

July 29, 2024

Dear Shareholder,

As the entire banking industry remains impacted by a market environment of tight liquidity and interest margins, the strength and diversity of Merchants' balance sheet continues to drive profitable performance for your Company. Certainly not insulated from market forces, net income at mid-year for Merchants Financial Group, Inc., was \$10.23 million, \$1.1 million below our plan and \$3.4 million below our performance through the first two quarters of 2023.

Despite the market environment challenges, net income from core banking has been solid in 2024. A significant driver of our variance to plan came in the form of identified increased risk in our consolidated loan portfolio. The moderate shift required an additional provision of \$850,000 to our Allowance for Credit Loss for the second quarter. In total, credit risk analysis has resulted in provision adjustments of \$1.1 million more than planned through the first two quarters of the year. Realized credit loss through two quarters has been negligible at just .03% and the caution demonstrated in form of increased reserves is related to some softening of commercial real estate valuations and a market environment of low commodities prices for our local farmers.

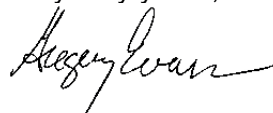
Additional second quarter performance notes and highlights include:

- Total deposits grew slightly again in the second quarter to \$2.25 billion, a 7.36% increase over 2023 and \$27.9 million above plan. Growing our funding base to accommodate loan demand and growth is the most critical focus for our entire banking team.
- Total net loans remained stable at \$2.18 billion, which is \$32.6 million above plan and represents growth of \$185.3 million from mid-year 2023. We are managing loan growth expectations prudently, given tightened liquidity across the entire industry. Much of the loan balance growth has been completion of commercial construction loan commitments made in previous years.
- Mortgage loan origination activity for the first half of the year was \$120.9 million. While the current interest rate environment remains challenging for prospective homebuyers, the volume generated by our team exceeded our mid-year target by \$8.3 million.

While our mid-year performance is far more modest than we had hoped, Merchants remains favorably positioned compared to the broader industry. While aggregated second-quarter performance benchmarks for our peer group will not be available for a couple of weeks, our performance in the first quarter was well above the median level of performance for the more than 400 banks in Minnesota and above the median for like-size banks throughout the upper Midwest. You have my promise of our intent to maintain that position as best we possibly can.

I hope you have been enjoying summer and taking advantage of the season of vibrancy in our communities. The outstanding team of Merchants' bankers is always in the middle of the action, volunteering at summer festivals, community celebrations and nonprofit events that contribute to the strength of our communities. We are grateful for our role as a community leader and driver of economic growth. Thank you for continuing to support our mission as we strive to be a safe, strong financial partner for our family, friends, and neighbors.

Very truly yours,

A handwritten signature in black ink, appearing to read "Gregory Evans".

Gregory M. Evans
President and CEO

Merchants Financial Consolidated

Consolidated Statements of Financial Condition

Unaudited

(\$ in thousands, except share data)

	<u>June 30, 2024</u>	<u>December 31, 2023</u>
<u>ASSETS</u>		
Cash and cash equivalents	36,088	39,056
Federal funds sold	-	-
Available-for-sale securities	197,367	202,215
Held-to-maturity securities	35,283	37,721
Loans held for sale	10,568	1,929
Loans and direct financing leases, net	2,171,680	2,131,813
Operating lease assets	19,227	20,469
Premises and equipment	25,211	25,728
Investment in restricted stock	6,840	9,430
Other real estate and other personal property owned	959	1,005
Accrued interest receivable and other assets	19,414	19,917
Cash value of life insurance	60,385	59,753
Mortgage servicing rights, net	15,101	15,336
Goodwill	35,665	35,665
Intangibles	158	317
Deferred tax assets	-	-
Total assets	<u>2,633,945</u>	<u>2,600,354</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
<u>Liabilities</u>		
Deposits		
Noninterest-bearing	440,513	482,293
Interest-bearing	<u>1,813,064</u>	<u>1,692,116</u>
Total deposits	2,253,577	2,174,409
Federal funds purchased	26,505	94,691
Repurchase agreements	15,063	15,065
Notes payable	17,280	7,262
Subordinated debentures	28,351	28,351
Deferred tax liability	1,176	1,617
Accrued interest payable and other liabilities	<u>19,455</u>	<u>15,024</u>
Total liabilities	2,361,407	2,336,418
<u>Stockholders' Equity</u>		
Common stock, par value \$.025 per share	68	68
Additional paid-in-capital	10,274	10,274
Retained earnings	280,459	273,170
Accumulated other comprehensive gain	(11,285)	(12,598)
Unearned ESOP shares	<u>(6,978)</u>	<u>(6,978)</u>
Total stockholders' equity	<u>272,538</u>	<u>263,936</u>
Total liabilities and stockholders' equity	<u>2,633,945</u>	<u>2,600,354</u>

Merchants Financial Consolidated

Consolidated Statements of Income

Unaudited

(\$ in thousands, except share data)

	<u>June 30, 2024</u>	<u>June 30, 2023</u>
<u>INTEREST INCOME:</u>		
Loan interest	55,702	43,969
Loan fees	3,093	3,874
Securities	3,427	3,831
Direct financing leases	826	816
Other income	1,085	3,464
Total interest income	<u>64,134</u>	<u>55,954</u>
<u>INTEREST EXPENSE:</u>		
Deposits	21,465	10,487
Notes payable, federal funds purchased and repurchase agreements	1,699	267
Subordinated debentures	992	1,389
Total interest expense	<u>24,156</u>	<u>12,143</u>
Net interest income	39,977	43,811
Provision for loan and lease losses	<u>1,544</u>	<u>488</u>
Net interest income after provision for loan and lease losses	38,434	43,323
<u>NON-INTEREST INCOME:</u>		
Trust department	1,322	1,125
Service charges and other fees	3,291	3,168
Loan servicing fees	3,422	3,534
Net gain on sale of available-for sale securities	532	(134)
Net gain on sale of loans	831	521
Net gain(loss) on sale of other real estate & other personal prop.	(6)	(23)
Other income	4,454	3,995
Total Non-interest income	<u>13,847</u>	<u>12,185</u>
<u>NON-INTEREST EXPENSE:</u>		
Salaries and employee benefits	21,245	19,887
Occupancy	9,269	8,838
Net loss on disposal of premises and equipment	-	-
Mortgage servicing rights	1,154	1,400
Other expense	7,000	6,818
Total non-interest expense	<u>38,668</u>	<u>36,944</u>
Income before income taxes	13,612	18,564
Provision for income taxes	<u>3,378</u>	<u>4,900</u>
Net income	<u>10,234</u>	<u>13,663</u>

Merchants Financial Consolidated

Consolidated Financial Highlights

Second Quarter 2024

Unaudited

	Quarterly					Year to Date	
	2nd Qtr 2024	1st Qtr 2024	4th Qtr 2023	3rd Qtr 2023	2nd Qtr 2023	June 30, 2024	June 30, 2023
(\$ in thousands, except share data)							
\$ Earnings							
Net Interest Income	\$ 20,713	19,265	20,765	21,220	21,313	39,977	43,811
Provision (Reversal) for loan loss	\$ 1,188	355	(152)	1,044	(489)	1,544	488
Other non-interest income	6,837	6,555	7,414	6,970	6,403	13,393	12,342
Security gains/losses	\$ -	532	-	-	114	532	(134)
Other non-interest expense	20,080	18,666	21,367	18,702	19,541	38,746	36,967
Pre-tax income	\$ 6,282	7,330	6,964	8,444	8,778	13,612	18,564
Taxes	\$ 1,497	1,881	1,565	2,005	2,298	3,378	4,900
Net Income	\$ 4,785	5,449	5,399	6,439	6,480	10,234	13,664
Pre-tax, pre-provision earnings	\$ 7,470	7,686	6,813	9,488	8,289	15,156	19,052
Earnings per share	\$ 0.58	0.67	0.66	0.79	0.79	1.25	1.67
Performance Ratios							
Return on average assets	0.73%	0.84%	0.82%	1.02%	1.05%	0.79%	1.09%
Return on average equity	7.12%	7.96%	8.40%	10.18%	10.49%	7.54%	11.22%
Yield on earning assets	5.52%	5.28%	5.51%	5.47%	5.37%	5.40%	5.20%
Cost of funds (inc non-int bearing deposits)	2.63%	2.59%	2.37%	1.97%	1.73%	2.61%	1.46%
Net interest margin	3.58%	3.38%	3.71%	3.99%	4.09%	3.48%	4.13%
Loan to Deposit Ratio	97.29%	97.44%	98.27%	95.90%	95.24%	97.29%	95.24%
Efficiency ratio	72.18%	70.32%	74.94%	65.54%	69.41%	71.27%	65.12%
Net overhead ratio	2.98%	2.81%	3.10%	2.85%	3.05%	2.89%	2.85%
Capital							
Tier 1 leverage capital ratio	11.21%	11.20%	11.35%	11.76%	11.47%	11.21%	11.47%
Common equity risk-based capital ratio	10.78%	10.56%	10.17%	10.24%	10.14%	10.78%	10.14%
Tier 1 risk-based capital ratio	11.93%	11.70%	11.29%	11.90%	11.83%	11.93%	11.83%
Total risk-based capital ratio	13.06%	12.95%	12.54%	13.15%	13.08%	13.18%	13.08%
Tangible capital to tangible assets	9.07%	9.10%	8.84%	8.82%	8.76%	9.07%	8.76%
Book value per share	\$ 33.32	32.97	32.27	31.38	30.64	33.32	30.64
Tangible book value per share	\$ 27.10	26.72	26.00	25.03	24.29	27.10	24.29
Outstanding shares	8,178,741	8,178,741	8,178,741	8,178,741	8,178,741	8,178,741	8,178,741
Average outstanding shares	8,178,741	8,178,741	8,178,741	8,178,741	8,178,741	8,178,741	8,178,741
Asset Quality							
Net charge-offs (recoveries) YTD	\$ 595	366	573	333	211	-	277
Net charge-offs (recoveries) to average loans	0.03%	0.02%	0.03%	0.02%	0.01%	0.00%	0.01%
Allowance for loan losses	26,996	25,644	25,030	24,736	23,899	26,996	23,899
Allowance to total loans	1.22%	1.17%	1.14%	1.16%	1.16%	1.22%	1.16%
Nonperforming loans (Nonaccrual & 90 days Past Due)	\$ 12,338	13,889	9,582	5,383	6,442	12,338	6,442
Other real estate owned	\$ 959	1,336	1,005	780	787	959	787
Nonperforming loans to total loans	0.56%	0.63%	0.44%	0.25%	0.31%	0.56%	0.31%
Nonperforming assets to total assets	0.50%	0.59%	0.41%	0.24%	0.29%	0.50%	0.29%
End of Period Balances							
Assets	\$ 2,636,537	2,594,133	2,603,726	2,521,613	2,469,913	2,636,537	2,469,913
Earning Assets	\$ 2,423,815	2,390,477	2,382,969	2,295,928	2,244,271	2,423,815	2,244,271
Total investments	\$ 302,119	288,772	310,638	297,284	308,702	302,119	308,702
Total loans	\$ 2,219,416	2,195,096	2,202,036	2,124,458	2,057,906	2,219,416	2,057,906
Intangible assets	\$ 50,925	51,067	51,317	51,924	51,913	50,925	51,913
Deposit	\$ 2,253,576	2,226,551	2,174,408	2,149,979	2,099,026	2,253,576	2,099,026
Customer repurchase agreements	\$ 15,063	15,057	15,065	15,029	12,147	15,063	12,147
Borrowings	\$ 17,280	6,780	7,262	7,160	7,160	17,280	7,160
Shareholders' Equity	\$ 272,538	269,633	263,936	256,635	250,607	272,538	250,607
Average Balances							
Assets	\$ 2,619,588	2,606,344	2,605,263	2,509,050	2,473,264	2,612,966	2,517,795
Earning Assets	\$ 2,543,235	2,519,968	2,384,629	2,289,640	2,257,853	2,531,601	2,303,648
Total investments	\$ 285,506	292,043	300,024	300,959	311,096	288,775	341,911
Total loans	\$ 2,202,257	2,173,463	2,121,982	2,048,773	1,967,521	2,187,860	1,939,253
Intangible assets	\$ 50,902	51,098	51,654	51,727	52,123	51,000	52,438
Deposit	\$ 2,246,240	2,201,079	2,248,983	2,157,232	2,137,709	2,223,659	2,187,208
Customer repurchase agreements	\$ 14,997	13,843	15,004	12,148	12,359	14,420	11,917
Borrowings	\$ 6,851	6,785	7,167	7,160	10,720	6,818	11,192
Shareholders' Equity	\$ 270,378	275,376	254,972	250,827	247,898	272,877	245,654
Stock Valuation							
Closing Market Price (OTCPink)	\$ 23.70	23.75	23.75	24.93	26.00	23.70	26.00
Multiple of Tangible Book Value	0.87	0.89	0.91	1.00	1.07	0.87	1.07
Price/EPS	8.78	8.17	6.80	5.54	7.00	18.94	15.56

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