mission in the communities we serve and celebrating our 150th anniversary.



Lanesboro and Rushford



Winona



Winona



St. Charles



Hastings



Winona



Cottage Grove



Lakeville



La Crescent and Onalaska



Hastings





Greg Evans

President & Chief Executive Officer
Merchants Financial Group, Inc.
and Merchants Bank, NA

A Letter From Our Chief Executive Officer

Throughout 2025, we celebrated the extraordinary 150-year history of Merchants' uninterrupted service to customers and our 19 communities. Our anniversary in July was a remarkable milestone that few businesses achieve, reserved for companies of unparalleled strength, stability, resilience and adaptability.

It's gratifying that all of the characteristics associated with remarkable staying power are represented in the form of 2025 record earnings of \$32.38 million, only the second time in Company history when earnings have exceeded \$30 million. That performance translated to a return on tangible common equity (TCE) of 12.74% and an increase in tangible book value (TBV) to \$33.26 (13.4% growth compared to year-end 2024).

Our 2025 performance compares handsomely to industry peers and is in greater alignment than the previous two years with the performance standard that I and the Leadership Team hold ourselves accountable for. The hard work and disciplined focus to transform our balance sheet and resolve a small number of large and stressed credit facilities over the past two years was the foundation for the strong performance rebound.

As Chief Financial Officer Sue Savat details in her Annual Report letter, the biggest drivers of our perfor-

mance improvement were the strength of the Company's deposit franchise and the optimal position of the balance sheet, which resulted in meaningful improvement in liquidity and net interest income. Other contributors were the risk profile stabilization of our consolidated loan portfolio and strong contributions from fee income business lines.

Our ability to grow deposits again in 2025 after generating above 11% deposit growth in 2024 was critical to year-end performance and our long-term relevance aspirations. Deposit growth for the year of 4.02% was slightly above our plan target. This would not be possible without the strength of our brand and the loyalty of our customers.

Loan growth in 2025 did not materialize as we had planned. Overall, commercial demand with existing customers and prospects was softer than anticipated. While our liquidity position is enviable with plenty of dry powder to fund new loans, we continue to be intensely disciplined regarding credit, pricing and geographic profile in sourcing new commercial loans, all of which contributed to some pipeline fallout and missed opportunities last year. Total net loans at year-end of \$2.04 billion represented a decline of 3.66% from 2024.



The lack of loan growth contributed significantly to our ability to reverse \$1.6 million of excess Allowance for Credit Loss (ACL) in 2025, a huge shift compared to the \$10.1 million of additional provision expense we booked in the fourth quarter of 2024 to accommodate a small number of stressed commercial real estate loans in the Twin Cities. While risk metrics for the consolidated loan portfolio remain slightly elevated, we have made outstanding progress in liquidating Other Real Estate Owned and reducing liability of ongoing holding costs associated with those properties.

Net charged-off loans totaled just .06%, appropriately in line with our historic levels and significantly improved from .37% in 2024. Total delinquencies greater than 30 days at year-end were .45% of total loans (compared to .47% at year-end 2024). Non-performing loans were .84% of total loans and 5.04% of capital (.33% and 2.18% respectively in 2024). Classified and criticized loans were at 35.99% and 48.25% of capital respectively, compared to 36.90% and 49.37% in 2024. The improvement in the identified risk profile allowed us to reduce ACL to 1.27% of total loans, compared to 1.35% at year-end 2024.

Future Focus on Growth, Operational Excellence & Efficiency

Early in 2025, your Board of Directors approved a new three-year plan, which is ambitious in strategic focus and the financial performance metrics Management will be accountable for to enhance the value of your capital investment at the rate you deserve. Our three strategic pillars remain unchanged:

- Intentionality around everything that contributes to a differentiated customer experience (service quality excellence)
- One Merchants spirit and consistency in all we do (operational excellence)
- Business growth and earnings optimization needed for earned independence and long-term relevance aspirations (performance excellence)

We continue to meaningfully invest in these pursuits and have facilitated significant business design changes to support our objectives. A few examples of 2025 accomplishments include:

- Streamlining the commercial credit approval process to be more responsive to customer needs and afford commercial bankers more time to engage with clients
- Automating and centralizing the consumer credit approval process so that retail bankers can be more universal in delivery of deposit and credit

solutions, allowing for more intentional and efficient staffing to meet customer needs

- Consolidation of our back-office loan and deposit operations teams under the leadership of a new Chief Operations/Process Officer, who is charged with re-engineering, automation and efficiency of workflows in a manner that contributes to our customer experience expectations

All strategic objectives are framed with a continuous improvement mindset and aligned to drive more intentional decision-making, foster innovation, build team alignment and employee confidence, and contribute to the professional and emotional intelligence of the 400-plus difference-makers on our team.

2026 Outlook – Building on Our Momentum

The past year was remarkable in so many ways. The way our customers and communities engaged with our anniversary celebration activities...the opportunities we had to participate in significant economic development projects throughout our footprint...the stories we heard from customers about how we have contributed to the fulfillment of their families' financial hopes and dreams across several generations...all helped reaffirm my sense of purpose as a community banker.

The significance of our 150-year milestone is not lost on our Leadership Team, but it does not guarantee our future in a consolidating industry. Only continued business growth, earnings performance, and the enhanced value of your investment will provide us with business options, one of which is the continued pursuit of earned independence and long-term relevance.

Our new long-range plan forecasts continued improvement of all key performance metrics in 2026, and I'm extremely optimistic that we will be successful in achieving our business and earnings growth objectives. Our balance sheet is optimally positioned for us to build on our momentum.

Thank you for your continued trust and confidence. For what will now be 151 years, the loyalty of our local Shareholders has consistently been the foundation of our success. You are a significant reason why Merchants remains strong, resilient and well-positioned for the future.


Gregory M. Evans



Sue Savat

Senior Vice President &
Chief Financial Officer

Merchants Financial Group, Inc.

A Letter From Our Chief Financial Officer

As we reflect on Merchants' 150th anniversary year, I am proud and honored to present to you, our Shareholders, a record year of net income. As I reflected on what this milestone meant for Merchants, 2025 demonstrated the resilience, diversification and adaptability that has defined this Company for generations.

Financial Performance Highlights

Merchants achieved record earnings of \$32.38 million for year-end 2025, marking only the second time in our history that earnings have exceeded \$30 million. Our return on average assets was 1.16% and our return on average equity was 11.16%, improvements of 65.8% and 62.6%, respectively compared to last year.

The improving yield curve throughout the year provided the opportunity to improve the yield on our earning assets (loans and investments) and reduce the cost of our funding (deposits) slightly. Our net margin improved from 3.27% at the end of 2024 to 3.36% at year-end 2025 but was a strong 3.55% in the fourth quarter of 2025. We were pleased to see good results in some non-interest income areas. This diversification is important, and revenue generated from our wealth management, mortgage origination and servicing and leasing division were strong contributors in 2025.

The year saw a few unusual income items with the sale of our Hampton location after the branch experienced a fire in 2024, sale of several Other Real Estate Owned (OREO) properties and rental income on those properties. We had unusual expenses in 2025 related to legal and holding expenses associated with the OREO property.

As we shared last year, our team worked hard in 2024 to reposition our balance sheet and increase deposits to allow for continued growth opportunities. We started 2025 in a great position and had strong deposit levels to support the economic needs of our communities. Due to lingering higher rates and uncertainty in the economy, many businesses and consumers were hesitant to make large capital investments. As such, we did not see the loan growth we anticipated.

Fortunately, the bond market provided us with the opportunity to put the deposits to work in investments in 2025. Pricing improved and we invested \$256.4 million during the year with yields averaging over 5.2% - stronger than we had seen in over 15 years. Net growth in the portfolio year-over-year was \$119.1 million, and our average yield ended the year at 4.29%, up from 3.75% a year ago. We focus on government sponsored entities mortgage-backed securities that provide con-



sistent cash flow. This cash flow allows us to reinvest in all economic cycles and gives us the flexibility to divest any securities should we have increased loan demand. While the duration on our portfolio lengthened a bit over the year, the investments were purchased at healthy discounts, have very attractive yields, and will continue to perform well in different rate cycles.

Margin Improvement & the Trajectory

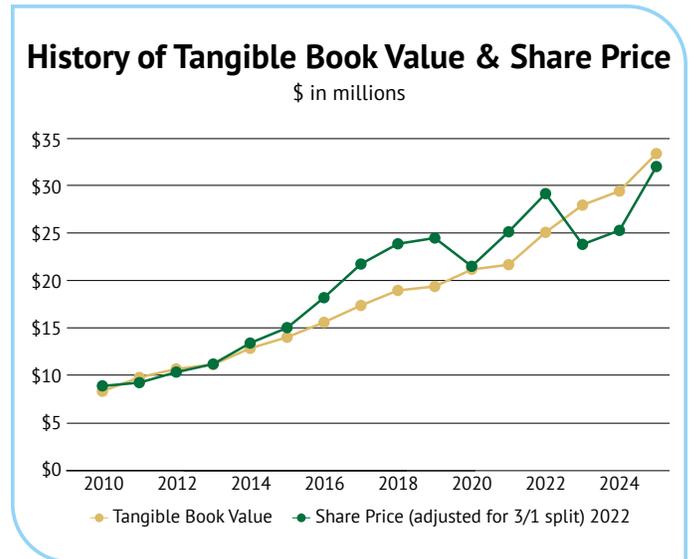
As mentioned earlier, we saw a nice improvement in our net interest margin in 2025. As is the case with most community banks, over 69% of our net revenue comes from our margin. After nearly a decade of rates near zero, when the Federal Reserve increased short-term rates by over 5.5% in 2022 and 2023 it created a challenging rate environment. The reduction in the Federal Reserve rate at the end of 2024 and through 2025, along with the increase in longer term rates, allowed us to slowly see growth in our earning yield and a reduction of our cost of funds. On average, we experienced a two basis points increase in our net margin per month in 2025. Barring any major economic crisis, we anticipate our margin will continue to increase at this pace or slightly better in 2026. Our projections show a net margin of 3.61 at the end of 2026.

Capital Strength, Dividend Philosophy & Utilization

Merchants' capital levels have always been a strength. We maintain healthy levels to ensure we can endure changes in risk in the industry, but we also balance those levels with strong dividend return to our shareholders and utilizing it for acquisition opportunities when they arise. We have been asked over the years what level of capital we strive for and our answer is that it depends on what we see on the horizon. We always prioritize maintaining and slightly growing our dividend, but we analyze the dividend level in the context of what else we should do with our capital. During times that are ripe for acquisition activity, we may grow capital more to allow for cash available; during times of stress in the credit area, we may grow capital to prepare for additional reserve needs. There is no one right answer for capital levels; our goal is to maximize capital utilization so that we continue to grow the value of the Company. We were pleased to be able to increase our dividend to shareholders in 2025 by 9.72%. The dividend this year reflected 19.96% of net income. With our strong earnings this year, our tangible equity ratio increased from 8.74% to 9.50%. This level sets us up well to pursue opportunities that may arise in 2026.

Tangible Book Value Appreciation

During this 150th anniversary year, it is so fulfilling to look back on the stability and strength of Merchants. One measure of stability is the tangible book value of the organization. Shown here is a chart of the tangible book value of Merchants over the past 15 years. The steady growth of the value of the franchise is admirable and once again demonstrates resilience, diversification, and adaptability.



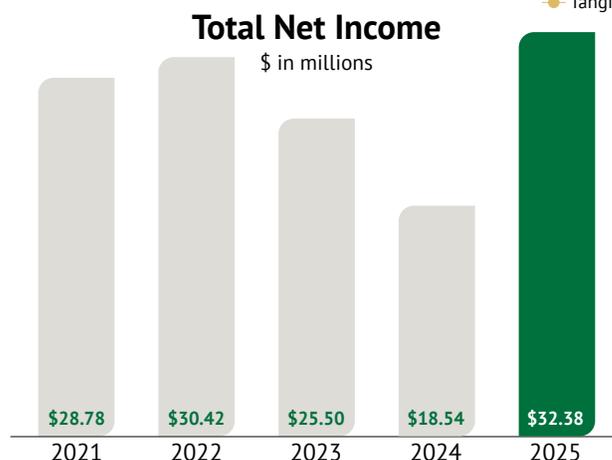
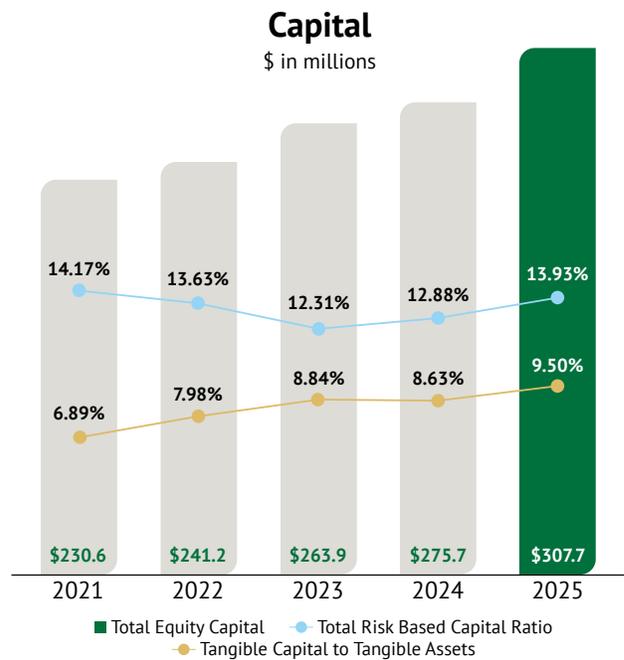
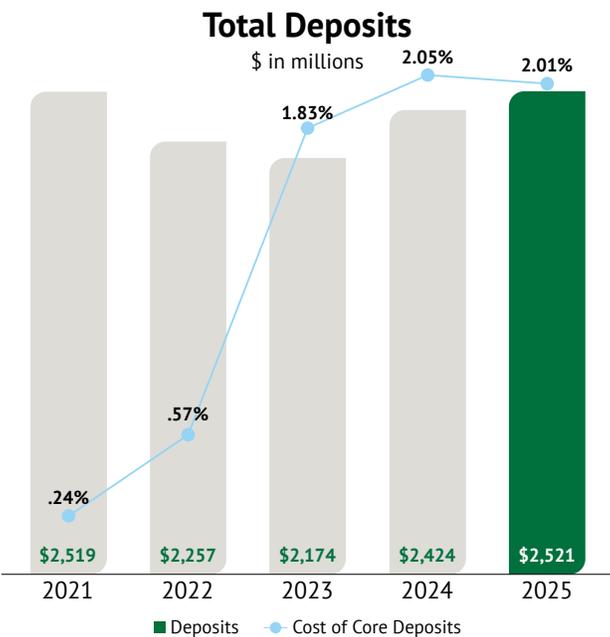
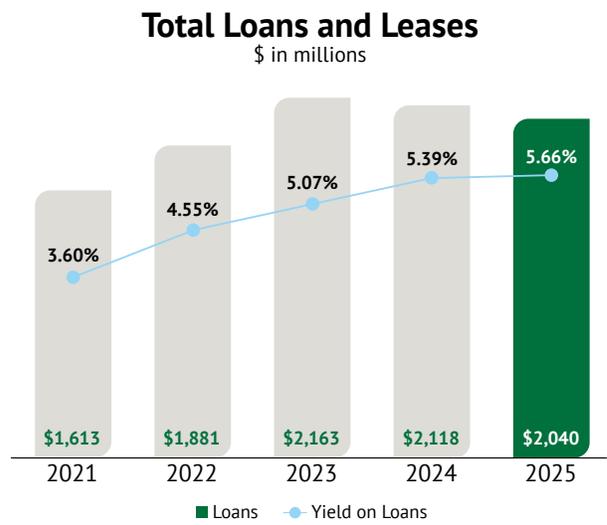
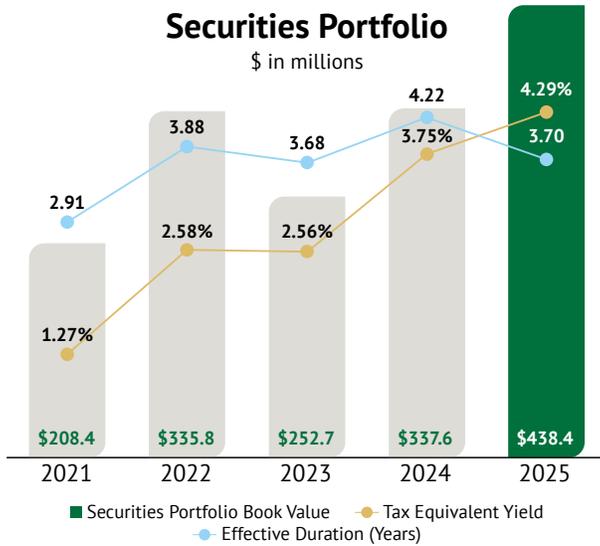
Greg mentioned our strategic pillars, successes for 2025, and focus going forward. I can attest to the fact that this messaging is ingrained in everything we do. Every decision is made with a focus on our customers and our communities. If we meet their needs, we will continue to be successful. It has been a turbulent five years in the banking industry, but Merchants is poised to be successful...with a goal to continue as a respected community bank for another 150 years!

Susan M. Savat

Susan M. Savat



2025 Financial Charts



Consolidated Financials

Condensed Consolidated Balance Sheets

Assets	<u>12/31/25</u>	<u>12/31/24</u>
Cash and Cash Equivalents	\$ 242,439,675	\$ 177,794,293
Investments	438,353,302	319,205,180
Loans and Leases, Net	2,011,316,202	2,086,285,266
Banking Houses, Furniture and Fixtures	24,043,182	24,835,199
Other Assets	184,329,197	173,986,842
Total	<u>2,900,481,558</u>	<u>2,782,106,780</u>
Liabilities & Equity		
Deposits	\$ 2,521,148,163	\$ 2,423,758,047
Other Liabilities	71,640,387	82,629,107
Equity	307,693,008	275,719,626
Total	<u>2,900,481,558</u>	<u>2,782,106,780</u>

Condensed Consolidated Statements of Income

Income	<u>12/31/25</u>	<u>12/31/24</u>
Interest Income	\$ 137,918,407	\$ 130,706,340
Interest Expense	51,212,514	50,009,988
Net Interest Income	86,705,893	80,696,352
Other Operating Income	36,491,205	31,729,136
Other Operating Expense	82,148,103	88,013,156
Income Before Taxes	41,048,995	24,412,331
Income Taxes	8,671,000	5,872,999
Net Income	<u>\$ 32,377,995</u>	<u>\$ 18,539,332</u>
Earnings Per Share*	\$ 4.10	\$ 2.34
Book Value Per Share*	\$ 38.94	\$ 34.79
Shares Outstanding	8,178,741	8,178,741

*Based on weighted average of shares outstanding for the year.

Executive Leadership Team



Greg Evans

President & Chief Executive Officer,
Merchants Financial Group, Inc. and
Merchants Bank, NA

- In banking since 1989
- Joined Merchants in 1989



Cat Breet

Chief Human Resource Officer

- In human resources since 1997
- Joined Merchants in 2022



Julie Carstensen

Chief Operations/Process Officer

- In banking since 1986
- Joined Merchants in 2025



Andrew Guzzo

Chief Banking Officer & President
(Winona)

- In banking since 2006
- Joined Merchants in 2017



Cindy Harrison

Chief Credit Officer

- In banking since 1992
- Joined Merchants in 1992



Erick Maki

Regional President, South Region

- In banking since 2001
- Joined Merchants in 2022



Dan Massett

Regional President, North Region

- In banking since 1991
- Joined Merchants in 2014



Steve Molander

Chief Information Officer

- In banking since 2001
- Joined Merchants in 2024



Sue Savat

Chief Financial Officer

- In banking since 1992
- Joined Merchants in 2000 (also from 1992-1995)



Dave Schlauderaff

President, Merchants Bank
Equipment Finance

- In equipment finance since 1998
- Joined Merchants in 2022



Dr. Julie Van Der Wilt

Chief Risk Officer

- In banking since 2007
- Joined Merchants in 2024



Market President Team



Larry Bodin
President, La Crescent and Onalaska

- In banking since 1986
- Joined Merchants in 2020



Bruce Goblirsch
President, Cottage Grove and Hastings

- In banking since 1986
- Joined Merchants in 2002



Ken Graner
President, Lanesboro and Rushford

- In banking since 1981
- Joined Merchants in 2009



Andrew Guzzo
Chief Banking Officer & President (Winona)

- In banking since 2006
- Joined Merchants in 2017



Brian Hokanson
President, Cannon Falls

- In banking since 1992
- Joined Merchants in 2025 (also from 2008-2023)



Jarett Jones
President, Rochester and St. Charles

- In banking since 1999
- Joined Merchants in 2020



Kirk Muhlenbruck
President, Northfield

- In banking since 1988
- Joined Merchants in 2021



Tom Pasch
President, Red Wing

- In banking since 2009
- Joined Merchants in 2021



Dave Schlauderaff
President, Merchants Bank Equipment Finance

- In equipment finance since 1998
- Joined Merchants in 2022



Matt Schuldt
President, Caledonia and Spring Grove

- In banking since 2009
- Joined Merchants in 2014



Dan Vlasak
President, Lakeville

- In banking since 1989
- Joined Merchants in 2009



Charity Weibel
President, Apple Valley and Rosemount

- In banking since 2001
- Joined Merchants in 2025



Commemorating 150 years of Serving our Communities

150 Years of Trust.
150 Years of Dreams.



Marking a Historic Milestone

In 2025, Merchants Bank celebrated an extraordinary achievement by commemorating our 150th anniversary. This landmark occasion reflected not only the Bank's enduring legacy of excellence but also our steadfast service beginning in Winona, Minnesota in 1875 and expanding to the broader communities in Minnesota and Wisconsin. The Board of Directors and Leadership Team wish to express profound gratitude to shareholders, customers, and employees whose partnerships have been a foundation of Merchants Bank's enduring success.



As President and CEO Greg Evans shared, "The longevity of Merchants Bank is a testament to our unwavering commitment to integrity, service, and earned loyalty – a commitment we will continue for the generations ahead."



Our History & Legacy of Service

Established in 1875 in Winona, Merchants Bank opened its doors with a mission to be the working man's bank and earn the trust of local families and merchants in the area. Throughout the decades, Merchants has weathered financial crises, changing political land-

scapes, and periods of rapid change with resilience and stability. Notable milestones include the remodel of the Winona-Downtown location earning a spot on the National Registrar of Historic Places in 1974; opening the first branch in Goodview in 1979; forming Merchants Financial Group, Inc in 1985; holding the first 10 Days of Giving food drive in Winona in 1989, launching an employee ESOP program in 2001; surpassing \$1 billion in assets in 2002 and also opening the first branch in Wisconsin later that year, and creating Advisory Boards for key markets in 2009. These strategic moves underscore Merchants' reputation for both tradition and forward-thinking leadership.

As the communities of Minnesota and Wisconsin evolved, so too did Merchants Bank, expanding our footprint to serve 19 communities – the most recent addition being the acquisition of the First National Bank of Northfield in 2019 – and fostering long-term relationships with our customers.



"Our local commitment ensures that we never lose sight of what matters most – the vitality and aspirations of the communities we serve," said Greg.



Philanthropic Leadership & Community Impact in 2025

Philanthropy remains at the core of Merchants Bank's values. In 2025, the Bank reaffirmed its leadership in community giving by contributing more than \$710,000 to nearly 400 nonprofit organizations across Minnesota and Wisconsin. Notable initiatives include partnership with the Federal Home Loan Bank to grant nonprofit partners more than \$40,000 through their Member Impact Fund grant program, a gift to kick-start the campaign for the PossAbilities Achievement Hub in Rochester to expand resources for those with disabilities, and a record-breaking 10 Days of Giving drive in Winona culminating in 294,859 pounds of food.



PossAbilities Achievement Hub Donation | Rochester

Historically employees contribute more than 10,000 volunteer hours annually, leading activities in schools, providing seminars related to future home ownership, serving on local boards, and participating in the newly launched Bundle Up Drive to provide warm clothing in the winter and countless other initiatives.



"Supporting our communities is not merely an obligation; it is a privilege woven into the fabric of our institution," remarked Andrew Guzzo, Chief Banking Officer and Regional President – Winona.



10 Days of Giving | Winona



First Merchants Bank Location
1875



Second Merchants Bank Location
1897



Merchants Bank Building
1912



Merchants Bank Building
1950s



Greg Evans, President & CEO, gives remarks



Safecracking the 125th time capsule



Andrew and Greg at Winona's event



Unveiling 125th time capsule items

150th Anniversary Community Engagement

To mark the sesquicentennial, Merchants Bank hosted a series of community events, including a Community Night in Winona, which drew hundreds of attendees – customers, families, and partners – celebrating with games, local food vendors, safe cracking and historical exhibitions.

Among the year's highlights was the 2025 Merchants Bank Summer of Dreams Photo Contest. Community members were encouraged to submit photographs reflecting their community connections and personal experiences with the Bank, ranging from first home purchases and successful business launches to their favorite community spot or nonprofit. Winning entries were announced and celebrated on social media along with several testimonials collected from the more than 400 contest entries.



"Coming together in our communities to celebrate this milestone was a wonderful experience for everyone," shared Andrew. "In addition to marking this anniversary with in-person events, the photo contest offered the opportunity to celebrate the stories that define Merchants Bank company-wide – stories of trust, partnership, and progress."



Vision for the Next 150 Years

Merchants Bank's growth strategy is anchored in meeting the diverse needs of the region we serve. The financial hopes and dreams of our customers has always been the driving force behind everything we do. Merchants is fortunate to offer a broad range of services across various business lines, which provides both opportunities to meet customers where they are and diversity of revenue streams to create a healthy, strong and stable institution.

As Merchants Bank looks to the future, we remain committed to being at the forefront of community investment and collaboration, working to build thriving communities. The strategic plan for 2026 and beyond emphasizes growth, operational efficiency, digital infrastructure, and an unwavering focus on customer service. The three strategic pillars providing a "True North" for the entire Merchants team are:

- Deliver **Exceptional Customer Experiences**
- Embrace a Commitment of **One Merchants** consistency and a culture of **Accountability**
- Deliver Business Growth and Earnings Optimization to drive **Long Term Relevance & Independence**



“While we honor our legacy, we are equally energized by the opportunities ahead,” said Steve Molander, Chief Information Officer. “We are undertaking a comprehensive modernization of our systems and security programs to ensure our services meet the expectations of today’s environment. By reinforcing our technology infrastructure and enhancing the customer experience, we are positioning the organization to reliably serve the evolving needs of our users, customers, and stakeholders.”

Honoring the Past, Shaping the Future

The 150th anniversary of Merchants Bank is more than a celebration of longevity; it is a reaffirmation of the enduring partnerships, innovative spirit, and unwavering service that has defined the Bank for a century and a half. No one can speak to that better than our shareholders.

“The record of success Merchants has had in Winona and the banking expansion throughout the region tells me that they’re doing something right,” said Dr. Andrew Edin.

“The Merchants stock will become a legacy within our family. It’s something we can pass on to our children, and we expect our children to pass on to their children,” shared Craig Zeches.

“My grandpa had Merchants stock, which he gifted to his children. My parents have done the same with myself, and my siblings and I’ll do the same with my kids,” noted Dan Merchlewitz.

“It’s a sacred investment. We were told to always hold on to that stock and never sell it. Merchants Bank will be with us as long as we’re walking on this great earth, and it will be with us when we’re gone because our children will hold our shares,” said Dianne Zeches.

As we commemorate this milestone, we extend our sincere appreciation to all who have made this journey possible and look forward with confidence to the next chapter of shared success.



150th Anniversary Chamber of Commerce Ribbon Cutting | Rochester



150th Anniversary Community Appreciation | Hastings



150th Anniversary Community Appreciation | Rosemount

150 Years of Merchants Bank.



Merchants Financial Group Board of Directors



Richard T. Lommen, Jr.
Chair of the Board
President & Owner
Courtesy Corporation



Ann E. Merchlewitz
Vice Chair of the Board
Senior Vice President & General Counsel
Saint Mary's University of Minnesota



Michael F. Cichanowski
Founder & Chief Executive Officer
Wenonah Canoe, Inc.



Gregory M. Evans
President & Chief Executive Officer
Merchants Financial Group, Inc. and
Merchants Bank, NA



Molly K. Jungbauer, CPA
Chief Executive Officer
Hollstadt Consulting, Inc.



John H. Killen
Senior Advisor
WinCraft, a Fanatics brand



Bradley J. Peterson
Chairman
Mississippi Welders Supply Co., Inc.



James A. Rogers III
CEO, Digital Pathology
Senior Administrator, Generative AI
Mayo Clinic



Bruce E. Ryan
President
Ryan Windows & Siding, Inc.

Merchants Bank Charter Board of Directors



Richard T. Lommen, Jr.
Chair of the Board
President & Owner
Courtesy Corporation



Ann E. Merchlewitz
Vice Chair of the Board
Senior Vice President & General Counsel
Saint Mary's University of Minnesota



Michael F. Cichanowski
Founder & Chief Executive Officer
Wenonah Canoe, Inc.



Gregory M. Evans
President & Chief Executive Officer
Merchants Financial Group, Inc. and
Merchants Bank, NA



Richard J. Falck
President, Falck Financial Services LLC
President, RJF, Inc.



Molly K. Jungbauer, CPA
Chief Executive Officer
Hollstadt Consulting, Inc.



John H. Killen
Senior Advisor
WinCraft, a Fanatics brand



Bradley J. Peterson
Chairman
Mississippi Welders Supply Co., Inc.



James A. Rogers III
CEO, Digital Pathology
Senior Administrator, Generative AI
Mayo Clinic



Bruce E. Ryan
President
Ryan Windows & Siding, Inc.



James A. Trendera, CPA
President
CP Advisors, LLC

Merchants Bank Advisory Boards

North Region/Cannon Falls Area



Les M. Anderson
Farmer
Anderson Farms



Lisa M. Lundell
Real Estate Broker/
Owner
Cannon Realty



Richard A. Peterson
Owner
Peterson Turkey
Hatchery, Inc.



Mark A. Poss
Director
Big Fish Ventures



Brenda A. Stelter
Owner
Anchor Promotions,
Apparel & Signage

North Region/Northfield



Cheryl A. Buck
Director - Business
Development
Professional
Risk Managers'
International
Association



**Matthew T.
Christensen**
VP/Risk &
Insurance Advisor
USI



Richard J. Falck
President, Falck
Financial Services LLC
President, RJF, Inc.



Chris J. Kennelly
Real Estate
Developer &
Entrepreneur
Trek Properties
NCC Builders
REVocity



Kristin L. Yahnke
Attorney & Partner
Blumhoefer, Yahnke,
and Lancaster LLP

North Region/Twin Cities Area



Ben E. Gathje
Owner/Operator
Culver's of
Cottage Grove



Peggy P. Johnson
Community
Relations Director
Dakota Electric
Association



Molly K. Jungbauer, CPA
Chief Executive Officer
Hollstadt Consulting, Inc.



James A. Trenda
President
CP Advisors, LLC



Richard H. Welshons
Twin Cities Manager
The Title Team/
DCA Title



Merchants Bank Advisory Boards

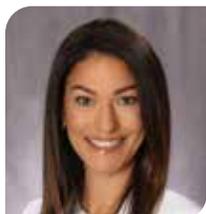
South Region/La Crosse Market Area



Dean L. Ashbacher
President & Chief
Executive Officer
Truss Specialists, Inc.



Derek S. Cortez, Ph.D.
Chief Executive Officer
Chileda, Inc.



Elizabeth M. Filter
President & Chief
Executive Officer
VARC, Inc.



Brian D. Wieser
Owner/Vice President
Wieser Brothers General
Contractor, Inc.

South Region/Rochester



John C. Beatty
Attorney
Dunlap & Seeger, PA



Aaron J. Benike
Vice President
of Operations
Benike Construction



Joselyn A. Raymundo
Entrepreneur,
Founder-CEO, Investor



James A. Rogers III
CEO, Digital
Pathology
Senior Administrator,
Generative AI
Mayo Clinic



Bruce E. Ryan
President
Ryan Windows
& Siding, Inc.

South Region/Rural Market Area



Adam P. Augedahl
Owner
Winona Controls, Inc.



John D. Diersen
Owner & Farmer
Minnigan Hills Farm



**Creighton M.
Horihan**
Owner
Horihan Companies



Joel B. Nelson
Farmer & Owner
Lanesboro Sales Commission
Decorah Sales Commission

Consolidated Financial Report

December 31, 2025

Merchants Financial Group, Inc. and Subsidiaries

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102 East Third Street • Winona, MN 55987
(507) 457-1100 • www.merchantsbank.com

INDEPENDENT AUDITOR'S REPORT

Audit Committee
Merchants Financial Group, Inc. and Subsidiary
Winona, Minnesota

Opinion

We have audited the consolidated financial statements of Merchants Financial Group, Inc. and Subsidiary, which comprise the consolidated balance sheet as of December 31, 2025, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Merchants Financial Group, Inc. and Subsidiary as of December 31, 2025, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of Merchants Financial Group, Inc. and Subsidiary and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Other Matter

The consolidated financial statements of Merchants Financial Group, Inc. and Subsidiary for the year ended December 31, 2024, were audited by other auditors, who expressed an unmodified opinion on those statements on February 13, 2025.

Responsibilities of Management for the Financial Statements

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

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about Merchants Financial Group, Inc. and Subsidiary's ability to continue as a going concern for one year from the date the consolidated financial statements are available to be issued.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Merchants Financial Group, Inc. and Subsidiary's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about Merchants Financial Group, Inc. and Subsidiary's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

Other Information Included in the Annual Report

Management is responsible for the other information included in the annual report. The other information comprises the information included in the annual report but does not include the consolidated financial statements and our auditor's report thereon. Our opinion on the consolidated financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the consolidated financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.


Crowe LLP

Oakbrook Terrace, Illinois
February 13, 2026

Merchants Financial Group, Inc. and Subsidiary

Consolidated Balance Sheets

December 31, 2025 and 2024

(In Thousands, Except Share Information)

Assets	2025	2024
Cash and cash equivalents	\$ 242,145	\$ 177,566
Federal funds sold	295	228
Cash and cash equivalents	<u>242,440</u>	177,794
Available-for-sale securities, at fair value (amortized cost \$408,152 and \$301,526)	400,820	283,149
Held-to-maturity securities (fair value \$35,450 and \$32,581)	37,534	36,057
Loans held for sale	14,014	1,049
Loans and direct financing leases, net of allowance for credit losses of \$25,996 and \$28,490	2,011,316	2,086,285
Operating lease assets, net	10,780	16,896
Premises and equipment, net	24,043	24,835
Investment in restricted stock, at cost	5,067	5,397
Other real estate owned	970	6,457
Accrued interest receivable and other assets	41,819	32,933
Cash value of life insurance	62,213	60,735
Mortgage servicing rights, net	13,800	14,801
Goodwill	35,665	35,665
Intangibles	-	54
Total assets	<u>\$ 2,900,481</u>	<u>\$ 2,782,107</u>
 Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Noninterest-bearing	\$ 476,273	\$ 463,169
Interest-bearing	2,044,875	1,960,589
Total deposits	<u>2,521,148</u>	<u>2,423,758</u>
Repurchase agreements	15,043	15,060
Notes payable	1,599	11,900
Subordinated debentures	28,351	28,351
Deferred taxes	4,959	1,865
Accrued interest payable and other liabilities	21,689	25,453
Total liabilities	<u>2,592,789</u>	<u>2,506,387</u>
 Commitments, Contingencies and Credit Risk		
Stockholders' Equity		
Common stock, par value \$0.008 per share; 25,000,000 shares authorized; shares issued: 8,178,741 in 2025 and 2024	68	68
Additional paid-in capital	10,261	10,242
Retained earnings	312,165	286,011
Accumulated other comprehensive loss	(5,021)	(12,655)
Unearned Employee Stock Ownership Plan (ESOP) shares	(9,781)	(7,946)
Total stockholders' equity	<u>307,692</u>	<u>275,720</u>
Total liabilities and stockholders' equity	<u>\$ 2,900,481</u>	<u>\$ 2,782,107</u>

See Notes to Consolidated Financial Statements.

Merchants Financial Group, Inc. and Subsidiary

Consolidated Statements of Income
Years Ended December 31, 2025 and 2024
(In Thousands, Except Per Share Information)

	2025	2024
Interest income:		
Loans	\$ 114,397	\$ 116,541
Securities	15,173	8,297
Direct financing leases	1,426	1,663
Other	6,923	4,206
	<u>137,919</u>	<u>130,707</u>
Interest expense:		
Deposits	48,902	45,825
Notes payable and repurchase agreements	866	2,605
Subordinated debentures	1,445	1,580
	<u>51,213</u>	<u>50,010</u>
Net interest income	86,706	80,697
Provision for (recapture of) credit losses	<u>(1,587)</u>	<u>10,101</u>
Net interest income after provision for (recapture of) credit losses	88,293	70,596
Noninterest income:		
Trust department	3,413	3,154
Service charges and other fees	7,074	7,002
Loan servicing fees	6,718	6,867
Net gain (loss) on sale of available-for-sale securities	114	(1,175)
Net gain on sale of loans	4,957	2,999
Net loss on sale of other real estate and other personal property owned including writedowns	(70)	(33)
Net gain on sale of premises and equipment	250	-
Operating lease income	5,172	6,303
Other	8,863	6,612
	<u>36,491</u>	<u>31,729</u>
Noninterest expenses:		
Salaries and employee benefits	44,283	41,146
Occupancy	14,117	13,533
Depreciation expense on operating leases	4,110	5,094
Mortgage servicing rights	3,141	2,659
Other	18,084	15,481
	<u>83,735</u>	<u>77,913</u>
Income before income taxes	41,049	24,412
Provision for income taxes	8,671	5,873
Net income	\$ 32,378	\$ 18,539
Earnings per common share	<u>\$ 4.10</u>	<u>\$ 2.34</u>

See Notes to Consolidated Financial Statements.

Merchants Financial Group, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income

Years Ended December 31, 2025 and 2024

(In Thousands)

	2025	2024
Net income	\$ 32,378	\$ 18,539
Other comprehensive income net of income tax effect:		
Reclassification adjustment for (gains) losses included in net income	(82)	846
Change in unrealized gains (losses) on available-for-sale securities	8,041	(606)
Change in unrealized loss on interest rate swap	(325)	(297)
Total other comprehensive income (loss)	7,634	(57)
Comprehensive income	\$ 40,012	\$ 18,482

Merchants Financial Group, Inc. and Subsidiary

Consolidated Statements of Stockholders' Equity

Years Ended December 31, 2025 and 2024

(In Thousands, Except Per Share Information)

	Common Stock	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unearned ESOP Shares	Total
Balance, January 1, 2024	\$ 68	\$ 10,274	\$ 273,170	\$ (12,598)	\$ (6,978)	\$ 263,936
Net income	-	-	18,539	-	-	18,539
Other comprehensive loss	-	-	-	(57)	-	(57)
ESOP shares purchased	-	-	-	-	(2,680)	(2,680)
ESOP shares released for allocation (Note 15)	-	(32)	-	-	1,712	1,680
Cash dividends declared (\$0.72 per share)	-	-	(5,698)	-	-	(5,698)
Balance, December 31, 2024	68	10,242	286,011	(12,655)	(7,946)	275,720
Net income	-	-	32,378	-	-	32,378
Other comprehensive income	-	-	-	7,634	-	7,634
ESOP shares purchased	-	-	-	-	(3,032)	(3,032)
ESOP shares released for allocation	-	19	-	-	1,197	1,216
Cash dividends declared (\$0.79 per share)	-	-	(6,224)	-	-	(6,224)
Balance, December 31, 2025	\$ 68	\$ 10,261	\$ 312,165	\$ (5,021)	\$ (9,781)	\$ 307,692

See Notes to Consolidated Financial Statements.

Merchants Financial Group, Inc. and Subsidiary

Consolidated Statements of Cash Flows Years Ended December 31, 2025 and 2024 (In Thousands)

	2025	2024
Cash Flows From Operating Activities		
Net income	\$ 32,378	\$ 18,539
Adjustments to reconcile net income to net cash provided by operating activities:		
Net accretion of bond premiums and discounts	(372)	(17)
Provision for (recapture of) credit losses	(1,587)	10,101
Net gain on sale of loans	(4,957)	(2,999)
Net change in fair value of loans held for sale	106	(10)
Proceeds from sales of loans held for sale	226,978	203,168
Originations and purchases of loans held for sale	(236,678)	(200,848)
Net loss (gain) on sale of available-for-sale securities	(114)	1,175
Amortization of mortgage servicing rights	2,958	2,658
Depreciation expense	5,466	6,517
Gain on sale of other real estate owned	(382)	(72)
Net charge-offs/write-downs of other real estate owned	452	105
Net gain on sale of premises and equipment	(250)	-
Deferred income taxes	136	270
Release of shares to ESOP	1,216	1,680
Increase in cash value of life insurance	(1,478)	(982)
Increase in accrued interest and other assets and other liabilities	(12,866)	(2,372)
Net cash provided by operating activities	11,006	36,913
Cash Flows From Investing Activities		
Cash flows from securities	(107,617)	(80,211)
Net purchases of restricted stock	330	4,033
Net decrease in loans and direct financing leases	74,864	29,214
Purchases (sales) of operating lease assets	2,006	(1,599)
Purchases of premises and equipment	(579)	(530)
Purchases of mortgage servicing rights	(554)	(551)
Proceeds from sales of equipment	265	-
Proceeds from sales of other real estate owned and foreclosed assets	7,109	554
Net cash used in investing activities	(24,176)	(49,090)
Cash Flows From Financing Activities		
Net increase in deposits	97,390	249,349
Net decrease in federal funds purchased	-	(94,690)
Net increase in repurchase agreements	(17)	(4)
Repayment of notes payable	(10,301)	(10,362)
Proceeds from notes payable	-	15,000
ESOP shares purchased	(3,032)	(2,680)
Cash dividends paid	(6,224)	(5,698)
Net cash provided by financing activities	77,816	150,915
Net increase in cash and cash equivalents	64,646	138,738
Cash and Cash Equivalents		
Beginning	177,794	39,056
Ending	\$ 242,440	\$ 177,794

See Additional Cash Flow Information - Note 18.

See Notes to Consolidated Financial Statements.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation

Nature of business: Merchants Financial Group, Inc. is a bank holding company with one wholly owned bank subsidiary, Merchants Bank, National Association (the Bank). The Bank has branch operations in Winona, Goodview, Rushford, Lanesboro, St. Charles, Rochester, La Crescent, Caledonia, Spring Grove, Cannon Falls, Red Wing, Hastings, Apple Valley, Lakeville, Cottage Grove, Rosemount, and Northfield, Minnesota; and Onalaska and Eau Claire, Wisconsin. The Bank provides retail, commercial loan and deposit services principally to customers. The Bank has a leasing division, Merchants Bank Equipment Finance, which operates in the Minneapolis–St. Paul, Minnesota metropolitan area.

Principles of consolidation: The accompanying consolidated financial statements include the accounts of Merchants Financial Group, Inc. and its wholly owned subsidiary. These entities are collectively referred to herein as the Company. All significant intercompany balances and transactions have been eliminated in consolidation.

Segment reporting: The Company's chief financial officer makes company-wide resource allocation decisions and assessments of performance based on a collective assessment of the Company's operations. Substantially all of the Company's operations involve the delivery of loan and deposits products to customers. Accordingly, all of the Company operations are considered by management to be aggregated in one reportable operating segment.

Use of accounting estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided and future results could differ.

Trust and investment assets: The Bank operates trust and investment services. Assets under management by the trust and investment departments, other than trust cash on deposit at the Bank, are not included in these consolidated financial statements because they are not assets of the Company. Total fiduciary accounts and other accounts (individual retirement accounts, health savings accounts, and other similar accounts) were \$438,771 and \$116,073 as of December 31, 2025, respectively. Total fiduciary accounts and other accounts (individual retirement accounts, health savings accounts, and other similar accounts) were \$382,558 and \$102,827 as of December 31, 2024, respectively.

Cash, cash equivalents and cash flows: For purposes of reporting cash flows, cash and cash equivalents includes cash on hand and amounts due from banks, including interest-bearing deposits in the Federal Reserve Bank and federal funds. Cash flows from loans, federal funds sold/purchased, deposits and repurchase agreements are reported net. The Bank maintains cash in deposit accounts which, at times, may exceed federally insured limits. The Bank has not experienced any losses in such accounts.

Federal funds: The Company has federal funds sold/purchased with correspondent financial institutions intended to support short-term liquidity needs. Interest income and expense on federal funds sold/purchased is included in other interest income and in notes payable and repurchase agreements interest expense in the consolidated statements of income, respectively.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation (Continued)

Securities: Debt securities for which the Company has both the positive intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost.

Securities classified as available-for-sale include debt securities that the Company intends to hold for an indefinite period of time, but not necessarily to maturity. Any decision to sell a security classified as available-for-sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. Securities available for sale are carried at fair value with unrealized gains or losses reported net of the related deferred tax effect in other comprehensive income. Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Purchase premiums are recognized in interest income using the effective interest method to the first call date. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

A debt security is placed on nonaccrual status at the time any principal or interest payments become 90 days delinquent. Interest accrued but not received for a security placed on non-accrual is reversed against interest income.

Allowance for Credit Losses – Held-to-Maturity Securities: Management measures expected credit losses on held-to-maturity securities on a collective basis by major security type. Accrued interest receivable on held-to-maturity debt securities totaled \$97 and \$236 at December 31, 2025 and 2024 respectively and is excluded from the estimate of credit losses. The estimate of expected credit losses considers historical credit loss information that is adjusted for current conditions and reasonable and supportable forecasts.

Management classifies the held-to-maturity portfolio into the following major security types: U.S. government-sponsored entities and obligations of states and political subdivisions. Nearly all securities are either explicitly or implicitly guaranteed by the U.S. government, are highly rated by major rating agencies or have a long history of no credit losses. There was no allowance for credit loss on held-to-maturity debt securities as of December 31, 2025 and 2024.

Allowance for Credit Losses – Available-For-Sale Securities: For available-for-sale debt securities in an unrealized loss position, the Company first assesses whether it intends to sell, or it is more likely than not that it will be required to sell the security before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the security's amortized cost basis is written down to fair value through income. For debt securities available-for-sale that do not meet the aforementioned criteria, the Company evaluates whether the decline in fair value has resulted from credit losses or other factors. In making this assessment, management considers the extent to which fair value is less than amortized cost, any changes to the rating of the security by a rating agency, and adverse conditions specifically related to the security, among other factors. If this assessment indicates that a credit loss exists, the present value of the cash flows expected to be collected from the security are compared to the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis, a credit loss exists and an allowance for credit losses is recorded for credit loss, limited by the amount that the fair value is less than the amortized cost basis. Any impairment that has not been recorded through an allowance for credit losses is recognized in other comprehensive income (loss).

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation (Continued)

Changes in the allowance for credit losses are recorded as a provision for (recapture of) credit loss expense (or reversal). Losses are charged against the allowance when management believes the uncollectibility on an available-for-sale security is confirmed or when either of the criteria regarding intent or requirement to sell is met. Accrued interest receivable on available for sale securities totaled \$1,366 and \$866 at December 31, 2025 and 2024, respectively, and is excluded from the estimate of credit losses.

Loans held for sale: Loans the Company originates with the intent to sell in the secondary market are classified as held for sale. Loans held for sale consist of first mortgage loans that are secured by residential real estate. The Company elected the fair value option for loans held for sale, and accordingly, all loans held for sale are recorded at fair value, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

Loans and direct lease financing receivables (loans):

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs, and an allowance for credit losses. Accrued interest receivable on loans totaled \$6,928 and \$7,100 at December 31, 2025 and 2024, respectively, and was reported in accrued interest receivable and other assets on the consolidated balance sheets and is excluded from the allowance for credit losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level yield method without anticipating prepayments.

Interest income on loans is discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. Consumer loans are typically charged off no later than 180 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. A loan is moved to non-accrual status in accordance with the Company's policy, typically after 90 days of non-payment.

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The Company's leasing operations consist of the leasing of various types of equipment and trucks used in manufacturing, construction and agricultural operations. For direct financing leases, the total net rentals receivable and the estimated residual value of the leased equipment, net of unearned income, are recorded as a net investment in direct financing leases, and the unearned income is recognized each month as it is earned so as to provide a constant periodic rate of return on the unrecovered investment.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation (Continued)

Allowance for loan and lease losses: The allowance for credit losses is a valuation account that is deducted from the loans' and leases' amortized cost basis to present the net amount expected to be collected. Loans and direct financing leases are charged against the allowance for loan and lease losses when management believes that collectability of the principal is unlikely. Subsequent recoveries, if any, are credited to the allowance.

Management estimates the allowance using relevant available information from internal and external sources, relating to past events, current conditions, and reasonable and supportable forecasts for an eight-quarter period. No reversion adjustments were necessary, as the starting point in the Company's estimate was a cumulative loss rate covering the expected contractual term of the portfolio. The Company uses historical credit loss experience and benchmark data to provide a basis for expected credit losses.

The methodology for estimating the amount of expected credit losses reported in the allowance for credit losses includes a pooled component for estimated expected credit losses for loan segments that share similar risk characteristics. These loan segments include commercial; commercial real estate; agricultural, including real estate; residential real estate; consumer; and direct financing leases. The Company employs a model based on probability of default and loss given default estimates. The model also utilizes a transition matrix approach that calculates an expected loss percentage for each loan segment by considering the probability of default, based upon the historical transition of loans from performing (various pass loan risk ratings) to criticized, and classified loan risk ratings to default.

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 credit losses and may require the Company to make additions to the allowance based on their judgment about information available to them at the time of their examination.

Qualitative adjustments to historical loss information are made for differences in current loan-specific risk characteristics such as: changes in the lending policies and procedures, including underwriting standards and collection, charge off, and recovery practices; changes in the nature and volume of the loan portfolio; changes in the experience, ability and depth of lending management and staff; changes in the quality of the institution's loan review system and the degree of oversight of the institution's board of directors; the existence and effect of any concentrations of credit, and changes in the level of such concentrations; the effect of external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the institution's current portfolio.

Loans that do not share risk characteristics are evaluated on an individual basis. Loans evaluated individually are not also included in the collective evaluation. When management determines that foreclosure is probable expected credit losses are based on the fair value of the collateral at the reporting date, adjusted for selling costs as appropriate.

Expected credit losses are estimated over the contractual term of the loans, adjusted for expected prepayments when appropriate. The contractual term excludes expected extensions, renewals, and modifications unless those options are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the Company.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation (Continued)

Allowance for Credit Losses on Off-Balance Sheet Credit Exposures: The Company estimates expected credit losses over the contractual period in which the Company is exposed to credit risk via a contractual obligation to extend credit unless that obligation is unconditionally cancellable by the Company. The allowance for credit losses on off-balance sheet credit exposures is adjusted through provision for (recapture of) credit loss expense. The estimate includes consideration of the likelihood that funding will occur and an estimate of expected credit losses on commitments expected to be funded over its estimated life. This liability is included in accrued interest payable and other liabilities on the consolidated balance sheet for the years ended December 31, 2025 and December 2024. The balance of this liability as of December 31, 2025 and 2024 was \$1,451 and \$1,864, respectively.

Operating leases: For operating leases in which the Company is the lessor, the cost of the equipment is recorded as an asset and is depreciated over its estimated useful life and the rental income is recognized ratably as the lease rental payments are earned. Rental income is included in the caption, other noninterest income, in the consolidated statements of income. All leases are short-term in nature and the Company elected the practical expedient where it is not required to calculate and recognize a right of use asset and lease liability on the balance sheet.

Investment in restricted stock: The Company is a member of the Federal Home Loan Bank of Des Moines (FHLB) and, as such, is required to maintain a minimum investment in capital stock of the Federal Home Loan Bank that varies with the level of advances outstanding. The stock is bought from and sold to the FHLB based upon its \$100 par value. The stock does not have a readily determinable fair value and, as such, is classified as restricted stock, carried at cost, and evaluated for impairment in accordance with guidance for depository and lending institutions. In accordance with this guidance, the stock's value is determined by the ultimate recoverability of the par value rather than by recognizing temporary declines. The determination of whether the par value will ultimately be recovered is influenced by criteria such as the following: (a) the significance of the decline in net assets of the FHLB as compared to the capital stock amount and the length of time this situation has persisted, (b) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance, (c) the impact of legislative and regulatory changes on the customer base of the FHLB and (d) the liquidity position of the FHLB.

Management has determined that the FHLB stock and Federal Reserve Bank stock were not impaired at December 31, 2025 and 2024.

Premises and equipment: Premises and equipment are stated at cost less accumulated depreciation. Depreciation is provided principally on a straight-line basis over the estimated useful lives of the assets. Land is reported under premises and equipment and carried at cost. The cost of maintenance and repairs is charged to expense as incurred, and significant improvements are capitalized. At the time of sale or disposition of an asset, the applicable cost and accumulated depreciation are removed from the books.

Transfers of financial assets: Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company, 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 the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation (Continued)

Mortgage servicing rights: The Company sells loans to investors in the secondary market and generally retains the right to service mortgage loans originated or purchased from unaffiliated correspondent banks. Mortgage servicing rights retained are initially measured at fair value, with the income statement effect recorded in gains on sales of loans, and have been recognized as a separate asset and are being amortized in proportion to and over the period of estimated net servicing income.

Servicing rights are subsequently measured using the amortization method which requires servicing rights to be amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. Mortgage servicing rights are periodically evaluated for impairment based on the fair value of those rights. Fair values are estimated using discounted cash flows based on current market rates of interest. For purposes of measuring impairment, the rights must be stratified by one or more predominant risk characteristics of the underlying loans. The Company stratifies its capitalized mortgage servicing rights based on the interest rates of the underlying loans. The amount of impairment recognized is the amount, if any, by which the amortized cost of the rights for each stratum exceeds their fair value.

Servicing fee income, which is reported on the consolidated statements of income in loan servicing fees, is recorded for fees earned for servicing loans. The fees are based on a fixed amount per loan and recorded as income when earned. Servicing fees totaled \$6,718 and \$6,867 for the years ended December 31, 2025 and 2024 respectively. Late fees and ancillary fees related to loan servicing are not material.

The Company recognizes it could experience some make-whole costs for loans serviced that are sold on the secondary market. If those mortgages go through foreclosure and there is a loss, the government sponsored entity may require the Company to cover any losses if it is proven that the Company failed to follow underwriting requirements at the time. In order to estimate the necessary reserve for this loss, management analyzed the historical claims rate and the loss severity for the origination years from 2000 through 2024 and applied that to the outstanding balances. As the government sponsored entities are no longer reviewing loans they acquired prior to 2009, a discount was applied to those remaining balances. Finally, management analyzed the improvement in the economy from 2009 to 2024 and applied an adjustment factor to recognize the improvement. The secondary market buyback reserve at December 31, 2025 and 2024 was \$100.

Loan commitments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when funded.

Derivative assets and liabilities: All derivatives are recognized as either assets or liabilities in the consolidated balance sheets. At the inception of a derivative contract, the Company designates the derivative as one of three types based on the Company's intentions and expectation of effectiveness as a hedge. These three types are a hedge of the fair value of a recognized asset or liability ("fair value hedge"), a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow hedge"), or an instrument with no hedging designation ("non-designated derivative"). For a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk, are recognized in current earnings as fair values change. For a cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. Changes in the fair value of derivatives not designated are reported currently in earnings, as noninterest income.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation (Continued)

Accrued settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged. Accrued settlements on derivatives not designated are reported in noninterest income. Cash flows from designated derivatives are classified in the cash flow statement the same as the cash flows of the items being hedged.

The Company formally documents the relationship between derivatives and hedged items, as well as the risk-management objective and the strategy for undertaking hedge transactions at the inception of the hedging relationship. This documentation includes linking the fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also assesses, both at the inception and on an ongoing basis, whether the derivative instruments that are designated are highly effective in offsetting changes in fair values or cash flows of the hedged items. The Company discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative is settled or terminates, a hedged forecasted transaction is no longer probable, a hedged firm commitment is no longer firm, or treatment of the derivative as a hedge is no longer appropriate or intended.

When hedge accounting is discontinued, subsequent changes in fair value of the derivative are recorded as noninterest income. When a fair value hedge is discontinued, the hedged asset or liability is no longer adjusted for changes in fair value and the existing basis adjustment is amortized or accreted over the remaining life of the asset or liability. When a cash flow hedge is discontinued but the hedged cash flows or forecasted transactions are still expected to occur, gains or losses that were accumulated in other comprehensive income are amortized into earnings over the same periods which the hedged transactions will affect earnings.

The Company is exposed to losses if a counterparty fails to make its payments under a contract where the company is in a net receiving position. The Company anticipates that the counterparties will be able to fully satisfy their obligations under the defined agreements. All of the contracts to which the Company is a party settle monthly or quarterly.

Mortgage Banking Derivatives: Commitments to fund mortgage loans (interest rate locks) to be sold into the secondary market and forward commitments for the future delivery of these mortgage loans are accounted for as non-designated derivatives. The fair value of the interest rate lock is recorded at the time the commitment to fund the mortgage loan is executed and is adjusted for the expected exercise of the commitment before the loan is funded. In order to economically hedge the change in interest rates resulting from its commitments to fund the loans, the Company enters into forward commitments for the future delivery of mortgage loans when interest rate locks are entered into. The fair value of these mortgage derivatives are estimated based on changes in mortgage interest rates from the date the interest on the loan is locked. Changes in the fair value of these derivatives are included in net gains on sales of loans on the consolidated statements of income.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation (Continued)

Interest rate swap on trust preferred securities: The Company uses derivative instruments to primarily protect against the risk of adverse interest rate movements on the cash flows of certain liabilities. Derivative instruments represent contracts between parties that usually require little or no initial net investment and result in one party delivering cash or another type of asset to the other party based upon a notional amount and an underlying asset as specified in the contract. A notional amount represents the number of units of a specific item, such as currency units. An underlying represents a variable, such as an interest rate or price index.

The amount of cash or other asset delivered from one party to the other is determined based upon the interaction of the notional amount of the contract with the underlying. Derivatives can also be implicit in certain contracts and commitments and are reported in accrued interest receivable and other assets on the consolidated balance sheet.

Goodwill: Represents the excess of the purchase price over the fair value of net assets acquired in business combinations. Goodwill is subject to an impairment test at least on an annual basis. The Company's goodwill impairment assessments in December 31, 2025, and 2024 concluded no impairment existed. Any future impairment will be recorded as noninterest expense in the period of assessment.

Intangibles: The core deposit intangible represents the capacity of the deposit accounts acquired in an acquisition to generate future income. The core deposit intangible is being amortized over the estimated three to eight year lives attributed to the deposits acquired. The amortization of the core deposit intangible was \$54 and \$263 in 2025 and 2024, respectively. The core deposit intangible was fully amortized in 2025 and there will be no future amortization in 2026.

Cash value of life insurance: The Company owns life insurance policies on certain key employees. Bank-owned life insurance is recorded at the amount that can be realized under the insurance contract at the consolidated balance sheets date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Other real estate: Assets are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

Income taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred taxes are provided on an asset and liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss or tax credit carryforwards, and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the amounts of assets and liabilities recorded for income tax and financial reporting purposes. Deferred tax assets are reduced by a valuation allowance when management determines that it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation (Continued)

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

Other equity investments: The Company has investments in low-income housing tax credits and has purchased eligible renewable energy tax credits which are recognized in accrued interest receivable and other assets on the balance sheet and as a component of income tax expense, respectively. These equity investments in entities which are not consolidated because the Company does not own more than a 50% interest or exercise control over the organization. Investments representing at least a 20% interest are generally accounted for using the equity method and investments in corporations representing less than 20% interest are generally accounted for at cost. All of these investments are periodically evaluated for impairment. Should an investment be impaired, it would be written down to its estimated fair value. The other investments are reported in other assets and the income and expense from such investments, if any, is reported in non-interest income and non-interest expense. Other investments totaled \$15,321 in 2025 and \$14,681 in 2024. These investments include historic and solar tax credits, along with other equity investments.

Employee stock ownership plan: The Company provides a noncontributory employee stock ownership plan covering substantially all employees eligible as to age and length of service. The amount of the contribution to the plan is determined annually at the discretion of the Board of Directors. Contributions are allocated to participants based on the ratio of each participant’s compensation to total compensation of all participants. The cost of shares issued to the ESOP, but not yet allocated to participants, is shown as a reduction of shareholders’ equity. Dividends on allocated ESOP shares reduce retained earnings; dividends on unearned ESOP shares is recorded as an expense and increases retained earnings.

Salary 401(k) plan: The Company provides a 401(k) plan, which covers substantially all of the Company’s employees who are eligible as to age and length of service. A participant may elect to make contributions of up to the maximum allowed by law of the participant’s annual compensation. The Company makes matching contributions up to three hundred dollars for each participant. Matching contributions of \$133 and \$123 were made in 2025 and 2024, respectively.

Earnings per common share: Basic earnings per share is calculated by dividing net income by the weighted-average common shares outstanding during the year. ESOP shares allocated to participants and shares released for allocation are treated as outstanding for purposes of computing weighted-average common shares outstanding. The weighted-average number of shares of common stock used to compute basic earnings per share was 7,902,554 and 7,926,015 in 2025 and 2024, respectively.

Comprehensive income: Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale and unrealized gains and losses on interest rate swaps which are also recognized as separate components of equity.

Loss contingencies: Loss contingencies, such as claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable, and an amount or range of loss can be reasonably estimated. Management does not believe there are such matters which exist now that will have a material effect on the financial statements.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 1. Basis of Presentation (Continued)

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates

Reclassification: Certain amounts in the 2024 consolidated financial statements have been reclassified to conform to the 2025 presentation.

Subsequent events: In preparing these consolidated financial statements, the Company has evaluated events and transactions for potential recognition or disclosure through February 13, 2026, the date the consolidated financial statements were available to be issued.

Note 2. Restrictions on Cash and Cash Equivalents

The subsidiary banks may be required to maintain reserve balances, in cash on premises or on deposit with the Federal Reserve Bank, based upon a percentage of deposits. There was no required reserve balance for the Company as of December 31, 2025 and 2024.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 3. Securities

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

	December 31, 2025				
	Amortized Cost	Gross	Gross	Credit Loss Recognized	Fair Value
		Unrealized Gains	Unrealized Losses		
Securities available for sale:					
GSE residential mortgage-backed securities	\$ 249,990	\$ 2,312	\$ (1,916)	\$ -	\$ 250,386
GSE collateralized residential mortgage obligations	136,804	911	(7,881)	-	129,834
Obligations of states and political subdivisions	41	-	-	-	41
US government corporations and agencies	1,575	-	(13)	-	1,562
GSE commercial mortgage-backed securities	19,742	-	(745)	-	18,997
Total securities available for sale	<u>\$ 408,152</u>	<u>\$ 3,223</u>	<u>\$ (10,555)</u>	<u>\$ -</u>	<u>\$ 400,820</u>
Securities held to maturity:					
GSE residential mortgage-backed securities	\$ 24,609	\$ 64	\$ (1,154)	\$ -	\$ 23,519
GSE collateralized residential mortgage obligations	8,614	-	(1,011)	-	7,603
Obligations of states and political subdivisions	265	7	-	-	272
GSE commercial mortgage-backed securities	4,046	48	(38)	-	4,056
Total securities held to maturity	<u>\$ 37,534</u>	<u>\$ 119</u>	<u>\$ (2,203)</u>	<u>\$ -</u>	<u>\$ 35,450</u>
	December 31, 2024				
	Amortized Cost	Gross	Gross	Credit Loss Recognized	Fair Value
		Unrealized Gains	Unrealized Losses		
Securities available for sale:					
GSE residential mortgage-backed securities	\$ 160,509	\$ 167	\$ (5,157)	\$ -	\$ 155,519
GSE collateralized residential mortgage obligations	103,557	212	(12,173)	-	91,596
Obligations of states and political subdivisions	54	-	-	-	54
US government corporations and agencies	6,828	-	(88)	-	6,740
GSE commercial mortgage-backed securities	30,578	4	(1,342)	-	29,240
Total securities available for sale	<u>\$ 301,526</u>	<u>\$ 383</u>	<u>\$ (18,760)</u>	<u>\$ -</u>	<u>\$ 283,149</u>
Securities held to maturity:					
GSE residential mortgage-backed securities	\$ 21,681	\$ 13	\$ (1,906)	\$ -	\$ 19,788
GSE collateralized residential mortgage obligations	10,010	-	(1,483)	-	8,527
Obligations of states and political subdivisions	293	4	-	-	297
GSE commercial mortgage-backed securities	4,073	-	(104)	-	3,969
Total securities held to maturity	<u>\$ 36,057</u>	<u>\$ 17</u>	<u>\$ (3,493)</u>	<u>\$ -</u>	<u>\$ 32,581</u>

GSE indicates government-sponsored enterprises, such as Federal National Mortgage Association (FNMA) or Federal Home Loan Mortgage Corporation (FHLMC).

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 3. Securities (Continued)

The amortized cost and fair value of the securities portfolio are shown by contractual maturity as of year-end 2025. Contractual maturities may differ from expected maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately:

	Amortized Cost	Fair Value
Available-for-Sale		
Due after one year through five years	\$ 41	\$ 41
Due after ten years	1,575	1,562
GSE residential mortgage-backed securities	249,990	250,386
GSE collateralized residential mortgage obligations	136,804	129,834
GSE commercial mortgage-backed securities	19,742	18,997
	<u>\$ 408,152</u>	<u>\$ 400,820</u>
Held-to-Maturity		
Due after one year through five years	\$ 87	\$ 87
Due after five years through ten years	178	185
GSE residential mortgage-backed securities	24,609	23,519
GSE collateralized residential mortgage obligations	8,614	7,603
GSE commercial mortgage-backed securities	4,046	4,056
	<u>\$ 37,534</u>	<u>\$ 35,450</u>

Net gain and (loss) on the sale of securities was \$114 and (\$1,175) in 2025 and 2024, respectively. Realized gains were \$407 and \$0 and realized losses were \$293 and \$1,175 on sales proceeds of \$67,571 and \$26,734 in 2025 and 2024, respectively. The Company sold its VISA B shares in 2024, resulting in Other Income reported of \$1,706.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 3. Securities (Continued)

As of December 31, 2025, the Bank's security portfolio consisted of 157 securities, 74 of which were in an unrealized loss position. The unrealized losses related primarily to changes in interest rates and are expected to vary with the movement of interest rates. No credit issues have been identified that cause management to believe the declines in market values are other than temporary. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, industry analysts' reports and projected cash flows, when applicable. Held-to-maturity securities are performing as agreed and non are classified as nonaccrual at December 31, 2025.

Unrealized losses on securities have not been recognized into income because the issuers bonds are of high credit quality, management does not intend to sell, and it is not more likely than not that management would be required to sell the bonds prior to their anticipated recovery, and the decline in fair value is largely due to changes in interest rates and other market conditions. The fair value is expected to recover as the bonds approach maturity.

There were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of stockholders' equity.

Pledged securities: Securities with a carrying value of \$90,454 and \$118,909 at December 31, 2025 and 2024, respectively, were pledged to secure public deposits, FHLB repurchase agreements, and for other purposes as required or permitted by law.

Note 4. Loans Held for Sale and Loan Servicing

Loans held for sale consist of the following:

	December 31	
	2025	2024
Loans held for sale, unpaid principal balance	\$ 13,880	\$ 1,022
Fair value adjustment	134	27
Total loans held for sale	<u>\$ 14,014</u>	<u>\$ 1,049</u>

Mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of these loans are as follows:

	December 31	
	2025	2024
Mortgage loan portfolios serviced for:		
FNMA	\$ 1,740,447	\$ 1,836,728
FHLMC	706,747	650,733
	<u>\$ 2,447,194</u>	<u>\$ 2,487,461</u>

Outstanding commitments at year-end:		
Commitments to fund loans	\$ 8,837	\$ 10,357
Commitments to sell loans	\$ 9,185	\$ 1,862

Merchants Financial Group, Inc. and Subsidiary

**Notes to Consolidated Financial Statements
(In Thousands, Except Share Information)**

Note 4. Loans Held for Sale and Loan Servicing (Continued)

Mortgage servicing rights, net of valuation allowance, are summarized as follows:

	Years Ended December 31	
	2025	2024
Balance at beginning of year, net	\$ 14,801	\$ 15,339
Mortgage servicing rights capitalized:		
Loans originated	1,586	1,569
Loans purchased	554	551
Amortization expense	(2,958)	(2,868)
Valuation provision change	(183)	210
Balance at end of year, net	<u>\$ 13,800</u>	<u>\$ 14,801</u>

The valuation allowance at December 31, 2025 and 2024, was \$184 and \$1, respectively, with the impairment loss recognized in mortgage servicing rights on the consolidated statements of income. The estimated fair value of the servicing assets aggregated \$31,160 and \$33,620 at December 31, 2025 and 2024, respectively. Fair value is estimated by discounting estimated future cash flows from the servicing assets using discount rates that approximate current market rates and using current expected future prepayment rates.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases

Composition of loans and direct financing leases receivable:

	December 31	
	2025	2024
Commercial	\$ 398,823	\$ 406,584
Commercial real estate	1,147,210	1,208,065
Agricultural, including real estate	140,968	143,847
Residential real estate	278,825	274,468
Consumer	50,844	55,883
Direct financing leases	23,688	29,127
Total loans	2,040,358	2,117,974
Less unearned income on loans and leases	3,046	3,199
Less allowance for credit losses	25,996	28,490
Loans and direct financing leases, net	<u>\$ 2,011,316</u>	<u>\$ 2,086,285</u>

Loans pledged to the Federal Home Bank of Des Moines for notes payable are discussed at Note 10.

Loans are made to individuals as well as commercial and tax-exempt entities. Specific loan terms vary as to interest rate, repayment and collateral requirements based on the type of loan requested and the creditworthiness of the prospective borrower. Credit risk tends to be geographically concentrated in that a majority of the loan customers are located in the markets serviced by the Company.

The Company's extension of credit is governed by the individual loan policies that were established to control the quality of the Company's loans. These policies and procedures are reviewed and approved by the Board of Directors on a regular basis.

Commercial loans: Commercial operating and term loans are originated in the Company's primary service area. These loans are made to individuals, partnerships, corporations, limited liability partnerships and limited liability companies for the purpose of assisting in the development of a business enterprise. Loans to closely held businesses will generally be guaranteed in full or for a meaningful amount by the business' major owners. Commercial loans are made based primarily on the historical and projected cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not perform as forecasted, and collateral securing loans may fluctuate in value due to economic or individual performance factors. Minimum standards and underwriting guidelines have been established for all commercial loan types.

Commercial real estate loans: The Company's goal is to create and maintain a high-quality portfolio of commercial real estate loans with customers who meet the quality and relationship profitability objectives of the Company. Commercial real estate loans are subject to underwriting standards and processes similar to commercial operating and term loans. These loans are analyzed using projected cash flows, and the repayment of these loans is largely dependent on the successful operation of the property. Loan performance may be adversely affected by factors impacting the general economy or conditions specific to the real estate market, such as geographic location and property type.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

Agricultural, including real estate: Agricultural operating and term loans are originated in the Company's primary service area and are generally used to purchase agricultural equipment or crop inputs. These loans are primarily secured by agricultural real estate and agricultural equipment or crops. Agricultural term and operating loans are made based primarily on the historical and projected cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not behave as forecasted, and collateral securing loans may fluctuate in value due to economic or individual performance factors. Minimum standards and underwriting guidelines have been established for all agricultural loan types.

The Company originates loans secured by agricultural real estate in its service area. Agricultural land in the Company's service area is considered to be prime agricultural land. These loans are underwritten using both a cash flow analysis and appraised values.

Residential real estate loans: The Company originates residential real estate loans in its service area. The underwriting process consists of a credit analysis, employment history, and an analysis of the secured real estate property. A significant portion of the residential real estate loans originated is sold in the secondary market and is required to meet the underwriting standards of the purchaser.

Consumer loans: The Company originates direct consumer loans, including personal, credit cards, recreational and vehicle loans, using a credit analysis as part of the underwriting process. Each loan type has a separate specified scoring that consists of several factors, including debt to income, type of collateral, loan to collateral value, credit history and the Company's relationship with the borrower.

Direct financing leases: Direct financing leases are originated in the Company's primary service area, and the equipment leased consists primarily of trucks, construction and agricultural equipment. Under the direct financing method of accounting, the minimum lease payments to be received under the lease contract, together with the guaranteed residual values, which range from 0.00% to 41.01% of the cost of related equipment which average 3.55%, are recorded as lease receivables when the lease is signed and the leased property is delivered to the customer. Direct financing leases are made based primarily on the historical and projected cash flow of the lessee and secondarily on the underlying equipment leased to the lessee. The cash flows of lessees, however, may not perform as forecasted, and collateral securing these leases may fluctuate in value due to economic or individual performance factors. Minimum standards and underwriting guidelines have been established for all direct financing leases.

Minimum lease payments: At December 31, 2025, the minimum future lease payments, including guaranteed residual values, unearned initial direct costs and unearned amounts, due under the direct financing leases are as follows:

Years Ending December 31,

2026	\$	8,359
2027		6,193
2028		4,212
2029		2,338
2030		1,699
Thereafter		887
Total lease payments receivable		<u>23,688</u>
Unearned lease residual income		(2,590)
Net investment in direct financing leases	\$	<u>21,098</u>

Merchants Financial Group, Inc. and Subsidiary

**Notes to Consolidated Financial Statements
(In Thousands, Except Share Information)**

Note 5. Loans and Direct Financing Leases (Continued)

Loans receivable aging by class:

	December 31, 2025					
	Current	30–59 Days Past Due	60–89 Days Past Due	Loans Past Due 90 Days or More	Total Past Due	Total
Commercial	\$ 397,163	\$ 597	\$ 641	\$ 422	\$ 1,660	\$ 398,823
Commercial real estate	1,143,953	3,257	-	-	3,257	1,147,210
Agricultural, including real estate	140,081	121	766	-	887	140,968
Residential real estate	276,457	955	366	1,047	2,368	278,825
Consumer	50,145	490	35	174	699	50,844
Direct financing leases	23,370	318	-	-	318	23,688
Total loans	\$ 2,031,169	\$ 5,738	\$ 1,808	\$ 1,643	\$ 9,189	\$ 2,040,358

	December 31, 2024					
	Current	30–59 Days Past Due	60–89 Days Past Due	Loans Past Due 90 Days or More	Total Past Due	Total
Commercial	\$ 403,705	\$ 1,500	\$ 1,006	\$ 373	\$ 2,879	\$ 406,584
Commercial real estate	1,206,721	699	-	645	1,344	1,208,065
Agricultural, including real estate	143,625	202	20	-	222	143,847
Residential real estate	270,065	3,329	221	853	4,403	274,468
Consumer	54,863	768	187	65	1,020	55,883
Direct financing leases	29,127	-	-	-	-	29,127
Total loans	\$ 2,108,106	\$ 6,498	\$ 1,434	\$ 1,936	\$ 9,868	\$ 2,117,974

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

The amount of interest income recognized on nonaccrual loans was \$207 and \$218 as of December 31, 2025 and 2024, respectively.

Recorded investment in nonaccrual loans and loans past due 90 days or more and still accruing by class of loans as of December 31, 2025 and 2024, were as follows:

	Nonaccrual With No Credit Loss	Nonaccrual With Credit Loss	Loans Past Due 90 Days or More and Still Accruing
2025			
Commercial	\$ 1,712	\$ 557	\$ -
Commercial real estate	10,356	-	-
Agricultural, including real estate	-	-	-
Residential real estate	2,130	1,814	-
Consumer	81	201	72
Direct financing leases	-	156	-
Total	\$ 14,279	\$ 2,728	\$ 72
2024			
Commercial	\$ 392	\$ 1,407	\$ 210
Commercial real estate	1,298	913	-
Agricultural, including real estate	170	-	-
Residential real estate	925	1,003	-
Consumer	283	80	50
Direct financing leases	16	257	-
Total	\$ 3,084	\$ 3,660	\$ 260

The Company categorizes loans into risk categories based on relevant information about the ability of the borrower to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company utilizes an internal asset classification system as a means of reporting problem and potential problem loans. Under the Company's risk rating system, the Company classifies problem and potential problem loans as "special mention," "substandard" and "doubtful." Loans classified as special mention have potential weaknesses which may, if not checked or corrected, weaken the loan or inadequately protect the Company's credit position at some future date. Substandard loans include those characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Deficiencies may include negative net income, debt service coverage ratio below 1.0, high financial leverage or low liquidity, or insufficient collateral. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Risk ratings are updated any time the situation warrants.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

Loans not meeting the criteria above that are analyzed individually as part of the above-described process are considered to be pass-rated loans. The analysis includes the non-homogeneous loans, such as commercial and commercial real estate loans. The analysis is performed on a quarterly basis. Homogeneous loans are evaluated at origination and when a loan becomes delinquent. The following tables present the risk category of loans by class of loans based on the most recent analysis performed and the contractual aging:

		December 31, 2025								
		Amortized Cost Basis by Origination Year								
		2025	2024	2023	2022	2021	Prior	Revolving	Revolving to Term	Total
Commercial										
Pass	\$	107,516	\$ 80,423	\$ 74,885	\$ 35,598	\$ 9,141	\$ 5,997	\$ 65,152	\$ -	\$ 378,712
Special Mention		345	198	27	-	73	116	1,710	-	2,469
Substandard		2,590	1,610	4,421	3,271	700	1,521	3,529	-	17,642
Doubtful		-	-	-	-	-	-	-	-	-
Total		110,451	82,231	79,333	38,869	9,914	7,634	70,391	-	398,823
Commercial real estate										
Pass		51,059	43,151	174,939	344,478	142,095	292,238	8,500	-	1,056,460
Special Mention		680	9,336	462	1,029	7,210	6,539	-	-	25,256
Substandard		2,068	726	3,948	16,963	12,217	29,572	-	-	65,494
Doubtful		-	-	-	-	-	-	-	-	-
Total		53,807	53,213	179,349	362,470	161,522	328,349	8,500	-	1,147,210
Agricultural, including real estate										
Pass		10,250	4,649	10,951	17,169	9,110	36,280	20,424	-	108,833
Special Mention		537	183	-	376	86	4,237	2,912	-	8,331
Substandard		2,095	1,476	1,164	2,296	1,736	5,662	9,375	-	23,804
Doubtful		-	-	-	-	-	-	-	-	-
Total		12,882	6,308	12,115	19,841	10,932	46,179	32,711	-	140,968
Residential real estate										
Pass		48,290	7,305	42,715	30,931	10,484	26,299	102,513	-	268,537
Special Mention		-	-	594	-	187	148	127	-	1,056
Substandard		23	82	172	2,750	1,480	1,949	2,776	-	9,232
Doubtful		-	-	-	-	-	-	-	-	-
Total		48,313	7,387	43,481	33,681	12,151	28,396	105,416	-	278,825
Consumer										
Pass		7,856	4,861	6,440	4,381	1,326	665	24,068	-	49,597
Special Mention		-	9	15	37	7	-	360	-	428
Substandard		185	116	246	39	35	101	97	-	819
Doubtful		-	-	-	-	-	-	-	-	-
Total		8,041	4,986	6,701	4,457	1,368	766	24,525	-	50,844
Direct financing leases										
Pass		7,369	5,188	5,296	2,530	1,224	1,390	-	-	22,997
Special Mention		-	-	-	-	-	-	-	-	-
Substandard		344	-	304	29	5	9	-	-	691
Doubtful		-	-	-	-	-	-	-	-	-
Total		7,713	5,188	5,600	2,559	1,229	1,399	-	-	23,688
Total loans	\$	241,207	\$ 159,313	\$ 326,579	\$ 461,877	\$ 197,116	\$ 412,723	\$ 241,543	\$ -	\$ 2,040,358

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

		December 31, 2024							
		Amortized Cost Basis by Origination Year							
		2024	2023	2022	2021	Prior	Revolving	Revolving to Term	Total
Commercial									
	Pass	\$ 87,644	\$ 106,224	\$ 55,618	\$ 20,669	\$ 13,585	\$ 73,123	\$ -	\$ 356,863
	Special Mention	3,670	8,791	4,137	1,292	721	3,347	-	21,958
	Substandard	2,049	6,958	6,462	1,299	3,800	7,195	-	27,763
	Doubtful	-	-	-	-	-	-	-	-
	Total	93,363	121,973	66,217	23,260	18,106	83,665	-	406,584
Commercial real estate									
	Pass	47,849	186,755	376,536	164,912	360,044	1,772	-	1,137,868
	Special Mention	49	1,453	3,812	10,651	383	-	-	16,348
	Substandard	1,813	8,292	11,706	8,241	23,797	-	-	53,849
	Doubtful	-	-	-	-	-	-	-	-
	Total	49,711	196,500	392,054	183,804	384,224	1,772	-	1,208,065
Agricultural, including real estate									
	Pass	8,046	13,870	21,122	11,499	47,767	23,412	-	125,716
	Special Mention	-	-	-	-	1,099	-	-	1,099
	Substandard	1,120	2,140	875	1,091	8,553	3,253	-	17,032
	Doubtful	-	-	-	-	-	-	-	-
	Total	9,166	16,010	21,997	12,590	57,419	26,665	-	143,847
Residential real estate									
	Pass	34,165	53,201	35,764	13,612	33,055	93,394	-	263,191
	Special Mention	-	-	234	196	-	69	-	499
	Substandard	88	1,152	1,736	552	3,717	3,533	-	10,778
	Doubtful	-	-	-	-	-	-	-	-
	Total	34,253	54,353	37,734	14,360	36,772	96,996	-	274,468
Consumer									
	Pass	9,108	10,873	6,609	2,299	1,387	24,297	-	54,573
	Special Mention	-	20	46	-	-	451	-	517
	Substandard	92	241	65	29	291	75	-	793
	Doubtful	-	-	-	-	-	-	-	-
	Total	9,200	11,134	6,720	2,328	1,678	24,823	-	55,883
Direct financing leases									
	Pass	7,988	8,905	3,967	3,364	3,820	-	-	28,044
	Special Mention	-	-	-	-	-	-	-	-
	Substandard	474	248	166	138	57	-	-	1,083
	Doubtful	-	-	-	-	-	-	-	-
	Total	8,462	9,153	4,133	3,502	3,877	-	-	29,127
Total loans		\$ 204,155	\$ 409,123	\$ 528,855	\$ 239,844	\$ 502,076	\$ 233,921	\$ -	\$ 2,117,974

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

A loan or lease is classified as a modification when a borrower is experiencing financial difficulties that lead to a restructuring of the loan or lease, and the Company grants concessions to the borrower in the restructuring 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. A loan or lease that is modified at a market rate of interest may no longer be classified as a modification in the calendar year subsequent to the restructuring if it is in compliance with the modified terms. Performance prior to the restructuring is considered when assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual at the time of the restructuring or after a shorter performance period.

The terms of certain loans were modified to borrowers experiencing financial difficulties during the year ended December 31, 2025 with a total recorded investment of \$1,149. The recorded investment by loan category was \$737, \$369, and \$43 in commercial real estate, commercial, and residential real estate, respectively. The recorded investment by type of modification was \$294 and \$855 for combination payment delay and term extension, respectively. The weighted average term extension was 26 months.

The Company has not committed to lend any additional amounts to these borrowers. There were no payment defaults for loans modified for the year ended December 31, 2025. At December 31, 2025, all modified loans are performing in accordance with the modified terms.

The terms of certain loans were modified during the year ended December 31, 2024 with a total recorded investment of \$2,402. The modification of these loans involved a modification of the terms of a loan to borrowers who were not experiencing financial difficulties.

Occasionally, the company modifies loans to borrowers in financial distress by providing principal forgiveness and term extensions. When principal forgiveness is provided the amount of forgiveness is charged-off against the allowance for credit losses.

In some cases, the Company provides multiple types of concessions on one loan. Typically, one type of concession, such as a term extension, is granted initially. If the borrower continues to experience financial difficulty, another concession, such as principal forgiveness, may be granted. In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without modification. This evaluation is performed under the Company's internal underwriting policy.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 5. Loans and Direct Financing Leases (Continued)

The change in the allowance for credit losses on loans and off balance sheet credit exposures for the years ended December 31, 2025 and 2024, was as follows:

	Commercial	Commercial Real Estate	Agricultural	Residential Real Estate	Consumer	Direct Financing Leases	Allowance on loans	Allowance on off balance sheet credit exposures
Allowance for credit losses:								
January 1, 2024	\$ 5,000	\$ 16,871	\$ 1,746	\$ 3,526	\$ 674	\$ 328	\$ 28,145	\$ -
Reclassification of off balance sheet allowance	(856)	(1,345)	(172)	(713)	(29)	-	(3,115)	3,115
Charge-offs	(1,323)	(6,220)	-	(205)	(641)	(23)	(8,412)	-
Recoveries	330	-	-	4	186	-	520	-
Provision for credit losses	2,134	6,830	309	1,175	901	3	11,352	(1,251)
December 31, 2024	5,285	16,136	1,883	3,787	1,091	308	28,490	1,864
Charge-offs	(968)	(93)	-	(5)	(868)	(122)	(2,056)	-
Recoveries	238	78	-	20	395	5	736	-
Provision for (recapture of) credit losses	(502)	(1,463)	326	(93)	549	9	(1,174)	(413)
December 31, 2025	\$ 4,053	\$ 14,658	\$ 2,209	\$ 3,709	\$ 1,167	\$ 200	\$ 25,996	\$ 1,451

The following tables present the amortized cost basis of collateral dependent loans, by the primary collateral type, which are individually evaluated to determine expected credit losses:

	December 31, 2025			
	Primary Type of Collateral			
	Real Estate	Consumer	Equipment	Total
Commercial	\$ -	\$ -	\$ 2,426	\$ 2,426
Commercial real estate	8,637	-	1,719	10,356
Agricultural, including real estate	-	-	-	-
Residential real estate	3,941	-	-	3,941
Consumer	168	113	-	281
Direct Financing Leases	-	-	-	-
Total	\$ 12,746	\$ 113	\$ 4,145	\$ 17,004

	December 31, 2024			
	Primary Type of Collateral			
	Real Estate	Consumer	Equipment	Total
Commercial	\$ -	\$ -	\$ 1,715	\$ 1,715
Commercial real estate	6,947	-	714	7,661
Agricultural, including real estate	170	-	-	170
Residential real estate	2,323	-	-	2,323
Consumer	114	261	-	375
Direct Financing Leases	-	-	279	279
Total	\$ 9,554	\$ 261	\$ 2,708	\$ 12,523

Merchants Financial Group, Inc. and Subsidiary

**Notes to Consolidated Financial Statements
(In Thousands, Except Share Information)**

Note 6. Operating Leases

Investment in operating lease assets includes the following as of December 31, 2025 and 2024:

	Years Ended December 31	
	2025	2024
Operating lease assets	\$ 22,646	\$ 31,649
Less accumulated depreciation	(11,866)	(14,753)
Net investment in operating leases	<u>\$ 10,780</u>	<u>\$ 16,896</u>

Future minimum lease payments receivable under operating leases as of December 31, 2025, are as follows:

<u>Years Ending December 31,</u>	
2026	\$ 5,405
2027	3,132
2028	1,448
Thereafter	795
Total lease payments receivable	<u>\$ 10,780</u>

At December 31, 2025 and 2024, none of these operating leases were classified as nonaccrual.

Note 7. Premises and Equipment

	Useful Lives (Years)	December 31	
		2025	2024
Land and improvements	15–40	\$ 7,138	\$ 7,138
Buildings and improvements	10–40	36,158	36,306
Furniture and equipment	3–7	11,902	13,225
		<u>55,198</u>	<u>56,669</u>
Less accumulated depreciation		31,155	31,834
		<u>\$ 24,043</u>	<u>\$ 24,835</u>

Note 8. Other Real Estate Owned

An analysis of activity for other real estate owned is as follows:

	Years Ended December 31	
	2025	2024
Balance at beginning of year	\$ 6,457	\$ 1,005
Transfers from loans	1,692	6,039
Proceeds from sales	(7,109)	(554)
Net charge-offs/impairments	(452)	(105)
Net gain on sales	382	72
Balance at end of year	<u>\$ 970</u>	<u>\$ 6,457</u>

Merchants Financial Group, Inc. and Subsidiary

**Notes to Consolidated Financial Statements
(In Thousands, Except Share Information)**

Note 8. Other Real Estate Owned (continued)

Expenses applicable to other real estate owned assets include the following amounts reported in other noninterest expense:

	Years Ended December 31	
	2025	2024
Net gain on sales	\$ (382)	\$ (72)
Net charge-offs/impairments	452	105
Operating expenses, net of rental income	1,112	195
	<u>\$ 1,182</u>	<u>\$ 228</u>

Note 9. Deposits

	December 31	
	2025	2024
Demand deposits	\$ 476,273	\$ 463,169
Savings and NOW accounts	1,558,610	1,457,252
Time deposits	486,265	503,337
	<u>\$ 2,521,148</u>	<u>\$ 2,423,758</u>

The aggregate amount of time deposit accounts that exceed the FDIC insurance limit were \$135,616 and \$153,204 at December 31, 2025 and 2024, respectively.

At December 31, 2025, the scheduled maturities of time deposits are as follows:

Years Ending December 31,

2026	\$ 450,649
2027	27,821
2028	6,700
2029	909
2030	186
	<u>\$ 486,265</u>

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 10. Repurchase Agreements

	<u>December 31</u>	
	<u>2025</u>	<u>2024</u>
Customer repurchase agreements	<u>\$ 15,043</u>	<u>\$ 15,060</u>

Securities sold under agreements to repurchase are held by the Company. Customer repurchase agreements are due on demand with interest at 3.358 percent at December 31, 2025. Securities sold under agreements to repurchase are secured by securities with a carrying amount of \$20,720 at year end 2025.

The Company has an option to borrow from the FHLB and the borrowing capacity is determined by the amount of eligible collateral pledged. The Company has pledged to the FHLB its FHLB stock, certain loans with a carrying value of \$882,242 and \$893,468 at December 31, 2025 and 2024, respectively, to secure any borrowings. These loans also collateralize the fixed-rate advances outstanding to the FHLB.

Note 11. Notes Payable

The Company has an ESOP loan with US Bank that bears interest at the one-month CME TERM SOFR plus 2.25 (at December 31, 2025, the interest rate is approximately 6.12 percent). Management believes we are in compliance with the general covenants, conditions and agreements of this loan.

Future scheduled payments are as follows:

<u>Years Ending December 31,</u>	
2026	\$ 388
2027	399
2028	409
2029	403
	<u>\$ 1,599</u>

Note 12. Subordinated Debentures

Subordinated debentures of \$23,196 are owed to Merchants Capital Trust II and bear interest at the three-month CME TERM SOFR plus 1.30 percent (at December 31, 2025, the interest rate is approximately 5.21 percent). They mature October 31, 2037. Early redemptions are permitted. The debentures are unsecured and are subordinate to all other indebtedness of the Company.

Subordinated debentures of \$5,155 are owed to Merchants Capital Trust—Jerema, Inc. Capital Trust I and mature July 23, 2034. The interest rate is equal to the three-month CME TERM SOFR plus 2.70 percent (at December 31, 2025, the interest rate is approximately 6.36 percent). Early redemptions are permitted. The debentures are unsecured and are subordinate to all other indebtedness of the Company.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 12. Subordinated Debentures (continued)

The Company may redeem the subordinated debentures, in whole or in part, but in all cases in a principal amount with integral multiples of \$1,000, on any interest payment date on or after October 30, 2012 for Merchants Capital Trust II and on any interest payment date after July 23, 2009 for Merchants Capital Trust – Jerema, Inc Capital Trust I. The redemption price is 100% of the principal amount of the debentures being redeemed, plus accrued and unpaid interest. There were no debt issuance costs or underwriting fees related to the offering. The Company's investment in the common stock of the trusts was \$851 and is included in accrued interest receivable and other assets.

The Company has the option to defer interest payments on the subordinated debentures from time to time for a period not to exceed five consecutive years. As of year-end 2025, the Company has not deferred interest payments. The Company is not considered the primary beneficiary of this trust (variable interest entity); therefore, the trust is not consolidated in the Company's consolidated financial statements, but rather the subordinated debenture is shown as a liability.

The underlying capital securities of the trusts qualify under risk-based capital guidelines as Tier 1 capital for regulatory purposes to the extent they do not exceed 33 percent of Tier I capital, with the remainder allowed as Tier II capital.

Note 13. Income Taxes

On January 1, 2025, the Company adopted ASU 2023-09 Income Taxes (Topic 740) Improvements to Income Tax Disclosures, primarily related to the rate reconciliation and income taxes paid information. In accordance with this ASU, the following table discloses the difference between the statutory rate and effective rate attributed to state taxes, tax-exempt interest, valuation changes, and nontaxable or nondeductible items and tax credits. The quantitative threshold for disaggregation for December 31, 2025 and 2024, were \$431 and \$256 respectively. This ASU was adopted prospectively and did not have a material impact to the consolidated financial statements or results of operations, however did impact certain disclosures.

The Company files income tax returns in the U.S. federal and various state jurisdictions. With limited separate company state exceptions, the Company is no longer subject to income tax examinations by U.S. federal tax and state tax authorities for years before 2022. The Company has no unrecognized tax benefits as of December 31, 2025, and 2024.

Merchants Financial Group, Inc. and Subsidiary

**Notes to Consolidated Financial Statements
(In Thousands, Except Share Information)**

Note 13. Income Taxes (continued)

The cumulative tax effects of the temporary differences are shown in the following table:

	December 31	
	2025	2024
Deferred tax assets:		
Allowance for credit losses	\$ 8,696	\$ 8,549
Deferred compensation	659	546
Other	379	297
Unrealized loss on available-for-sale securities	2,050	5,137
Total deferred tax assets	<u>11,784</u>	<u>14,529</u>
Deferred tax liabilities:		
Direct financing leases	(4,901)	(5,538)
Mortgage servicing rights	(4,072)	(3,571)
Premises and equipment	(1,114)	(1,794)
Intangibles	(6,656)	(5,491)
Total deferred tax liabilities	<u>(16,743)</u>	<u>(16,394)</u>
Net deferred tax liabilities	<u>\$ (4,959)</u>	<u>\$ (1,865)</u>

The provision for income taxes charged to operations consists of the following:

	Year Ended December 31 2025
Current tax expense	
Federal	\$ 5,410
State	3,125
Total Current	<u>\$ 8,535</u>
Deferred tax expense	
Federal	\$ (89)
State	225
Total Deferred	<u>\$ 136</u>
Total income tax expense	
Federal	\$ 5,321
State	3,350
Total income tax expense	<u>\$ 8,671</u>
	Year Ended December 31 2024
Current tax expense	\$ 5,625
Deferred tax expense (benefit)	248
	<u>\$ 5,873</u>

Merchants Financial Group, Inc. and Subsidiary

**Notes to Consolidated Financial Statements
(In Thousands, Except Share Information)**

Note 13. Income Taxes (continued)

The Company did not have any Income tax expense in foreign jurisdictions.

At December 31, 2025 and 2024, there was no valuation allowance for deferred tax assets.

	Years Ended December 31	
	2025	
	Amounts	Percentages*
Income taxes at the U.S. federal statutory tax rate	\$ 8,619	21.0%
State and local income taxes, net of federal income tax benefit [1]	2,544	6.2%
Net Tax Credits taken, net of amortization:		
Renewable Energy Tax Credits	(1,024)	-2.5%
Low-income Housing Tax Credits	11	0.0%
Historic Tax Credits	(13)	0.0%
Other	-	0.0%
Changes in valuation allowances	-	0.0%
Nontaxable or nondeductible items:		
Tax exempt interest income	(762)	-1.9%
Forecasted K-1 Income/(Loss)	(340)	-0.8%
Bank owned life insurance income	(420)	-1.0%
Meals and entertainment	26	0.1%
Other adjustments	30	0.1%
Total	8,671	21.1%

* Percentages show on effective tax rate reconciliation are calculated as Reconciling Item Amount / Consolidated Pretax Income from Continuing Operations.

[1] State taxes in Minnesota make up the majority (greater than 50%) of the tax effect in this category.

	Year Ended December 31 2024
Computed "expected" tax expense	\$ 5,127
Increase (decrease) in income taxes resulting from:	
State income taxes, net of federal tax benefit	1,533
Tax-exempt interest income (net of disallowed expenses)	(671)
Tax credit amortization	556
Other	(672)
	\$ 5,873

The Company paid the following amounts in taxes to federal and state authorities in 2025:

	Years Ended December 31 2025
U.S. Federal taxes	\$ 2,100
State and local taxes	
Minnesota	2,006
Other states	117
Total income taxes paid	\$ 4,223

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 13: Income Taxes (continued)

In March 2023, the FASB issued ASU 2023-02, Investments – Equity Method and Joint Ventures – Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method (PAM). Allowing reporting entities to consistently account for equity investments made primarily for the purpose of receiving income tax credits and other income tax benefits.

The Company has investments that generate income tax credits and other income tax benefits from a tax credit program for which it has elected, on a tax-credit-program-by-tax-credit-program basis, to apply the proportional amortization method. The Company currently has \$15,321 of tax credit investments and they are recognized in Accrued interest receivable and other assets on the Consolidated Balance Sheet. The amount of amortization recognized as a component of income tax expense for 2025 and 2024 was \$1,360 and \$556, respectively. The income tax benefit recognized during the periods of 2025 and 2024 were \$1,389 and \$305. Due to the implementation of ASU 2023-02, the Company amortized \$163 of an equity investment in 2024, that was made in 2022 and benefits recognized in 2022 and 2023. The remaining future commitments on these related projects is \$5,344.

The Company also purchased a 2024 eligible renewable energy tax credit in 2025. The tax benefit of \$998 was recognized as a component of income tax expense in 2025. There is no future commitment to fund the project related to the renewable energy tax credit.

The amortization and benefits are recognized in the Provision for income taxes line on the Consolidated Statements of Income and as a net in the Cash Flows From Investing Activities in the Consolidated Statements of Cash Flows. There were no significant modifications or events that resulted in a change in the nature of the investments or a change in the relationship with the underlying projects in 2025.

Note 14: Commitments, Contingencies and Credit Risk

Financial instruments with off-balance-sheet risk: The Company is 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, credit card commitments and standby letters of credit. They involve, to varying degrees, elements of credit risk in excess of amounts recognized on the consolidated balance sheets.

The Company's exposure to credit loss in the event of nonperformance by the other parties to the financial instruments for these commitments is represented by the contractual amounts of the instruments. The Company uses the same credit policies in making commitments as it does for on-balance-sheet instruments. These commitments were as follows:

	December 31	
	2025	2024
Commitments to extend credit	\$ 592,225	\$ 545,875
Credit card commitments	100,570	100,686
Standby letters of credit	5,228	7,170
	<u>\$ 698,023</u>	<u>\$ 653,731</u>

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 14: Commitments, Contingencies and Credit Risk (continued)

Financial instruments with concentrations of credit risk:

Commitments to extend credit and credit card commitments: 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. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. If deemed necessary upon extension of credit, the amount of collateral obtained is based on management's credit evaluation of the party. Collateral held varies, but may include accounts receivable, crops, livestock, inventory, property and equipment, residential real estate and income-producing commercial properties. Credit card commitments are unsecured.

Standby letters of credit: Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required in instances which the Company deems necessary.

Concentration by institution: The nature of the Company's business requires that it maintain amounts due from banks that, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts.

Note 15. Employee Stock Ownership Plan

The Company has a leveraged employee stock ownership plan (ESOP). There were no shares purchased by the ESOP in 2023. The details of leveraged shares are as follows:

Year Leveraged	Shares Purchased	Price Paid	Cumulative Shares Released as of December 31, 2025	Cumulative Shares Released as of December 31, 2024
2020	201,189	\$ 30.00	117,094	97,298
2021	27,180	\$ 31.33	13,590	10,872
2022	68,850	\$ 35.00	27,540	20,655
2024	90,435	\$ 29.65	18,226	9,113
2025	98,584	\$ 30.75	2,385	

The ESOP shares were pledged as collateral for its debt. As the debt is repaid, shares are released from collateral and allocated to employees based on the proportion of loan principal paid during the year. The Company intends to make annual contributions to the ESOP sufficient for the ESOP to repay its loan, including interest. The shares pledged as collateral are deducted from stockholders' equity as unearned ESOP shares in the accompanying consolidated balance sheets. As shares are released from collateral, the Company reports compensation expense equal to the fair value of the shares, and the shares become outstanding for earnings per share computations.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 15. Employee Stock Ownership Plan (Continued)

The Company obtains an annual independent appraisal of fair value of its common shares. The appraised fair value as of December 31, 2025 and 2024, was \$30.75 per share and \$29.65 per share, respectively.

Dividends on allocated ESOP shares are recorded as a reduction of retained earnings; dividends on unallocated ESOP shares are recorded as compensation expense and may be used by the ESOP for debt service. Total ESOP compensation expense was \$2,494 and \$2,343 for the years ended December 31, 2025 and 2024, respectively.

Participants who receive shares of stock under the plan have a put option requiring the Company to repurchase the shares at fair value for a 60-day period after distribution of the shares and during the first 60 days of the next plan year. In addition, if a participant receives an offer from a third party to purchase the shares, the participant must first give the Company the option of purchasing the shares. In 2025, 120,604 shares were purchased from participants and retained by the ESOP, and in 2024, 117,545 shares were purchased and retained by the ESOP. In the event a terminated ESOP participant desires to sell his/her shares of the Company's stock, or for certain employees who elect to diversify their account balances, the Company may be required to purchase the shares from the participant at their fair market value. As permitted, the ESOP elected to purchase the shares in lieu of the Company. In addition, at December 31, 2025, 167,211 shares of the Company's stock, with an aggregate fair market value of approximately \$5,141 are held by ESOP participants who will be eligible to elect their diversification privileges under the ESOP during the year ending December 31, 2026.

Shares of the Company held by the ESOP at December 31, 2025 and 2024 are as follows:

	December 31	
	2025	2024
Allocated shares	1,155,211	1,192,730
Shares released for allocation	40,897	60,401
Unreleased (unearned) shares	307,403	249,716
Total shares held	<u>1,503,511</u>	<u>1,502,847</u>
Fair value of unreleased (unearned) shares	<u>\$ 9,493</u>	<u>\$ 7,725</u>

The fair value of allocated shares subject to repurchase obligation was \$36,780 as of December 31, 2025.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 16. Loans and Other Transactions With Related Parties

Shareholders, officers and directors of the Company, including their families and companies of which they are principal owners, are considered to be related parties. These related parties were loan customers of, and had other transactions with, the Company in the ordinary course of business. Total loans to related parties were approximately \$6,542 and \$7,507 at December 31, 2025 and 2024, respectively. Total deposits with related parties were approximately \$9,176 and \$11,318 at December 31, 2025 and 2024, respectively.

Note 17. Regulatory Capital Requirements

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

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end 2025 and 2024, the most recent notification from regulatory authorities categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the Bank's category.

Quantitative measures established by regulation to ensure capital adequacy require the Company and Bank to maintain minimum ratios (set forth in the following table) of total and Tier I capital to risk-weighted assets, of Tier I capital to average assets, and common equity Tier 1 capital (all as defined in the regulations). Management believes, as of December 31, 2025, that the Company and Bank meet all capital adequacy requirements to which they are subject.

Merchants Financial Group, Inc. and Subsidiary

**Notes to Consolidated Financial Statements
(In Thousands, Except Share Information)**

Note 17. Regulatory Capital Requirements (Continued)

The following table presents regulatory capital information for the Company.

	Actual		Minimum Capital Requirements		Well Capitalized Standard	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2025:						
Total capital (to risk-weighted assets):						
Consolidated	\$ 340,513	13.93%	\$ 256,668	>10.50	N/A	N/A
Merchants Bank	342,648	14.02%	256,538	>10.50	\$ 244,323	>10.0%
Common equity Tier 1 capital (to risk-weighted assets):						
Consolidated	287,017	11.74%	171,134	>7.0%	158,911	>6.5%
Merchants Bank	315,202	12.90%	171,027	>7.0%	158,810	>6.5%
Tier I capital (to risk-weighted assets):						
Consolidated	314,517	12.86%	207,884	>8.50%	N/A	N/A
Merchants Bank	315,202	12.90%	207,675	>8.50%	195,459	>8.0%
Leverage ratio:						
Consolidated	314,517	11.35%	110,843	>4.0%	N/A	N/A
Merchants Bank	315,202	11.28%	111,793	>4.0%	139,741	>5.0%
As of December 31, 2024:						
Total capital (to risk-weighted assets):						
Consolidated	\$ 318,628	12.88%	\$ 259,751	>10.50	N/A	N/A
Merchants Bank	320,728	12.98%	259,549	>10.50	\$ 247,189	>10.0%
Common equity Tier 1 capital (to risk-weighted assets):						
Consolidated	262,639	10.61%	173,277	>7.0%	160,900	>6.5%
Merchants Bank	290,374	11.75%	173,033	>7.0%	160,673	>6.5%
Tier I capital (to risk-weighted assets):						
Consolidated	290,138	11.73%	210,246	>8.50%	N/A	N/A
Merchants Bank	290,374	11.75%	210,111	>8.50%	197,752	>8.0%
Leverage ratio:						
Consolidated	290,138	10.81%	103,069	>4.0%	N/A	N/A
Merchants Bank	290,374	10.58%	109,793	>4.0%	137,241	>5.0%

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 17. Regulatory Capital Requirements (Continued)

In order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold a 2.5% capital conservation buffer, composed of common equity Tier 1 capital above its minimum risk-based capital requirements. The buffer is measured relative to risk-weighted assets.

The Company's principal source of funds for dividend payments in dividends received from the Bank. Banking regulations limits the amount of dividends that may be paid without prior approval of regulatory agencies. As of December 31, 2025, \$37,230 of retained earnings is available to pay dividends.

Note 18. Additional Cash Flow Information

Cash flows from securities:

	Years Ended December 31	
	2025	2024
Available-for-sale securities:		
Maturities, prepayments and calls	\$ 76,214	\$ 44,765
Sales	67,571	26,734
Purchases	(249,946)	(153,407)
Held-to-maturity securities:		
Maturities, prepayments and calls	4,962	4,694
Purchases	(6,418)	(2,997)
	<u>\$ (107,617)</u>	<u>\$ (80,211)</u>
Supplemental disclosures of cash flow information:		
Cash payments for interest	\$ 52,591	\$ 47,480
Cash payments for income taxes	4,223	8,532
Supplemental schedule of noncash investing and financing activities:		
Other real estate and other personal property owned acquired in settlement of loans	<u>\$ 1,692</u>	<u>\$ 6,039</u>

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 19. Derivatives

The Company entered into an interest rate swap agreement in 2023 with a notional amount of \$22,000. The interest rate swap contract was designated as a fair value hedging instrument with the objective of protecting against the risk of adverse interest rate movements on the cash flows of a fixed rate customer loan throughout a fifteen-year period with a three-year forward start date. The trade date was June 27, 2023, the effective date is June 1, 2026, and the maturity date is June 30, 2041. Under the swap, the Company will receive interest at a rate of CME TERM SOFR plus a margin of 1.555 percent and pay a fixed rate of 4.75 percent which agrees to the customer loan rate. The rate received by the Company as of December 31, 2025, was 5.24 percent.

The Company entered into an interest rate swap agreement in 2016 with a notional amount of \$13,000. The interest rate swap contract was designated as a cash flow hedging instrument with the objective of protecting against the risk of adverse interest rate movements on the cash flows of Merchants Trust II preferred securities throughout the ten year period beginning January 30, 2017 and ending January 30, 2027 from the risk of variability of those payments resulting from changes in the three-month CME TERM SOFR. Under the swap, the Company will pay a fixed interest rate of 3.463 percent and receive a variable interest rate of three-month CME TERM SOFR plus a margin of 1.30 percent on the notional amount, with quarterly settlements. The rate received by the Company as of December 31, 2025 was 4.95 percent.

The Company entered into an interest rate swap agreement in 2020 with an original notional amount of \$3,800. The notional amount was \$1,900 and \$1,520 as of December 31, 2025 and 2024 respectively. The interest rate swap contract was designated as a cash flow hedging instrument with the objective of protecting against the risk of adverse interest rate movements on the cash flows of Merchants ESOP loan throughout the nine year period beginning July 22, 2020 and ending December 31, 2029 from the risk of variability of those payments resulting from changes in the three-month CME TERM SOFR. Under the swap, the Company will pay a fixed interest rate of 2.50% and receive a variable interest rate of one-month CME TERM SOFR plus a margin of 2.25% on the notional amount, with semi-annual settlements. The rate received by the Company as of December 31, 2025 was 5.94%.

The hedges were all deemed to be effective during all periods presented. The Company expects the hedges to remain effective during the remaining terms of the swaps.

The estimated fair value of the interest rate derivative contracts outstanding was a gain of \$363 and \$814 as of December 31, 2025 and 2024, respectively, and was included in other assets in the consolidated balance sheets.

The effective portion of the gain due to changes in the fair value of the derivative hedging instrument, net of tax, was a loss of \$325 and a loss of \$296 for the years ended December 31, 2025 and 2024, respectively. This is included in other comprehensive income. No ineffectiveness related to the interest rate derivative was recognized during the reporting period. Therefore, changes in the fair value of the interest rate swap have had no impact on net income.

There were no net cash flows as a result of the interest rate swap agreements for the years ended December 31, 2025 and 2024. Cash is only disbursed or received upon exceeding contractual thresholds.

The Company was in receipt of \$1,840 and \$2,230 cash as collateral related to the derivative contracts at December 31, 2025 and 2024, respectively, due to fluctuations in the market.

There are no credit-risk-related contingent features associated with our derivative contracts.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 20. Fair Value Measurements

ASC Topic 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

ASC Topic 820 requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert expected future amounts, such as cash flows or earnings, to a single present value amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, ASC Topic 820 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

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

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

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

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 20. Fair Value Measurements (Continued)

The fair value hierarchy is as follows:

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Investment securities available for sale: The fair value of residential mortgage-backed securities and collateralized residential mortgage obligations is generally determined based on matrix pricing. Matrix pricing is a mathematical technique that utilizes observable market inputs including, for example, yield curves, credit ratings and prepayment speeds. Fair values determined using matrix pricing are categorized as Level 2 in the fair value hierarchy.

The fair value of investments in obligations of states and political subdivisions is generally based on a discounted cash flow model that uses significant inputs, such as credit rating, coupon rate, maturity date and call features, some of which are unobservable in the markets. Fair values determined using a discounted cash flow analysis with significant unobservable inputs are categorized as Level 3 in the fair value hierarchy. The activity of investments in obligations of states and political subdivisions for the years ended December 31, 2025 and 2024 are as follows:

	Years Ended December 31	
	2025	2024
Balance, beginning	\$ 54	\$ 90
Maturities	(13)	(35)
Change in unrealized gain/loss	-	(1)
Balance, ending	<u>\$ 41</u>	<u>\$ 54</u>

Interest rate lock commitments and forward sale commitments: Interest rate lock commitments related to the origination of mortgage loans that will be sold are considered derivative instruments. The Company estimates the fair value of these derivatives using the difference between the guaranteed interest rate in the commitment and the current market interest rate plus the present value of estimated cash flow from servicing and marketing gains. To reduce the net interest rate exposure arising from its loan sale activity, the Company enters into a commitment to sell these loans at essentially the same time that the interest rate lock commitment on the loan is quoted. The commitments to sell loans are also considered derivative instruments, with estimated fair values based on changes in current market rates. These commitments are not designated as hedging instruments and, therefore, changes in fair value are recognized immediately into income. The fair values of the Company's derivative instruments are deemed to be Level 2 measurements and are included in the caption, accrued interest receivable and other assets, in the consolidated balance sheets. The gain on the derivative instruments was \$25 in 2025 and the gain was \$76 in 2024 and is included in the caption, gain on sale of loans, in the consolidated statements of income.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 20. Fair Value Measurements (Continued)

Loans held for sale: Fair value of loans held for sale is based on commitments on hand from investors or prevailing market prices and the fair value of expected future servicing. The fair values of the Company's loans held for sale are deemed to be Level 2 measurements, and the change in fair value is included in the caption, gain on sale of loans, in the consolidated statements of income.

Interest rate swap on loan: The Company utilizes an interest rate swap agreement to convert a customer fixed rate loan to a variable rate. This has been designated as a fair value hedge. This interest rate swap is recorded at fair value based on third party vendors who compile prices from various sources and may determine fair value of identical or similar instruments by using pricing models that consider observable market data. The fair value of the Company's interest rate swap is deemed to be a Level 2 measurement and is included in other assets in the consolidated statements of financial condition.

Interest rate swap on trust preferred securities: The Company utilizes an interest rate swap agreement to convert one of our variable rate trust preferred securities to a fixed rate. This has been designated as a cash flow hedge. This interest rate swap is recorded at fair value based on third party vendors who compile prices from various sources and may determine fair value of identical or similar instruments by using pricing models that consider observable market data. The fair value of the Company's interest rate swap is deemed to be a Level 2 measurement and is included in other assets in the consolidated statements of financial condition.

Interest rate swap on ESOP Debt: The Company utilizes an interest rate swap agreement to convert our variable rate ESOP loan to a fixed rate. This has been designated as a cash flow hedge. This interest rate swap is recorded at fair value based on third party vendors who compile prices from various sources and may determine fair value of identical or similar instruments by using pricing models that consider observable market data. The fair value of the Company's interest rate swap is deemed to be a Level 2 measurement and is included in other assets in the consolidated statements of financial condition.

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 20. Fair Value Measurements (Continued)

The following tables summarize financial assets and financial liabilities measured at fair value on a recurring basis segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	Fair Value Measurements at December 31, 2025			
	Total	Level 1	Level 2	Level 3
Financial assets:				
Investment securities available for sale:				
GSE residential mortgaged-backed securities	\$ 250,386	\$ -	\$ 250,386	\$ -
GSE collateralized residential mortgage obligations	129,834	-	129,834	-
Obligations of states and political subdivisions	41	-	-	41
US government corporations and agencies	1,562	-	1,562	-
GSE commercial mortgage-backed securities	18,997	-	18,997	-
Loans held for sale	14,014	-	14,014	-
Interest rate lock commitments	126	-	126	-
Forward sale commitments	7	-	7	-
Interest rate swaps	363	-	363	-
	<u>\$ 415,330</u>	<u>\$ -</u>	<u>\$ 415,289</u>	<u>\$ 41</u>

	Fair Value Measurements at December 31, 2024			
	Total	Level 1	Level 2	Level 3
Financial assets:				
Investment securities available for sale:				
GSE residential mortgaged-backed securities	\$ 155,519	\$ -	\$ 155,519	\$ -
GSE collateralized residential mortgage obligations	91,596	-	91,596	-
Obligations of states and political subdivisions	54	-	-	54
US government corporations and agencies	6,740	-	6,740	-
GSE commercial mortgage-backed securities	29,240	-	29,240	-
Loans held for sale	1,049	-	1,049	-
Interest rate lock commitments	35	-	35	-
Forward sale commitments	95	-	95	-
Interest rate swaps	814	-	814	-
	<u>\$ 285,142</u>	<u>\$ -</u>	<u>\$ 285,088</u>	<u>\$ 54</u>

Merchants Financial Group, Inc. and Subsidiary

**Notes to Consolidated Financial Statements
(In Thousands, Except Share Information)**

Note 20. Fair Value Measurements (Continued)

Financial instruments recorded at fair value on a nonrecurring basis: The Company is required, on a nonrecurring basis, to adjust the carrying value of certain assets or provide valuation allowances related to certain assets using fair value measurements in accordance with generally accepted accounting principles.

Collateral dependent loans and leases: The specific reserves for collateral-dependent loans and leases are determined based on the fair value of collateral method in accordance with ASC Topic 310. Under the fair value of collateral method, the specific reserve is equal to the difference between the carrying value of the loan or lease and the fair value of the collateral less estimated selling costs. When a specific reserve is required for an impaired loan or lease, the impaired loan is essentially measured at fair value. The fair value of collateral for impaired loans was determined based on appraisals with further adjustments made to the appraised values due to various factors, including the age of the appraisal, age of comparables included in the appraisal, and known changes in the market and in the collateral. The fair value of collateral for leases was determined based on comparable equipment values with further adjustments made due to various factors, including the age of comparables, and known changes in the market and on the collateral. The resulting fair value measurement is disclosed in the nonrecurring hierarchy table. Where estimates of fair value used for other collateral supporting commercial loans or leases are based on assumptions not observable in the marketplace, such valuations have been classified as Level 3.

Other real estate and other personal property owned: Other real estate and other personal property owned, upon initial recognition, is measured and reported at fair value less estimated costs of disposal through a charge-off to the allowance for possible loan losses based upon the fair value of the other real estate and other personal property acquired. The fair value of other real estate and other personal property owned is estimated based on assumptions not observable in the marketplace, and such valuations have been classified as Level 3.

Assets measured at fair value on a nonrecurring basis are included in the tables below:

	Fair Value at December 31, 2025			
	Total	Level 1	Level 2	Level 3
Collateral-dependent loans and leases	\$ 2,461	\$ -	\$ -	\$ 2,461
Other real estate owned and other personal property owned	970	-	-	970
	<u>\$ 3,431</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,431</u>

	Fair Value at December 31, 2024			
	Total	Level 1	Level 2	Level 3
Collateral-dependent loans and leases	\$ 2,924	\$ -	\$ -	\$ 2,924
Other real estate owned and other personal property owned	6,457	-	-	6,457
	<u>\$ 9,381</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 9,381</u>

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 20. Fair Value Measurements (Continued)

ASC Topic 825 requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring or nonrecurring basis. The methodologies for estimating the fair value of financial assets and financial liabilities that are measured at fair value on a recurring or nonrecurring basis are discussed above. The methodologies for other financial assets and financial liabilities are discussed below.

	Fair Value Measurements at December 31, 2025			
	Total	Level 1	Level 2	Level 3
Financial assets:				
Cash and cash equivalents	\$ 242,145	\$ 242,145	\$ -	\$ -
Federal funds sold	295	-	295	-
Held-to-maturity securities	37,534	-	35,450	-
Loans and direct financing leases, net	2,011,316	-	-	1,967,518
Accrued interest receivable and other assets	41,819	-	41,819	-
Cash value of life insurance	62,213	-	62,213	-
Mortgage servicing rights	13,800	-	-	31,160
Financial liabilities:				
Deposits	2,521,148	-	2,521,632	-
Repurchase agreements	15,043	-	15,043	-
Notes payable	1,599	-	1,599	-
Subordinated debentures	28,351	-	28,351	-
Accrued interest payable and other liabilities	21,689	-	21,689	-
	\$ 4,996,952	\$ 242,145	\$2,728,091	\$ 1,998,678
Fair Value Measurements at December 31, 2024				
	Total	Level 1	Level 2	Level 3
Financial assets:				
Cash and cash equivalents	\$ 177,566	\$ 177,566	\$ -	\$ -
Federal funds sold	228	-	228	-
Held-to-maturity securities	36,057	-	32,581	-
Loans and direct financing leases, net	2,086,285	-	-	1,936,417
Accrued interest receivable and other assets	5,114	-	5,114	-
Cash value of life insurance	32,933	-	32,933	-
Mortgage servicing rights	14,801	-	-	33,619
Financial liabilities:				
Deposits	2,423,758	-	2,426,418	-
Repurchase agreements	15,060	-	15,060	-
Notes payable	11,900	-	11,917	-
Subordinated debentures	28,351	-	28,351	-
Accrued interest payable and other liabilities	25,453	-	25,453	-
	\$ 4,857,506	\$ 177,566	\$2,578,055	\$ 1,970,036

Merchants Financial Group, Inc. and Subsidiary

Notes to Consolidated Financial Statements (In Thousands, Except Share Information)

Note 20. Fair Value Measurements (Continued)

Interest rate risk: The Company assumes interest rate risk (the risk that general rate levels will change) as a result of its normal operations. As a result, fair values of the Company's financial instruments will change when interest rate levels change, and that change may be either favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed-rate obligations are more likely to prepay in a falling-rate environment and less likely to prepay in a rising-rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising-rate environment and less likely to do so in a falling-rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company's overall interest rate risk.

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, investment in restricted stock, accrued interest receivable, cash value of life insurance, accrued interest payable, federal funds purchased, short-term borrowings and variable-rate long-term borrowings approximate their fair values. The fair value of commitments to extend credit is based on fees currently charged to enter into similar agreements with comparable credit risks and the current creditworthiness of the parties. Commitments are generally short-term in nature and, if drawn upon, are advanced under current market terms and conditions for credits with comparable risks. Therefore, the fair values of these financial instruments are not significant.

Investment securities: The fair values of investment securities were generally determined based on matrix pricing. Matrix pricing is a mathematical technique that utilizes observable market inputs including, for example, yield curves, credit ratings and prepayment speeds.

Loans and direct financing leases, net: The fair values for loans and direct financing leases are determined using estimated future cash flows, discounted at rates commensurate with the risks involved, and calculated using a pricing model.

Deposits: The estimated fair values of demand deposits and savings and NOW accounts are assumed to equal their carrying amounts, which represents the amounts payable on demand. Fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies current adjusted risk-free rates to a schedule of aggregated expected periodic maturities on certificates of deposit.

Notes payable and subordinated debentures: The fair values of notes payable with fixed interest rates are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements. Due to the inactive market for trust preferred subordinated debentures, it was not practical for management to estimate the fair value using a discounted cash flow model, and therefore, management concluded the carrying amount reported approximates its fair value.



 **Merchants**
Financial Group

(507) 457-1100 | 102 East Third Street, Winona, MN 55987 | www.merchantsbank.com

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