



S SECURITY
BANCORP, INC.
2019 Annual Report

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President's Message

To Our Stockholders:

On behalf of the Board of Directors, Officers and Employees of Security Bancorp, Inc. and its wholly-owned subsidiary, Security Federal Savings Bank, we are pleased to present our twenty-second Annual Report as a public company.

Net income for the year ended December 31, 2019 was \$2.5 million, or \$6.61 per share, compared to \$2.2 million, or \$5.74 per share, in 2018. This \$332,000, or 15%, increase in net income was primarily due to an increase in net interest income. The Company's consolidated assets totaled \$224.5 million at December 31, 2019 compared to \$213.6 million a year earlier, representing a 5.1% increase. The increase in assets was primarily attributable to an increase in loans which was funded by cash and a decrease in investments. Total stockholders' equity was \$24.7 million at December 31, 2019, compared to \$22.1 million from the prior year. During the year ended December 31, 2019, the Company paid its twenty-second annual dividend of \$1.00 per share.

Income diversification remained a primary focus of the Company during 2019 and we believe that this diversification will further enhance the Company's performance in the future. At December 31, 2019, real estate loans represented 71% of the Bank's total loan portfolio. Diversification has also been achieved through the Bank's mortgage and financial services departments which provide additional sources of non-interest income. As a result, the Bank's mortgage department services an off-balance sheet loan portfolio of \$78.7 million at December 31, 2019.

Our management team continues to be proud of the quality of our loan portfolio. At December 31, 2019, the Bank had \$720,000, or 0.32%, in non-performing assets. We believe that this low level of non-performing assets is indicative of both our conservative underwriting practices as well as the quality of customers that choose to bank with Security Federal Savings Bank.

Security Bancorp, Inc. is positioned to meet future challenges and opportunities by offering high quality financial products and services that are provided by our dedicated staff, management, and directors who recognize the importance of customer and stockholder satisfaction all of which, will continue to be the key ingredients to our continued success and profitability.

We are very proud to serve Warren County with three conveniently located full-service bank locations as well as five ATM locations.

On behalf of the Board of Directors, management and staff, we would like to thank you for your continued loyalty and confidence in us and your investment in Security Bancorp, Inc.

Sincerely,

A handwritten signature in black ink that reads "Joe H. Pugh". The signature is written in a cursive, slightly stylized font.

Joe H. Pugh
President and CEO

BUSINESS OF THE COMPANY

Security Bancorp, Inc. (“Company”), a Tennessee corporation, was organized on March 18, 1997 for the purpose of becoming the holding company for Security Federal Savings Bank of McMinnville, TN (“Bank”) upon its conversion from a federal mutual savings bank to a federal stock savings bank (“Conversion”). The Company issued 436,425 shares of common stock at \$10.00 per share and on June 30, 1997 the conversion was completed. At December 31, 2019, the Company’s total consolidated assets were \$224.5 million and had a total consolidated stockholders’ equity of \$24.7 million. The Company is not engaged in any significant business activity other than holding the stock of the Bank. Accordingly, the information set forth in this report, including financial statements and related data, applies primarily to the Bank.

The Bank was organized in 1960 as a federal savings and loan association. Effective February 11, 2009, the Bank converted to a Tennessee chartered commercial bank and the Company became a bank holding company regulated by the Board of Governors of the Federal Reserve System (“Federal Reserve”). The Bank’s primary regulator is the Tennessee Department of Financial Institutions (“Department”) and the Federal Deposit Insurance Corporation (“FDIC”). The Bank’s deposits are insured up to applicable limits by the FDIC and the Bank is a member of the Federal Home Loan Bank (“FHLB”) System.

The Bank operates as a community-oriented financial institution devoted to serving the needs of its customers in its primary market area of Warren County, Tennessee and contiguous counties. The Bank’s business consists primarily of attracting deposits from the general public and using those funds to originate residential real estate loans, acquisition and development loans, commercial business loans, and consumer loans.

FORWARD-LOOKING STATEMENTS

This Annual Report, including information included or incorporated by reference, contains future oral and written statements by the Company and its management may contain, forward-looking statements about the Company and the Bank, which we believe are within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, without limitation, statements with respect to anticipated future operating and financial performance, growth opportunities, interest rates acquisition and divestiture opportunities, and synergies, efficiencies, cost savings and funding advantages expected to be realized from prior acquisitions. Words such as “may,” “could,” “should,” “would,” “believe,” “anticipate,” “estimate,” “expect,” “intend,” “plan,” and similar expressions are intended to identify these forward-looking statements. Forward-looking statements by the Company and its management are based on beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions of management and are not guarantees of future performance. The Company disclaims any obligation to update or revise any forward-looking statements based on the occurrence of future events, the receipt of new information, or otherwise. The important factors we discuss below and elsewhere in this document, as well as other factors discussed under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included herein, and identified in our filings with the Department, FDIC, Federal Reserve, and those presented by our management from time to time, could cause actual results to differ materially from those indicated by the forward-looking statements made in this Annual Report.

COMMON STOCK INFORMATION

The Company's common stock is traded on the over-the-counter market through the OTC "Electronic Bulletin Board" under the symbol of "SCYT". As of December 31, 2019, there were approximately 203 stockholders of record and 436,425 shares of common stock outstanding (including treasury stock of 54,227 shares). Generally, if the Bank satisfies its regulatory capital requirements, it may make dividend payments up to the limits prescribed in the regulations. However, institutions that have converted to the stock form of ownership may not declare or pay a dividend on, or repurchase any of, its common stock if the effect thereof would cause the regulatory capital of the institution to be reduced below the amount required in accordance with the regulations. To date, the Company has not established a policy of paying regular cash dividends.

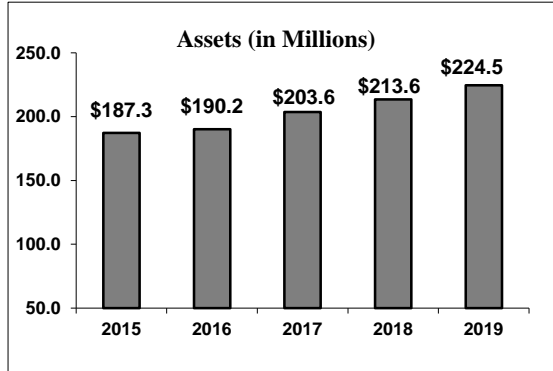
The following table sets forth market price range of the Company's common stock for the four quarters of fiscal years 2017, 2018 and 2019.

<u>2017</u>	<u>High</u>	<u>Low</u>	<u>Dividend</u>
First Quarter	\$46.00	44.00	N/A
Second Quarter	48.00	48.00	N/A
Third Quarter	50.00	50.00	1.00/share
Fourth Quarter	52.00	51.50	N/A
<u>2018</u>			
First Quarter	52.00	52.00	N/A
Second Quarter	54.75	52.00	N/A
Third Quarter	57.86	54.75	1.00/share
Fourth Quarter	58.20	56.45	N/A
<u>2019</u>			
First Quarter	59.00	56.60	N/A
Second Quarter	57.00	56.70	N/A
Third Quarter	57.00	57.00	1.00/share
Fourth Quarter	59.00	57.00	N/A

FINANCIAL HIGHLIGHTS

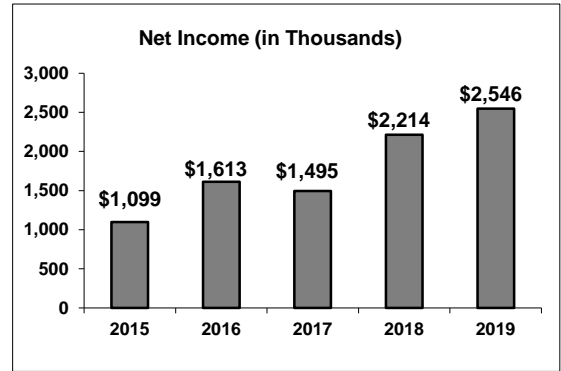
Total Assets

Assets at December 31, 2019 were \$224.5 million.



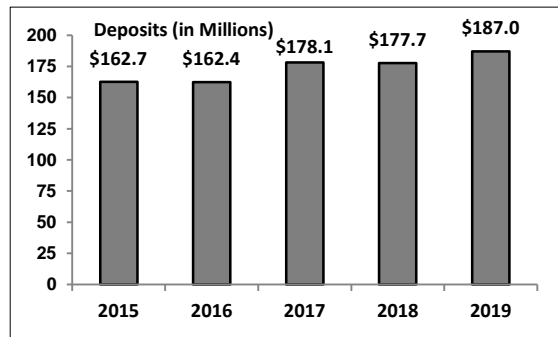
Net Income

Net income was \$2.5 million in 2019.



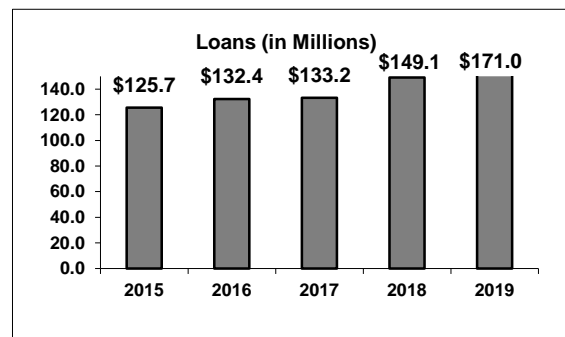
Deposits

Deposits at December 31, 2019 were \$187.0 million.



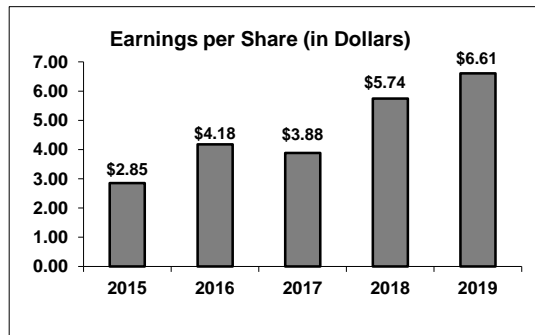
Loans

In 2019, net loans were \$171.0 million.



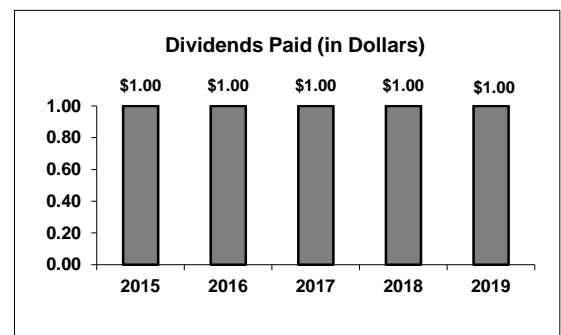
Earnings per Share

Earnings per share were \$6.61 in 2019.



Dividends

The Bank declared a \$1.00 dividend in 2019.



SELECTED CONSOLIDATED FINANCIAL INFORMATION

The following table sets forth certain information concerning the consolidated financial position and results of operations of the Company at and for the dates indicated. The consolidated data is derived in part from, and should be read in conjunction with, the Consolidated Financial Statements of the Company and its Subsidiary presented herein.

	At December 31,				
	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(In thousands)				
SELECTED FINANCIAL CONDITION DATA:					
Total assets	\$224,467	\$213,579	\$203,587	\$190,242	\$187,256
Loans receivable, net	170,953	149,054	133,190	132,367	125,712
Cash and due from banks	8,932	16,065	18,665	13,314	15,142
Investment securities available for sale	35,774	39,591	42,706	35,510	38,181
Deposits	187,039	177,654	178,099	162,362	162,653
FHLB advances	5,000	4,000	-0-	-0-	-0-
Repurchase agreements	5,382	7,652	3,032	6,619	4,792
Stockholders' equity, substantially restricted	24,699	22,125	20,476	19,417	18,344

	Year Ended December 31,				
	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(In thousands)				
SELECTED OPERATING DATA:					
Interest income	\$9,502	\$8,385	\$7,251	\$6,558	\$6,212
Interest expense	<u>1,798</u>	<u>1,238</u>	<u>768</u>	<u>748</u>	<u>785</u>
Net interest income	7,704	7,147	6,483	5,810	5,427
Provision for loan losses	<u>108</u>	<u>170</u>	<u>54</u>	<u>74</u>	<u>377</u>
Net interest income after provision for loan losses	<u>7,596</u>	<u>6,977</u>	<u>6,429</u>	<u>5,736</u>	<u>5,050</u>
Other income	1,726	1,744	1,724	2,052	1,822
Other expenses	<u>5,918</u>	<u>5,775</u>	<u>5,599</u>	<u>5,461</u>	<u>5,168</u>
Income before income tax expense	3,404	2,946	2,554	2,327	1,704
Income tax expense	<u>858</u>	<u>732</u>	<u>1,059</u>	<u>714</u>	<u>605</u>
Net income	<u>\$2,546</u>	<u>\$2,214</u>	<u>\$1,495</u>	<u>\$1,613</u>	<u>\$1,099</u>

At December 31,

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
KEY OPERATING RATIOS					
Performance Ratios:					
Return on average assets (net income divided by average assets)	1.18%	1.07%	0.76%	0.85%	0.60%
Return on average equity (net income divided by average equity)	10.87	10.53	7.48	8.48	6.04
Interest rate spread (difference between average yield on interest- earning assets and average cost of interest-bearing liabilities)	3.47	3.43	3.50	3.22	3.11
Net interest margin (net interest income as a percentage of average interest-earning assets)	3.77	3.63	3.62	3.33	3.22
Noninterest expense as a percent of average assets	2.74	2.78	2.84	2.88	2.80
Average interest-earning assets to interest-bearing liabilities	133.65	128.05	127.74	126.89	122.74
Efficiency ratio (other expenses divided by the sum of net interest income and noninterest income)	62.76	64.95	68.22	69.46	71.30
Capital Ratios:					
Average equity to average assets	10.85	10.12	10.14	10.02	9.86
Tangible capital to assets	10.97	10.65	10.01	10.30	10.50
Core capital to assets	10.97	10.65	10.01	10.30	10.50
Tier I capital to risk adjusted assets	14.34	14.85	15.28	14.20	14.40
Asset Quality Ratios:					
Allowance for loan losses to total loans at end of period	0.97	1.05	1.09	1.07	1.02
Net charge offs to average outstanding loans during the period	0.02	0.04	0.02	0.05	0.14
Ratio of nonperforming assets to total assets(1)	0.32	0.36	0.33	0.82	1.07
Ratio of allowance for loan losses to nonperforming assets(1)	231.81	208.13	216.08	92.00	64.96
SELECTED OTHER DATA:					
Number of:					
Real estate loans outstanding	1,996	1,998	2,007	2,027	2,056
Deposit accounts	10,069	9,992	9,914	9,935	9,788
Full service offices	3	3	3	3	3

(1) Nonperforming assets consist of non-accrual loans, accruing loans contractually past due 90 days or more, and foreclosed property.

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

General

Management's discussion and analysis of the financial condition and results of operations is intended to assist in understanding the consolidated financial condition and results of operations of the Company. The information contained in this section should be read in conjunction with the Consolidated Financial Statements and accompanying notes thereto included herein.

Operating Strategy

The business of the Bank consists principally of attracting deposits from the general public and using such deposits to originate mortgage loans secured primarily by one- to four-family residences. The Bank also originates mortgage loans secured by residential real estate, consumer, commercial business, acquisition and development, and commercial real estate loans. The Bank invests primarily in investment grade federal agency securities and mortgage-backed securities. The Bank intends to continue to fund its assets primarily with deposits, although FHLB advances and repurchase agreements may be used as supplemental sources of funds.

Operating results are dependent primarily on net interest income, which is the difference between the income earned on its interest-earning assets, such as loans and investments, and the cost of its interest-bearing liabilities, consisting of deposits and other borrowings. Operating results are also significantly affected by general economic and competitive conditions, primarily changes in market interest rates, governmental legislation and policies concerning monetary and fiscal affairs and housing, as well as financial institutions and the actions of the regulatory authorities.

The Bank's strategy is to operate as a conservative, well-capitalized, profitable community-oriented financial institution dedicated to financing home ownership and other consumer and local business needs and to provide quality service to all customers. The Bank believes that it has successfully implemented its strategy by (i) maintaining strong capital levels, (ii) maintaining effective control over net noninterest income to attempt to achieve profitability under differing interest rate scenarios, (iii) limiting interest rate risk by diversifying its assets, (iv) emphasizing local loan originations, and (v) emphasizing high-quality customer service with a competitive fee structure.

Interest Rate Risk Management

The Bank's principal financial objective is to maintain long-term profitability by utilizing conservative underwriting standards and reducing nonperforming assets. The Bank has sought to reduce exposure of its earnings to changes in market interest rates by managing the mismatch between asset and liability maturities and interest rates. The principal element in achieving the objective is to increase the interest-rate sensitivity of the Bank's assets by originating loans with interest rates based on market interest rates. The Bank relies on retail deposits as its primary external source of funds. Management believes retail deposits, compared to brokered deposits and long-term borrowings reduce the effects of interest rate fluctuations because these deposits generally represent a more stable source of funds.

Liquidity and Capital Resources

The Bank's primary sources of funds are deposits and proceeds from principal and interest payments on loans. While maturities and scheduled amortization of loans are a predictable source of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition. The Bank's primary investing activity is loan originations and to a lesser extent, investment securities. The Bank maintains liquidity levels adequate to fund loan commitments, investment opportunities, deposit withdrawals and other financial commitments. At December 31, 2019, the Bank's liquidity ratio was 12.93%. The Bank also had unfunded loan commitments of \$35.2 million and outstanding commercial letters of credit of \$731,000. At December 31, 2019, management had no knowledge of any trends, events or uncertainties that will have or are likely to have material effects on the liquidity, capital resources or operations of the Bank.

Comparison of Financial Condition at December 31, 2019 and 2018

Total assets increased \$10.9 million, or 5.1%, to \$224.5 million at December 31, 2019 from \$213.6 million at December 31, 2018. Loans, net, increased \$21.9 million, or 14.7%, to \$171.0 million at December 31, 2019 from \$149.1 million at December 31, 2018 primarily as a result of an increase in commercial loans. Investment securities decreased \$3.8 million, or 9.6%, to \$35.8 million at December 31, 2019 from \$39.6 million at December 31, 2018. The decrease in investments was due to funds from maturities of investments that was used to fund loan growth. Deposits increased \$9.4 million, or 5.3%, to \$187.0 million at December 31, 2019 from \$177.7 million at December 31, 2018. The increase is primarily attributable to an increase in interest-bearing demand deposits account balances, savings account balances and certificates of deposits. Stockholders' equity increased \$2.6 million, or 11.6%, to \$24.7 million at December 31, 2019 from \$22.1 million at December 31, 2018.

Comparison of Operating Results for the Years Ended December 31, 2019 and 2018

Net Income. Net income for the year ended December 31, 2019 was \$2.5 million compared to \$2.2 million for the year ended December 31, 2018. The \$332,000, or 15%, increase was primarily due to an increase in loan interest income from loan growth.

Net Interest Income. Net interest income after provision for loan losses for the year ended December 31, 2019 increased \$619,000, or 8.9%. Total interest income increased \$1.1 million, or 13.3%, to \$9.5 million for the year ended December 31, 2019 from \$8.4 million a year earlier primarily as a result of an increase in interest income on loans. Interest expense increased \$560,000, or 45.2%, to \$1.8 million for the year ended December 31, 2019 from \$1.2 million a year earlier primarily a result of interest rate increases as well as the increase in other borrowings.

Provision for Loan Losses. Provisions for loan losses are charges to earnings to bring the total allowance for loan losses to a level considered adequate by management to provide for estimated loan losses based on management's evaluation of the collectability of the loan portfolio, including past loan loss experience, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, and current economic conditions. The provision for loan losses decreased \$62,000, or 36.5% to \$108,000 for the year ended December 31, 2019 from \$170,000 a year earlier. The decrease in the provision during the year was the result of having adequate balances in allowance for loan losses. Management deemed the allowance for loan losses adequate at December 31, 2019.

Other Income. Total other income decreased by \$18,000, or 1.0%, but remained unchanged at \$1.7 million for the year ended December 31, 2019 compared to the same period in 2018. Gains on the sale of loans increased \$54,000, or 14.5%, to \$426,000 during fiscal 2019 compared to \$372,000 in 2018. This increase was due to the increased volume in the sales of residential mortgages. Financial service fees increased \$12,000, or 4.0%, to \$311,000 in fiscal 2019 from \$299,000 in fiscal 2018.

Other Expenses. Total other expenses increased by \$142,000, or 2.5%, to \$5.9 million for the year ended December 31, 2019 from \$5.8 million compared to the prior year. Data processing increased \$41,000, or 6.2%, to \$707,000 in fiscal 2019 from \$666,000 in fiscal 2018. Legal and professional fees increased \$34,000, or 17.6%, to \$225,000 in fiscal 2019 from \$191,000 in fiscal 2018.

Income Tax Expense. Income tax expense increased \$126,000, or 17.2%, to \$858,000 for the year ended December 31, 2019 compared to \$732,000 a year earlier. The income tax expense increase was due to an increase in taxable income.

Average Balances, Interest and Average Yield/Cost. The earnings of the Bank depend largely on the spread between the yield on interest-earning assets (primarily loans and investments) and the cost of interest-bearing liabilities (primarily deposit accounts and borrowings), as well as the relative size of the Bank's interest-earning assets and interest-bearing liabilities.

The following table sets forth, for the periods indicated, information regarding average balances of assets and liabilities as well as the total dollar amounts of interest income from average interest-earning assets and interest expense on average interest-bearing liabilities, resultant yields, interest rate spread, net interest margin, and ratio of average interest-earning assets to average interest-bearing liabilities. Average balances have been calculated using the average of daily balances during the year.

	At December 31, 2019	Year Ended December 31,					
		2019			2018		
		Average Balance	Interest and Dividends	Yield/ Cost	Average Balance	Interest and Dividends	Yield/ Cost
(Dollars in thousands)							
Interest-earning assets:							
Loans receivable	5.40%	\$158,780	\$8,557	5.39%	\$141,698	\$7,285	5.14%
Investment securities	1.87%	36,277	687	1.89%	42,194	794	1.88%
Other	<u>2.43%</u>	<u>9,345</u>	<u>258</u>	<u>2.76%</u>	<u>12,892</u>	<u>306</u>	<u>2.37%</u>
Total interest-earning assets	4.73%	204,402	9,502	4.65%	196,784	8,385	4.26%
Noninterest-earning assets		11,470			10,928		
Total assets		<u>\$215,872</u>			<u>\$207,712</u>		
Interest-bearing liabilities:							
Interest-bearing checking, MMDA and Savings	0.75%	79,884	558	0.70%	80,121	429	0.54%
Certificates of deposit	<u>1.84%</u>	<u>61,645</u>	<u>995</u>	<u>1.61%</u>	<u>62,794</u>	<u>709</u>	<u>1.13%</u>
Total interest-bearing deposits	1.22. %	141,529	1,553	1.10%	142,915	1,138	0.80%
FHLB advances and other borrowings	<u>2.03%</u>	<u>11,412</u>	<u>245</u>	<u>2.15%</u>	<u>5,603</u>	<u>100</u>	<u>1.78%</u>
Total interest-bearing liabilities	<u>1.27%</u>	<u>152,941</u>	<u>1,798</u>	<u>1.18%</u>	<u>148,518</u>	<u>1,238</u>	<u>0.83%</u>
Noninterest-bearing liabilities		<u>39,511</u>			<u>38,175</u>		
Total liabilities		192,452			186,693		
Equity		23,420			21,019		
Total liabilities and equity		<u>\$215,872</u>			<u>\$207,712</u>		
Net interest income			<u>\$7,704</u>			<u>\$7,147</u>	
Interest rate spread	<u>3.46%</u>			<u>3.47%</u>			<u>3.43%</u>
Net interest margin				<u>3.77%</u>			<u>3.63%</u>
Ratio of average interest-earning assets to average interest-bearing liabilities				<u>133.65%</u>			<u>132.50%</u>

Effect of Inflation and Changing Prices

The Consolidated Financial Statements and related financial data presented herein have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars, without considering the change in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of the Bank's operations. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution's performance than do general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Off-Balance Sheet Arrangements

As of the date of this Annual Report, the Company does not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Company's financial condition, change in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors. The Bank does have commitments to originate loans in the ordinary course of business, as disclosed herein. The term "off-balance sheet arrangement" generally means any transaction, agreement, or other contractual arrangement of to which an entity unconsolidated with the Company is a party under which the Company has (i) any obligation arising under a guarantee contract, derivative instrument or variable interest; or (ii) a retained or contingent interest in assets transferred to such entity or similar arrangement that serves as credit, liquidity or market risk support for such assets.



Independent Auditor's Report

To the Board of Directors
Security Bancorp, Inc. and Subsidiary
P.O. Box 7027
McMinnville, TN 37111

We have audited the accompanying consolidated financial statements of Security Bancorp, Inc. and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Security Bancorp, Inc. and Subsidiary as of December 31, 2019 and 2018, and the results of its operations and its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Alexander Thompson Arnold PLLC

Milan, Tennessee
February 26, 2020

SECURITY BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

December 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Assets		
Cash and cash equivalents	\$ 6,237,553	\$ 5,036,323
Interest-bearing deposits with banks	2,694,619	11,028,636
Investment securities available-for-sale, at fair value	35,774,079	39,590,956
Federal Home Loan Bank stock, at cost	955,600	955,600
Loans, net	170,953,231	149,054,168
Loans held for sale	-	665,828
Premises and equipment, net	2,720,940	2,715,813
Foreclosed assets	567,600	77,250
Cash surrender value of life insurance	2,447,138	2,397,799
Accrued interest receivable	1,162,969	1,062,114
Other assets	<u>953,694</u>	<u>994,077</u>
Total assets	<u>\$ 224,467,423</u>	<u>\$ 213,578,564</u>
Liabilities and stockholders' equity		
Liabilities		
Deposits:		
Noninterest-bearing		
Demand deposits	\$ 37,779,911	\$ 35,853,971
Interest-bearing		
Demand deposits	48,335,548	45,999,974
Savings	36,548,037	34,769,670
Time	<u>64,375,398</u>	<u>61,030,767</u>
Total deposits	187,038,894	177,654,382
Repurchase agreements	5,382,173	7,651,636
Accrued interest payable	166,192	118,487
Custodial escrow payable	100,244	121,022
FHLB borrowings	5,000,000	4,000,000
Accrued expenses and other liabilities	<u>2,081,303</u>	<u>1,907,948</u>
Total liabilities	<u>199,768,806</u>	<u>191,453,475</u>
Stockholders' equity		
Preferred stock - \$.01 par value, 250,000 shares authorized, zero shares issued	-	-
Common stock - \$.01 par value; 3,000,000 shares authorized; 436,425 issued	4,364	4,364
Additional paid-in capital	4,516,516	4,500,811
Retained earnings	21,962,263	19,797,831
Accumulated other comprehensive income (loss)	50,185	(473,846)
Treasury stock - at cost; 54,227 and 52,227 shares at December 31, 2019 and 2018	<u>(1,834,711)</u>	<u>(1,704,071)</u>
Total stockholders' equity	<u>24,698,617</u>	<u>22,125,089</u>
Total liabilities and stockholders' equity	<u>\$ 224,467,423</u>	<u>\$ 213,578,564</u>

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

SECURITY BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Interest income		
Interest and fees on loans	\$ 8,557,259	\$ 7,283,904
Interest on investment securities	687,443	793,924
Interest other	208,879	250,782
Dividends - FHLB stock	47,767	56,145
Total interest income	<u>9,501,348</u>	<u>8,384,755</u>
Interest expense		
Interest on demand deposits and savings	557,840	429,034
Interest on time deposits	995,266	708,839
Other interest	244,542	100,021
Total interest expense	<u>1,797,648</u>	<u>1,237,894</u>
Net interest income	7,703,700	7,146,861
Provision for loan losses	107,684	169,570
Net interest income after provision for loan losses	<u>7,596,016</u>	<u>6,977,291</u>
Other income		
Deposit service charges and fees	800,532	832,831
Gain on sale of interest-bearing deposits with banks	2,367	-
Gain on sale of investment securities	12,675	1,809
Gain on sale of loans	425,882	371,888
Gain on sale of foreclosed assets	6,611	45,452
Gain on sale of premises and equipment	80	88
Financial services fees	310,614	298,675
Servicing fee, net	48,056	61,746
Earnings on cash surrender value	49,339	60,485
Other income	69,480	71,059
Total other income	<u>1,725,636</u>	<u>1,744,033</u>
Other expense		
Salaries and employee benefits	3,349,129	3,328,888
Net occupancy expense	686,723	675,491
Loss on sale of interest-bearing deposits with banks	-	7,076
Legal and professional fees	224,546	190,963
FDIC assessments	32,000	48,200
Data processing	707,374	666,337
Financial services expenses	24,581	23,907
Advertising	89,807	88,739
Deferred compensation	145,691	113,341
Other operating expense	657,960	631,999
Total other expense	<u>5,917,811</u>	<u>5,774,941</u>
Income before income taxes	3,403,841	2,946,383
Provision for income tax expense	858,310	732,075
Net income	<u>\$ 2,545,531</u>	<u>\$ 2,214,308</u>
Earnings per common share:		
Net income	<u>\$ 6.61</u>	<u>\$ 5.74</u>
Weighted average shares outstanding	<u>384,813</u>	<u>385,468</u>

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

SECURITY BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Years Ended December 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Net income for the year	\$ 2,545,531	\$ 2,214,308
Other comprehensive income, net of tax		
Unrealized gains (losses) on securities available-for-sale:		
Unrealized gains (losses) arising during the period	535,882	(162,324)
Reclassification adjustment for (gains) losses included in net income	<u>(11,851)</u>	<u>(1,691)</u>
Net unrealized gains (losses)	<u>524,031</u>	<u>(164,015)</u>
 Total comprehensive income	 <u>\$ 3,069,562</u>	 <u>\$ 2,050,293</u>

Required disclosure of related tax effects allocated to each component of other comprehensive income:

	<u>Before-tax Amount</u>	<u>Tax (Expense) or Benefit</u>	<u>Net-of-tax Amount</u>
Year Ended December 31, 2019			
Unrealized gains (losses) on securities available-for-sale:			
Unrealized gains (losses) arising during the period	\$ 573,136	\$ (37,254)	\$ 535,882
Reclassification adjustment for (gains) losses included in net income	<u>(12,675)</u>	<u>824</u>	<u>(11,851)</u>
Net unrealized gains (losses)	<u>\$ 560,461</u>	<u>\$ (36,430)</u>	<u>\$ 524,031</u>
 Year Ended December 31, 2018			
Unrealized gains (losses) on securities available-for-sale:			
Unrealized gains (losses) arising during the period	\$ (173,609)	\$ 11,285	\$ (162,324)
Reclassification adjustment for (gains) losses included in net income	<u>(1,809)</u>	<u>118</u>	<u>(1,691)</u>
Net unrealized gains (losses)	<u>\$ (175,418)</u>	<u>\$ 11,403</u>	<u>\$ (164,015)</u>

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

SECURITY BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the Years Ended December 31, 2019 and 2018

	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Treasury Stock</u>
Balance - January 1, 2018	\$ 4,364	\$ 4,479,250	\$ 17,968,433	\$ (309,831)	\$ (1,666,586)
Shareholder distributions	-	-	(384,910)	-	-
Net income for the year	-	-	2,214,308	-	-
Purchase of treasury stock	-	-	-	-	(44,006)
Stock option expense	-	18,180	-	-	-
Management recognition plan shares issued	-	3,381	-	-	6,521
Change in unrealized gain (loss) on securities available-for-sale, net of applicable deferred income taxes	-	-	-	(164,015)	-
Balance - December 31, 2018	4,364	4,500,811	19,797,831	(473,846)	(1,704,071)
Shareholder distributions	-	-	(381,099)	-	-
Net income for the year	-	-	2,545,531	-	-
Purchase of treasury stock	-	-	-	-	(174,375)
Exercise of stock options	-	(6,281)	-	-	37,213
Stock option expense	-	18,180	-	-	-
Management recognition plan shares issued	-	3,806	-	-	6,522
Change in unrealized gain (loss) on securities available-for-sale, net of applicable deferred income taxes	-	-	-	524,031	-
Balance - December 31, 2019	\$ 4,364	\$ 4,516,516	\$ 21,962,263	\$ 50,185	\$ (1,834,711)

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

SECURITY BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Operating Activities		
Net income	\$ 2,545,531	\$ 2,214,308
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation	169,649	163,162
Provision for loan losses	107,684	169,570
Gain on sale of premises and equipment	(80)	(88)
(Gain) loss on sale of foreclosed assets	21,696	(45,452)
Gain on sale of investment securities	(12,675)	(1,809)
(Gain) loss on sale of interest-bearing deposits with banks	(2,367)	7,076
Gain on sale of loans	(425,882)	(371,888)
Premium amortization, net of discount accretion	81,974	230,754
Management recognition plan compensation	22,227	28,082
Loans originated for sale	(14,350,547)	(10,992,513)
Proceeds from sale of loans	15,442,257	11,695,850
Increase in accrued interest receivable	(100,855)	(65,040)
Increase in deferred federal and excise income taxes	(68,683)	(41,530)
(Increase) decrease in other assets	(56,417)	11,246
Increase in accrued interest payable	47,705	30,942
Increase in cash surrender value life insurance	(49,339)	(51,928)
Decrease in custodial escrow payable	(20,778)	(121,241)
Increase in accrued expenses and other liabilities	173,355	256,710
Net cash provided by operating activities	<u>3,524,455</u>	<u>3,116,211</u>
Investing Activities		
Proceeds from maturities, prepayments and calls of securities available-for-sale	10,377,654	3,948,561
Proceeds from sales of securities available-for-sale	-	3,001,809
Purchases of securities available-for-sale	(5,940,562)	(4,279,633)
Proceeds from sale of interest-bearing deposits with banks	2,469,038	1,222,924
Investment in interest-bearing deposits with banks	5,867,346	(293,296)
Proceeds from sale of premises and equipment	80	-
Purchases of premises and equipment	(174,776)	(188,641)
Increase in loans, net	<u>(22,675,911)</u>	<u>(16,081,680)</u>
Net cash used by investing activities	<u>(10,077,131)</u>	<u>(12,669,956)</u>
Financing Activities		
Net change in demand deposits and savings	6,039,881	1,995,029
Net change in time deposits	3,344,631	(2,439,252)
Net change in repurchase agreements	(2,269,463)	4,619,980
Proceeds from sale of foreclosed assets	157,118	143,640
Increase in FHLB borrowings	1,000,000	4,000,000
Purchase of treasury stock	(174,375)	(44,006)
Exercise of stock options	37,213	-
Shareholder distributions	<u>(381,099)</u>	<u>(384,910)</u>
Net cash provided by financing activities	<u>7,753,906</u>	<u>7,890,481</u>
Net increase (decrease) in cash and cash equivalents	1,201,230	(1,663,264)
Cash and cash equivalents - beginning of year	<u>5,036,323</u>	<u>6,699,587</u>
Cash and cash equivalents - end of year	<u>\$ 6,237,553</u>	<u>\$ 5,036,323</u>
Supplemental Disclosure of Cash Flow Information		
Cash paid for income taxes	<u>\$ 948,886</u>	<u>\$ 733,820</u>
Cash paid for interest	<u>\$ 1,749,943</u>	<u>\$ 1,206,952</u>
Transfer from loans to foreclosed assets	<u>\$ 800,536</u>	<u>\$ 134,116</u>
Transfer from foreclosed assets to loans	<u>\$ 131,372</u>	<u>\$ 85,928</u>

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

SECURITY BANCORP, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019 and 2018

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

The consolidated financial statements include all the accounts of Security Bancorp, Inc. (the Company) and its wholly owned subsidiary, Security Federal Savings Bank (the Bank). Significant intercompany balances and transactions have been eliminated in consolidation.

The accounting and reporting policies of the Company and its subsidiary conform to accounting principles generally accepted in the United States of America and to general practice within the banking industry.

B. Nature of Operations

The Company and the Bank provide a full range of banking, financial and mortgage services to individual and corporate customers principally in Warren County, Tennessee, through its three locations in McMinnville, Tennessee, and the surrounding area. The Bank is subject to competition from other financial services companies and financial institutions. The Company and the Bank are also subject to the regulations of certain federal agencies and undergo periodic examinations by those regulatory authorities.

C. Use of Estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and with general practices of the banking industry in the United States of America. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the balance sheet date. These estimates and assumptions are susceptible to significant change in the near term and actual results could differ significantly from those estimates. Those estimates and assumptions relate principally to the determination of the adequacy of the allowance for loan losses and the valuation of other real estate acquired through foreclosure. The accounting policies for loans and other significant accounting policies are presented below.

D. Comprehensive Income

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

SECURITY BANCORP, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

E. Cash and Cash Equivalents

For purposes of reporting, cash and cash equivalents include cash on hand, cash items in process of collection, amounts due from banks which do not bear interest, and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

F. Investment Securities

Debt securities classified as available-for-sale are those debt securities that the Bank 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 movement in interest rates, changes in the maturity mix of the Bank's assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. These securities are carried at estimated fair value based on information provided by a third party pricing service with any unrealized gains or losses excluded from net income and reported in accumulated other comprehensive income (loss), which is reported as a separate component of stockholders' equity, net of the related deferred tax effect.

Gains and losses realized on sales of investment debt securities, determined using the adjusted cost basis of the specific securities sold, are included in noninterest income in the consolidated statements of income. Additionally, declines in the estimated fair value of individual investment securities below their cost that are other-than-temporary are reflected as realized losses in the statements of income. Factors affecting the determination of whether an other-than-temporary impairment has occurred include, among other things, the length of time and the extent to which the fair value has been less than cost, the financial condition and near term prospects of the issuer, that the Bank does not intend to sell these securities, and it is more likely than not that the Company will not be required to sell before a period of time sufficient to allow for any anticipated recovery in fair value.

Dividend and interest income, including amortization of premium and accretion of discount arising at acquisition, from all categories of investment securities are included in interest income in the consolidated statements of income.

Securities sold under agreements to repurchase are treated as collateralized financial transactions. These agreements are recorded at the amount at which the securities were sold plus accrued interest. The Company monitors its exposure with respect to securities sold under repurchase agreements and may be required to provide additional collateral based on the fair value of the underlying securities.

G. Federal Home Loan Bank (FHLB) Stock

Restricted stock is stock from the FHLB, which is restricted as to the marketability. Because no ready market exists for this investment, there is no quoted market value, the Bank's investment in this stock is carried at cost.

SECURITY BANCORP, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

H. Loans and Allowance for Loan Losses

Loans are stated at the principal amount outstanding, net of the allowance for loan losses and deferred loan fees. Interest on loans is accrued based on the principal amounts outstanding. When principal or interest is delinquent for ninety days or more, the Bank evaluates the loan for nonaccrual status.

Loans are placed on non-accrual when a loan is specifically determined to be impaired. The Bank does not accrue interest or amortize deferred net loan fees on any loan where the financial condition of the borrower has deteriorated to the point where the payment in full of principal and interest is not expected. The Bank does not accrue interest on any loan where the principal and/or interest has been in default for a period of 90 days or more, unless the loan is both well-secured and in the process of collection, in which case the Directors' Loan Committee or Board of Directors must approve the accrual status. Furthermore, the Committee or Board must re-approve the status every month the loan remains in default.

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. The allowance is based on two basic principles of accounting: FASB ASC 450, Contingencies, which requires that losses be accrued when they are probably of occurring and estimable and FASB ASC 310, Receivables, which requires that losses or impaired loans be accrued based on the differences between the loan balance and either the value of collateral, if such loans are considered to be collateral dependent and in the process of collection, or the present value of future cash flows. A loan is considered impaired when based on current information and events, the Bank has concerns about the ability to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

The Bank's allowance for loan losses has three basic components: the specific allowance, the formula allowance and the pooled allowance. Each of these components is determined based upon estimates that can and do change when the actual events occur. As a result of the uncertainties inherent in the estimation process, management's estimate of loan losses and the related allowance could change in the near term.

The specific allowance component is used to individually establish an allowance for loans identified for impairment testing. When impairment is identified, a specific reserve may be established based on the Bank's calculation of the estimated loss embedded in the individual loan. Impairment testing includes consideration of the borrower's overall financial condition, resources and payment record, support available from financial guarantors and severity of inherent losses. Large groups of smaller balance, homogeneous loans are collectively evaluated for impairment. Accordingly, the bank does not separately evaluate individual consumer and residential loans for impairment.

SECURITY BANCORP, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

The formula allowance component is used for estimating the loss on internally risk rated loans exclusive of those identified as impaired. The loans meeting the Bank's internal criteria or classification, such as special mention, substandard, doubtful and loss, as well as specifically identified impaired loans, are segregated from performing loans within the portfolio. These internally classified loans are then grouped by loan type. Each loan type is assigned an allowance factor based on management's estimate of the associated risk, complexity and size of the individual loans within the particular loan category. Classified loans are assigned a higher allowance factor than on-classified loans due to management's concerns regarding collectability or management's knowledge of particular elements surrounding the borrower. Allowance factors increase with the worsening of the internal risk rating.

The pooled formula component is used to estimate the losses inherent in the pools of non-classified loans. These loans are then also segregated by loan type and allowance factors are assigned by management based on delinquencies, loss history, trends in volume and terms of loans, effects of changes in lending policy, the experience and depth of management, national and local economic trends, concentrations of credit, results of the loan review system and the effect of external factors.

Allowance factors and overall size of the allowance may change from period to period based on management's assessment of the above-described factors and the relative weights given to each factor. In addition, various regulatory agencies periodically review the allowance for loan losses. These agencies may require the Bank to make additions to the allowance for loan losses based on their judgments of collectability based on information available to them at the time of their examination.

Management considers loans impaired when, based on current information, it is probable that the Bank will not collect all principal and interest payments according to contractual terms. Loans are evaluated for impairment in accordance with the Banks' portfolio monitoring and ongoing risk assessment procedures. Management considers the financial condition of the borrower, cash flow of the borrower, payment status of the loan, and the value of the collateral, if any securing the loan. Generally, impaired loans do not include large groups of smaller balance homogenous loans which are evaluated collectively for impairment and are generally placed on nonaccrual when the loan becomes ninety days past due as to principal or interest. Loans specifically reviewed for impairment are not considered impaired during periods of "minimal delay" in payment provided eventual collection of all amount due is expected. The impairment of a loan is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, or the fair value of the collateral if repayment is expected to be provided solely by the collateral. In appropriate circumstances, interest income on impaired loans may be recognized on a cash basis.

The Bank's charge-off policy states after all the collection efforts have been exhausted and the loan is deemed to be a loss, it will be charged to the Bank's established allowance for loan losses.

Fees on loans and costs incurred in origination of loans are generally recognized at the time the loan is recorded. For origination fees greater than \$1,000, the first \$1,000 is recorded to income immediately and the remainder is deferred over the life of the loan or 5 years, whichever is shortest. Because loan fees are not significant and the majority of loans have maturities of one year or less, the results of operations are not materially different than the results which would be obtained by accounting for loan fees and costs in accordance with accounting principles set forth in the FASB ASC Topic 310, Receivables.

SECURITY BANCORP, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019 and 2018

I. Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or market, as determined by outstanding commitments from investors.

J. Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Provisions for depreciation are computed principally on the straight-line method and are charged to noninterest expense over the estimated useful lives of the assets. Maintenance agreements are amortized to expense over the period of time covered by the agreement. Costs of major additions, replacements or improvements are capitalized, while expenditures for maintenance and repairs are charged to expense as incurred.

K. Foreclosed Assets

Other real estate acquired through foreclosure is carried at approximate market value. Approximate market value is the amount the Company could reasonably expect to receive in a current sale of the subject property to a willing buyer in other than a forced or liquidation sale. The excess of cost over approximate market value at the time of foreclosure is charged to the allowance for loan losses. Subsequent declines in fair value are recognized and charged to noninterest expense.

L. Cash Surrender Value of Life Insurance

The Bank purchased single premium life insurance on certain employees of the Bank. Appreciation in value of the insurance policies is classified as noninterest income. Insurance policies can be surrendered subject to certain surrender penalties applied by the insurance carriers, as well as potential income taxes to be paid.

M. Income Taxes

The Company and the Bank file consolidated federal and state income tax returns. Deferred income taxes are provided on significant temporary differences between income determined for financial reporting and income tax purposes. Such differences include expense items relating to the Bank's bad debt expense, FHLB stock dividends, depreciation, deferred compensation plan recognized for financial reporting and deferred for income tax purposes, the effect of unrealized gains (losses) on securities available-for-sale, and various tax credits obtained by the Company.

N. Fair Value Measurements

The Company follows the guidance of FASB ASC 825, *Financial Instruments*, and FASB ASC 820, *Fair Value Measurement*. This guidance permits entities to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This guidance clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Under this guidance, fair value measurements are not adjusted for transaction costs. This guidance established a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure

SECURITY BANCORP, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2019 and 2018

fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

O. Compensated Absences

Compensated absences for sick and personal time have not been accrued since they cannot be reasonably estimated. The Bank's policy is to recognize the costs of compensated absences when actually paid to employees.

P. Earnings per Common Share

Basic earnings per common share is computed by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per common share is computed by dividing net income, adjusted for the effect of assumed conversions, by the weighted average number of common shares outstanding plus amounts representing the dilutive effect of stock options outstanding. Dilutive potential common shares are calculated using the treasury stock method.

Q. Stock Compensation Plans

The Company recognizes compensation cost relating to share-based payment transactions in accordance with ASC Topic 718. Compensation cost has been measured based on the grant date fair value of the equity or liability instruments issued. Compensation cost is calculated and recognized

over the employee service period, generally defined as the vesting period. The Company uses a stock option pricing model to determine the fair value of the award on the grant date.

R. Profit Sharing Plan

Profit sharing plan costs are discretionary and do not exceed the amount that can be deducted for federal income tax purposes.

S. Treasury Stock

Common stock shares repurchased are recorded as treasury stock at cost.

T. Financial Instruments

In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit and commercial letters of credit. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. The guidance changes how entities account for equity investments that do not result in consolidation and are not accounted for under the equity method of accounting. The guidance also changes certain disclosure requirements and other aspects of current accounting principles. Adoption of ASU 2016-

SECURITY BANCORP, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2019 and 2018

01, which was effective for the Company on January 1, 2019, did not have a material impact on the Company's financial statements.

U. Revenue Recognition

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*, to replace a wide range of industry-specific rules with a broad, principles-based framework for recognizing and measuring revenue from contracts with customers. The guidance is codified at FASB ASC 606. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The Company's revenue is composed of net interest income and noninterest income. The scope of the guidance explicitly excludes net interest income as well as many other revenues for financial assets and liabilities including loans, leases, and securities. Accordingly, the majority of the Company's revenues were not affected. Adoption of ASU 2014-09, which was effective for the Company on January 1, 2019, did not have a material impact on the Company's financial statements.

V. Advertising and Promotions

The Company's policy is to charge advertising and promotions to expense as incurred, which includes no direct-response advertising.

W. Mortgage Servicing Rights

Mortgage servicing rights represent the rights to future income related to servicing mortgage loans for others. These rights are capitalized at the lower of their carrying amount or fair value and included in other assets on the consolidated balance sheets. The carrying amount of mortgage loans originated or purchased is allocated between the loans and the mortgage servicing rights. Mortgage servicing rights are capitalized when the underlying loans are sold or securitized. Mortgage servicing rights are amortized over the estimated period of, and in proportion to, net servicing income.

The Bank periodically evaluates mortgage servicing rights for impairment by estimating the fair value based on a discounted cash flow methodology. If the carrying amount of the mortgage servicing rights exceeds estimated fair value, a valuation allowance is established. Changes to the valuation allowance are charged or credited to mortgage servicing income.

X. Trust Department

Assets under management of the Bank's trust department are not included in these consolidated financial statements. The market value of assets under management of the trust department as of December 31, 2019 and 2018, was \$2,552,234 and \$2,641,870, respectively.

Y. Date of Management Review

The Company has evaluated the accompanying financial statements for subsequent events and transactions through February 26, 2020, the date these financial statements were available for issue, based on FASB ASC 855, Subsequent Events, and have determined that no material subsequent events have occurred that would affect the information presented in the accompanying consolidated financial statements or require additional disclosure.

SECURITY BANCORP, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 2 - DETAILED NOTES ON ACCOUNTS

A. Due From Banks

At December 31, 2019 and 2018, the Bank had concentrations of credit risk with financial institutions in the form of correspondent bank accounts. Total uninsured balances held at correspondent banks amounted to \$3,522,596 and \$3,376,015 as of December 31, 2019 and 2018, respectively. In addition, federal funds sold are not insured or guaranteed by other parties. If the financial institutions failed to completely perform under the terms of the financial instruments, the exposure for credit loss would be the amount of the financial instruments less amounts covered by regulatory insurance.

Correspondent bank balances are maintained for check clearing and other services. The Bank is required to maintain average balances in cash or on deposit with the Federal Reserve Bank based on a percentage of deposits. The total of those required reserve balances was \$1,544,000 and \$1,346,000 as of December 31, 2019 and 2018, respectively, and the Bank had in excess of this.

B. Interest-Bearing Deposits with Banks

Interest-bearing deposits with banks consists of an account with the FHLB, an account with the Federal Reserve Bank, sweep accounts with correspondent banks, and certificates of deposit with various financial institutions purchased for investment. As of December 31, 2019 and 2018, all certificates held by the Bank were within regulatory insurance maximums. If the FHLB or Federal Reserve Bank were to completely fail to perform under the terms of the financial instruments, the exposure for credit loss would be the total amount of deposits the Bank maintains with the institution. If the financial institutions failed to completely perform under the terms of the financial instruments, the exposure for credit loss would be the amount of the financial instruments less amounts covered by regulatory insurance. Total uninsured balances held at other banks amounted to \$979,619 and \$5,111,756 as of December 31, 2019 and 2018, respectively.

C. Investment Securities

Debt and equity securities have been classified in the financial statements according to management intent. As of December 31, 2019 and 2018, the Bank held only investment securities available-for-sale in its portfolio. The book value and approximate market value of investment securities at December 31, 2019 and 2018, together with gross unrealized gains and losses are as follows:

<u>December 31, 2019</u>	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
U.S. government agency securities	\$ 9,969,870	\$ 160	\$ (26,281)	\$ 9,943,749
Mortgage-backed securities	15,739,974	91,636	(38,538)	15,793,072
State and municipal securities	9,571,527	26,893	(5,982)	9,592,438
State and municipal securities taxable	421,339	7,745	-	429,084
Federal Home Loan Mortgage Corporation stock	5,336	10,400	-	15,736
Total available-for-sale	<u>35,708,046</u>	<u>136,834</u>	<u>(70,801)</u>	<u>35,774,079</u>
Federal Home Loan Bank stock	955,600	-	-	955,600
Total investment securities	<u>\$ 36,663,646</u>	<u>\$ 136,834</u>	<u>\$ (70,801)</u>	<u>\$ 36,729,679</u>

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<u>December 31, 2018</u>	Amortized <u>Cost</u>	Gross Unrealized <u>Gains</u>	Gross Unrealized <u>Losses</u>	Fair <u>Value</u>
U.S. government agency securities	\$ 11,511,799	\$ -	\$ (151,485)	\$ 11,360,314
Mortgage-backed securities	15,789,835	10,426	(332,549)	15,467,712
State and municipal securities	11,478,027	344	(145,753)	11,332,618
State and municipal securities taxable	1,429,440	-	(4,900)	1,424,540
Federal Home Loan Mortgage Corporation stock	5,336	436	-	5,772
Total available-for-sale	<u>40,214,437</u>	<u>11,206</u>	<u>(634,687)</u>	<u>39,590,956</u>
Federal Home Loan Bank stock	955,600	-	-	955,600
Total investment securities	<u>\$ 41,170,037</u>	<u>\$ 11,206</u>	<u>\$ (634,687)</u>	<u>\$ 40,546,556</u>

The book value and approximate market value of securities (other than equity securities) available-for-sale at December 31, 2019, by contractual maturity are as follows. Certain securities are distributed according to their stated final maturity. However, expected maturities will differ from contractual maturities due to scheduled monthly payments and because borrowers may have the right to call or prepay obligations, in whole or in part, with or without call or prepayment penalties.

	Amortized <u>Cost</u>	Fair <u>Value</u>
Due in one year or less	\$ 7,176,072	\$ 7,177,798
Due in one to five years	9,327,231	9,327,985
Due in five to ten years	3,038,094	3,030,404
Due in over ten years	421,339	429,084
	<u>19,962,736</u>	<u>19,965,271</u>
Mortgage-backed securities	15,739,974	15,793,072
Federal Home Loan Mortgage Corporation stock	5,336	15,736
	<u>\$ 35,708,046</u>	<u>\$ 35,774,079</u>

Proceeds from sale of investment securities, call of securities prior to maturity, or prepayment of principal, gross realized gains, and gross realized losses from such sales for the years ended December 31, 2019 and 2018, for investment securities available-for-sale are shown as follows:

	<u>2019</u>	<u>2018</u>
Proceeds from sales, maturities, prepayments, and calls	<u>\$ 10,377,654</u>	<u>\$ 6,950,370</u>
Gross realized gains	\$ 13,095	\$ 6,000
Gross realized losses	<u>(420)</u>	<u>(4,191)</u>
Net realized gain	<u>\$ 12,675</u>	<u>\$ 1,809</u>

Investment securities with a book value of \$21,193,180 and \$21,235,215 and a fair value of \$21,200,584 and \$20,885,982 at December 31, 2019 and 2018, respectively, were pledged to secure public deposits, repurchase agreements, and for other purposes as required or permitted by law.

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The following table presents information on securities with gross unrealized losses at December 31, 2019 and 2018, aggregated by investment category and the length of time that the individual securities have been in a continuous loss position:

	<u>Less Than Twelve Months</u>		<u>Over Twelve Months</u>		<u>Total</u>	
	Gross		Gross		Gross	
	Unrealized	Fair	Unrealized	Fair	Unrealized	Fair
	<u>Losses</u>	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>	<u>Value</u>
<u>December 31, 2019</u>						
U.S. government						
agency securities	\$ (20,734)	\$ 4,171,755	\$ (5,547)	\$ 3,771,835	\$ (26,281)	\$ 7,943,590
Mortgage-backed securities	(29,193)	4,666,330	(9,345)	2,827,785	(38,538)	7,494,115
State and municipal securities	(20)	101,099	(5,962)	2,746,618	(5,982)	2,847,717
State and municipal securities taxable	-	-	-	-	-	-
Total	<u>\$ (49,947)</u>	<u>\$ 8,939,184</u>	<u>\$ (20,854)</u>	<u>\$ 9,346,238</u>	<u>\$ (70,801)</u>	<u>\$ 18,285,422</u>
	<u>Less Than Twelve Months</u>		<u>Over Twelve Months</u>		<u>Total</u>	
	Gross		Gross		Gross	
	Unrealized	Fair	Unrealized	Fair	Unrealized	Fair
	<u>Losses</u>	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>	<u>Value</u>
<u>December 31, 2018</u>						
U.S. government						
agency securities	\$ (1,520)	\$ 979,900	\$ (149,965)	\$ 10,380,414	\$ (151,485)	\$ 11,360,314
Mortgage-backed securities	(7,127)	2,717,787	(325,422)	12,749,925	(332,549)	15,467,712
State and municipal securities	(16,132)	2,972,197	(129,621)	8,360,421	(145,753)	11,332,618
State and municipal securities taxable	(960)	428,480	(3,940)	996,060	(4,900)	1,424,540
Total	<u>\$ (25,739)</u>	<u>\$ 7,098,364</u>	<u>\$ (608,948)</u>	<u>\$ 32,486,820</u>	<u>\$ (634,687)</u>	<u>\$ 39,585,184</u>

In reviewing the investment portfolio for other-than-temporary impairment of individual securities, consideration is given to (1) the timeframe involved in which the fair value has been less than cost, (2) the financial condition of the issuer, and (3) the ability of the Bank to maintain its investment in the issuer for a time that would provide for any anticipated recovery in the fair value.

As of December 31, 2019, the Bank had 21 debt securities noted with unrealized losses. Of the total debt securities, 8 were mortgage-backed securities, 6 were U.S. government agency securities, and 7 were state and municipal securities. In analyzing the reasons for the unrealized losses, management considers whether the securities are issued by the federal government or its agencies, whether downgrades of bond ratings have occurred, and also reviews any applicable industry analysts' reports. With respect to the unrealized losses on the securities noted and the analysis performed relating to the securities, management currently believes that the declines in the market value are temporary.

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D. Loans

Loans outstanding at December 31, 2019 and 2018, by major lending classifications are as follows:

	<u>2019</u>	<u>2018</u>
Real estate	\$ 122,970,978	\$ 107,251,160
Commercial and industrial	35,301,106	28,532,741
Consumer installment and other	<u>14,349,700</u>	<u>14,857,241</u>
Total loans	172,621,784	150,641,142
Less: Allowance for loan losses	<u>(1,668,553)</u>	<u>(1,586,974)</u>
Net loans	<u>\$ 170,953,231</u>	<u>\$ 149,054,168</u>

Loans on nonaccrual status as of December 31, 2019 and 2018, by category are as follows:

	<u>2019</u>	<u>2018</u>
Real estate	\$ 116,607	\$ 626,835
Commercial and industrial	-	41,622
Consumer installment and other	<u>35,589</u>	<u>16,760</u>
Total	<u>\$ 152,196</u>	<u>\$ 685,217</u>

An aging analysis of loans by category as of December 31, 2019 and 2018, is as follows:

	30-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing
<u>December 31, 2019</u>						
Real estate	\$ 1,866,152	\$ 116,607	\$ 1,982,759	\$ 120,988,219	\$ 122,970,978	\$ -
Commercial and industrial	-	-	-	35,301,106	35,301,106	-
Consumer installment and other	<u>54,956</u>	<u>35,589</u>	<u>90,545</u>	<u>14,259,155</u>	<u>14,349,700</u>	-
Real estate	<u>\$ 1,921,108</u>	<u>\$ 152,196</u>	<u>\$ 2,073,304</u>	<u>\$ 170,548,480</u>	<u>\$ 172,621,784</u>	<u>\$ -</u>
<u>December 31, 2018</u>						
Real estate	\$ 1,216,976	\$ 759,246	\$ 1,976,222	\$ 105,274,938	\$ 107,251,160	\$ -
Commercial and industrial	91,902	41,622	133,524	28,399,217	28,532,741	-
Consumer installment and other	<u>86,467</u>	<u>15,159</u>	<u>101,626</u>	<u>14,755,615</u>	<u>14,857,241</u>	-
Total	<u>\$ 1,395,345</u>	<u>\$ 816,027</u>	<u>\$ 2,211,372</u>	<u>\$ 148,429,770</u>	<u>\$ 150,641,142</u>	<u>\$ -</u>

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An analysis of impaired loans by category as of December 31, 2019 and 2018, is as follows:

	Recorded	Unpaid	Specific	Average	Interest
	<u>Investment</u>	<u>Principal</u>	<u>Allowance</u>	<u>Recorded</u>	<u>Income</u>
<u>December 31, 2019</u>				<u>Investment</u>	<u>Recognized</u>
<u>With no specific allocation recorded:</u>					
Real estate	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial and industrial	-	-	-	-	-
Consumer installment and other	-	-	-	-	-
 <u>With allocation recorded:</u>					
Real estate	1,317,841	1,311,160	272,925	1,413,903	69,789
Commercial and industrial	105,541	104,794	25,000	113,808	5,724
Consumer installment and other	25,553	25,488	12,432	28,690	1,537
 <u>Total:</u>					
Real estate	1,317,841	1,311,160	272,925	1,413,903	69,789
Commercial and industrial	105,541	104,794	25,000	113,808	5,724
Consumer installment and other	25,553	25,488	12,432	28,690	1,537
Totals	<u>\$ 1,448,935</u>	<u>\$ 1,441,442</u>	<u>\$ 310,357</u>	<u>\$ 1,556,401</u>	<u>\$ 77,050</u>
	Recorded	Unpaid	Specific	Average	Interest
	<u>Investment</u>	<u>Principal</u>	<u>Allowance</u>	<u>Recorded</u>	<u>Income</u>
<u>December 31, 2018</u>				<u>Investment</u>	<u>Recognized</u>
<u>With no specific allocation recorded:</u>					
Real estate	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial and industrial	-	-	-	-	-
Consumer installment and other	-	-	-	-	-
 <u>With allocation recorded:</u>					
Real estate	1,509,967	1,501,615	296,360	1,596,219	74,050
Commercial and industrial	122,074	119,943	44,105	129,789	6,888
Consumer installment and other	31,826	31,139	15,774	42,883	2,348
 <u>Total:</u>					
Real estate	1,509,967	1,501,615	296,360	1,596,219	74,050
Commercial and industrial	122,074	119,943	44,105	129,789	6,888
Consumer installment and other	31,826	31,139	15,774	42,883	2,348
Totals	<u>\$ 1,663,867</u>	<u>\$ 1,652,697</u>	<u>\$ 356,239</u>	<u>\$ 1,768,891</u>	<u>\$ 83,286</u>

The Bank is exposed to risk of loss on loans due to the borrower's difficulties, which may arise from a number of factors including problems within the respective industry or general economic conditions within the Bank's trade area.

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The Bank evaluates the credit risk of each customer on an individual basis and when deemed appropriate, collateral is obtained. Collateral varies by individual loan customer, but may include accounts receivable, inventory, real estate, equipment, deposits, agricultural crops and livestock, personal guarantees, and general security agreements. Access to collateral is dependent upon the type of collateral obtained. On a regular basis, the Bank monitors its collateral position relative to the loan balance outstanding and takes the appropriate action, as necessary.

The Bank primarily grants commercial, residential, and consumer loans to customers within its defined market area, primarily in Warren County, Tennessee, and continuous counties, all of which are affected by the general economic conditions of the area. Although the Bank reviews the diversification of the loan portfolio on a regular basis to avoid concentrations of credit risk, the overall quality of the loan portfolio and the borrowers' ability to repay the loans are, to some extent, affected by the health of the local economy taken as a whole.

Credit risk management procedures include assessment of loan quality through the use of an internal loan rating system. Each loan is assigned a rating upon origination and the rating may be revised over the life of the loan as circumstances warrant. The rating system utilizes five major classification types based on risk of loss with Pass being the lowest level of risk and Uncollectable being the highest level of risk. Loans internally rated Pass and are considered loans with low to average level of risk of credit losses. Loans in this risk grade would possess sufficient mitigating factors, such as adequate collateral or strong guarantors possessing the capacity to repay the debt if required, for any weakness that may exist. Loans rated Special Mention have potential weaknesses that deserve management's close attention. Substandard loans are inadequately protected by the current sound worth and paying capacity of the obligor or the collateral pledged, if any. Doubtful loans have all the characteristics of Substandard loans with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Uncollectable loans are considered to be non-collectible and of little value that their continuance as bankable assets is not warranted. This does not mean the loan has absolutely no recovery value, but rather it is neither practical nor desirable to defer writing off the loan, even though partial recovery may be obtained in the future. Charge-offs against the allowance for loan losses are taken in the period in which the loan becomes uncollectible. Consequently, the Bank typically does not maintain a recorded investment in loans within this category. Loans by internal risk rating by category as of December 31, 2019 and 2018, are as follows:

<u>December 31, 2019</u>	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
Real estate	\$ 118,996,031	\$ 463,310	\$ 3,511,637	\$ -	\$ 122,970,978
Commercial and industrial	35,176,660	104,794	19,652	-	35,301,106
Consumer installment and other	14,194,559	77,055	76,417	1,669	14,349,700
Total	<u>\$ 168,367,250</u>	<u>\$ 645,159</u>	<u>\$ 3,607,706</u>	<u>\$ 1,669</u>	<u>\$ 172,621,784</u>

<u>December 31, 2018</u>	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
Real estate	\$ 102,374,576	\$ 273,330	\$ 4,603,254	\$ -	\$ 107,251,160
Commercial and industrial	28,284,829	118,641	129,271	-	28,532,741
Consumer installment and other	14,682,258	42,617	132,366	-	14,857,241
Total	<u>\$ 145,341,663</u>	<u>\$ 434,588</u>	<u>\$ 4,864,891</u>	<u>\$ -</u>	<u>\$ 150,641,142</u>

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The Bank seeks to assist customers that are experiencing financial difficulty by renegotiating loans within lending regulations and guidelines. At the time of restructuring, a loan is evaluated for an asset-specific allowance for credit losses. The Bank continues to specifically reevaluate the loan in subsequent periods, regardless of the borrower's performance under the modified terms. If a borrower subsequently defaults on the loan after it is restructured, the Bank provides an allowance for credit losses for the amount of the loan that exceeds the value of the related collateral. There were no loans that were restructured during the years ended December 31, 2019 and 2018.

E. Allowance for Loan Losses

Activity in the allowance for loan losses by category for the years ended December 31, 2019 and 2018, is as follows:

<u>December 31, 2019</u>	Beginning				Ending		ASC 310	ASC 450
	<u>Balance</u>	<u>Charge-offs</u>	<u>Recoveries</u>	<u>Provision</u>	<u>Balance</u>	<u>Individually</u>	<u>Collectively</u>	
Real estate	\$ 835,591	\$ (38,531)	\$ 2,068	\$ 70,000	\$ 869,128	\$ 272,925	\$ 596,203	
Commercial and industrial	503,807	-	5,668	10,000	519,475	25,000	494,475	
Consumer installment and other	247,576	(12,904)	17,594	27,684	279,950	12,432	267,518	
Total	<u>\$1,586,974</u>	<u>\$ (51,435)</u>	<u>\$ 25,330</u>	<u>\$ 107,684</u>	<u>\$ 1,668,553</u>	<u>\$ 310,357</u>	<u>\$ 1,358,196</u>	

<u>December 31, 2018</u>	Beginning				Ending		ASC 310	ASC 450
	<u>Balance</u>	<u>Charge-offs</u>	<u>Recoveries</u>	<u>Provision</u>	<u>Balance</u>	<u>Individually</u>	<u>Collectively</u>	
Real estate	\$ 765,774	\$ (47,498)	\$ 1,363	\$ 115,952	\$ 835,591	\$ 296,360	\$ 539,231	
Commercial and industrial	481,575	(2,017)	9,249	15,000	503,807	44,105	459,702	
Consumer installment and other	221,972	(16,780)	3,766	38,618	247,576	15,774	231,802	
Total	<u>\$1,469,321</u>	<u>\$ (66,295)</u>	<u>\$ 14,378</u>	<u>\$ 169,570</u>	<u>\$ 1,586,974</u>	<u>\$ 356,239</u>	<u>\$ 1,230,735</u>	

F. Loan Servicing

Mortgage loans serviced for Federal Home Loan Mortgage Corporation (FHLMC) are not included in the accompanying consolidated balance sheet. The unpaid principal balances of these loans were \$78,691,559 and \$75,797,656 at December 31, 2019 and 2018, respectively.

Mortgage servicing rights are included in other assets in the accompanying consolidated balance sheet. A summary of transactions in mortgage servicing rights for the years ended December 31, 2019 and 2018, is as follows:

	<u>2019</u>	<u>2018</u>
Balance, beginning of year	\$302,390	\$287,914
Amount capitalized	185,557	137,486
Amount amortized	<u>(141,095)</u>	<u>(123,010)</u>
Balance, end of year	<u>\$ 346,852</u>	<u>\$ 302,390</u>

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G. Premises and Equipment

Premises and equipment and related accumulated depreciation at December 31, 2019 and 2018, are as follows:

	Estimated Useful Life	2019	2018
Land	0	\$ 1,005,343	\$ 1,005,343
Buildings and improvements	5-40	2,536,335	2,527,138
Furniture and equipment	5	1,472,777	1,363,682
Vehicles	5	122,091	121,190
Construction in progress		25,681	-
Total		5,162,227	5,017,353
Less: accumulated depreciation		(2,441,287)	(2,301,540)
Premises and equipment, net		<u>\$ 2,720,940</u>	<u>\$ 2,715,813</u>

H. Deposits

The total amount of demand deposits reclassified as loans at December 31, 2019 and 2018, was \$32,357 and \$44,217. The aggregate amounts of time deposits in denominations of \$250,000 or more at December 31, 2019 and 2018, were \$18,877,590 and \$14,995,616, respectively. At December 31, 2019, the scheduled maturities of time deposits are as follows:

On or before December 31, 2020	\$41,222,869
On or before December 31, 2021	13,364,229
On or before December 31, 2022	5,549,259
On or before December 31, 2023	2,217,788
On or before December 31, 2024	2,021,253
Total	<u>\$ 64,375,398</u>

I. Lines of Credit and FHLB Lines of Credit

The Bank currently has available from correspondent banks lines of short-term credit in the form of federal fund purchases. Interest on these lines is at the current daily rate at the time of purchase. The line with First Tennessee is for \$5,000,000, unsecured and may be drawn for fourteen consecutive days before collateral is required. Currently, there are no borrowings against this line. The line with ServisFirst Bank is for \$4,000,000, unsecured and must be repaid in a maximum of thirty consecutive calendar days. There are no borrowings against this line.

The Bank has available a line of credit with the FHLB of Cincinnati. The Bank has an additional borrowing capacity of \$25,703,920. Currently, there is \$2,000,000 borrowed against this line at a weighted average rate of 1.66% with the full balance due by December 31, 2022. The Bank has \$2,940,000 in 1-4 family loans pledged as collateral against this line. The Bank also has available a line of credit to borrow up to \$10,000,000 in overnight funds, which would limit the borrowing capacity by the borrowed amount. The terms of the borrowings are subject to market rates at the time of the advance with maturities of one to twenty years. Currently, the Bank has \$3,000,000 borrowed against this line.

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J. Income Taxes

Allocation of Federal and State income taxes between current and deferred is as follows as of December 31, 2019 and 2018:

<u>December 31, 2019</u>	<u>Current</u>	<u>Deferred</u>	<u>Total Expense</u>
State income tax	\$ 213,130	\$ -	\$ 213,130
Federal income tax	<u>676,839</u>	<u>(31,659)</u>	<u>645,180</u>
Total expense	<u>\$ 889,969</u>	<u>\$ (31,659)</u>	<u>\$ 858,310</u>

<u>December 31, 2018</u>	<u>Current</u>	<u>Deferred</u>	<u>Total Expense</u>
State income tax	\$ 182,565	\$ -	\$ 182,565
Federal income tax	<u>618,202</u>	<u>(68,692)</u>	<u>549,510</u>
Total expense	<u>\$ 800,767</u>	<u>\$ (68,692)</u>	<u>\$ 732,075</u>

The Company adopted practices in accordance with the FASB ASC Topic 740, Income Taxes. FASB ASC Topic 740 on Income Taxes provides guidance for how an entity should recognize, measure, present and disclose uncertain tax positions that it has taken or expects to take on a tax return. As of December 31, 2019 and 2018, the Company had no unrecognized tax benefits. The Company's policy is to recognize penalties and interest on unrecognized tax benefits in provision for income tax expense in the consolidated statements of income. There were no amounts related to interest and penalties recognized for the years ended December 31, 2019 and 2018.

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The components of the net deferred tax asset (liability) included in other assets (liabilities) are as follows:

	<u>2019</u>	<u>2018</u>
Deferred tax asset:		
Allowance for loan losses	\$ 399,506	\$ 374,771
Unearned loan fees	12,511	11,409
Non-accrual loan interest	(2,858)	7,066
Deferred compensation	321,136	297,918
Net unrealized loss on securities available-for-sale	-	<u>149,740</u>
Subtotal	<u>730,295</u>	<u>840,904</u>
Deferred tax liability:		
FHLB stock dividends	176,071	176,071
Net unrealized gain on stocks available-for-sale	15,848	105
Depreciation	100,269	92,797
Deferred gains on mortgage servicing rights	78,145	78,145
Other	<u>31,659</u>	<u>68,683</u>
Subtotal	<u>401,992</u>	<u>415,801</u>
Net deferred tax asset	<u>\$ 328,303</u>	<u>\$ 425,103</u>

The ratio of applicable income taxes to net income before taxes differed from the statutory rate of 21% in 2019 and 2018. The reasons for these differences are as follows:

	<u>2019</u>	<u>2018</u>
Tax expense at statutory rate	\$714,807	\$619,847
Increase (decrease) resulting from:		
State income taxes, net of federal tax benefit	13,853	11,867
Allowance for loan losses	17,132	24,707
Tax exempt interest, net of nondeductible expenses	(29,375)	(33,429)
Earnings on cash surrender value life insurance	(10,361)	(10,905)
Other differences	<u>152,254</u>	<u>119,988</u>
	<u>\$858,310</u>	<u>\$732,075</u>

NOTE 3 - DIVDEND RESTRICTION

Due to state banking regulations, the Bank may not declare dividends in any calendar year that exceed the total of its net income of that year combined with its retained net income of the preceding two years without the prior approval of the commissioner. As of December 31, 2019 and 2018, the Bank's retained earnings available for the payment of dividends was \$4,948,555 and \$4,171,143, respectively.

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NOTE 4 - EMPLOYEE BENEFIT PLANS

The Bank has in effect a contributory profit sharing plan, a deferred compensation plan, and an employee stock ownership plan (ESOP). Employees become eligible to participate in the plans after reaching age 21 and completing one year of service.

The Bank's contributions to the profit sharing plan are discretionary and totaled \$109,525 and \$89,898 at December 31, 2018 and 2017, respectively. Employer contributions vest on a graduated schedule from two to six years of service.

The Bank has a deferred compensation plan for the benefit of its directors. Under the plan, any director electing to defer directors' fees will be entitled to receive the accumulated benefits, including interest earned, over a period of ten or fifteen years following retirement. The Bank recognizes the liability for these benefits over the director's service period. As of December 31, 2019 and 2018, the liability for these benefits was \$1,222,696 and \$1,133,838, respectively. Expenses related to the deferred compensation plan were \$145,691 and \$113,341 at December 31, 2019 and 2018, respectively.

The deferred compensation plan also provides for payments of benefits in the event of early termination or death. The Bank purchased single premium, whole life insurance policies to facilitate the funding of these benefits. The Bank is the sole owner and beneficiary of such policies. As of December 31, 2019 and 2018, the cash surrender value of these policies was \$2,447,138 and \$2,397,799, respectively.

At December 31, 2019 and 2018, the ESOP held common shares of 23,032 and 23,033, and all have been allocated to participants. Allocated ESOP shares are treated as outstanding in the computation of earnings per share. The Bank recorded no charges in relation to the ESOP in 2019 and 2018. Contributions are allocated to participants based on their eligible compensation relative to total eligible compensation. Dividends on ESOP shares are paid to the ESOP trust.

NOTE 5 - STOCK OPTION PLANS

The Company has two stock option plans that provide for both incentive stock options and nonqualified stock options. The exercise price of each option shall not be less than 100 percent of the fair market value of the common stock on the date of the grant. All options have been granted at the fair market value of the shares at the date of grant.

The maximum number of common shares that can be sold or optioned under the 2007 Incentive Stock Plan is 17,000 shares. The maximum term is ten years for incentive options and fifteen years for nonqualified options. Each option vests on an equal incremental basis over five years.

The effect of stock options forfeited is recognized as the forfeitures occur. The fair value of each stock option was estimated on the grant date using the Black-Scholes option-pricing model. The Company incurred compensation expense for stock options of \$18,180 and \$18,180 at December 31, 2019 and 2018, respectively. At December 31, 2019 and 2018, the total remaining compensation cost to be recognized on non-vested options is \$10,605 and \$28,786, respectively. If not exercised, the options will expire from 2021 to 2025.

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A summary of activity in the stock option plans for the years ended December 31, 2019 and 2018, is as follows:

<u>December 31, 2019</u>	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>
Outstanding at beginning of year	11,000	\$ 37.02
Options granted	-	-
Options reissued	-	-
Options exercised	(1,100)	-
Options terminated	<u>-</u>	-
Outstanding at end of year	<u>9,900</u>	\$ 38.00
<u>December 31, 2018</u>	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>
Outstanding at beginning of year	11,000	\$ 37.02
Options granted	-	-
Options reissued	-	-
Options terminated	<u>-</u>	-
Outstanding at end of year	<u>11,000</u>	\$ 37.02

There is no aggregate intrinsic value of options outstanding at December 31, 2019 and 2018. The aggregate intrinsic value represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on December 31, 2019 and 2018. This amount changes based on changes in the market value of the Company's stock. The fair value (present value of the estimated future benefit to the option holder) of each option grant is estimated on the date of grant using the Black-Scholes option pricing model.

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Information pertaining to options outstanding at December 31, 2019 and 2018, is as follows:

<u>December 31, 2019</u>					
<u>Options Outstanding</u>			<u>Options Exercisable</u>		
Number	Weighted Average Remaining Life	Weighted Average Exercise Price	Number	Weighted Average Exercise Price	
<u>Outstanding</u>	<u>Life</u>	<u>Price</u>	<u>Exercisable</u>	<u>Price</u>	
8,800	5.7 Years	\$ 39.24	7,040	\$ 39.24	
<u>1,100</u>	1.4 Years	28.12	<u>1,100</u>	28.12	
<u>9,900</u>	4.8 Years	38.00	<u>8,140</u>	38.00	

<u>December 31, 2018</u>					
<u>Options Outstanding</u>			<u>Options Exercisable</u>		
Number	Weighted Average Remaining Life	Weighted Average Exercise Price	Number	Weighted Average Exercise Price	
<u>Outstanding</u>	<u>Life</u>	<u>Price</u>	<u>Exercisable</u>	<u>Price</u>	
8,800	6.7 Years	\$ 39.24	5,280	\$ 39.24	
<u>2,200</u>	2.4 Years	28.12	<u>2,200</u>	28.12	
<u>11,000</u>	5.8 Years	37.02	<u>7,480</u>	37.02	

Information related to non-vested options for the years ended December 31, 2019 and 2018, is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Non-vested options, December 31, 2017	5,280	\$ 37.02
Reissued	-	39.24
Granted	-	39.24
Vested	(1,760)	39.24
Forfeited/expired	<u>-</u>	-
Non-vested options, December 31, 2018	3,520	37.02
Reissued	-	39.24
Granted	-	39.24
Vested	(1,760)	39.24
Forfeited/expired	<u>-</u>	-
Non-vested options, December 31, 2019	<u>1,760</u>	37.02

The total value of shares that vested during 2019 and 2018, was \$81,435 and \$81,435, respectively.

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NOTE 6 - MANAGEMENT RECOGNITION PLAN

The Company's management recognition plan serves as a means of providing existing directors and employees of the Bank with an ownership interest in the Company. Common shares awarded under the management recognition plan vest equally over a five-year period. Compensation expense related to those shares is recognized on a straight-line basis corresponding with the vesting period. Prior to vesting, each participant granted shares under the management recognition plan may direct the voting of the shares allocated to the participant and will be entitled to receive any dividends or other distributions paid on such shares.

Shares that vested and were issued to participants in the management recognition plan totaled 180 and 180 shares in 2019 and 2018. Total compensation expense associated with the management recognition plan was \$10,326 and \$9,903 at December 31, 2019 and 2018, respectively.

NOTE 7 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The following summary presents the methodologies and assumptions used to estimate the fair value of the Bank's financial instruments presented below. The Bank operates as a going concern, and, except for its investment securities portfolio, no active market exists for its financial instruments. Much of the information used to determine fair value is highly subjective and judgmental in nature, and therefore, the results may not be precise. The subjective factors include, among other things, estimates of cash flows, risk characteristics, credit quality, and interest rates, all of which are subject to change. Since the fair value is estimated as of December 31, 2019 and 2018, the amounts, which will actually be realized or paid upon settlement or maturity of the various instruments, could be significantly different. Certain financial instruments are excluded from disclosure requirements. Accordingly, the aggregate fair value amounts presented are not intended to represent the underlying value of the Bank.

A. Cash, Due From Banks, Interest-Bearing Deposits with Banks, Federal Funds Sold, Accrued Interest Receivable, and Accrued Interest Payable

The carrying amount for cash, due from banks, interest-bearing deposits, federal funds sold, accrued interest receivable and accrued interest payable is a reasonable estimate of fair value for those assets and liabilities.

B. Investment Securities

In estimating fair values, management makes use of prices or dealer quotes for U.S. Treasury securities, other U.S. government agency securities, tax exempt securities, and mortgage-backed certificates. As required by FASB ASC Topic 820, Fair Value Measurements and Disclosures, securities available-for-sale are recorded at fair value.

C. Stock Investments

The carrying value of Federal Home Loan Bank stock is a reasonable estimate of the fair value.

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D. Loans

The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings for the same remaining maturities. The risk of default is measured as an adjustment to the discount rate, and no future interest income is assumed for nonaccrual loans.

The fair value of loans does not include the value of the customer relationship or the right to fees generated by the account.

E. Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at lower of aggregate cost or market.

F. Cash Surrender Value of Life Insurance

Carrying amount of bank-owned life insurance is the cash surrender value as of the end of the periods presented and approximates fair value.

G. Other Assets, Other Liabilities and Repurchase Agreements

Financial instruments included in other assets, other liabilities and repurchase are short-term and, therefore, valued at their carrying values.

H. Deposit Liabilities

The fair value of deposits with no stated maturities (which includes demand deposits, savings accounts, and money market deposits) is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using a discounted cash flow model based on the rates currently offered for deposits of similar maturities.

FASB ASC Topic 820, Fair Value Measurements and Disclosures requires deposit liabilities with no stated maturity to be reported at the amount payable on demand without regard for the inherent funding value of these instruments. The Bank believes that significant value exists in this funding source.

I. FHLB Borrowings

The fair value of borrowings are based on current rates for similar financing.

J. Loan Commitments and Standby Letters of Credit

The Bank has reviewed its loan commitments and standby letters of credit and determined that differences between the fair value and notional principal amounts are not significant.

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The estimated fair values of the Bank's financial instruments are as follows:

	<u>December 31, 2019</u>		<u>December 31, 2018</u>	
	<u>Carrying</u> <u>Amount</u>	<u>Fair</u> <u>Value</u>	<u>Carrying</u> <u>Amount</u>	<u>Fair</u> <u>Value</u>
Financial assets:				
Cash and due from banks	\$ 6,237,553	\$ 6,237,553	\$ 5,036,323	\$ 5,036,323
Interest-bearing deposits with banks	2,694,619	2,694,619	11,028,636	11,028,636
Securities available-for-sale	35,774,079	35,774,079	39,590,956	39,590,956
FHLB stock	955,600	955,600	955,600	955,600
Loans, net: ⁽¹⁾				
Held for investment	170,953,231	170,291,782	149,054,168	148,402,558
Loans held for sale	-	-	665,828	665,828
Cash surrender value of life insurance	2,447,138	2,447,138	2,397,799	2,397,799
Accrued interest receivable	1,162,969	1,162,969	1,062,114	1,062,114
Other assets	953,694	953,694	994,077	994,077
Financial liabilities:				
Deposits: ⁽¹⁾				
Without stated maturities	122,663,496	122,663,496	116,623,615	116,623,615
With stated maturities	64,375,398	64,262,863	61,030,767	60,973,816
Repurchase agreements	5,382,173	5,382,173	7,651,636	7,651,636
Accrued interest payable	166,192	166,192	118,487	118,487
Custodial escrow payable	100,244	100,244	121,022	121,022
FHLB borrowings	5,000,000	4,985,500	4,000,000	4,089,600
Accrued expenses and other liabilities	2,081,303	2,081,303	1,907,948	1,907,948
Unrecorded financial instruments:				
Commitments to extend credit	35,173,535	35,173,535	33,560,168	33,560,168
Standby letters of credit	730,856	730,856	434,200	434,200

⁽¹⁾As mentioned in the assumptions above, the fair value of these financial instruments does not include any value for the customer relationship or the right to future fee income which may be generated by these relationships.

The Bank adopted FASB ASC Topic on Fair Value Measurements and Disclosures effective January 1, 2008. The codification defines fair value, establishes a framework for measuring fair value and expands disclosure requirements regarding fair value measurements. This standard clarifies the principle that fair value should be based on assumptions market participants would use when pricing the asset or liability and establishes a hierarchy that prioritizes information used to develop these assumptions. The hierarchy is as follows:

A. Level 1 Inputs

Unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.

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B. Level 2 Inputs

Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Such inputs may include quoted prices for similar assets or liabilities in active market, and inputs other than quoted market prices that are observable for the assets and liabilities such as interest rates and yield curves that are observable at commonly quoted intervals.

C. Level 3 Inputs

Unobservable inputs for determining fair values of assets and liabilities that reflect an entity's own assumptions about the assumptions that market participants would use pricing the assets and liabilities.

Securities available-for-sale are the only balance sheet components reported at fair value. They are valued using Level 2 inputs. The Bank obtains fair value measurements from a third party vendor. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and terms and conditions of bonds, and other factors.

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of December 31, 2019 and 2018:

<u>December 31, 2019</u>	<u>Level 1</u> <u>Inputs</u>	<u>Level 2</u> <u>Inputs</u>	<u>Level 3</u> <u>Inputs</u>	<u>Total</u> <u>Fair Value</u>
Financial assets:				
U.S. government agency securities	\$ -	\$ 9,943,749	\$ -	\$ 9,943,749
Mortgage-backed securities	-	15,793,072	-	15,793,072
State and municipal securities	-	9,592,438	-	9,592,438
State and municipal securities taxable	-	429,084	-	429,084
Federal Home Loan Mortgage Corporation stock	-	15,736	-	15,736
Total	\$ -	\$ 35,774,079	\$ -	\$ 35,774,079
<u>December 31, 2018</u>	<u>Level 1</u> <u>Inputs</u>	<u>Level 2</u> <u>Inputs</u>	<u>Level 3</u> <u>Inputs</u>	<u>Total</u> <u>Fair Value</u>
Financial assets:				
U.S. government agency securities	\$ -	\$ 11,360,314	\$ -	\$ 11,360,314
Mortgage-backed securities	-	15,467,712	-	15,467,712
State and municipal securities	-	11,332,618	-	11,332,618
State and municipal securities taxable	-	1,424,540	-	1,424,540
Federal Home Loan Mortgage Corporation stock	-	5,772	-	5,772
Total	\$ -	\$ 39,590,956	\$ -	\$ 39,590,956

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Certain non-financial assets measured at fair value on a non-recurring basis include intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment. Foreclosed assets are recorded at the lower of cost or fair value. Fair value is measured based on independent appraisals and may be discounted by management based on historical experience and knowledge and changes in market conditions from time of valuation. Values of impaired loans are reviewed at least annually or more often if circumstances require more frequent evaluations. The following table summarizes non-financial assets measured at fair value on a recurring basis as of December 31, 2019 and 2018:

<u>December 31, 2019</u>	Level 1 <u>Inputs</u>	Level 2 <u>Inputs</u>	Level 3 <u>Inputs</u>	Total <u>Fair Value</u>
Non-financial assets:				
Foreclosed assets	\$ -	\$ 567,600	\$ -	\$ 567,600
Impaired loans	-	<u>1,441,442</u>	-	<u>1,441,442</u>
Total	<u>\$ -</u>	<u>\$2,009,042</u>	<u>\$ -</u>	<u>\$2,009,042</u>
<u>December 31, 2018</u>	Level 1 <u>Inputs</u>	Level 2 <u>Inputs</u>	Level 3 <u>Inputs</u>	Total <u>Fair Value</u>
Non-financial assets:				
Foreclosed assets	\$ -	\$ 77,250	\$ -	\$ 77,250
Impaired loans	-	<u>1,652,697</u>	-	<u>1,652,697</u>
Total	<u>\$ -</u>	<u>\$1,729,947</u>	<u>\$ -</u>	<u>\$1,729,947</u>

The total amount of foreclosed assets that represents residential real estate at December 31, 2019 and 2018, is \$567,600 and \$0, respectively.

NOTE 8 - FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk, interest rate risk and liquidity risk, in excess of the amounts recognized in the accompanying balance sheets. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by one of the other parties to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies and procedures in making commitments and conditional obligations as it does for on balance-sheet instruments. Financial instruments, whose contract amounts represent credit risk at December 31, 2019 and 2018, are as follows:

	<u>2019</u>	<u>2018</u>
Commitments to extend credit	<u>\$35,173,535</u>	<u>\$33,560,168</u>
Standby letters of credit	<u>\$ 730,856</u>	<u>\$ 434,200</u>

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Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of the collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the customer. Collateral held, if any, varies but may include certificates of deposit, accounts receivable, inventory, property and equipment, real estate, crops, and income-producing properties. Of the \$35,173,535 unfunded commitments as of December 31, 2019, \$25,634,487 had variable interest rates and \$9,529,048 had fixed interest rates. Of the \$33,560,168 unfunded commitments as of December 31, 2018, \$25,417,619 had variable interest rates and \$8,142,549 had fixed interest rates.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The standby letters of credit at December 31, 2019, are short-term guarantees generally expiring on or before December 31, 2020. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank evaluates each customer's credit worthiness on a case-by-case basis. When deemed necessary, the Bank may hold a variety of collateral to support these commitments similar to the types of collateral held for commitments to extend credit.

NOTE 9 - SIGNIFICANT GROUP OF CONCENTRATIONS OF CREDIT RISK

Most of the Company's loans, commitments and commercial and standby letters of credit have been granted to customers in the Company's market area. Many such customers are depositors of the Bank. A substantial portion of the Company's customers' ability to honor their contracts is dependent on the business economy in those areas. Seventy-one percent of the Company's loan portfolio is concentrated in real estate. A substantial portion of these loans is secured by real estate in the Company's primary market area. Accordingly, the ultimate collectability of the loan portfolio is susceptible to changes in market conditions in the Company's primary market area.

NOTE 10 - LEASE AGREEMENTS

The Bank has a lease agreement for a digital mailing system. Rental expense was \$2,340 and \$2,340 as of December 31, 2019 and 2018, respectively. Future minimum lease payments are as follows:

Due on or before:	
December 31, 2020	\$2,340
December 31, 2021	<u>585</u>
	<u>\$2,925</u>

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NOTE 11 - RELATED PARTIES

As of December 31, 2019 and 2018, the Bank had entered into loan transactions with its directors, officers, and their affiliates. Direct and indirect loans to executive officers and directors of the Bank and their related interests are as follows:

	<u>2019</u>	<u>2018</u>
Loans outstanding at beginning of the year	\$ 1,462,353	\$ 714,004
New borrowings	81,541	682,741
Repayments of loans	(297,962)	(125,161)
Added to (removed from) related party loans	-	190,769
Loans outstanding at the end of the year	<u>\$ 1,245,932</u>	<u>\$ 1,462,353</u>

Deposits from related parties held by the Bank at December 31, 2019 and 2018, amounted to \$1,522,500 and \$1,300,969, respectively.

There were \$354,470 and \$402,796 in repurchase agreements held by a related party at December 31, 2019 and 2018, respectively.

NOTE 12 - LEGAL MATTERS

The Company and subsidiaries are involved in legal proceedings arising in the normal course of business. In the opinion of management, after consulting with counsel, the ultimate resolution of these matters will not have a material adverse effect on the financial position and results of operations of the Company and subsidiaries.

NOTE 13 - REGULATORY REQUIREMENTS

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2019, that the Bank meets all capital adequacy requirements to which it is subject.

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As of December 31, 2019, the most recent notification from the applicable regulatory agencies categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management feels have changed the institution's category. The Bank's actual capital amounts and ratios are also shown in the table. The actual capital amounts were calculated as of December 31, 2019 and 2018.

<u>December 31, 2019</u>	<u>Actual:</u>		<u>For Capital Adequacy Purposes:</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Provisions:</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
Common Equity Tier 1 Capital (to risk-weighted assets)	\$ 24,440,000	14.336%	\$ 7,671,645	≥4.500%	\$11,081,265	≥6.500%
Total capital (to risk-weighted assets)	\$ 26,114,000	15.318%	\$ 10,228,860	≥6.000%	\$17,048,100	≥10.00%
Tier I capital (to risk-weighted assets)	\$ 24,440,000	14.336%	\$ 13,638,480	≥8.000%	\$13,638,480	≥8.000%
Tier I capital (to average assets)	\$ 24,440,000	10.968%	\$ 8,913,160	≥4.000%	\$11,141,450	≥5.000%

<u>December 31, 2018</u>	<u>Actual:</u>		<u>For Capital Adequacy Purposes:</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Provisions:</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
Common Equity Tier 1 Capital (to risk-weighted assets)	\$ 22,433,000	14.847%	\$ 6,799,230	≥4.500%	\$ 9,821,110	≥6.500%
Total capital (to risk-weighted assets)	\$ 24,020,000	15.897%	\$ 9,065,640	≥6.000%	\$15,109,400	≥10.00%
Tier I capital (to risk-weighted assets)	\$ 22,433,000	14.847%	\$ 12,087,520	≥8.000%	\$12,087,520	≥8.000%
Tier I capital (to average assets)	\$ 22,433,000	10.651%	\$ 8,424,440	≥4.000%	\$10,530,550	≥5.000%

NOTE 14 - CAPITAL CONSERVATION BUFFER

As part of the Basel III regulations, there was a calculation for a capital conservation buffer (buffer ratio) beginning in 2016. The buffer ratio is the lowest of the following three ratios: 1) the institution's actual common equity tier 1 capital ratio minus the minimum required common equity tier 1 capital ratio; 2) the institution's tier 1 capital ratio minus the minimum required tier 1 capital ratio; or 3) the institution's total capital ratio minus the minimum required total capital ratio.

The buffer ratio is used to determine the maximum payout ratio (as a percentage of eligible retained income) for payouts in the form of distributions and discretionary bonus payments. The buffer ratio had a transition period from January 1, 2016 through December 31, 2018. It became fully implemented on January 1, 2019. The ratio is calculated and applied each calendar quarter. The table below outlines the buffer ratio calculations for each transitional year as well as the first year of full implementation:

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Transition period	Capital Conservation Buffer	Maximum Payout Ratio (as a percentage of eligible retained income)
Calendar year 2016	> 0.625% ≤ 0.625% and > 0.469% ≤ 0.469% and > 0.313% ≤ 0.313% and > 0.156% ≤ 0.156%	No payout ratio limitation applies 60 percent 40 percent 20 percent 0 percent
Calendar year 2017	> 1.25% ≤ 1.25% and > 0.938% ≤ 0.938% and > 0.625% ≤ 0.625% and > 0.313% ≤ 0.313%	No payout ratio limitation applies 60 percent 40 percent 20 percent 0 percent
Calendar year 2018	> 1.875% ≤ 1.875% and > 1.406% ≤ 1.406% and > 0.938% ≤ 0.938% and > 0.469% ≤ 0.469%	No payout ratio limitation applies 60 percent 40 percent 20 percent 0 percent
Fully Implemented	Capital Conservation Buffer	Maximum Payout Ratio (as a percentage of eligible retained income)
Calendar year 2019	> 2.50% ≤ 2.50% and > 1.875% ≤ 1.875% and > 1.25% ≤ 1.25% and > 0.625% ≤ 0.625%	No payout ratio limitation applies 60 percent 40 percent 20 percent 0 percent

The Bank's capital conservation buffer as of December 31, 2019 and 2018, was 7.32% and 7.90%, respectively.



Independent Auditor's Report on Supplementary Information

To the Board of Directors
Security Bancorp, Inc. and Subsidiary
P.O. Box 7027
McMinnville, TN 37111

We have audited the consolidated financial statements of Security Bancorp, Inc. and Subsidiary as of and for the years ended December 31, 2019 and 2018, and our report thereon dated February 26, 2020, which expressed an unmodified opinion on those financial statements, appears on page 12. Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information on the following pages is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies, and it is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Alexander Thompson Arnold PLLC

Milan, Tennessee
February 26, 2020

SECURITY BANCORP, INC. AND SUBSIDIARY
CONSOLIDATING BALANCE SHEET

December 31, 2019

Assets	Security Bancorp, Inc.	Security Federal Savings Bank	Eliminations	Consolidated
Cash and cash equivalents	\$ 87,864	\$ 6,237,553	\$ (87,864)	\$ 6,237,553
Interest-bearing deposits with banks	-	2,694,619	-	2,694,619
Investment securities available-for-sale	-	35,774,079	-	35,774,079
Investment in subsidiary	24,490,225	-	(24,490,225)	-
Federal Home Loan Bank stock, at cost	-	955,600	-	955,600
Loans, net	-	170,953,231	-	170,953,231
Premises and equipment, net	69,993	2,650,947	-	2,720,940
Foreclosed assets	-	567,600	-	567,600
Cash surrender value life insurance	-	2,447,138	-	2,447,138
Accrued interest receivable	-	1,162,969	-	1,162,969
Other assets	55,500	898,194	-	953,694
	<u>55,500</u>	<u>898,194</u>	<u>-</u>	<u>953,694</u>
Total assets	<u>\$ 24,703,582</u>	<u>\$ 224,341,930</u>	<u>\$(24,578,089)</u>	<u>\$ 224,467,423</u>
Liabilities and stockholders' equity				
Liabilities				
Deposits:				
Noninterest-bearing				
Demand deposits	\$ -	\$ 37,867,775	\$ (87,864)	\$ 37,779,911
Interest-bearing				
Demand deposits	-	48,335,548	-	48,335,548
Savings	-	36,548,037	-	36,548,037
Time	-	64,375,398	-	64,375,398
Total deposits	-	187,126,758	(87,864)	187,038,894
Repurchase agreements	-	5,382,173	-	5,382,173
Accrued interest payable	-	166,192	-	166,192
Escrow payable	-	100,244	-	100,244
FHLB borrowings	-	5,000,000	-	5,000,000
Accrued expenses and other liabilities	4,965	2,076,338	-	2,081,303
Total liabilities	<u>4,965</u>	<u>199,851,705</u>	<u>(87,864)</u>	<u>199,768,806</u>
Stockholders' equity				
Preferred stock	-	-	-	-
Common stock	4,364	1,000	(1,000)	4,364
Additional paid-in capital	4,516,516	4,124,942	(4,124,942)	4,516,516
Retained earnings	21,962,263	20,314,098	(20,314,098)	21,962,263
Accumulated other comprehensive income	50,185	50,185	(50,185)	50,185
Treasury stock	(1,834,711)	-	-	(1,834,711)
Total stockholders' equity	<u>24,698,617</u>	<u>24,490,225</u>	<u>(24,490,225)</u>	<u>24,698,617</u>
Total liabilities and stockholders' equity	<u>\$ 24,703,582</u>	<u>\$ 224,341,930</u>	<u>\$(24,578,089)</u>	<u>\$ 224,467,423</u>

See independent auditor's report on supplementary information.

**SECURITY BANCORP, INC. AND SUBSIDIARY
CONSOLIDATING STATEMENT OF INCOME**

For the Year Ended December 31, 2019

	<u>Security Bancorp, Inc.</u>	<u>Security Federal Savings Bank</u>	<u>Eliminations</u>	<u>Consolidated</u>
Interest income				
Interest and fees on loans	\$ -	\$ 8,557,259	\$ -	\$ 8,557,259
Interest on investment securities	-	687,443	-	687,443
Interest other	13,591	195,288	-	208,879
Dividends - FHLB stock	-	47,767	-	47,767
Total interest income	<u>13,591</u>	<u>9,487,757</u>	<u>-</u>	<u>9,501,348</u>
Interest expense				
Interest on demand deposits and savings	-	557,840	-	557,840
Interest on time deposits	-	995,266	-	995,266
Other interest	-	244,542	-	244,542
Total interest expense	<u>-</u>	<u>1,797,648</u>	<u>-</u>	<u>1,797,648</u>
Net interest income	13,591	7,690,109	-	7,703,700
Provision for loan losses	<u>-</u>	<u>107,684</u>	<u>-</u>	<u>107,684</u>
Net interest income after provision for loan losses	<u>13,591</u>	<u>7,582,425</u>	<u>-</u>	<u>7,596,016</u>
Other income				
Deposit service charges and fees	-	800,532	-	800,532
Gain on sale of interest-bearing deposits with banks	-	2,367	-	2,367
Gain on sale of investments	-	12,675	-	12,675
Gain on sale of loans	-	425,882	-	425,882
Gain on sale of foreclosed assets	-	6,611	-	6,611
Gain on sale of premises and equipment	-	80	-	80
Income from subsidiary	2,556,646	-	(2,556,646)	-
Financial service fees	-	310,614	-	310,614
Servicing fee, net	-	48,056	-	48,056
Earnings on cash surrender value	-	49,339	-	49,339
Other income	6,900	65,580	(3,000)	69,480
Total other income	<u>2,563,546</u>	<u>1,721,736</u>	<u>(2,559,646)</u>	<u>1,725,636</u>
Other expense				
Salaries and employee benefits	-	3,349,129	-	3,349,129
Net occupancy expense	1,752	684,971	-	686,723
Legal and professional fees	-	224,546	-	224,546
FDIC assessments	-	32,000	-	32,000
Data processing	-	707,374	-	707,374
Financial service expenses	-	24,581	-	24,581
Advertising	-	89,807	-	89,807
Deferred Compensation	-	145,691	-	145,691
Other operating expense	33,294	627,666	(3,000)	657,960
Total other expense	<u>35,046</u>	<u>5,885,765</u>	<u>(3,000)</u>	<u>5,917,811</u>
Income before income taxes	2,542,091	3,418,396	(2,556,646)	3,403,841
Provision for income tax expense (benefit)	<u>(3,440)</u>	<u>861,750</u>	<u>-</u>	<u>858,310</u>
Net income	<u>\$ 2,545,531</u>	<u>\$ 2,556,646</u>	<u>\$ (2,556,646)</u>	<u>\$ 2,545,531</u>

See independent auditor's report on supplementary information.

SECURITY BANCORP, INC.

Directors

Joe H. Pugh

President and Chief Executive Officer

Robert W. Newman

Chairman of the Board

Attorney

Ray ("Buzz") Spivey, Jr.

Vice-Chairman of the Board

President of the Cumberland Lumber & Mfg. Co.

Thomas L. Foster

Secretary

Owner of Foster & Foster Realty and

Auction Company

Herschel Wells, Jr.

Owner of Tennessee Warehouse and Distribution

Dr. R. Neil Schultz (1)

Retired Orthodontist

Dr. John T. Mason, III (1)

Retired Professor of Chemical Engineering

at Tennessee Technological University

Earl H. Barr (1)

Owner and Manager of Barr's, Inc.

Dr. Franklin J. Noblin (1)

Retired Dentist

Donald R. Collette (1)

Retired General Manager of

McMinnville Electric System

Officers

Joe H. Pugh

President and Chief Executive Officer

Michael D. Griffith

Executive Vice President

Barbara A. Page

Senior Vice President

Angela D. Brown

Chief Financial Officer

(1) Director emeritus.

**SECURITY FEDERAL SAVINGS BANK OF
MCMINNVILLE, TN**

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Attorney

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Angela D. Brown
Senior Vice President/
Chief Financial Officer

Ken Martin
Senior Vice President

Danny Martin
Senior Vice President

Barbara A. Page
Senior Vice President

Sherry Clendenon
Senior Vice President/Compliance
and Training

Kelly T. Basham
Senior Vice President

(1) Director emeritus.

CORPORATE INFORMATION

Corporate Headquarters

306 West Main Street
McMinnville, Tennessee 37110

Common Stock

Traded over-the-counter on the
OTC Electronic Bulletin Board
under the symbol: SCYT

Independent Auditors

Alexander Thompson Arnold, PLLC
Milan, Tennessee

General Counsel

Stanley & Bratcher
McMinnville, Tennessee

Special Securities Counsel

Breyer & Associates PC
McLean, Virginia

Transfer Agent

Computershare Investor Services
211 Quality Circle, Suite 210
College Station, Texas 77845

ANNUAL MEETING

The Annual Meeting of Stockholders will be held Wednesday, April 15, 2020 at 2:00 p.m., Central Time, at the Bank's Mortgage/Financial Services Building located at 305 West Morford Street, McMinnville, Tennessee.



SECURITY
BANCORP, Inc.

P.O. Box 7027 • McMinnville, TN 37111

