



October 25, 2022

Dear Shareholder,

I am pleased to report strong performance results for the third quarter for Merchants Financial Group, Inc. Year-to-date net income through September 30 was \$22,114,264, which is \$6.4 million ahead of the plan that we set for 2022 but \$3.45 million behind results for the same period of our record performance year of 2021. In recognition of continued strong performance, your Board of Directors has authorized a semiannual dividend payment of \$.33/share, to be paid on December 23, 2022 to Shareholders of record as of November 18, 2022. The dividend amount is a 10% increase over the semiannual payment of \$.30 for the first half of the year.

Our forecast for 2022 was reflective of the fact that key revenue drivers in 2021 – Small Business Administration Paycheck Protection Program loan fee income and residential mortgage loan production income – would not recur. We also did not anticipate the frequency and scale of Federal Reserve interest rate hikes. Our performance is the culmination of a total team effort with each of our three Bank Regions and our Equipment Finance division exceeding net income expectations. The one business unit not meeting forecast targets has been our Secondary Market Mortgage division, which has been heavily impacted by the increasing rate environment. Total residential mortgage loan volume has been just 49% of the level achieved for the same period last year.

An absolute performance highlight to date has been new commercial loan origination activity. I'm extremely proud of our commercial banking team for continuing to find opportunities with businesses across our footprint in a competitive and challenging environment for new business. Total new commercial loan activity through three quarters has been \$452.8 million, driving year-over-year growth in total loans of 11.34%.

Loan growth combined with the dramatic interest rate increases being driven by the Federal Reserve Bank to curb inflation have resulted in total interest income that is \$5.12 million above our forecast. While our net interest margin has improved as a result, we are mindful of the expectations of our valued deposit customers. Total deposits have declined 4.77% since last year, but our liquidity position remains very strong with a consolidated loan-to-deposit ratio of 77% (a year-over-year improvement from 65.87%).

In the coming weeks we will be revisiting our current Strategic Plan with our Board of Directors and Strategic Planning Team to assess our progress and reestablish key priorities as we look to the future. It's gratifying to once again be in position to celebrate significant strategic accomplishment and performance success, while also being earnest in our focus to identify opportunities we have for growth.

On behalf of the Merchants team, I'd like to wish you and your family a wonderful holiday season. We look forward to sharing our 2022 results with you early next year. Thank you for your continued support.

Very truly yours,

A handwritten signature in black ink that reads 'Gregory M. Evans'.

Gregory M. Evans
President and CEO

Merchants Financial Consolidated

Consolidated Statements of Financial Condition

Unaudited

(\$ in thousands, except share data)

	<u>September 30, 2022</u>	<u>December 31, 2021</u>
<u>ASSETS</u>		
Cash and cash equivalents	369,329	845,680
Federal funds sold	389	413
Available-for-sale securities	246,909	197,372
Held-to-maturity securities	37,984	10,440
Loans held for sale	15,543	24,071
Loans and direct financing leases, net	1,757,620	1,579,275
Operating lease assets	21,141	13,024
Premises and equipment	26,670	27,666
Investment in restricted stock	7,165	6,880
Other real estate and other personal property owned	803	1,123
Accrued interest receivable and other assets	13,895	14,191
Cash value of life insurance	57,831	48,986
Mortgage servicing rights, net	16,864	16,268
Goodwill	35,665	35,665
Intangibles	951	1,494
Deferred tax assets	2,036	-
Total assets	<u>2,610,794</u>	<u>2,822,549</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
<u>Liabilities</u>		
<u>Deposits</u>		
Noninterest-bearing	644,089	620,988
Interest-bearing	1,657,343	1,897,575
Total deposits	2,301,431	2,518,564
Federal funds purchased	-	-
Repurchase agreements	6,450	1,700
Notes payable	12,040	14,540
Subordinated debentures	41,254	41,254
Deferred tax liability	-	3,370
Accrued interest payable and other liabilities	15,591	12,483
Total liabilities	2,376,766	2,591,910
<u>Stockholders' Equity</u>		
Common stock, par value \$.025 per share	68	68
Additional paid-in-capital	10,135	10,135
Retained earnings	248,293	228,632
Accumulated other comprehensive gain	(14,724)	(791)
Unearned ESOP shares	(9,745)	(7,405)
Total stockholders' equity	<u>234,028</u>	<u>230,640</u>
Total liabilities and stockholders' equity	<u>2,610,794</u>	<u>2,822,549</u>

Merchants Financial Consolidated

Consolidated Statements of Income

Unaudited

(\$ in thousands, except share data)

	<u>September 30, 2022</u>	<u>September 30, 2021</u>
<u>INTEREST INCOME:</u>		
Loan interest	51,193	48,794
Loan fees	7,505	14,630
Securities	3,424	1,573
Direct financing leases	1,892	2,472
Other income	5,001	1,511
Total interest income	<u>69,015</u>	<u>68,980</u>
<u>INTEREST EXPENSE:</u>		
Deposits	3,522	5,163
Notes payable, federal funds purchased and repurchase agreements	230	294
Subordinated debentures	1,301	930
Total interest expense	<u>5,053</u>	<u>6,386</u>
	-	-
Net interest income	63,962	62,594
	-	-
Provision for loan and lease losses	<u>(1,886)</u>	<u>(1,917)</u>
	-	-
Net interest income after provision for loan and lease losses	65,848	64,511
<u>NON-INTEREST INCOME:</u>		
Trust department	1,531	1,395
Service charges and other fees	4,072	4,035
Loan servicing fees	5,428	5,306
Net gain on sale of available-for sale securities	-	-
Net gain on sale of loans	1,998	12,406
Net gain(loss) on sale of other real estate & other personal prop.	(159)	346
Other income	5,418	4,996
Total Non-interest income	<u>18,281</u>	<u>28,484</u>
<u>NON-INTEREST EXPENSE:</u>		
Salaries and employee benefits	30,114	32,506
Occupancy	11,906	10,998
Net loss on disposal of premises and equipment	15	-
Mortgage servicing rights	2,604	4,209
Other expense	9,348	10,338
Total non-interest expense	<u>53,987</u>	<u>58,052</u>
	-	-
Income before income taxes	30,142	34,943
	-	-
Provision for income taxes	<u>8,028</u>	<u>9,374</u>
	-	-
Net income	<u>22,114</u>	<u>25,569</u>

Merchants Financial Consolidated

Consolidated Financial Highlights

Third Quarter 2022

Unaudited

(\$ in thousands, except share data)	Quarterly					Year to Date	
	3rd Qtr 2022	2nd Qtr 2022	1st Qtr 2022	4th Qtr 2021	3rd Qtr 2021	September 30, 2022	September 30, 2021
\$ Earnings							
Net Interest Income	\$ 23,629	20,829	19,504	19,493	21,391	63,962	62,594
Provision (Reversal) for loan loss	\$ (496)	206	(1,596)	(293)	(641)	(1,886)	(1,917)
Other non-interest income	6,202	6,198	6,042	7,698	8,044	18,284	28,484
Security gains/losses	\$ -	-	-	-	-	-	-
Other non-interest expense	19,033	18,018	17,098	23,260	19,991	54,149	58,052
Pre-tax income	\$ 11,294	8,805	10,044	4,225	10,084	30,142	34,943
Taxes	2,994	2,339	2,695	1,016	2,680	8,028	9,374
Net Income	\$ 8,300	6,466	7,349	3,209	7,404	22,114	25,569
Pre-tax, pre-provision earnings	\$ 10,798	9,010	8,448	3,932	9,443	28,256	33,026
Earnings per share	\$ 1.01	0.79	0.90	0.39	0.91	2.70	3.13
Performance Ratios							
Return on average assets	1.27%	0.95%	1.06%	0.45%	1.08%	1.09%	1.14%
Return on average equity	14.93%	11.26%	12.88%	5.46%	12.81%	13.01%	8.64%
Yield on earning assets	4.20%	3.54%	3.29%	3.10%	3.54%	3.67%	3.40%
Cost of funds (inc non-int bearing deposits)	0.39%	0.33%	0.37%	0.40%	0.42%	0.37%	0.43%
Net interest margin	3.76%	3.19%	2.93%	2.70%	3.10%	3.57%	2.78%
Efficiency ratio	62.77%	65.31%	65.97%	84.78%	66.50%	64.59%	61.98%
Net overhead ratio	2.78%	2.49%	2.35%	3.08%	2.73%	2.54%	2.40%
Capital							
Tier 1 leverage capital ratio	9.80%	9.43%	9.19%	9.05%	9.34%	9.80%	9.34%
Common equity risk-based capital ratio	10.20%	12.40%	11.09%	10.81%	10.87%	10.20%	10.87%
Tier 1 risk-based capital ratio	12.03%	14.69%	13.18%	12.92%	12.99%	12.03%	12.99%
Total risk-based capital ratio	13.25%	15.94%	14.43%	14.17%	14.24%	13.28%	14.24%
Tangible capital to tangible assets	7.60%	7.34%	6.93%	6.89%	7.20%	7.60%	7.20%
Book value per share	\$ 28.61	28.15	28.32	28.20	28.43	28.61	28.43
Tangible book value per share	\$ 22.08	21.58	21.75	21.62	21.94	22.08	21.94
Outstanding shares	8,178,741	2,726,247	2,726,247	2,726,247	2,726,247	8,178,741	2,726,247
Asset Quality							
Net charge-offs (recoveries)	\$ 164	30	(26)	760	677	163,859	676,686
Net charge-offs (recoveries) to average loans	0.01%	0.00%	0.00%	0.05%	0.04%	0.01%	0.04%
Allowance for loan losses	26,600	27,230	27,080	28,650	29,026	26,600	29,026
Allowance to total loans	1.48%	1.61%	1.67%	1.76%	1.79%	1.48%	1.79%
Allowance to total loans (excluding PPP loans)	1.48%	1.61%	1.68%	1.78%	1.83%	1.48%	1.83%
Nonperforming loans (Non-accrual & 90 days Past D)	\$ 10,735	12,874	12,717	15,820	17,177	10,735	17,177
Other real estate owned	\$ 803	1,034	1,123	1,123	2,345	803	2,345
Nonperforming loans to total loans	0.60%	0.76%	0.78%	0.97%	1.06%	0.60%	1.06%
Nonperforming assets to total assets	0.44%	0.53%	0.49%	0.60%	0.71%	0.44%	0.71%
End of Period Balances							
Assets	\$ 2,610,794	2,647,781	2,823,191	2,822,549	2,737,846	2,610,794	2,737,846
Earning Assets	\$ 2,397,498	2,440,300	2,629,824	2,716,064	2,622,584	2,397,498	2,622,584
Total investments	\$ 349,991	328,707	293,943	263,678	218,724	349,991	218,724
Total loans	\$ 1,799,932	1,692,173	1,622,246	1,631,837	1,621,726	1,799,932	1,621,726
Paycheck Protection Program loans	\$ 980	3,307	10,112	20,486	33,787	980	33,787
Intangible assets	\$ 53,480	53,730	53,771	53,805	53,121	53,480	53,121
Deposit	\$ 2,301,431	2,340,997	2,522,497	2,518,563	2,416,784	2,301,431	2,416,784
Customer repurchase agreements	\$ 6,450	14,923	2	1,700	12,369	6,450	12,369
Borrowings	\$ 12,040	12,040	14,540	14,540	14,920	12,040	14,920
Shareholders' Equity	\$ 234,028	230,234	231,661	230,640	232,553	234,028	232,553
Average Balances							
Assets	\$ 2,594,556	2,733,221	2,824,581	2,818,012	2,725,744	2,716,610	2,994,751
Earning Assets	\$ 2,389,460	2,528,827	2,626,093	2,701,256	2,609,615	2,513,927	2,704,218
Total investments	\$ 336,860	305,710	286,201	245,478	219,235	309,776	200,176
Total loans	\$ 1,680,305	1,660,766	1,620,556	1,612,873	1,644,148	1,654,094	1,833,158
Paycheck Protection Program loans	\$ 2,144	6,710	15,299	27,137	93,278	2,144	93,278
Intangible assets	\$ 53,507	53,615	53,320	53,077	52,997	53,481	52,587
Deposit	\$ 2,355,357	2,422,069	2,511,768	2,496,254	2,408,889	2,429,158	2,385,668
Customer repurchase agreements	\$ 11,173	9,935	7,779	10,803	12,047	9,641	13,672
Borrowings	\$ 12,040	14,265	14,540	14,916	14,920	13,606	16,486
Shareholders' Equity	\$ 220,500	230,249	231,334	232,978	229,369	227,321	395,576
Stock Valuation							
Closing Market Price (OTCPink)	\$ 27.00	25.50	26.50	25.08	24.33	27.00	24.33
Multiple of Tangible Book Value	1.22	1.18	1.22	1.16	1.11	1.22	1.11

**Previous quarter per share data restated to reflect May 13, 2022 Stock Split