



**LEDYARD FINANCIAL GROUP, INC.
AND SUBSIDIARY**

CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

With Independent Auditor's Report



INDEPENDENT AUDITOR'S REPORT

Board of Directors and Shareholders
Ledyard Financial Group, Inc. and Subsidiary

We have audited the accompanying consolidated financial statements of Ledyard Financial Group, Inc. and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in shareholders' 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 U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the 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 audits. We conducted our audits in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from 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 consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Ledyard Financial Group, Inc. and Subsidiary as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Berry Dunn McNeil & Parker, LLC

Portland, Maine
March 5, 2019

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

Consolidated Balance Sheets

December 31, 2018 and 2017

ASSETS

	<u>2018</u>	<u>2017</u>
Cash and due from banks	\$ 5,440,928	\$ 8,361,165
Interest-bearing deposits	<u>3,841,622</u>	<u>4,189,405</u>
Total cash and cash equivalents	9,282,550	12,550,570
Securities available-for-sale	138,074,738	137,049,950
Securities held-to-maturity	1,389,271	1,558,857
Nonmarketable equity securities	2,056,950	1,659,706
Loans held for sale	138,125	-
Loans receivable, net of allowance for loan losses of \$5,215,495 in 2018 and \$5,509,514 in 2017	305,905,218	295,098,837
Accrued interest receivable	1,810,309	1,673,348
Premises and equipment, net	9,773,467	9,596,082
Bank owned life insurance	10,954,385	10,699,934
Other assets	<u>8,677,292</u>	<u>6,742,796</u>
	\$ <u>488,062,305</u>	\$ <u>476,630,080</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

	<u>2018</u>	<u>2017</u>
Deposits		
Demand	\$ 107,072,931	\$ 96,621,978
NOW accounts	78,920,569	77,076,839
Money market accounts	144,698,316	140,941,204
Savings	41,114,351	37,439,464
Time deposits, other	32,657,613	42,425,812
Time, \$250,000 and over	<u>4,602,186</u>	<u>6,993,113</u>
Total deposits	409,065,966	401,498,410
Securities sold under agreements to repurchase	7,510,711	9,925,462
Advances from Federal Home Loan Bank (FHLB)	16,433,014	13,965,847
Accrued expenses and other liabilities	<u>6,559,708</u>	<u>4,597,814</u>
Total liabilities	<u>439,569,399</u>	<u>429,987,533</u>
Shareholders' equity		
Common stock, \$0.33 par value; 5,500,000 shares authorized, 3,352,738 and 3,318,922 shares issued, 3,228,532 and 3,188,075 shares outstanding at December 31, 2018 and 2017, respectively	1,117,579	1,106,307
Additional paid-in capital	12,457,437	11,910,643
Treasury stock, at cost; 124,206 and 130,847 shares at December 31, 2018 and 2017, respectively	(1,627,840)	(1,714,903)
Retained earnings	37,509,826	34,608,234
Accumulated other comprehensive (loss) income	<u>(964,096)</u>	<u>732,266</u>
Total shareholders' equity	<u>48,492,906</u>	<u>46,642,547</u>
	\$ <u>488,062,305</u>	\$ <u>476,630,080</u>

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

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

Consolidated Statements of Income

Years Ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Interest and dividend income		
Interest and fees on loans	\$ 12,754,536	\$ 11,661,121
Investment securities	3,592,663	3,576,222
Other interest-earning assets	<u>308,895</u>	<u>281,813</u>
Total interest and dividend income	<u>16,656,094</u>	<u>15,519,156</u>
Interest expense		
Deposits	719,796	641,299
Borrowed funds	<u>452,168</u>	<u>397,092</u>
Total interest expense	<u>1,171,964</u>	<u>1,038,391</u>
Net interest income	15,484,130	14,480,765
Provision for loan losses	<u>-</u>	<u>-</u>
Net interest income after provision for loan losses	<u>15,484,130</u>	<u>14,480,765</u>
Noninterest income		
Ledyard Financial Advisors division income	10,511,630	9,437,325
Service fees	828,264	823,719
Net gain on sales of securities	-	38,955
Other	<u>854,452</u>	<u>563,829</u>
Total noninterest income	<u>12,194,346</u>	<u>10,863,828</u>
Noninterest expense		
Salaries and employee benefits	13,721,021	12,716,548
Occupancy and equipment	4,287,308	3,895,472
Federal Deposit Insurance Corporation (FDIC) insurance fees	141,593	142,558
Other general and administrative	<u>3,601,622</u>	<u>3,381,935</u>
Total noninterest expense	<u>21,751,544</u>	<u>20,136,513</u>
Income before income taxes	5,926,932	5,208,080
Income tax expense before deferred tax asset adjustment	774,609	859,056
Adjustment of deferred tax asset for tax law enactment	<u>-</u>	<u>503,786</u>
Total income tax expense	<u>774,609</u>	<u>1,362,842</u>
Net income	<u>\$ 5,152,323</u>	<u>\$ 3,845,238</u>
Basic earnings per share	\$ 1.66	\$ 1.25
Diluted earnings per share	\$ 1.64	\$ 1.23
Weighted average numbers of shares outstanding	3,110,156	3,076,184

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

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

Consolidated Statements of Comprehensive Income

Years Ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Net income	\$ 5,152,323	\$ 3,845,238
Other comprehensive (loss) income, net of tax		
Available-for-sale securities		
Changes in net unrealized (losses) gains on securities available-for-sale, net of income tax benefit of \$574,998 in 2018 and income tax expense of \$(782,293) in 2017	(2,163,089)	1,518,568
Reclassification adjustment for gains realized on securities available-for-sale, net of income taxes of \$(13,245) in 2017.	<u> -</u>	<u> (25,710)</u>
Total available-for-sale securities	<u>(2,163,089)</u>	<u>1,492,858</u>
Interest rate swaps		
Unrealized interest rate swap asset (liability), net of income tax expense of \$(124,067) in 2018 and income tax benefit of \$46,849 in 2017	<u>466,727</u>	<u> (90,942)</u>
Total interest rate swaps	<u>466,727</u>	<u> (90,942)</u>
Total other comprehensive (loss) income	<u>(1,696,362)</u>	<u>1,401,916</u>
Total comprehensive income	<u>\$ 3,455,961</u>	<u>\$ 5,247,154</u>

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

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY
Consolidated Statements of Changes in Shareholders' Equity

Years Ended December 31, 2018 and 2017

	Common Stock	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total
Balance, December 31, 2016	<u>\$1,093,961</u>	<u>\$11,438,457</u>	<u>\$(1,799,630)</u>	<u>\$ 32,946,852</u>	<u>\$ (790,150)</u>	<u>\$ 42,889,490</u>
Net income	-	-	-	3,845,238	-	3,845,238
Other comprehensive income, net of tax effect	-	-	-	-	1,401,916	1,401,916
Total comprehensive income	-	-	-	3,845,238	1,401,916	5,247,154
Cash dividends paid, \$0.65 per share	-	-	-	(2,063,356)	-	(2,063,356)
Reclassification for change in statutory income tax rate for items included in Accumulated Other Comprehensive (Loss) Income	-	-	-	(120,500)	120,500	-
Stock awards issued (6,463 shares)	2,154	55,452	84,727	-	-	142,333
Stock-based compensation expense	-	501,080	-	-	-	501,080
Restricted stock issued, net (30,576 shares)	10,192	(84,346)	-	-	-	(74,154)
Balance, December 31, 2017	<u>1,106,307</u>	<u>11,910,643</u>	<u>(1,714,903)</u>	<u>34,608,234</u>	<u>732,266</u>	<u>46,642,547</u>
Net income	-	-	-	5,152,323	-	5,152,323
Other comprehensive loss, net of tax effect	-	-	-	-	(1,696,362)	(1,696,362)
Total comprehensive (loss) income	-	-	-	5,152,323	(1,696,362)	3,455,961
Cash dividends paid, \$0.70 per share	-	-	-	(2,250,731)	-	(2,250,731)
Stock awards issued (6,642 shares)	2,214	67,392	87,063	-	-	156,669
Stock-based compensation expense	-	780,285	-	-	-	780,285
Restricted stock issued, net (27,174 shares)	9,058	(300,883)	-	-	-	(291,825)
Balance, December 31, 2018	<u>\$1,117,579</u>	<u>\$12,457,437</u>	<u>\$(1,627,840)</u>	<u>\$ 37,509,826</u>	<u>\$ (964,096)</u>	<u>\$ 48,492,906</u>

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

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

Consolidated Statements of Cash Flows

Years Ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities		
Net income	\$ 5,152,323	\$ 3,845,238
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization or accretion	1,448,284	1,346,681
Net gain on sales of securities	-	(38,955)
Loss on disposal of bank premises	-	24,087
Deferred income tax expense	121,155	685,842
Amortization of limited partnerships	547,777	513,906
Stock-based compensation	780,285	501,080
Fair value of stock awards issued from treasury stock	156,669	142,333
Increase in accrued interest receivable	(136,961)	(20,097)
(Increase) decrease increase in other assets	(1,737,738)	24,175
Net increase in loans held for sale	(138,125)	-
Increase in accrued expenses and other liabilities	<u>1,961,894</u>	<u>498,908</u>
Net cash provided by operating activities	<u>8,155,563</u>	<u>7,523,198</u>
Cash flows from investing activities		
Proceeds from sales, calls, maturities and paydowns of securities available-for-sale	12,560,669	13,485,536
Proceeds from sales, calls, maturities and paydowns of securities held-to-maturity	160,560	195,344
Net (purchase) redemption of FHLB stock	(397,244)	42,700
Purchase of securities available-for-sale	(17,081,473)	(6,845,860)
Low income housing investment	(78,415)	(455,449)
Net increase in loans to customers	(10,806,381)	(5,932,006)
Purchase of premises and equipment	<u>(858,715)</u>	<u>(2,529,087)</u>
Net cash used by investing activities	<u>(16,500,999)</u>	<u>(2,038,822)</u>
Cash flows from financing activities		
Net change in deposits	7,567,556	(485,244)
Net proceeds (repayments) from short-term borrowings	2,467,167	(6,034,153)
Net (decrease) increase in securities sold under agreements to repurchase	(2,414,751)	3,046,633
Restricted stock issued	(291,825)	(74,154)
Cash dividends paid on common stock	<u>(2,250,731)</u>	<u>(2,063,356)</u>
Net cash provided (used) by financing activities	<u>5,077,416</u>	<u>(5,610,274)</u>
Net decrease in cash and cash equivalents	(3,268,020)	(125,898)
Cash and cash equivalents, beginning of year	<u>12,550,570</u>	<u>12,676,468</u>
Cash and cash equivalents, end of year	<u>\$ 9,282,550</u>	<u>\$ 12,550,570</u>
Supplementary cash flow information:		
Interest paid on deposits and borrowed funds	<u>\$ 1,167,616</u>	<u>\$ 1,036,718</u>
Income taxes paid	<u>\$ 135,614</u>	<u>\$ 110,000</u>

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

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Nature of Business

Ledyard Financial Group, Inc. (the Company) is headquartered in Hanover, New Hampshire and, as a bank holding company, it provides financial services to its customers through its wholly-owned bank subsidiary, Ledyard National Bank (the Bank). The Bank provides retail and commercial banking and wealth advisory services through its office locations in Central New Hampshire and Vermont.

1. Summary of Significant Accounting Policies

The accounting policies of the Company are in conformity with U.S. generally accepted accounting principles (U.S. GAAP) and general practices within the banking industry. The following is a description of the more significant policies.

Basis of Presentation

The Company follows accounting standards as set by the Financial Accounting Standards Board (FASB). FASB sets U.S. GAAP that management follows to consistently report the Company's financial condition, results of operations and cash flows.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned bank subsidiary. All intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

In preparing financial statements in conformity with U.S. GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of other real estate owned. In connection with the determination of the allowance and the carrying value of other real estate owned, management obtains independent appraisals for significant properties and collateral securing significant loans. Accordingly, the ultimate collectability of a substantial portion of the Company's loan portfolio is susceptible to changes in local market conditions.

While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's loan portfolio. Such agencies may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Significant Group Concentrations of Credit Risk

The Company's operations are affected by various risk factors, including interest rate risk, credit risk, and risk from geographic concentration of lending activities. Management attempts to manage interest rate risk through various asset/liability management techniques designed to match maturities of assets and liabilities. Loan policies and administration are designed to provide assurance that loans will only be granted to creditworthy borrowers, although credit losses are expected to occur because of subjective factors beyond the control of the Company. Although the Company has a diversified loan portfolio and economic conditions are stable, most of its lending activities are conducted within the geographic area where it is located. As a result, the Company and its borrowers may be especially vulnerable to the consequences of changes in the local economy. In addition, a substantial portion of the Company's loans are secured by real estate.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents include cash and due from banks, and interest-bearing deposits.

The Company's due from bank accounts and interest-bearing deposits, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant risk on cash and cash equivalents.

Investment Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as held-to-maturity and carried at cost, adjusted for amortization of premiums and accretion of discounts over the period to call or maturity using methods approximating the interest method. Securities not classified as held-to-maturity, including equity securities with readily determinable fair values, are classified as available-for-sale and are carried at fair value. Nonmarketable equity securities, consisting of stock in the FHLB and Federal Reserve Bank (FRB), are carried at cost and evaluated for impairment. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Unrealized gains and losses on securities available-for-sale are reported as a net amount in other comprehensive income, net of tax.

For declines in the fair value of individual debt securities available-for-sale below their cost that are deemed to be other-than-temporary, where the Company does not intend to sell the security and it is more likely than not that the Company will not be required to sell the security before recovery of its amortized cost basis, the other-than-temporary decline in the fair value of the debt security related to 1) credit loss is recognized in earnings, and 2) other factors, is recognized in other comprehensive income or loss. Credit loss is deemed to exist if the present value of expected future cash flows using the effective rate at acquisition is less than the amortized cost basis of the debt security. For individual debt securities where the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the security's cost basis and its fair value at the balance sheet date.

LEDYARD FINANCIAL GROUP, INC. AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

In estimating other-than-temporary impairment losses, management considers 1) the length of time and the extent to which the fair value has been less than cost, 2) the financial condition and near-term prospects of the issuer, and 3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are stated at the amount of unpaid principal, increased by deferred loan costs and reduced by an allowance for loan losses.

Loans past due 30 days or more are considered delinquent. Management is responsible to initiate immediate collection efforts to minimize delinquency and any eventual adverse impact on the Company.

In general, consumer loans will be charged off if the loan is delinquent for 120 consecutive days. Commercial and real estate loans are charged off in part or in full if they are considered uncollectible.

Loan interest income is accrued daily on the outstanding balances. Accrual of interest is discontinued when a loan is specifically determined to be impaired or management believes, after considering collection efforts and other factors, that the borrower's financial condition is such that collection of interest is doubtful. Any unpaid interest previously accrued on those loans is reversed from income. Interest income is generally not recognized on specific impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are generally applied as a reduction of the loan principal balance. Interest income on other nonaccrual loans is recognized only to the extent of interest payments received. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loan origination and commitment fees and certain direct origination costs are being deferred and the net amount amortized as an adjustment of the related loan's yield. The Company is generally amortizing these amounts over the contractual life of the loan.

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Notes to Consolidated Financial Statements

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Allowance for Loan Losses

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 for loan losses is evaluated on a regular basis by management. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance consists of general, allocated and unallocated components, as further described below.

General Component

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by the following loan segments: residential real estate, commercial real estate, construction, commercial and consumer. Management uses an average of historical losses based on a time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels/trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and changes in lending policies, experience, ability, depth of lending management and staff; and national and local economic conditions. There were no changes in the Company's policies or methodology pertaining to the general component for loan losses during 2018. Management follows a similar process to estimate its liability for off-balance-sheet commitments to extend credit.

The qualitative factors are determined based on the various risk characteristics of each loan segment. Risk characteristics relevant to each portfolio segment are as follows:

Residential real estate: All loans in this segment are collateralized by 1-4 family residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality of this segment.

Commercial real estate: Loans in this segment are primarily income-producing properties or properties occupied by businesses. The underlying cash flows generated by the properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates or a general slowdown in business which, in turn, will have an effect on the credit quality of this segment. Management obtains rent rolls and business financial statements on an annual basis and continually monitors the cash flows of these loans.

Construction: Loans in this segment include real estate development loans for which payment is derived from sale of the property. Credit risk is affected by cost overruns, time to sell at an adequate price, and market conditions.

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Commercial: Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer spending, will have an effect on the credit quality in this segment.

Consumer: Repayment of loans in this segment is generally dependent on the credit quality of the individual borrower.

Allocated Component

The allocated component relates to loans that are classified as impaired. Impairment is measured on a loan-by-loan basis for commercial, commercial real estate, construction and residential real estate loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan. Large groups of smaller balance homogenous loans are collectively evaluated for impairment, and the allowance resulting therefrom is reported as the general component, as described above.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable 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 the 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 Company periodically may agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring (TDR). All TDRs are classified as impaired.

Unallocated Component

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general reserves in the portfolio.

Credit Related Financial Instruments

In the ordinary course of business, the Company has entered into commitments to extend credit, commercial letters of credit and standby letters of credit. Such financial instruments are recorded when they are funded.

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Derivative Financial Instruments

Fair values for interest rate swap agreements are based upon the amounts required to settle the contracts.

The Company utilizes interest rate swap agreements to provide an effective hedge against changes in the London Interbank Offered Rates (LIBOR) swap curve. Interest rate swaps are contracts in which a series of interest rate flows are exchanged over a prescribed period. The notional amount on which the interest payments are based is not exchanged.

At the inception of a derivative contract, the Company designates the derivative as one of two types based on the Company's intentions and belief as to likely effectiveness as a hedge. These two types are (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value hedge"), or (2) a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow hedge"). For a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item, are recognized in current earnings as fair values change. For a cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. For both types of hedges, changes in the fair value of derivatives that are not highly effective in hedging the changes in fair value or expected cash flows of the hedged item are recognized immediately in current earnings. Changes in the fair value of derivatives that do not qualify for hedge accounting are reported currently in earnings, as non-interest income.

Interest rate derivative financial instruments receive hedge accounting treatment only if they are designated as a hedge and are expected to be, and are, effective in substantially reducing interest rate risk arising from the assets and liabilities identified as exposing the Company to risk. Those derivative financial instruments that do not meet the hedging criteria discussed below would be classified as trading activities and would be recorded at fair value with changes in fair value recorded in income. Derivative hedge contracts must meet specific effectiveness tests (i.e., over time the change in their fair values due to the designated hedge risk must be within 80 to 125 percent of the opposite change in the fair values of the hedged assets or liabilities). Changes in fair value of the derivative financial instruments must be effective at offsetting changes in the fair value of the hedged items due to the designated hedge risk during the term of the hedge. Further, if the underlying financial instrument differs from the hedged asset or liability, there must be a clear economic relationship between the prices of the two financial instruments. If periodic assessment indicates derivatives no longer provide an effective hedge, the derivatives contracts would be closed out and settled or classified as a trading activity.

Other Real Estate Owned

Real estate properties acquired through or in lieu of loan foreclosure are initially recorded at fair value less estimated selling cost at the date of foreclosure. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses.

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After foreclosure, these assets are carried at the lower of their new cost basis or fair value less cost to sell. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. Valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of its cost or fair value less cost to sell.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost, less accumulated depreciation. The provision for depreciation is computed over the estimated useful life of the related asset, principally by the straight-line method. Improvements to leased property are amortized over the lesser of the term of the lease or life of the improvements.

Income Taxes

The Company recognizes income taxes under the asset and liability method. Under this method, deferred tax assets and liabilities are established for the temporary differences between the book bases and the tax bases of the Company's assets and liabilities at enacted tax rates expected to be in effect when the amounts related to such temporary differences are realized or settled. Adjustments to the Company's deferred tax assets are recognized as deferred income tax expense or benefit based on management's judgment relating to the realizability of such assets.

FASB Accounting Standards Codification (ASC) Topic 740, *Income Taxes*, defines the criteria that an individual's tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. Topic 740 prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service and State tax authorities for the years ended December 31, 2015 through 2017.

Earnings per Share

Basic earnings per share data is computed based on the weighted average number of the Company's common shares outstanding during the year. Potential common stock is considered in the calculation of weighted average shares outstanding for diluted earnings per share, and is determined using the treasury stock method.

Stock Based Compensation Plans

Restricted stock awards are measured at the fair value of the stock at the grant date and recognized as expense over the period in which they vest.

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Ledyard Financial Advisors Assets and Fees

Assets held by Ledyard Financial Advisors (a division of Ledyard National Bank) for its customers, other than trust cash on deposit at the Bank, are not included in these financial statements because they are not assets of the Bank. Ledyard Financial Advisors earns fees for its wealth management services, which are determined as a percentage of client assets under management, as of the last day of the month. As services are provided over time, the Company has determined the performance obligation to be satisfied over time and therefore, revenue is recognized as earned.

Comprehensive Income

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

Recently Issued Accounting Pronouncements

In January 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This 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. This guidance also changes certain disclosure requirements and other aspects of current US GAAP. Public businesses must use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. This guidance was effective for fiscal years beginning after December 15, 2017, including interim periods within the fiscal year. The Company had determined the ASU did not have a material effect on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. The ASU was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Management is reviewing the guidance in the ASU to determine whether it will have a material effect on the Company's consolidated financial condition and results of operations.

In June 2016, the FASB issued ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*. The ASU requires entities to measure credit losses on loans receivable using a current expected credit loss model, instead of the incurred loss model used in current accounting principles. The ASU is effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. Management is currently reviewing the ASU to assess its effect on the Company's consolidated financial condition and results of operations.

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In May 2017, the FASB issued ASU No. 2017-09, *Compensation - Stock Compensation, Scope of Modification Accounting (Topic 718)*. The ASU was issued to provide clarity and reduce both 1) diversity in practice and 2) cost and complexity when applying the guidance in Topic 718, Compensation-Stock Compensation, to a change to the terms or conditions of a share-based payment award. The ASU includes guidance on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718. The ASU is effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The amendments should be applied on a prospective basis to an award modified on or after the adoption date. Management has reviewed the guidance in the ASU to and has determined it did not have a material effect on the Company's consolidated financial statements.

In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging (Topic 815)*. The amendments in this ASU improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition, this ASU makes certain targeted improvements to simplify the application of the hedge accounting guidance in current U.S. GAAP. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early application is permitted in any interim period after issuance of the ASU. Management is currently reviewing the ASU to assess its effect on the Company's consolidated financial condition and results of operations.

Business Segments

U.S. GAAP requires public companies to report (i) certain financial and descriptive information about "reportable operating segments," as defined, and (ii) certain enterprise-wide financial information. Operating segment information is reported using a "management approach" that is based on the way management organizes the segments for purposes of making operating decisions and assessing performance.

The Company's two primary business segments are banking and wealth advisory services.

Banking consists principally of lending to commercial and consumer customers, as well as deposit gathering activities.

Wealth advisory services includes, as its principal business lines, financial planning services, investment management services, personal tax services, trustee services and estate planning.

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The Company's business segment disclosure is based on information generated by an internal profitability reporting system, which generates information by business segment based on the needs of management responsible for managing those segments. Allocations between the business segments can be subjective in nature and are reviewed and refined as circumstances warrant. Any allocations that may affect the reported results of any business segment will not affect the consolidated financial position or results of operations of the Company as a whole. The Company does not allocate assets by segment.

The following tables provide selected financial information for the Company's business segments:

	<u>Banking</u>	<u>Wealth Advisory Services</u>	<u>Total Consolidated</u>
<u>Year ended December 31, 2018</u>			
Net interest income	\$ 15,484,130	\$ -	\$ 15,484,130
Noninterest income	1,682,716	10,511,630	12,194,346
Noninterest expense	14,899,542	6,852,002	21,751,544
Income before income taxes	2,267,304	3,659,628	5,926,932
Income tax (benefit) expense	(239,840)	1,014,449	774,609
Net income	2,507,144	2,645,179	5,152,323

	<u>Banking</u>	<u>Wealth Advisory Services</u>	<u>Total Consolidated</u>
<u>Year ended December 31, 2017</u>			
Net interest income	\$ 14,480,765	\$ -	\$ 14,480,765
Noninterest income	1,426,503	9,437,325	10,863,828
Noninterest expense	12,950,080	7,186,433	20,136,513
Income before income taxes	2,957,188	2,250,892	5,208,080
Income tax expense	471,264	891,578	1,362,842
Net income	2,485,924	1,359,314	3,845,238

Subsequent Events

For the purposes of the presentation of these financial statements in conformity with U.S. GAAP, management has considered transactions or events occurring through March 5, 2019, which is the date that the financial statements are available to be issued. Management has not evaluated subsequent events after that date for inclusion in the financial statements.

2. Cash and Due from Banks

The Bank is required to maintain certain reserves of vault cash or deposits with the FRB. The amount of this reserve requirement, included in cash and due from banks, was approximately \$303,000 and \$276,000 as of December 31, 2018 and 2017, respectively.

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3. Investment Securities

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

	2018			
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<u>Securities available-for-sale</u>				
U.S. Government sponsored enterprises	\$ 13,289,565	\$ -	\$ (161,169)	\$ 13,128,396
Mortgage-backed securities	54,488,748	51,372	(1,500,008)	53,040,112
State and municipal	58,679,655	1,060,026	(1,360,819)	58,378,862
Corporate bonds	<u>13,670,636</u>	<u>2,744</u>	<u>(146,012)</u>	<u>13,527,368</u>
Total securities available-for-sale	<u>\$140,128,604</u>	<u>\$ 1,114,142</u>	<u>\$(3,168,008)</u>	<u>\$ 138,074,738</u>
<u>Securities held-to-maturity</u>				
Mortgage-backed securities	\$ 514,830	\$ 14,168	\$ -	\$ 528,998
State and municipal	<u>874,441</u>	<u>8,531</u>	<u>-</u>	<u>882,972</u>
Total securities held-to-maturity	<u>\$ 1,389,271</u>	<u>\$ 22,699</u>	<u>\$ -</u>	<u>\$ 1,411,970</u>

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Notes to Consolidated Financial Statements

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	2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<u>Securities available-for-sale</u>				
U.S. Government sponsored enterprises	\$ 14,581,447	\$ 2,244	\$ (124,529)	\$ 14,459,162
Mortgage-backed securities	45,531,615	153,340	(443,785)	45,241,170
Collateralized mortgage obligations	12,939	173	-	13,112
State and municipal	60,447,725	1,622,090	(525,715)	61,544,100
Corporate bonds	<u>15,792,001</u>	<u>55,269</u>	<u>(54,864)</u>	<u>15,792,406</u>
Total securities available-for-sale	<u>\$ 136,365,727</u>	<u>\$ 1,833,116</u>	<u>\$ (1,148,893)</u>	<u>\$ 137,049,950</u>
<u>Securities held-to-maturity</u>				
Mortgage-backed securities	\$ 677,755	\$ 18,484	\$ -	\$ 696,239
State and municipal	<u>881,102</u>	<u>24,925</u>	<u>-</u>	<u>906,027</u>
Total securities held-to-maturity	<u>\$ 1,558,857</u>	<u>\$ 43,409</u>	<u>\$ -</u>	<u>\$ 1,602,266</u>

At December 31, 2018 and 2017, securities with a carrying value of \$22,481,614 and \$27,167,902, respectively, were pledged to secure public deposits and for other purposes required or permitted by law.

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2018 follow:

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within 1 year	\$ 12,607,907	\$ 12,582,676	\$ 874,441	\$ 882,972
Over 1 year through 5 years	18,826,207	18,710,866	-	-
After 5 years through 10 years	20,459,237	21,271,405	-	-
Over 10 years	33,746,505	32,469,679	-	-
Mortgage-backed securities	<u>54,488,748</u>	<u>53,040,112</u>	<u>514,830</u>	<u>528,998</u>
	<u>\$ 140,128,604</u>	<u>\$ 138,074,738</u>	<u>\$ 1,389,271</u>	<u>\$ 1,411,970</u>

There were no sales of securities available-for-sale in 2018. During 2017, proceeds from sales of securities available-for-sale were \$1,130,000 and gross gains on the sales of securities available-for-sale were \$38,955. There were no gross losses on sales of securities available-for-sale in 2017. There were no sales of securities held-to-maturity in 2018 and 2017.

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The following table presents information pertaining to securities with gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous loss position at December 31, 2018 and 2017:

	2018					
	<u>Less Than 12 Months</u>		<u>Greater Than 12 Months</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>
U.S. Government sponsored enterprises	\$ 2,063,626	\$ (14,825)	\$ 11,064,770	\$ (146,344)	\$ 13,128,396	\$ (161,169)
Mortgage-backed securities	13,270,935	(220,772)	29,603,063	(1,279,236)	42,873,998	(1,500,008)
State and municipal	6,715,732	(148,010)	18,479,450	(1,212,809)	25,195,182	(1,360,819)
Corporate bonds	<u>3,546,928</u>	<u>(20,104)</u>	<u>8,964,910</u>	<u>(125,908)</u>	<u>12,511,838</u>	<u>(146,012)</u>
Total	<u>\$ 25,597,221</u>	<u>\$ (403,711)</u>	<u>\$ 68,112,193</u>	<u>\$ (2,764,297)</u>	<u>\$ 93,709,414</u>	<u>\$ (3,168,008)</u>

	2017					
	<u>Less Than 12 Months</u>		<u>Greater Than 12 Months</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>
U.S. Government sponsored enterprises	\$ 4,641,759	\$ (42,348)	\$ 7,446,253	\$ (82,181)	\$ 12,088,012	\$ (124,529)
Mortgage-backed securities	12,950,066	(29,753)	16,740,478	(414,032)	29,690,544	(443,785)
State and municipal	5,047,240	(29,753)	15,463,927	(495,962)	20,511,167	(525,715)
Corporate bonds	<u>2,946,858</u>	<u>(29,545)</u>	<u>2,594,679</u>	<u>(25,319)</u>	<u>5,541,537</u>	<u>(54,864)</u>
Total	<u>\$ 25,585,923</u>	<u>\$ (131,399)</u>	<u>\$ 42,245,337</u>	<u>\$ (1,017,494)</u>	<u>\$ 67,831,260</u>	<u>\$ (1,148,893)</u>

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Management evaluates securities for other-than-temporary impairment on a quarterly basis and more frequently when economic or market concerns warrant such evaluation. Consideration is given to: (1) the length of time and the extent to which the fair value has been less than cost; (2) the financial condition and near-term prospects of the issuer; and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

These unrealized losses related principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other-than-temporary.

4. Loans

The composition of net loans at December 31 was as follows:

	<u>2018</u>	<u>2017</u>
Commercial	\$ 42,257,787	\$ 31,462,097
Commercial real estate	123,422,671	123,867,828
Construction	1,139,606	2,746,040
Residential real estate	131,418,109	128,907,928
Consumer	<u>12,537,707</u>	<u>13,271,559</u>
Subtotal	310,775,880	300,255,452
(Less) add:		
Allowance for loan losses	(5,215,495)	(5,509,514)
Net deferred loan costs	<u>344,833</u>	<u>352,899</u>
Loans, net	<u>\$305,905,218</u>	<u>\$295,098,837</u>

The Company has transferred a portion of its originated commercial and commercial real estate loans to participating lenders. The amounts transferred have been accounted for as sales and are therefore not included in the Company's accompanying consolidated balance sheets. The Company and participating lenders share ratably in any gains or losses that may result from a borrower's lack of compliance with contractual terms of the loan. The Company continues to service the loans on behalf of the participating lenders and, as such, collects cash payments from the borrowers and remits payments (net of servicing fees) to participating lenders. At December 31, 2018 and 2017, the Company was servicing loans for participants aggregating \$12,674,480 and \$11,539,978, respectively.

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An analysis of the allowance for loan losses follows for the year ended December 31, 2018:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
Balance at beginning of year	\$ 1,083,047	\$ 2,943,851	\$ 41,371	\$ 689,441	\$ 107,562	\$ 644,242	\$ 5,509,514
Provision for (reduction in) loan losses	358,715	(532,839)	(26,372)	87,512	7,260	105,724	-
Loans charged off	(284,479)	-	-	(92,360)	(13,723)	-	(390,562)
Recoveries of loans previously charged off	84,815	-	-	7,068	4,660	-	96,543
Balance at end of year	<u>\$ 1,242,098</u>	<u>\$ 2,411,012</u>	<u>\$ 14,999</u>	<u>\$ 691,661</u>	<u>\$ 105,759</u>	<u>\$ 749,966</u>	<u>\$ 5,215,495</u>

An analysis of the allowance for loan losses follows for the year ended December 31, 2017:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
Balance at beginning of year	\$ 608,538	\$ 2,798,559	\$ 78,558	\$ 1,540,365	\$ 184,756	\$ 488,875	\$ 5,699,651
Provision for (reduction in) loan losses	404,593	111,892	(37,187)	(563,597)	(71,068)	155,367	-
Loans charged off	-	-	-	(326,442)	(11,310)	-	(337,752)
Recoveries of loans previously charged off	69,916	33,400	-	39,115	5,184	-	147,615
Balance at end of year	<u>\$ 1,083,047</u>	<u>\$ 2,943,851</u>	<u>\$ 41,371</u>	<u>\$ 689,441</u>	<u>\$ 107,562</u>	<u>\$ 644,242</u>	<u>\$ 5,509,514</u>

The following table presents the allowance for loan losses and select loan information for the year ended December 31, 2018:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
Allowance for loan losses							
Ending balance	<u>\$ 1,242,098</u>	<u>\$ 2,411,012</u>	<u>\$ 14,999</u>	<u>\$ 691,661</u>	<u>\$ 105,759</u>	<u>\$ 749,966</u>	<u>\$ 5,215,495</u>
Individually evaluated for impairment	<u>\$ -</u>	<u>\$ 135</u>	<u>\$ -</u>	<u>\$ 24,786</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 24,921</u>
Collectively evaluated for impairment	<u>\$ 1,242,098</u>	<u>\$ 2,410,877</u>	<u>\$ 14,999</u>	<u>\$ 666,875</u>	<u>\$ 105,759</u>	<u>\$ 749,966</u>	<u>\$ 5,190,574</u>
Loans							
Ending balance	<u>\$ 42,257,787</u>	<u>\$ 123,422,671</u>	<u>\$ 1,139,606</u>	<u>\$ 131,418,109</u>	<u>\$ 12,537,707</u>		<u>\$ 310,775,880</u>
Individually evaluated for impairment	<u>\$ 1,608,398</u>	<u>\$ 671,864</u>	<u>\$ 73,592</u>	<u>\$ 2,260,988</u>	<u>\$ -</u>		<u>\$ 4,614,842</u>
Collectively evaluated for impairment	<u>\$ 40,649,389</u>	<u>\$ 122,750,807</u>	<u>\$ 1,066,014</u>	<u>\$ 129,157,121</u>	<u>\$ 12,537,707</u>		<u>\$ 306,161,038</u>

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The following table presents the allowance for loan losses and select loan information for the year ended December 31, 2017:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
Allowance for loan losses							
Ending balance	\$ <u>1,083,047</u>	\$ <u>2,943,851</u>	\$ <u>41,371</u>	\$ <u>689,441</u>	\$ <u>107,562</u>	\$ <u>644,242</u>	\$ <u>5,509,514</u>
Individually evaluated for impairment	\$ <u>300,000</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>20,525</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>320,525</u>
Collectively evaluated for impairment	\$ <u>783,047</u>	\$ <u>2,943,851</u>	\$ <u>41,371</u>	\$ <u>668,916</u>	\$ <u>107,562</u>	\$ <u>644,242</u>	\$ <u>5,188,989</u>
Loans							
Ending balance	\$ <u>31,462,097</u>	\$ <u>123,867,828</u>	\$ <u>2,746,040</u>	\$ <u>128,907,928</u>	\$ <u>13,271,559</u>		\$ <u>300,255,452</u>
Individually evaluated for impairment	\$ <u>382,998</u>	\$ <u>47,892</u>	\$ <u>270,967</u>	\$ <u>1,848,338</u>	\$ <u>-</u>		\$ <u>2,550,195</u>
Collectively evaluated for impairment	\$ <u>31,079,099</u>	\$ <u>123,819,936</u>	\$ <u>2,475,073</u>	\$ <u>127,059,590</u>	\$ <u>13,271,559</u>		\$ <u>297,705,257</u>

All of the following tables are presented net of third-party guarantees.

The Bank categorizes each loan category, with the exception of consumer loans, by credit risk exposure. The following tables present the credit risk profile by creditworthiness category as of December 31, 2018 and 2017.

Loans in the "pass" category are considered to be low to average risk.

Loans in the "special mention" category are starting to show signs of potential weakness and are being closely monitored by management.

Loans in the "substandard" category are inadequately protected by the current net worth and paying capacity of the borrowers and/or the collateral pledged, thus there is an increased possibility that the Company will sustain some loss if the weakness is not corrected.

Loans classified as "doubtful" have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable.

Loans in the "loss" category are considered uncollectible and of such little value that their continuance as loans is not warranted.

On an annual basis, or more often if needed, the Company formally reviews the ratings on all commercial, commercial real estate, construction and residential real estate loans. Semi-annually, the Company engages an independent third-party to review a significant portion of loans within these segments. Management uses the results of these reviews as part of its annual review process.

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The following table presents the ratings as of December 31, 2018:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>
Pass	\$ 36,126,698	\$ 115,642,712	\$ 1,066,014	\$ 128,194,246
Special mention	2,236,054	588,287	-	193,943
Substandard	3,895,035	7,191,672	73,592	2,875,461
Doubtful	-	-	-	154,459
Total	<u>\$ 42,257,787</u>	<u>\$ 123,422,671</u>	<u>\$ 1,139,606</u>	<u>\$ 131,418,109</u>

The following table presents the ratings as of December 31, 2017:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>
Pass	\$ 28,516,124	\$ 113,538,497	\$ 2,388,674	\$ 125,500,794
Special mention	276,202	586,352	-	203,285
Substandard	2,365,068	9,742,979	357,366	3,203,849
Doubtful	304,703	-	-	-
Total	<u>\$ 31,462,097</u>	<u>\$ 123,867,828</u>	<u>\$ 2,746,040</u>	<u>\$ 128,907,928</u>

The following table presents an aging analysis of past due loans as of December 31, 2018:

	30-59 Days Past Due	60-89 Days Past Due	90 Days and Greater	Total Past Due	Current	Total Loans	Loans on Nonaccrual
Commercial	\$ 9,351	\$ -	\$ -	\$ 9,351	\$ 42,248,436	\$ 42,257,787	\$ 1,534,066
Commercial real estate	-	-	-	-	123,422,671	123,422,671	189,111
Construction	-	-	-	-	1,139,606	1,139,606	-
Residential real estate	1,009,701	442,079	198,651	1,650,431	129,767,678	131,418,109	1,590,308
Consumer	122,147	1,040	-	123,187	12,414,520	12,537,707	-
Total	<u>\$ 1,141,199</u>	<u>\$ 443,119</u>	<u>\$ 198,651</u>	<u>\$ 1,782,969</u>	<u>\$ 308,992,911</u>	<u>\$ 310,775,880</u>	<u>\$ 3,313,485</u>

The following table presents an aging analysis of past due loans as of December 31, 2017:

	30-59 Days Past Due	60-89 Days Past Due	90 Days and Greater	Total Past Due	Current	Total Loans	Loans on Nonaccrual
Commercial	\$ 302	\$ 42,087	\$ -	\$ 42,389	\$ 31,419,708	\$ 31,462,097	\$ 305,005
Commercial real estate	34,604	-	-	34,604	123,833,224	123,867,828	47,892
Construction	-	-	-	-	2,746,040	2,746,040	-
Residential real estate	816,325	223,850	266,591	1,306,766	127,601,162	128,907,928	1,483,727
Consumer	2,306	-	-	2,306	13,269,253	13,271,559	-
Total	<u>\$ 853,537</u>	<u>\$ 265,937</u>	<u>\$ 266,591</u>	<u>\$ 1,386,065</u>	<u>\$ 298,869,387</u>	<u>\$ 300,255,452</u>	<u>\$ 1,836,624</u>

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At December 31, 2018 there were no loans 90 days past due and still accruing interest. During 2017, there was one loan 90 days past due and still accruing interest totaling \$115,462.

The following table presents a summary of information pertaining to impaired loans by loan category as of December 31, 2018:

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Investment</u>	<u>Interest Income Recognized</u>	<u>Interest Income Recognized on a Cash Basis</u>
With no related allowance						
Commercial	\$ 1,608,398	\$ 1,608,398	\$ -	\$ 843,347	\$ 84,214	\$ 84,214
Commercial real estate	660,689	660,689	-	354,291	25,848	25,848
Construction	73,592	73,592	-	172,280	4,877	4,877
Residential real estate	<u>1,667,761</u>	<u>1,667,761</u>	<u>-</u>	<u>1,625,986</u>	<u>66,221</u>	<u>66,221</u>
	<u>\$ 4,010,440</u>	<u>\$ 4,010,440</u>	<u>\$ -</u>	<u>\$ 2,995,904</u>	<u>\$ 181,160</u>	<u>\$ 181,160</u>
With an allowance recorded						
Commercial	\$ -	\$ -	\$ -	\$ 152,352	\$ -	\$ -
Commercial real estate	11,175	11,175	135	5,588	-	-
Residential real estate	<u>593,227</u>	<u>593,227</u>	<u>24,786</u>	<u>428,677</u>	<u>21,220</u>	<u>21,220</u>
	<u>\$ 604,402</u>	<u>\$ 604,402</u>	<u>\$ 24,921</u>	<u>\$ 586,617</u>	<u>\$ 21,220</u>	<u>\$ 21,220</u>
Total						
Commercial	\$ 1,608,398	\$ 1,608,398	\$ -	\$ 995,699	\$ 84,214	\$ 84,214
Commercial real estate	671,864	671,864	135	359,879	25,848	25,848
Construction	73,592	73,592	-	172,280	4,877	4,877
Residential real estate	<u>2,260,988</u>	<u>2,260,988</u>	<u>24,786</u>	<u>2,054,663</u>	<u>87,441</u>	<u>87,441</u>
	<u>\$ 4,614,842</u>	<u>\$ 4,614,842</u>	<u>\$ 24,921</u>	<u>\$ 3,582,521</u>	<u>\$ 202,380</u>	<u>\$ 202,380</u>

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The following table presents a summary of information pertaining to impaired loans by loan category as of December 31, 2017:

	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Investment</u>	<u>Interest Income Recognized</u>	<u>Interest Income Recognized on a Cash Basis</u>
With no related allowance						
Commercial	\$ 78,295	\$ 78,295	\$ -	\$ 87,155	\$ 2,207	\$ 2,207
Commercial real estate	47,892	47,892	-	56,561	-	-
Construction	270,967	270,967	-	275,250	16,159	16,159
Residential real estate	<u>1,584,211</u>	<u>1,584,211</u>	<u>-</u>	<u>1,700,732</u>	<u>59,356</u>	<u>59,356</u>
	<u>\$ 1,981,365</u>	<u>\$ 1,981,365</u>	<u>\$ -</u>	<u>\$ 2,119,698</u>	<u>\$ 77,722</u>	<u>\$ 77,722</u>
With an allowance recorded						
Commercial	\$ 304,703	\$ 304,703	\$ 300,000	\$ 328,229	\$ -	\$ -
Residential real estate	<u>264,127</u>	<u>264,127</u>	<u>20,525</u>	<u>394,821</u>	<u>-</u>	<u>-</u>
	<u>\$ 568,830</u>	<u>\$ 568,830</u>	<u>\$ 320,525</u>	<u>\$ 723,050</u>	<u>\$ -</u>	<u>\$ -</u>
Total						
Commercial	\$ 382,998	\$ 382,998	\$ 300,000	\$ 415,384	\$ 2,207	\$ 2,207
Commercial real estate	47,892	47,892	-	56,561	-	-
Construction	270,967	270,967	-	275,250	16,159	16,159
Residential real estate	<u>1,848,338</u>	<u>1,848,338</u>	<u>20,525</u>	<u>2,095,553</u>	<u>59,356</u>	<u>59,356</u>
	<u>\$ 2,550,195</u>	<u>\$ 2,550,195</u>	<u>\$ 320,525</u>	<u>\$ 2,842,748</u>	<u>\$ 77,722</u>	<u>\$ 77,722</u>

Troubled Debt Restructurings

A loan modification constitutes a troubled debt restructuring if the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider. To determine whether or not a loan should be classified as a troubled debt restructuring, management evaluates a loan based upon the following criteria:

- The borrower demonstrates financial difficulty; common indicators include past due status with bank obligations, substandard credit bureau reports, or an inability to refinance with another lender, and,
- The Company has granted a concession; common concessions include maturity date extension, interest rate adjustments to below market pricing, reduction of principal and deferment of payments.

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The following tables present the recorded investment in troubled debt restructurings as of December 31, 2018 and 2017 based on payment performance status:

December 31, 2018	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>	<u>Total</u>
Performing	\$ 74,333	\$ 482,753	\$ 73,592	\$ 670,679	\$ 1,301,357
Non-performing	<u>-</u>	<u>28,522</u>	<u>-</u>	<u>260,149</u>	<u>288,671</u>
Total	<u>\$ 74,333</u>	<u>\$ 511,275</u>	<u>\$ 73,592</u>	<u>\$ 930,828</u>	<u>\$ 1,590,028</u>
December 31, 2017	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Construction</u>	<u>Residential Real Estate</u>	<u>Total</u>
Performing	\$ 77,993	\$ -	\$ 270,967	\$ 364,610	\$ 713,570
Non-performing	<u>305,005</u>	<u>47,892</u>	<u>-</u>	<u>264,127</u>	<u>617,024</u>
Total	<u>\$ 382,998</u>	<u>\$ 47,892</u>	<u>\$ 270,967</u>	<u>\$ 628,737</u>	<u>\$ 1,330,594</u>

Troubled debt restructured loans are considered impaired and carry individual specific reserves. At December 31, 2018 and 2017 the specific reserve related to troubled debt restructured loans was \$23,457 and \$320,525. As of December 31, 2018, there were no commitments to lend additional amounts to customers with outstanding loans that are classified as troubled debt restructurings. As of December 31, 2017, the Company was contractually committed to lend up to \$120,000 in additional funds to one customer with an outstanding line of credit that is classified as a troubled debt restructuring.

The following tables summarize troubled debt restructurings that occurred during the periods indicated:

<u>During the Year Ended December 31, 2018</u>			
	<u>Number of Loans</u>	<u>Pre- Modification Outstanding Recorded Investment</u>	<u>Post- Modification Outstanding Recorded Investment</u>
Commercial	1	\$ 9,351	\$ 9,351
Commercial real estate	1	482,753	482,753
Residential real estate	<u>1</u>	<u>313,953</u>	<u>313,953</u>
Total	<u>3</u>	<u>\$ 806,057</u>	<u>\$ 806,057</u>

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	During the Year Ended December 31, 2017		
	<u>Number of Loans</u>	<u>Pre- Modification Outstanding Recorded Investment</u>	<u>Post- Modification Outstanding Recorded Investment</u>
Commercial	1	\$ 19,993	\$ 19,993
Residential real estate	<u>1</u>	<u>264,127</u>	<u>264,127</u>
Total	<u><u>2</u></u>	<u><u>\$ 284,120</u></u>	<u><u>\$ 284,120</u></u>

A loan is considered to be in payment default once it is greater than 30 days contractually past due under the modified terms. There were no troubled debt restructurings modified within the twelve-month period ended December 31, 2018, for which there was a payment default during the period.

5. Premises and Equipment

A summary of the cost and accumulated depreciation of premises and equipment follows:

	<u>2018</u>	<u>2017</u>
Land and improvements	\$ 2,110,093	\$ 2,110,093
Buildings and improvements	10,526,298	9,924,296
Equipment	<u>7,979,260</u>	<u>7,722,547</u>
	20,615,651	19,756,936
Accumulated depreciation	<u>(10,842,184)</u>	<u>(10,160,854)</u>
	<u><u>\$ 9,773,467</u></u>	<u><u>\$ 9,596,082</u></u>

Depreciation, included in occupancy and equipment expense, amounted to \$681,330 and \$599,245 for the years ended December 31, 2018 and 2017, respectively.

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Pursuant to the terms of noncancelable lease agreements in effect at December 31, 2018, pertaining to premises and equipment, future minimum rent commitments under various operating leases are as follows:

2019	\$ 799,957
2020	801,010
2021	802,063
2022	709,447
2023	193,963
Thereafter	<u>496,273</u>
	<u>\$ 3,802,713</u>

The leases contain options to extend for periods from three to ten years. The cost of such extensions is not included above. Total rent expense for the years ended December 31, 2018 and 2017 amounted to \$827,882 and \$782,816, respectively.

6. Deposits

At December 31, 2018, the scheduled maturities of time deposits are as follows:

2019	\$ 25,531,353
2020	8,604,644
2021	939,648
2022	1,693,606
2023	<u>490,548</u>
	<u>\$ 37,259,799</u>

Deposit accounts with related parties were \$3,680,543 and \$3,919,785 at December 31, 2018 and 2017, respectively.

7. Securities Sold Under Agreements to Repurchase

Securities sold under repurchase agreements mature within twelve months and are collateralized by mortgage-backed securities with a book value of \$11,388,960 and a fair value of \$10,928,273 at December 31, 2018 and by mortgage-backed securities with a book value of \$13,610,719 and a fair value of \$13,444,427 at December 31, 2017. All securities collateralizing the repurchase agreements are under the Company's control. The maximum amount of repurchase agreements outstanding at any month-end during 2018 and 2017 was \$7,925,926 and \$11,328,828, respectively. The average amount of repurchase agreements outstanding during 2018 and 2017 was \$7,131,617 and \$7,793,080, respectively. The weighted average interest rate on repurchase agreements outstanding at December 31, 2018 and 2017 was 0.44% and 0.08%, respectively.

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8. Advances from Federal Home Loan Bank and Other Borrowings

The Company has fixed-rate advances with the FHLB of \$16,433,014 and \$13,965,847 at December 31, 2018 and 2017. At December 31, 2018 and 2017 interest rates of fixed-rate advances ranged from 0.00% to 2.67%.

Outstanding FHLB borrowings are secured by a blanket lien on qualified collateral consisting primarily of loans with first mortgages secured by one to four family properties, certain unencumbered investment securities, and other qualified assets.

The contractual maturities of advances at December 31, 2018 were as follows:

2019	\$ 12,500,000
2021	3,000,000
2037	<u>933,014</u>
 Total	 <u>\$ 16,433,014</u>

The Bank has a long-term line of credit with the FHLB that does not expire, in the amount of \$2,803,000. There were no amounts outstanding at December 31, 2018 or 2017. The Company, through the Bank, has the ability to borrow from the FRB Discount Window due to its pledge of \$9,631,703 and \$11,791,751 of state and municipal securities that it owned at December 31, 2018 and 2017. No amounts were outstanding at December 31, 2018 or 2017. The Company, through the Bank, has unsecured lines of credit at two correspondent banks totaling \$10,500,000. No amounts were outstanding on these lines of credit at December 31, 2018 or 2017.

9. Income Taxes

Allocation of federal and state income taxes between current and deferred portions was as follows:

	<u>2018</u>	<u>2017</u>
Current tax provision		
Federal	\$ 562,623	\$ 786,566
State	<u>90,831</u>	<u>(109,566)</u>
	<u>653,454</u>	<u>677,000</u>
 Deferred tax (benefit) expense		
Federal	124,913	534,187
State	<u>(3,758)</u>	<u>151,655</u>
	<u>121,155</u>	<u>685,842</u>
	<u>\$ 774,609</u>	<u>\$ 1,362,842</u>

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The income tax provision differs from the expense that would result from applying federal statutory rates to income before income taxes, as follows:

	<u>2018</u>	<u>2017</u>
Computed tax expense	\$ 1,245,072	\$ 1,770,747
Increase (reduction) in income taxes resulting from:		
Tax exempt income	(397,484)	(789,916)
Income from life insurance	(53,434)	(102,181)
Tax credits, net of amortization	(133,023)	(112,431)
State tax	85,852	27,779
Adjustment of deferred tax asset for tax law enactment	-	503,786
Other	<u>27,626</u>	<u>65,058</u>
	<u>\$ 774,609</u>	<u>\$ 1,362,842</u>

The components of the net deferred tax asset were as follows:

	<u>2018</u>	<u>2017</u>
Deferred tax assets		
Allowance for loan losses	\$ 1,241,176	\$ 1,258,188
Employee benefit plan	935,468	819,393
Nonaccrual interest	36,576	35,576
Limited partnerships	187,272	118,749
Tax credit carryforward	219,024	400,850
Net unrealized loss on securities available-for-sale and interest rate swaps	256,279	-
Other	<u>4,617</u>	<u>24,563</u>
	<u>2,880,412</u>	<u>2,657,319</u>
Deferred tax liabilities		
Net unrealized gain on securities available-for-sale and interest rate swaps	-	194,653
Depreciation	774,492	676,884
Prepaid expenses	157,793	166,926
Deferred rent	<u>-</u>	<u>506</u>
	<u>932,285</u>	<u>1,038,969</u>
Net deferred tax asset	<u>\$ 1,948,127</u>	<u>\$ 1,618,350</u>

No valuation allowance is deemed necessary for the deferred income tax asset. The net deferred tax asset is included with other assets in the consolidated balance sheet.

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Deferred tax assets and liabilities are recognized at the expected future tax rate. On December 31, 2017, the federal tax rate decreased from 35% to 21% effective January 1, 2018. Accordingly, deferred tax assets and liabilities were revalued at December 31, 2017 to reflect the 21% tax rate.

The Company invests in qualified affordable housing projects. At December 31, 2018 and 2017, the balance of the investment for qualified housing projects was \$4,467,238 and \$3,516,998, respectively. These balances are reflected in other assets on the consolidated balance sheets. New investments in qualified affordable housing projects are amortized using the proportional amortization method. All investments made before January 1, 2015 are amortized using the effective yield method. During the years ended December 31, 2018 and 2017, the Company recognized amortization expense of \$547,777 and \$513,906, respectively, which was included within income tax expense in the consolidated statements of income. Additionally, during the years ended December 31, 2018 and 2017, the Company recognized tax credits from its investments in affordable housing tax projects of \$557,237 and \$550,371, respectively. At December 31, 2018, the Company had \$219,024 of available tax credits available for carryforward which expire in 2037.

10. Earnings per Share

The following sets forth the computation of basic and diluted earnings per share for 2018 and 2017.

	<u>2018</u>	<u>2017</u>
Net income, as reported	<u>\$ 5,152,323</u>	<u>\$ 3,845,238</u>
Weighted-average shares outstanding	<u>3,110,156</u>	3,076,184
Effect of unvested stock grants	<u>40,153</u>	48,009
Effect of dilutive stock options	<u>-</u>	<u>651</u>
Adjusted weighted-average shares and assumed conversion	<u><u>3,150,309</u></u>	<u><u>3,124,193</u></u>
Basic earnings per share	\$ 1.66	\$ 1.25
Diluted earnings per share	\$ 1.64	\$ 1.23

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11. Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, standby and commercial letters-of-credit, and interest rate caps and floors written on adjustable rate loans. Such instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters-of-credit is represented by the contractual notional amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. For interest rate caps and floors written on adjustable rate loans, the contract or notional amounts do not represent exposure to credit losses.

The Company generally requires collateral or other security to support financial instruments with credit risk.

At December 31, 2018 and 2017, the following financial instruments were outstanding whose contract amounts represent credit risk:

	<u>Contract Amount</u>	
	<u>2018</u>	<u>2017</u>
Commitments to grant loans	\$ <u>63,409,606</u>	\$ <u>57,865,901</u>
Commercial and standby letters-of-credit	\$ <u>670,305</u>	\$ <u>612,855</u>

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee.

Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial property.

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Standby letters-of-credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. The credit risk involved in issuing letters-of-credit is essentially the same as that involved in extending loan facilities to customers.

At times, the Company places interest rate caps and floors on loans written by the Company to enable customers to transfer, modify, or reduce their interest rate risk.

12. Legal Contingencies

Various legal claims arise from time-to-time in the normal course of business which, in the opinion of management, will have no material effect on the Company's financial statements.

13. Shareholders' Equity and Regulatory Matters

On July 28, 2017, the Company's Board of Directors declared a three-for-one stock split in the form of a stock dividend that was paid in September 2017.

The Company and its bank subsidiary are subject to various regulatory capital requirements administered by the Office of the Comptroller of the Currency (OCC). Failure to meet minimum capital requirements can result in mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements.

These capital requirements represent quantitative measures of the Company's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's capital amounts and classification are also subject to qualitative judgments by its regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios of total and Tier 1 capital, and Common Equity Tier 1 (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital to average assets (as defined). Management believes that, as of December 31, 2018, the Company and its bank subsidiary meet all capital requirements to which they are subject. As of December 31, 2018, the most recent notification from the OCC categorized the banking subsidiary as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, a financial institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category. Prompt corrective action provisions are not applicable to bank holding companies.

The ability of the Company to pay cash dividends depends on the receipt of dividends from its banking subsidiary. The Company, as the sole shareholder of the banking subsidiary, is entitled to dividends from legally available funds when and as declared by the banking subsidiary's Board of Directors.

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Regulatory capital requirements limit a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% above its minimum risk-based capital requirements. The final Basel III capital rule became effective for the Bank on January 1, 2015. The capital conservation buffer requirement is being phased in from January 1, 2016 through January 1, 2019, when the full capital conservation buffer requirement will be effective. As of December 31, 2018 and 2017, the Company and the Bank had a capital conservation buffer in excess of the phased-in regulatory requirement of 1.875% and 1.25%, respectively.

The actual capital amounts and ratios for the Company and the Bank are presented below.

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<u>December 31, 2018</u>						
(Dollar amounts in thousands)						
Total Capital to Risk Weighted Assets						
Company	\$ 53,473	16.7 %	\$ 25,625	8.0 %	\$ 32,032	10.0 %
Bank	\$ 49,296	15.4 %	\$ 25,598	8.0 %	\$ 31,997	10.0 %
Tier 1 Capital to Risk Weighted Assets						
Company	\$ 49,457	15.4 %	\$ 19,219	6.0 %	\$ 25,625	8.0 %
Bank	\$ 45,280	14.2 %	\$ 19,198	6.0 %	\$ 25,598	8.0 %
Common Equity Tier 1 Capital to Risk Weighted Assets						
Company	\$ 49,457	15.4 %	\$ 14,414	4.5 %	\$ 20,821	6.5 %
Bank	\$ 45,280	14.2 %	\$ 14,399	4.5 %	\$ 20,798	6.5 %
Tier 1 Capital to Average Assets						
Company	\$ 49,457	10.0 %	\$ 19,711	4.0 %	\$ 24,639	5.0 %
Bank	\$ 45,280	9.2 %	\$ 19,698	4.0 %	\$ 24,623	5.0 %

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	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollar amounts in thousands)					
<u>December 31, 2017</u>						
Total Capital to Risk Weighted Assets						
Company	\$ 49,669	15.7 %	\$ 25,378	8.0 %	\$ 31,722	10.0 %
Bank	\$ 46,648	14.7 %	\$ 25,354	8.0 %	\$ 31,722	10.0 %
Tier 1 Capital to Risk Weighted Assets						
Company	\$ 45,678	14.4 %	\$ 19,033	6.0 %	\$ 25,378	8.0 %
Bank	\$ 42,666	13.5 %	\$ 19,015	6.0 %	\$ 25,354	8.0 %
Common Equity Tier 1 Capital to Risk Weighted Assets						
Company	\$ 45,687	14.4 %	\$ 14,275	4.5 %	\$ 20,619	6.5 %
Bank	\$ 42,666	13.5 %	\$ 14,262	4.5 %	\$ 20,600	6.5 %
Tier 1 Capital to Average Assets						
Company	\$ 45,687	9.4 %	\$ 19,400	4.0 %	\$ 24,249	5.0 %
Bank	\$ 42,666	8.8 %	\$ 19,388	4.0 %	\$ 24,235	5.0 %

14. Derivative Financial Instruments

The Company uses interest rate swap agreements for asset/liability management purposes, to hedge various exposures or to modify interest rate characteristics of various balance sheet accounts. Such derivatives are used as part of the asset/liability management process and are linked to specific assets or liabilities, and have high correlation between the contract and the underlying item being hedged, both at inception and throughout the hedge period. The notional amount of the interest rate swaps does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest rate swaps.

Interest rate swaps related to borrowings are cash flow hedges and interest rate swaps related to loans and municipal bonds are fair value hedges.

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At December 31, 2018 and 2017, the information pertaining to outstanding interest rate swap agreements used to hedge bonds, fixed-rate loans, and borrowings is as follows:

	<u>2018</u>	<u>2017</u>
Notional amount	\$30,642,660	\$24,779,354
Weighted average pay rate	3.30 %	3.33 %
Weighted average receive rate	2.83 %	1.96 %
Weighted average maturity in years	11.60	13.08
Unrealized gain on cash flow hedges	\$ 833,490	\$ 242,696

These agreements provide for the Company to make payments at a fixed-rate in exchange for receiving payments at a floating-rate, determined by a specified index. Interest expense recorded on these swap transactions totaled \$118,050 and \$225,458 during 2018 and 2017, respectively, and is reported as components of the applicable interest income or expense in the consolidated statements of income. Gains of \$2,524 and \$20,015 for the fair value of the hedges were recorded in earnings for the years ended December 31, 2018 and 2017, respectively. The Company expects the hedges to remain highly effective during the remaining terms of the swaps.

The following table reflects the fair value and cash flow hedges included in the consolidated balance sheets as of December 31, 2018 and 2017:

	<u>2018</u>		<u>2017</u>	
	<u>Notional Value</u>	<u>Fair Value</u>	<u>Notional Value</u>	<u>Fair Value</u>
Included in other assets				
Interest rate swaps related to borrowings	\$10,000,000	\$ 318,886	\$10,000,000	\$ 195,877
Interest rate swaps related to loans	2,040,540	150,506	2,099,354	125,216
Interest rate swaps related to municipal bonds	<u>12,680,000</u>	<u>534,054</u>	<u>8,910,000</u>	<u>79,136</u>
Total included in other assets	<u>\$24,720,540</u>	<u>\$ 1,003,446</u>	<u>\$21,009,354</u>	<u>\$ 400,229</u>
Included in other liabilities				
Interest rate swaps related to municipal bonds	\$ -	\$ -	\$ 3,770,000	\$ 13,921
Interest rate swaps related to loans	<u>5,922,120</u>	<u>131,350</u>	-	-
Total included in other liabilities	<u>\$ 5,922,120</u>	<u>\$ 131,350</u>	<u>\$ 3,770,000</u>	<u>\$ 13,921</u>

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15. Employee Benefits

The Company sponsors a 401(k) profit sharing plan which covers all employees who are at least 18 years of age and who have completed one year of employment. Eligible employees contribute a percentage of their annual compensation to the 401(k) plan and the Company makes a flat contribution to all eligible employees, regardless of the amount contributed by the employee. In addition, the Company may make discretionary contributions on behalf of employees under the plan. For the years ended December 31, 2018 and 2017, expense attributable to the plan amounted to \$503,172 and \$445,823, respectively.

Included in accrued expenses and other liabilities in the balance sheets at December 31, 2018 and 2017 are liabilities established pursuant to deferred compensation agreements with certain officers of the Company of \$2,487,003 and \$2,258,579, respectively. Deferred compensation expense related to these plans amounted to \$283,235 and \$249,196 for the years ended December 31, 2018 and 2017, respectively.

16. Stock-Based Compensation

On April 19, 2006, the shareholders of the Company approved the 2006 Stock Option and Incentive Plan (the current plan). The maximum number of shares of stock reserved and available for issuance under this Plan is 150,000 shares. In May 2013, the shareholders voted to add 150,000 new shares. Awards may be granted in the form of incentive stock options and restricted stock, or any combinations of the preceding, and the exercise price shall not be less than 100% of the fair market value on the date of grant. No stock options are exercisable more than ten years after the date the stock option is granted. The stock options vest over a three-year period. The restricted stock awards granted through December 31, 2018 each vest over a period of one to four years.

On January 1, 2006, the Company adopted FASB guidance for the incentive stock option and restricted stock grants relating to the current plan and previous plans. In accordance with that guidance, the Company recorded \$780,285 and \$501,080 of compensation expense during the years ended December 31, 2018 and 2017, respectively. Total compensation expense related to nonvested awards not yet recognized is \$1,380,330 as of December 31, 2018 and is expected to be recognized over a weighted average period of 2.1 years.

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A summary of nonvested restricted stock awards as of December 31, 2018 and changes during the year then ended are presented below:

	<u>Shares</u>	<u>Weighted Average Grant-Date Fair Value</u>
Nonvested shares at December 31, 2017	93,805	\$ 17.37
Granted	46,412	21.75
Vested	(37,416)	16.96
Forfeited	<u>(310)</u>	20.79
 Nonvested shares at December 31, 2018	 <u>102,491</u>	 19.54

During 2018, the Company's Board of Directors adopted the 2018 Stock Grant Plan (2018 Plan). Under the 2018 Plan, the maximum number of shares available for issuance is 150,000. No shares were issued from the 2018 Plan during 2018.

17. Other Noninterest Income and Expense

The components of other noninterest income and expense which are in excess of 1% of total revenues (total interest and dividend income and noninterest income) and not shown separately in the statements of income are as follows for the years ended December 31:

	<u>2018</u>	<u>2017</u>
Noninterest income		
Bank owned life insurance	\$ 254,450	\$ 258,034
Noninterest expense		
Professional fees	\$ 585,935	\$ 418,180
Printing, postage and stationery	323,261	373,231
Directors' fees	273,942	257,310
Advertising	639,545	609,357
ATM processing	247,991	253,872

18. Related Party Transactions

The Company has had, and may be expected to have in the future, transactions in the ordinary course of business with directors, principal officers, their immediate families and affiliated companies in which they are principal shareholders (commonly referred to as related parties), all of which have been, in the opinion of management, on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. Loans granted to related parties amounted to \$7,468,397 and \$1,575,281 at December 31, 2018 and 2017, respectively.

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During January 2007, the Bank entered into a long-term lease with a company whose principal is a director and shareholder of the Company. This lease is for space that is the headquarters for the Bank's Ledyard Financial Advisors division. The lease has an initial term of 10 years. The lease has three five-year options to renew. Lease payments to the related party were \$386,006 and \$361,857 in 2018 and 2017, respectively. Future minimum rent commitments and rent expense related to this related party lease are included in Note 5.

19. Components of Other Comprehensive (Loss) Income

The following table presents the components of other comprehensive (loss) income for the years ended December 31, 2018 and 2017:

	<u>December 31, 2018</u>			<u>December 31, 2017</u>		
	<u>Before Tax</u>	<u>Tax Effect</u>	<u>Net of Tax</u>	<u>Before Tax</u>	<u>Tax Effect</u>	<u>Net of Tax</u>
Changes in net unrealized (losses) gains on securities available- for-sale	\$(2,738,087)	\$ (574,998)	\$(2,163,089)	\$ 2,300,861	\$ 782,293	\$ 1,518,568
Reclassification adjustment for net realized gains	-	-	-	(38,955)	(13,245)	(25,710)
Unrealized interest rate swap asset (liability)	<u>590,794</u>	<u>124,067</u>	<u>466,727</u>	<u>(137,791)</u>	<u>(46,849)</u>	<u>(90,942)</u>
Other comprehensive (loss) income	<u>\$(2,147,293)</u>	<u>\$ (450,931)</u>	<u>\$(1,696,362)</u>	<u>\$ 2,124,115</u>	<u>\$ 722,199</u>	<u>\$ 1,401,916</u>

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	<u>Unrealized Gains and Losses on Available-for- Sale Securities</u>	<u>Unrealized Gains and Losses on Cash Flow Hedges</u>	<u>Total</u>
Balance at December 31, 2016	\$ (1,041,272)	\$ 251,122	\$ (790,150)
Other comprehensive loss before reclassifications	1,518,568	(90,942)	1,427,626
Amounts reclassified from accumulated other comprehensive loss	(25,710)	-	(25,710)
Reclassification for change in statutory income tax rate for items in Accumulated Other Comprehensive Income (Loss)	<u>88,950</u>	<u>31,550</u>	<u>120,500</u>
Balance at December 31, 2017	540,536	191,730	732,266
Other comprehensive income before reclassifications	(2,163,089)	466,727	(1,696,362)
Amounts reclassified from accumulated other comprehensive income	<u>-</u>	<u>-</u>	<u>-</u>
Balance at December 31, 2018	<u>\$ (1,622,553)</u>	<u>\$ 658,457</u>	<u>\$ (964,096)</u>

On December 22, 2017, the U.S. federal government enacted the Tax Cuts and Jobs Act of 2017. The Tax Cuts and Jobs Act of 2017 established a 21 percent U.S. federal corporate income tax rate. The Bank remeasured its net deferred tax asset through a charge to provision for income taxes. As a result of the remeasurement of deferred taxes for items in accumulated other comprehensive income or loss (AOCI), the Bank made a reclassification from AOCI to undivided profits in the amount of \$120,500. The amount of that reclassification is the difference between the amount initially charged or credited directly to other comprehensive income at the previously enacted U.S. federal corporate income tax rate and the amount that would have been charged or credited directly to other comprehensive income using the newly enacted 21 percent U.S. federal corporate income tax rate.

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20. Fair Value

U.S. GAAP defines fair value, establishes a framework for measuring fair value, and requires certain disclosures about fair value measurements.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. U.S. GAAP also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three levels of inputs that may be used to measure fair value are:

- Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.
- Level 3: Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

Financial Instruments Recorded at Fair Value on a Recurring Basis

Investment securities: Fair values for securities are determined by obtaining quoted market prices on nationally recognized securities exchanges or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities.

Loans held for sale: Fair values of loans held for sale are based on commitments on hand from investors or prevailing market prices.

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Interest rate swaps: The fair value measurements utilize a discounted cash flow model that incorporates and considers observable data that may include publicly available third party market quotes in developing the curve utilized for discounting future cash flows.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

	<u>Fair Value Measurements at December 31, 2018, Using</u>		
		Quoted Prices In Active Markets for Identical Assets <u>(Level 1)</u>	Significant Other Observable Inputs <u>(Level 2)</u>
	<u>Total</u>		
Assets (market approach)			
Securities available-for-sale			
U.S. Government sponsored enterprises	\$ 13,128,396	\$ -	\$ 13,128,396
Mortgage-backed securities	53,040,112	-	53,040,112
State and municipal	58,378,862	-	58,378,862
Corporate bonds	<u>13,527,368</u>	<u>-</u>	<u>13,527,368</u>
	<u>\$ 138,074,738</u>	<u>\$ -</u>	<u>\$ 138,074,738</u>
Loans held for sale	<u>\$ 138,125</u>	<u>\$ -</u>	<u>\$ 138,125</u>
Interest rate swaps	<u>\$ 1,003,446</u>	<u>\$ -</u>	<u>\$ 1,003,446</u>
Liabilities (market approach)			
Interest rate swaps	<u>\$ 131,350</u>	<u>\$ -</u>	<u>\$ 131,350</u>

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	<u>Fair Value Measurements at December 31, 2017, Using</u>		
	<u>Total</u>	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Assets (market approach)			
Securities available-for-sale			
U.S. Government sponsored enterprises	\$ 14,459,162	\$ -	\$ 14,459,162
Mortgage-backed securities	45,241,170	-	45,241,170
Collateralized mortgage obligations	13,112	-	13,112
State and municipal	61,544,100	-	61,544,100
Corporate bonds	<u>15,792,406</u>	<u>-</u>	<u>15,792,406</u>
	<u>\$ 137,049,950</u>	<u>\$ -</u>	<u>\$ 137,049,950</u>
Interest rate swaps	<u>\$ 400,229</u>	<u>\$ -</u>	<u>\$ 400,229</u>
Liabilities (market approach)			
Interest rate swaps	<u>\$ 13,921</u>	<u>\$ -</u>	<u>\$ 13,921</u>

Assets and liabilities measured at fair value on a nonrecurring basis are summarized below:

	<u>Fair Value Measurements at December 31, 2017, Using</u>		
	<u>Total</u>	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Assets (market approach)			
Collateral-dependent impaired loans	\$ 4,703	\$ -	\$ 4,703

There were no collateral dependent impaired loans at December 31, 2018. Certain collateral dependent impaired loans were written down to their fair value of \$4,703 at December 31, 2017, resulting in an impairment charge through the provision for loan losses, which was included in earnings for the period.

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The estimated fair values and related carrying amounts for assets and liabilities for which fair value is only disclosed are as follows:

<u>December 31, 2018</u>	<u>Carrying</u>	<u>Estimated</u>	Quoted	<u>Significant</u>	<u>Significant</u>
	<u>Amount</u>	<u>Fair</u>	Prices In	<u>Other</u>	<u>Unobservable</u>
		<u>Value</u>	Active	<u>Inputs</u>	<u>Inputs</u>
			Markets for	<u>(Level 2)</u>	<u>(Level 3)</u>
			Identical		
			Assets		
			(Level 1)		
Financial assets					
Securities held-to-maturity	\$ 1,389,271	\$ 1,411,970	\$ -	\$ 1,411,970	\$ -
Loans					
Commercial	40,913,712	36,923,362	-	1,608,398	35,314,964
Commercial real estate	120,713,815	98,134,034	-	671,729	97,462,305
Construction	1,121,857	911,575	-	73,592	837,983
Residential real estate	130,409,309	112,666,843	-	2,236,202	110,430,641
Consumer	12,401,692	11,333,787	-	-	11,333,787
Accrued interest receivable	1,810,309	1,810,309	-	1,810,309	-
Financial liabilities					
Deposits	409,065,966	-	-	408,786,660	-
Repurchase agreements	7,510,711	7,510,711	-	7,510,711	-
Advances from Federal Home					
Loan Bank	16,433,014	-	-	16,072,946	-
Accrued interest payable	50,260	50,260	-	50,260	-

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<u>December 31, 2017</u>	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>	<u>Quoted Prices In Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Financial assets					
Securities held-to-maturity	\$ 1,558,857	\$ 1,602,266	\$ -	\$ 1,602,266	\$ -
Loans					
Commercial	30,311,543	31,216,642	-	82,998	31,133,644
Commercial real estate	120,658,200	123,651,586	-	47,892	123,603,694
Construction	2,698,777	2,752,591	-	270,967	2,481,624
Residential real estate	127,941,896	128,683,716	-	1,827,813	126,855,903
Consumer	13,135,521	13,244,408	-	-	13,244,408
Accrued interest receivable	1,673,348	1,673,348	-	1,673,348	-
Financial liabilities					
Deposits	401,498,410	-	-	401,487,554	-
Repurchase agreements	9,925,462	9,925,462	-	9,925,462	-
Advances from Federal Home					
Loan Bank	13,965,847	-	-	13,995,558	-
Accrued interest payable	45,912	45,912	-	45,912	-

Excluded from the tables above were financial instruments measured at fair value on a recurring and nonrecurring basis, as previously described.