2023 Annual Report

SOUTHERN MICHIGAN
BANCORP, INC.


SOUTHERN MICHIGAN
BANK & TRUST

Jackson Downtown Branch

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Message to our Shareholders

John R. Waldron
President and
Chief Executive Officer

It is my honor and privilege to share the 2023 financial results for Southern Michigan Bancorp, Inc. Consolidated net income for 2023 was $10,905,000, or $2.40 per share compared to $13,491,000, or $2.97 per share in 2022. The decrease in earnings was primarily due to the challenging interest rate environment, including higher deposit costs, coupled with increased non-interest expenses, as the bank continued to grow. Southern's return on average assets and return on average equity were 0.80 percent and 11.94 percent, respectively in 2023 compared to 1.10 percent and 15.68 percent in 2022.

Southern ended 2023 with record year-end total assets of $1.41 billion, which was $138.3 million, or 10.8 percent higher than $1.28 billion on December 31, 2022. Loan totals also reached an historic high of $1.04 billion, increasing $149.8 million, or 16.9 percent from $886.6 million as of December 31, 2022.

Our unwavering, disciplined credit culture continued to result in strong asset quality. Net loan charge-offs amounted to only $15,000 for 2023. Delinquent and non-accrual loans at December 31, 2023 totaled $1,055,000, or 0.10 percent of total loans, down from $1,190,000, or 0.13 percent of total loans at December 31, 2022.

In 2023, we opened a loan production office and a full-service branch in downtown Jackson. Both projects were managed by R.W. Mercer Co. We are pleased to highlight Kirk Mercer in the 2023 Annual Report. Mr. Mercer began a banking relationship with Southern in 1975 and recently retired as CEO of R.W. Mercer Co.

Ridderman Oil has roots back to the 1970s and is owned by Steve and Jon Ridderman. The company specializes in supplying fuel, oil, and lubricants. Ridderman Oil also owns and operates three convenience stores/gas stations.

These family-owned operations are multi-generational and thriving. We congratulate them for their success and thank them for their business.

Southern will be adding two new branches to our network in 2024. This summer we will open our second full-service branch in Sturgis, which will be located at 711 S. Centreville Road. Later this year, we anticipate opening a second branch in Jackson, which will be located at the corner of Horton and Weatherwax roads. Both branches will offer commercial and residential loans, business and retail banking services, and wealth management expertise.

As previously announced on October 3, 2023, after decades of leadership and service, CEO John Castle and President Kurt Miller announced their plans to retire from Southern Michigan Bancorp, Inc. and Southern Michigan Bank & Trust. Mr. Castle will continue to serve as Chairman of the Board while Mr. Miller has transitioned to serve as Vice Chairman. Until their retirement in June 2024, they will assist in managing the day-to-day operations. I welcome their continued guidance and involvement as both are outstanding bankers.

As we look to 2024 and beyond, we will continue to draw on the key to our past success; our ability to execute our strategic plan. On behalf of the entire Southern team, thank you for your support.

Sincerely,

John R. Waldron

John R. Waldron
President and Chief Executive Officer

Portage Branch

Kirk A. Mercer

Robert Mercer's business began when he purchased Hillsdale Oil Service in 1960. He would later welcome his son, Kirk, into the business, establishing a reputable petroleum services company, while continuing to maintain the family farm.

At 23 years old, Kirk Mercer took out his first loan. The $2,500 note for the purchase of a farm tractor was administered at the North Adams branch of First National Bank of South Central Michigan, where Bob Stanley was the manager. Southern Michigan Bank & Trust (SMBT) would later acquire that branch, and to this day Bob Stanley serves as an adjustor for the bank.

"I first met Kirk's dad, Robert, when he was repairing gas pumps at the gas station next to the bank in the early 1970's," said Stanley. "He and his brother Fred were operating out of a one-car garage in Hillsdale. Robert at that time also liked to farm, so his son Kirk got into the business, and he purchased a John Deere farm tractor."

Together, Robert and Kirk would quickly outgrow the one-car garage operation, and they moved their headquarters to an office in Jackson. In 1976, Kirk purchased the company from his father and reincorporated it as R.W. Mercer Co.

The following years generated exponential growth. While headquarters remained in Jackson, the company expanded to seven locations, six in Michigan and one in Indiana. They kept their roots as a petroleum service and installation company and expanded

Pictured from left to right:
John Waldron, President and CEO; Brooke Miles, Commercial Loan Admin Assistant; Kirk Mercer, former Owner and CEO of R.W. Mercer Co.; and Eric Anglin, EVP, COO, CSO

Pictured from left to right: John Waldron and Kirk Mercer

their offerings to include general contracting. "We started the general contracting division to build primarily convenience stores," said Kirk. "From there, it became fairly easy to transition into building small manufacturing facilities, fast food restaurants, hotels, office buildings, and others."

In 1996, Kirk's son, Andy, joined the company. "It was just a great opportunity to continue the family business," Andy said. "I worked here as a kid in the backroom, pushing a broom and washing trucks on weekends. It was an easy transition."

While growing their contracting business, they noticed an increase in demand for electrical contracting services. Having several electricians on staff, a new electrical division emerged handling new construction, remodeling, and service upgrades for both residential and commercial projects such as gas stations, industrial plants, and grain mills.

A fourth division of the company was added in 2003, specializing in sales, installation, and service of car washing systems. Their unique set of offerings allows them to serve a vast array of people and businesses.

With a bulk of construction work residing in Jackson, their paths would start to cross with John Waldron, who at the time worked for another financial institution, but now serves as President & CEO of Southern. Kirk reminisced, "Every time I had a customer call me saying, 'I want to put on an addition,' 'I want to do a remodel,' 'I want to build something new,' inevitably I got to the point of, 'how are you going to finance it?' For quite a few years, it seemed like eight out of ten times the answer was John Waldron, and I thought, who is this guy? He was first up on almost every deal I came across. It became clear to me that was because he was a hustler, he works hard, makes the customer feel good, makes you feel like he wants your business, and he's not just doing you a favor."

Kirk and John developed a long-lasting relationship, partnering on many projects. "R.W. Mercer Co. is a locally owned business that has endured over the years and is now thriving," said Waldron. "The company does high-quality work, is well-managed, and has a great reputation in the community. Overall, Kirk and Andy are just genuinely good people."

In 2010, Andy succeeded ownership of the company from his father. "It is extremely rewarding to have Andy carry on the family business," said Kirk. "Andy has continued to make the business more successful than it ever has been. I am extremely proud of what he has done and is continuing to do today."

As a third generation owned company, R.W. Mercer Co. has continued growing under Andy's management with the acquisition of West Michigan Electric and the addition of general contracting

"It is extremely rewarding to have Andy carry on the family business," said Kirk. "Andy has continued to make the business more successful than it ever has been. I am extremely proud of what he has done and is continuing to do today." - Kirk Mercer

offices in Grand Rapids and Detroit.

"When I joined the company with my father, our growth began," said Kirk. "During my tenure, I was growth oriented, and I was more focused on the growth of the company than the overall management of the company. Since Andy joined, we have continued to be focused on growth, but Andy is an extremely strong manager, and his hard work and vision on how to organize, operate, and manage our business is much better."

Kirk followed John Waldron to Southern before the bank had any brick-and-mortar presence in Jackson. Treasury Sales and Treasury Support teams assisted with the onboarding along with the nearby Hillsdale Branch, enabling them to manage accounts online and complete mobile deposits. While remote banking is still in play, within a year Southern established a full-service branch and loan production office downtown.

"I think John is a great addition to Southern and we're glad to still have him here in Jackson," said Kirk.

In December of 2022, Andy was nominated to join the Southern Michigan Bancorp, Inc. Board of Directors. The recommendation was derived from his leadership and presence in the Jackson area, as well as his experience on the governance boards of ABC Michigan Worker's Compensation Fund, Petroleum Equipment Institute, Michigan Petroleum Association, Gilbarco Veeder-Root, and WDP Charities.

Today, Kirk stays busy investing in various commercial real estate endeavors and serves as managing partner for five hotels. While he does not hold the responsibilities with R.W. Mercer Co. he once had, Kirk still goes into the office most days. "The best part of my job is while I do not have any ownership, Andy continues to allow me to participate in many of the business decisions that affect our day-to-day operation," he said. "The other great part of my job is that I can set my schedule, and I am happy to say that any continued expansions and new developments in the future are entirely up to Andy."

Bob Stanley, who approved Kirk's first loan in May of 1975 has expressed plans to retire this year in June, culminating 35 years of service with Southern, and a total of 59 years in the banking industry.

Pictured from left to right: Kirk Mercer and Bob Stanley look at the original purchase agreement from 1975

Ridderman Oil

In 1971, Jack and Gena Ridderman moved their family to Plainwell, Michigan after Jack accepted a position as the local Amoco agent. Shortly after establishing a presence in the area, their sons Robert and Steve joined in the business and began expanding into new territories with the acquisition of the Otsego Amoco station. In 1976, Amoco concluded their agent program, leading Jack to buy it outright, and open Ridderman & Sons Oil Co. The business was officially incorporated, and additional acquisitions followed, including Pierce Oil and Banks Oil, in 1976 and 1981, respectively.

From there, they built the D Avenue Fuel Plaza in 1991 and Sprinkle Road BP in 1996. In 1999, Robert assumed the role of President. Ridderman & Sons Oil Co. was established as a well-known fuel supplier, including diesel exhaust fluid, wholesale gasoline, and automotive lubricants.

In 2004 Steve's son, Jon Ridderman, entered the scene as a driver and gradually transitioned to a leadership role in the lubricant division. "As a child, I always wanted to work for Ridderman Oil," expressed Jon. "Working with my dad has been a great experience. Everything I know I learned from him."

In 2010, there was a change in leadership as Robert resigned, leading Steve to succeed him as president and Jon to assume the position of secretary treasurer.

Steve and Jon would solidify their ownership of the company in 2014 when they purchased Jack and Gena's remaining share of the

*Pictured from left to right:
John Waldron, President and CEO; Steve Ridderman, President of Ridderman Oil; Jon Ridderman, Secretary Treasurer of Ridderman Oil; and Justin Horn, VP, Commercial Loan Officer*

Pictured from left to right:* *Jon Ridderman, Secretary Treasurer of Ridderman Oil; Justin Horn, VP, Commercial Loan Officer; Nick Grabowski, EVP, Chief Lending Officer; John Waldron, President and CEO; Eric Anglin, EVP, COO, CSO; and Steve Ridderman, President of Ridderman Oil

business. Their growth continued in Plainwell as they established an office warehouse at 950 Industrial Parkway in 2019 and opened a new gas station at 582 10th St. in 2023.

Adding to the family dynamic, Jon's sister, Kellay Ridderman, has been an integral part of the company for over four years. She leads Pizza Perfect, a food venture located within their facilities.

Travis Arbelius, a cousin of Jon and Kellay, has contributed over 12 years of expertise in various food businesses for the company and now works at Pizza Perfect as well. Additionally, Steve's wife Mary has been the Sales Director since 2019.

When asked if it was rewarding to have his children carry on the family business, Steve responded, "Absolutely, without question."

Working alongside the family is a dedicated administrative team that has allowed them to redirect time toward strategy and growth. Store managers have significantly enhanced customer service, ensuring that staff perform at a high level. One person in particular, Scott Galloway, has been a key asset, spearheading their Peddle Truck (bobtail) division since joining the organization six years ago.

Today, Ridderman Oil continues to play a crucial role in supplying fuel, oil, and lubricants to a significant portion of Grand Rapids, Kalamazoo, and Plainwell.

In addition to ensuring the operation of automobiles, Ridderman also focuses on optimizing the efficiency of local farms. They are proud to exclusively collaborate with top-quality brands of lubricants and fuels in the industry.

The company offers 24/7 emergency services, delivering generator fuel to local businesses in Southwest Michigan, including

"They supply a vital commodity to individuals and businesses in our area who rely on their organization and excellent service. Ridderman is similar to Southern in the fact they pride themselves in knowing their customers and serving those in the communities where they live and work." - Justin Horn

area hospitals. Their efforts ensure uninterrupted operations until power is restored. Ridderman Oil is fully licensed, insured, and Ridderman Oil's partnership with Southern Michigan Bank & Trust has played a pivotal role in fueling the company's growth endeavors. "We like the simplicity of banking with Southern," said Jon. "They know us and fill the void as we need new equipment or a line of credit to help grow. We can call and talk with our bankers when we need them."

VP Commercial Loan Officer Justin Horn shares a mutual admiration for the company, "Ridderman is an excellent customer and a joy to work with," said Horn. "They interact with all facets of the Bank from commercial lending to the branch, and various treasury services. Ridderman Oil is a longstanding company in the area with an outstanding reputation. They have experienced significant growth in the past several years."

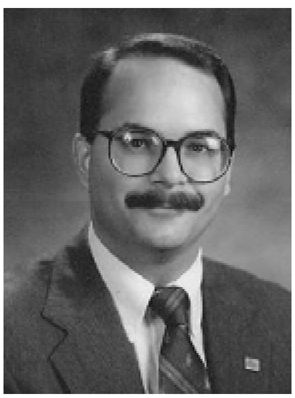
Taking advantage of the numerous products Southern offers has helped support Ridderman's daily operations. "Positive Pay and other security items are great so we know we are protected from theft," said Jon. "The money courier service has been a lifesaver as well."

"They supply a vital commodity to individuals and businesses in our area who rely on their organization and excellent service," said Horn. "Ridderman is similar to Southern in the fact they pride themselves in knowing their customers and serving those in the communities where they live and work."

With a strong foundation and decades of experience, Ridderman Oil is trusted to get the job done, and poised for a bright future.

Pictured:
Jack and Gena Ridderman's original nametags and Standard Oil hat

Celebrating a Legacy



John H. Castle
Chairman and CEO
2002-2023

Kurt G. Miller
President and CCO
2002-2023

Dedicated bankers. Trusted leaders. Inspiring mentors. Passionate community advocates.

Those words – and so many more – describe John Castle and Kurt Miller, who are retiring after decades of service and leadership to Southern Michigan Bank & Trust. As the cornerstone of our executive leadership team, they have long been synonymous with Southern, guiding our growth and expansion while ensuring we stay true to our roots as a community bank.

Since 2002, John has served as Chairman and CEO, while Kurt has served as President and Chief Credit Officer. Titles never mattered much to either as they partnered to lead our operations. Combined, they have contributed almost a century of knowledge and commitment to our success.

Fittingly, John and Kurt jointly announced their retirements in fall 2023, both staying with us to assist with managing the day-to-day operations until their retirement in June 2024, while our Board appointed John Waldron to serve as Southern's next President and CEO. John continues to lead our Board as Chairman and Kurt has transitioned to Vice Chairman – and both the Board and our leadership team continue to lean on them for their sage advice and wise counsel.

This engaged duo epitomize the Bank's mission "to be a trusted partner working for the betterment of our communities." John and Kurt have always understood the critical importance of local decision making and local control, whether a new homeowner comes to Southern for a first mortgage, an entrepreneur seeks out an expansion loan or a retiring couple wants to safeguard their nest egg.

Banking is deeply personal to these two – and they know choosing a bank is deeply personal for our customers.

John began his career with Southern in February 1980, a recent graduate of Central Michigan University with his degree in economics and finance who moved to Coldwater – ready to make a difference. He joined the Bank as a trust assistant. Kurt started his career with Southern in June 1974 as a teller, joining full-time in June 1980 after completing his degree in business administration at Western Michigan University.

In the early 1980s, Southern was a very different – and much smaller – institution, with $85 million in assets managed by approximately 60 team members working in four offices focused on Branch County. John remembers that all transactions were recorded by hand on ledger cards placed on a rolling cart that was wheeled into the vault each night for safekeeping. Kurt recalls his time as a teller date-stamping and initialing passbooks to track deposits and withdrawals for customers.

Over the decades, each held roles that forged their leadership styles – and their commitment to Southern. John's path led him to positions of increased responsibility within the Trust Department. Kurt was promoted to manage the Bank's commercial credit department. That's when the pair met and began forging a friendship.

Top left:
Miller and Castle receive a Legacy Award at the 2023 Coldwater Area Chamber of Commerce Awards Dinner

Top right:
Deb Larr, Nick Grabowski, and John Castle present a check to James and Kathy Olmstead, founders of Tommy's House

Bottom right:
Southern was granted a Rebate Award for the renovation of Southern Flats from the Coldwater DDA, pictured: Mackenzie Miller, MEDC Community Development Manager; Kurt Miller; John Castle; Michael Caywood, DDA Chairperson; and Audrey Tappenden, BCEGA Director

Their home lives ran parallel paths, too – each married, John to Helyn and Kurt to Lisa, each made their homes in Coldwater and each raised three children. They both dove into the lifeblood of their community, serving on civic boards, volunteering for nonprofits, supporting the schools and being present in a way that is the true hallmark of community banking.

After exploring individual career paths, John and Kurt felt themselves ready for a new set of challenges. Recognizing the cohesiveness of their partnership, the Board hired John and Kurt in 2002, appointing them to the leadership roles they would hold for the next twenty-two years.

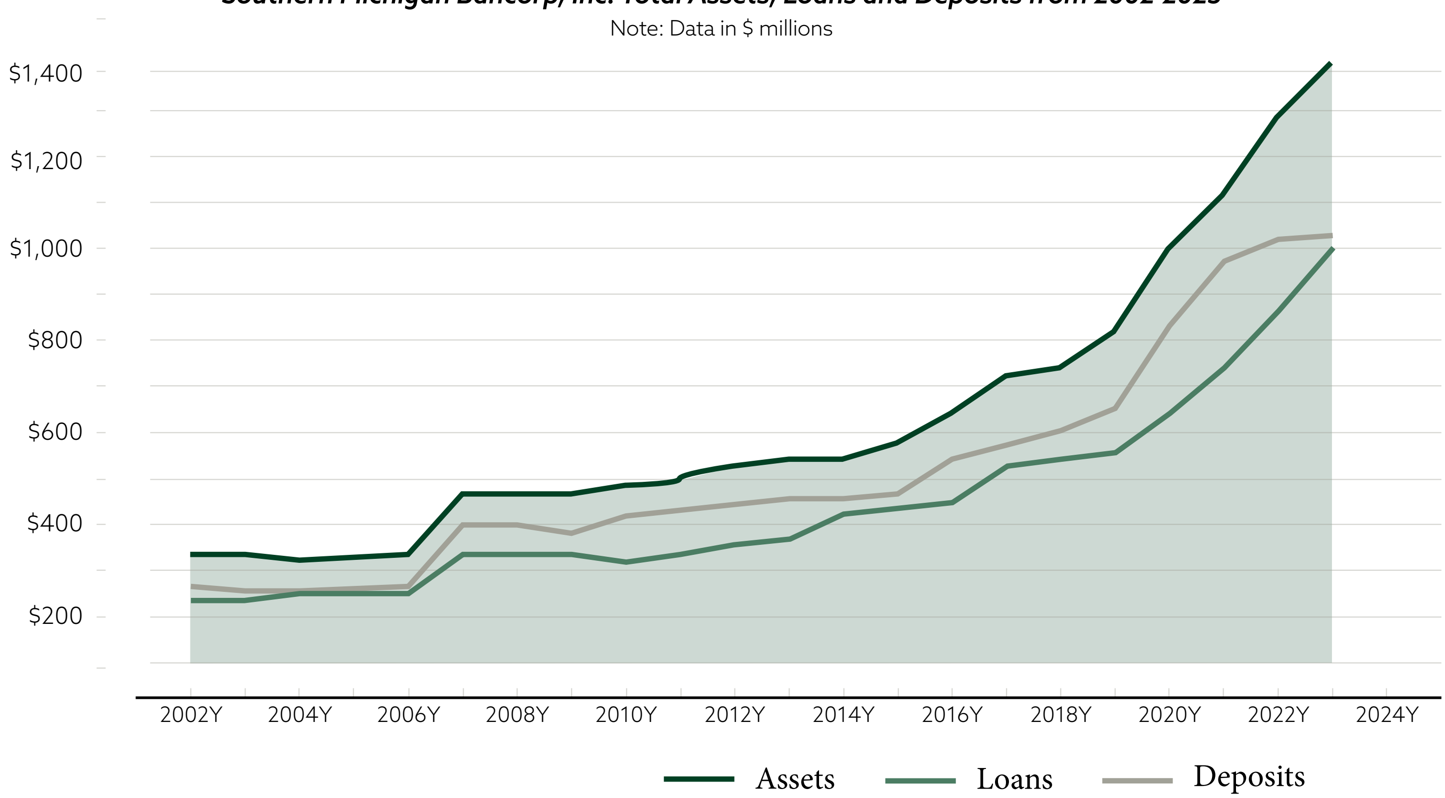
John and Kurt skillfully navigated Southern through a complicated merger, building a stronger financial institution after acquiring another community bank. They guided Southern ably through both the Great Recession in 2008 and the global pandemic in 2020, leading calmly through choppy and uncertain waters, ensuring stability and continuity for customers, employees and the communities we serve.

They focused on culture, working to instill a sense of pride in the Bank and in the community that translated into every interaction. John and Kurt felt fortunate to attract good people who were also great at banking, allowing Southern to build a strong and unified team that propelled organic growth and accelerated their momentum.

Their leadership ushered in an era of profitable growth. When John and Kurt took the helm in 2002, the Bank's balance sheet reported total assets of $318.2 million, total loans of $234.2 million and total deposits of $262.4 million. Southern finished 2023 with consolidated assets of $1.41 billion, total loans of $1.04 billion

Southern Michigan Bancorp, Inc. Total Assets, Loans and Deposits from 2002-2023

Note: Data in $ millions



and deposits totaling $1.16 billion – substantial growth that has benefited all of our stakeholders.

Under their joint leadership, Southern has flourished, growing into an organization with 18 offices across six counties powered by more than 250 team members serving customers with integrity and dedication. We annually support hundreds of nonprofits, municipalities, schools, community groups and service clubs with both financial contributions and volunteer hours.

After more than 150 years, Southern remains proudly headquartered in Coldwater and fiercely independent as a community bank.

On behalf of our Board, our wonderful team and incredible customers, I want to extend my deepest gratitude to both John and Kurt for a job extremely well done. Words are so important, but they cannot capture our full appreciation as Kurt and John retire on June 30, 2024 – 50 years to the day Kurt stepped into teller window #5 at our Union City branch – an immeasurable debt of gratitude goes with them.

All our best for a wonderful next chapter.

Sincerely,

Jamie Clark
Chairman of the Corporate Governance Committee,
on behalf of Southern Michigan Bancorp, Inc. Board of Directors

Top left:
Lisa Ridgeway, VP, Branch Manager; Deb Davis, VP, Commercial Loan Officer; John Castle; and Kurt Miller meet with Drew Schweitzer, President and CEO, and Tom Beuchler, Past President and CEO of Schweitzer, Inc.

Top right:
Mark O'Connell, Kellogg Community College Past President and Kurt Miller

Bottom right:
John Castle and Dave Phipps, Commercial Real Estate Developer

Financial Summary

For the Year	2023	2022
Net interest income	$39,980,000	$38,102,000
Provision for credit losses	950,000	275,000
Non-interest income	7,738,000	7,380,000
Non-interest expense	33,420,000	29,134,000
Net income	10,905,000	13,491,000

Per Share		
Basic earnings	$2.40	$2.98
Diluted earnings	2.40	2.97
Cash dividends declared	0.56	0.52

At Year End		
Assets	$1,414,795,000	$1,276,523,000
Gross loans	1,036,417,000	886,626,000
Allowance for credit losses	11,697,000	9,588,000
Deposits	1,157,971,000	1,091,051,000
Shareholders' equity	97,830,000	86,164,000

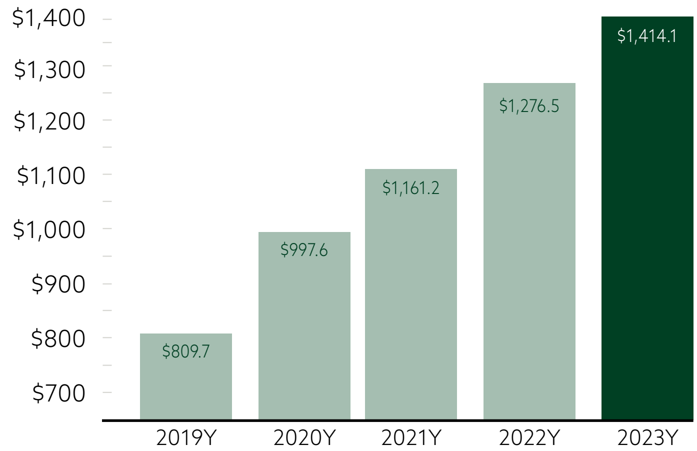
Ratios		
Return on average assets	0.80%	1.10%
Return on average equity	11.94%	15.68%
Total risk-based capital ratio	13.25%	13.25%
ACL as percentage of loans	1.13%	1.08%

Southern Michigan Bancorp, Inc. is a bank holding company. The Company's wholly-owned subsidiary, Southern Michigan Bank and Trust (SMBT) offers individuals, businesses, institutions and governmental agencies a full range of commercial banking services primarily in the southern Michigan communities in which they are located and in areas immediately surrounding these communities.

$1,414.1

Total Assets

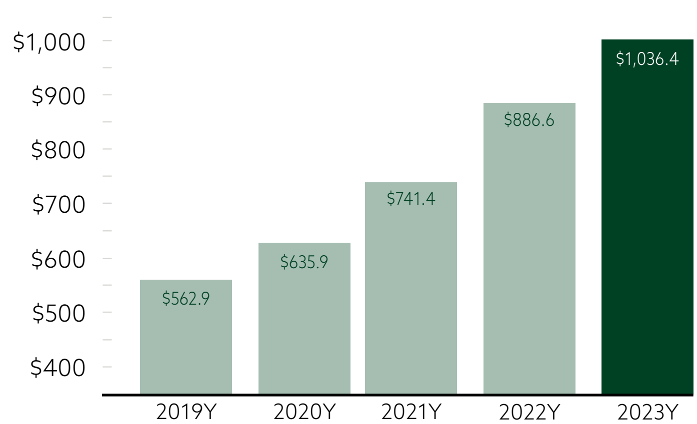
Note Data in $ millions



$1,036.4

Total Loans

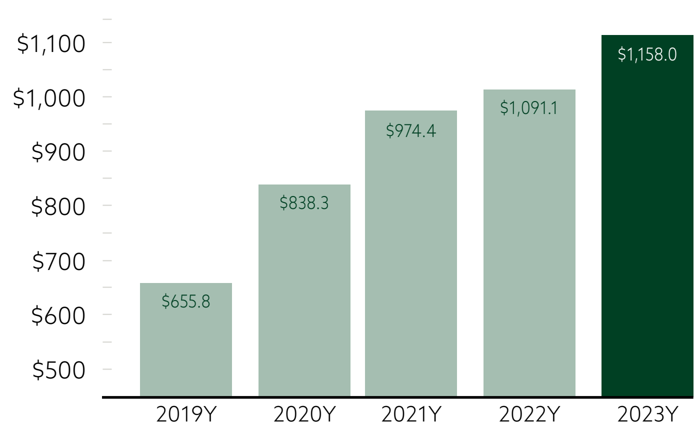
Note Data in $ millions



$1,158.0

Total Deposits

Note Data in $ millions



Executive Officers & Board of Directors

SMB & SMBT Executive Officers

John R. Waldron
President and CEO

Nicholas M. Grabowski
EVP, Chief Lending Officer

Eric M. Anglin
EVP, Chief Operating Officer,
Chief Strategy Officer

Aaron L. Lewis
EVP, Chief Credit Officer

Kevin A. Twardy
SVP, Chief Financial Officer

SMB & SMBT Board of Directors

Melissa J. Bauer
B&M Crop Consulting

John H. Castle
Chairman

Charles James Scott Clark
Clark Logic

Patrick H. Flannery
Hillsdale College

Stacey Hamlin
Jeffrey N. Hamlin DMD, PC

Travis L. Hampton
Value Max Products

Nolan E. (Rick) Hooker
Best American Car Washes

Brian P. McConnell
Burr Oak Tool, Inc.

Andrew R. Mercer
R.W. Mercer Co.

Kurt G. Miller
Vice Chairman

John R. Waldron
President and CEO

Directors Emeritus

Dean Calhoun

John S. Carton

H. Kenneth Cole

James T. Grohalski

Gregory J. Hull

Thomas E. Kolassa

Thomas D. Meyer

Coldwater Main Office

SMBT Officers

Commercial Loans

Douglas W. Kiessling
Regional VP,
Commercial Loan Manager

Tom Swoish
Regional VP,
Commercial Loan Manager

Sarah Headley
1st VP, Commercial Loan Officer

Gabriel Alvez
VP, Commercial Loan Officer

Deb Davis
VP, Commercial Loan Officer

Corey Donner
VP, Commercial Loan Officer

Rachel Doty
VP, Commercial Loan Officer

Adam Losinski
VP, Commercial Loan Officer

Greg Miller
VP, Commercial Loan Officer

Jim Sobeske
VP, Commercial Loan Officer

Samantha Gripman
VP, Credit Manager

JACKSON MARKET AREA
Bill Jors
SVP, Commercial Loan Officer

Mike Jors
VP, Commercial Loan Officer

Matthew Miller
VP, Commercial Loan Officer

David Kreger
VP, Commercial Loan Officer

PORTAGE TRADE CENTRE
Justin Horn
VP, Commercial Loan Officer

Retail Loans

Brandy Titus
1st VP, Head of Mortgage Sales

DeAnne Hawley
VP, Retail Loan Sales Manager

Connie Caudill
VP, Collections Manager

Stacey Donner
VP, Mortgage Loan Officer

Jodie Johnson
VP, Mortgage Loan Officer

Shari Kline
VP, Mortgage Loan Officer

Diane Krimmel
AVP, Consumer Loan Specialist

LeAndra Otis
AVP, Mortgage Loan Officer

Retail Loan Operations

Tina Mack
VP, Retail Loan Operations Manager

Phyllis Wingate
VP, Retail Lending Functions
and Systems

Retail

Derek Naylor
1st VP, Head of Retail,
Chief Deposit Officer

Retail Banking

Lori Neill
VP, Retail Banking Operations
Manager

BATTLE CREEK BRANCH
Lisa Ridgeway
VP, Branch Manager

CENTREVILLE BRANCH
Jenny Haydon
Branch Manager

COLDWATER MAIN & EAST CHICAGO BRANCHES
Felicia Landis
Branch Manager

CONSTANTINE BRANCH
Veronica Featherstone
Branch Manager

HILLSDALE BRANCH
Jennifer Crist
AVP, Branch Manager

JACKSON BRANCH
Sara Walz
Branch Manager

MARSHALL BRANCH
Kara Mead
VP, Commercial Loan Officer,
Branch Manager

MENDON BRANCH
Doreen Tobin
AVP, Branch Manager

PORTAGE BRANCH
Shannon Valdez
AVP, Branch Manager

STURGIS BRANCH
Scott Reed
AVP, Branch Manager

THREE RIVERS BRANCH
Kelsey McClish
Branch Manager

UNION CITY/TEKONSHA BRANCHES
Elizabeth DiDonato
Branch Manager

Treasury Management

Deanna Manville
AVP, Treasury Sales Officer

Melissa Easter
Treasury Sales Officer

Karen Fleisher
Treasury Sales Officer

Municipal Banking

Aimee Kornowicz
VP of Municipal Banking

Finance

Danice Chartrand
SVP, Accounting Director

Kim Hudelson
VP, Controller

Information Technology

Greg Sopcak
1st VP, Head of Information
Technology

Joseph Duke
VP, Information Technology

Cody Smoker
Systems Administrator

Marketing

Quinn White
VP, Head of Marketing

Operations

Angie Smith
1st VP, Head of Operations

Maggie Usher
VP, Treasury and eService
Operations Manager

Becky Omo
AVP, Deposit Operations Manager

Lani Smith
AVP, Operations Support Manager

Vikki Kline
Core System Administrator

Risk Management

Scott McQueen
1st VP, Risk Management Officer

Jennifer Pope
VP, Information Security Officer

Stacy Pelikan
Audit and Insurance Officer,
Bank Security Officer

Wealth Management

Matt Moses
SVP, Head of Wealth Management

Melissa Natzke-Barlow
VP, Senior Investment Officer

Sherrie Cochran
VP, Wealth Management Officer

Buzz Leach
VP, Wealth Management Officer

Shaun Fedder
VP, Wealth Management Officer

Shareholder Information

Annual Meeting

The annual meeting of shareholders for Southern Michigan Bancorp, Inc. will be held in-person on Thursday, May 9, 2024 at 4:00 p.m. local time, at the Dearth Community Center, located at 262 S. Sprague St., Coldwater, Michigan.

Market Information

Inquiries regarding stock certificate administration, address changes, transfers, and other related services should be directed to:

Equiniti Trust Company
Website: www.equiniti.com
Phone: (718) 921-8124
Toll Free: (800) 937-5449
Email: helpast@equiniti.com

Market Makers

D.A. Davidson & Co.
Dublin, Ohio
(800) 394-9230

For further information on Southern Michigan Bancorp, Inc. please see the 'Investor Relations' tab on our website: www.smb-t.com

Coldwater Main Office
Executive Board Room

SOUTHERN MICHIGAN
BANCORP, INC.

Forward-looking Statements

This Southern Michigan Bancorp, Inc. Annual Report contains forward-looking statements that are based on management's beliefs, assumptions, current expectations, estimates and projections about the financial services industry, the economy, and Southern Michigan Bancorp, Inc. Forward-looking statements are identifiable by words or phrases such as "anticipates," "believes," "expects," "forecasts," "intends," "is likely," "may," "plans," or "projects," and variations of such words and similar expressions. Management's determination of the provision and allowance for credit losses, the appropriate carrying value of intangible assets (including goodwill and mortgage servicing rights), deferred tax assets and other real estate owned, and the fair value of investment securities involves judgments that are inherently forward-looking. All statements with references to future time periods are forward-looking. All of the information concerning interest rate sensitivity is forward-looking. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions ("risk factors") that are difficult to predict with regard to timing, extent, likelihood and degree of occurrence. Therefore, actual results and outcomes may materially differ from what may be expressed or forecasted in such forward-looking statements.

Risk factors may emerge and could cause a difference between an ultimate actual outcome and a preceding forward-looking statement. Southern Michigan Bancorp, Inc. undertakes no obligation to update, clarify or revise forward-looking statements whether as a result of new information, future events, or otherwise.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion provides a review of the consolidated financial condition and results of operations of Southern Michigan Bancorp, Inc. (Southern) and its subsidiaries for the periods indicated. This discussion should be read in conjunction with the consolidated financial statements and related notes to the consolidated financial statements.

Overview

Southern is a Michigan corporation and registered financial holding company. Southern wholly owns Southern Michigan Bank & Trust (the Bank), Southern Michigan Bancorp Capital Trust I (a Delaware statutory trust), SMB Risk Management, Inc. (a Nevada captive insurance company), and 27 Marshall Street, LLC. The Bank wholly owns SMB Financial Services, Inc., a Michigan corporation.

Southern's business, primarily conducted through the Bank, is concentrated in a single industry segment – commercial banking. The Bank offers a variety of deposit, payment, credit, and other financial services to all types of customers. These services include time, savings, and demand deposits; safe deposit box services; and automated teller machine services. Loans, including both commercial and consumer, are extended primarily on a secured basis to corporations, partnerships, and individuals. Commercial lending covers such categories as business, industrial, agricultural, construction, inventory, and real estate. Consumer lending covers direct and indirect loans to purchasers of residential real property and consumer goods. Trust and investment services are offered, including investment management, trustee services, IRA rollovers and retirement plans, institutional and personal custody, estate settlement, wealth management, estate planning assistance, wealth transfer planning assistance, charitable gift planning assistance, and cash management custody. The Bank operates fifteen banking offices located in Battle Creek, Centreville, Coldwater, Constantine, Hillsdale, Jackson, Marshall, Mendon, Portage, Sturgis, Tekonsha, Three Rivers, and Union City, Michigan, and a loan production office in Jackson, Michigan.

At December 31, 2023, on a consolidated basis, Southern had assets of $1.41 billion, deposits of $1.16 billion, a loan portfolio of $1.04 billion, trust assets under management totaling $329.9 million, and shareholders' equity of $97.8 million.

Results of Operations

Southern's net income for 2023 was $10,905,000, compared to $13,491,000 in 2022, a decrease of $2,586,000, or 19.17%. Net interest income for 2023 was $39,980,000, compared to $38,102,000 in 2022, an increase of $1,878,000, or 4.93%. Provision for credit losses of $950,000 was expensed in 2023, up from $275,000 in 2022. Non-interest income increased 4.85%, or $358,000, to $7,738,000 in 2023. Non-interest expense increased 14.71%, or $4,286,000, to $33,420,000 in 2023. The following is a summary of percentage changes from the prior year for various financial statement elements:

	Percent Change from Prior Year 2023	2022		Percent Change from Prior Year 2023	2022
Net interest income	4.93%	14.36%	Total assets	10.83%	9.94%
Provision for credit losses	245.45%	-81.67%	Investment securities (1)	-6.65%	0.80%
Non-interest income	4.85%	-18.08%	Gross loans (2)	16.91%	19.40%
Non-interest expense	14.71%	9.08%	Allowance for credit losses	22.00%	2.88%
Federal income tax	-5.38%	9.27%	Deposits	6.13%	11.98%
Net income	-19.17%	14.75%	Shareholders' equity	13.54%	-11.85%

(1) Includes available-for-sale and held-to-maturity securities
(2) Includes loans held for sale

Results of operations can be measured by various ratio analyses. Two widely recognized performance indicators are return on average equity and return on average assets. Southern's return on average equity was 11.94% in 2023, 15.68% in 2022, and 12.32% in 2021. The return on average assets was 0.80% in 2023, 1.10% in 2022, and 1.06% in 2021.

Net Interest Income

Interest income is the total amount earned on funds invested in loans, investment securities, interest-bearing correspondent bank balances, and federal funds sold. Interest expense is the amount of interest paid on interest-bearing checking and savings accounts, time deposits, short-term advances, subordinated debentures, and other long-term borrowings. Net interest income, on a fully taxable equivalent (FTE) basis, is the difference between interest income and interest expense, adjusted for the tax benefit received on tax-exempt loans and investment securities. Net interest margin is calculated by dividing net interest income (FTE) by average interest earning assets. Net interest spread is the difference between the average yield on interest earning assets and the average cost of interest-bearing liabilities. Because non-interest bearing sources of funds also support earning assets, the net interest margin exceeds the net interest spread.

The presentation of net interest income on an FTE basis is not in accordance with Generally Accepted Accounting Principles (GAAP) but is customary in the banking industry. This non-GAAP measure ensures comparability of net interest income arising from both taxable and tax-exempt loans and investment securities. The adjustments to determine tax equivalent net interest income are itemized in Table 1 on the following page.

Net interest income is the most important source of Southern's earnings. Changes in Southern's net interest income are influenced by several factors, including changes in the level of interest earning assets, changes in the mix of interest earning assets and interest-bearing liabilities, the level and direction of market interest rates, and the steepness of the yield curve.

For 2023, Southern's net interest margin (FTE) was 3.16%, compared to 3.36% for 2022. Southern's interest rate spread was 2.66%, compared to 3.18% in 2022. The decrease in the interest spread was due to funding costs increasing more than the earning asset yields. The significant rise in market interest rates that has occurred over the past year resulted in disintermediation from lower interest rate non-maturity deposits to time deposits. Despite the lower interest spread, total net interest income (FTE) increased by $1,728,000 primarily due to the 16.91% growth in loan balances during the year.

For 2022, Southern's net interest margin (FTE) was 3.36%, compared to 3.27% for 2021. Southern's interest rate spread was 3.18%, compared to 3.14% in 2021. The increase in the interest spread was due to earning asset yields increasing more than funding costs as prime rate increased from 3.25% in January 2022 to end the year at 7.50%. Growth in loan balances also contributed to an increase in interest income of $7,076,000 or 18.9% on a tax equivalent adjusted basis. Despite the rising rate environment, the average yield on loans actually decreased slightly in 2022 (4.66%) as compared to 2021 (4.73%) due to a $3.2 million decrease in Paycheck Protection Program loan fees. Customer deposit pricing increased as well but lagged with the market resulting in total interest expense increase of $2,190,000 when comparing 2022 to 2021. The combined asset growth and rising interest rates resulted in a positive net effect to net interest income (FTE) of $4,886,000.

The following table presents a summary of net interest income (FTE) for 2023, 2022, and 2021.

Table 1: Average Balances and Tax Equivalent Interest Rates

(Dollars in Thousands)	2023 Average Balance	2023 Interest	2023 Yield/ Rate	2022 Average Balance	2022 Interest	2022 Yield/ Rate	2021 Average Balance	2021 Interest	2021 Yield/ Rate
ASSETS									
Interest earning assets:									
Loans(1)(2)(3)	$ 975,302	$ 54,911	5.63%	$ 785,344	$ 36,609	4.66%	$ 690,064	$ 32,613	4.73%
Taxable investment securities(4)	179,548	6,291	3.50	205,025	4,948	2.41	185,135	3,330	1.80
Tax-exempt investment securities(1)	59,759	1,380	2.31	65,201	1,714	2.63	60,585	1,353	2.23
Federal funds sold and other(5)	61,838	3,125	5.05	92,322	1,249	1.35	93,927	148	0.16
Total interest earning assets	1,276,447	65,707	5.15	1,147,892	44,520	3.88	1,029,711	37,444	3.64
Non-interest earning assets:									
Cash and due from banks	17,962			18,634			17,737		
Other assets(6)	80,289			65,315			67,542		
Less allowance for credit losses	(11,232)			(9,318)			(8,190)		
Total assets	$ 1,363,466			$ 1,222,523			$ 1,106,800		
LIABILITIES AND SHAREHOLDERS' EQUITY									
Interest-bearing liabilities:									
Demand deposits	$ 541,653	$ 11,358	2.10%	$ 545,052	$ 2,861	0.52%	$ 464,486	$ 1,159	0.25%
Savings deposits	108,487	130	0.12	119,004	46	0.04	105,369	38	0.04
Time deposits	253,040	9,105	3.60	115,136	1,211	1.05	113,803	1,070	0.94
Securities sold under agreements to repurchase and overnight borrowings	4,325	36	0.83	11,465	27	0.24	15,526	29	0.19
Other borrowings	75,124	3,145	4.19	15,321	336	2.19	22,064	438	1.99
Subordinated debentures	34,616	1,603	4.63	34,547	1,437	4.16	26,070	994	3.81
Total interest-bearing liabilities(7)	1,017,245	25,377	2.49	840,525	5,918	0.70	747,318	3,728	0.50
Non-interest bearing liabilities:									
Demand deposits	241,681			283,996			252,576		
Other	13,225			11,978			11,468		
Shareholders' equity	91,315			86,024			95,438		
Total liabilities and shareholders' equity	$ 1,363,466			$ 1,222,523			$ 1,106,800		
Net interest income		$ 40,330			$ 38,602			$ 33,716	
Interest rate spread			2.66%			3.18%			3.14%
Net margin on interest earning assets			3.16%			3.36%			3.27%

(1) Includes tax equivalent adjustment of interest (assuming a 21% tax rate) for securities and loans of $115,000 and $24,000, respectively, for 2023; $360,000 and $26,000, respectively, for 2022; and $284,000 and $20,000, respectively, for 2021.
(2) Average balance includes average non-accrual loan balances of $970,000 in 2023, $1,213,000 in 2022, and $1,909,000 in 2021.
(3) Interest income includes loan fees of $1,169,000 in 2023, $1,389,000 in 2022, and $4,495,000 in 2021.
(4) Average balance includes average unrealized gain/(loss) of ($18,753,000) in 2023, ($15,112,000) in 2022, and $2,869,000 in 2021.
(5) Includes average federal reserve deposit account balances of $57,955,000 in 2023, $88,939,000 in 2022, and $63,198,000 in 2021.
(6) Includes $13,588,000 in 2023, $13,624,000 in 2022, and $13,660,000 in 2021 relating to goodwill and other intangible assets.
(7) Interest expense on deferred compensation balances totaling $211,000, $114,000, and $93,000 for 2023, 2022, and 2021, respectively, is excluded from interest expense.

The next table sets forth, for the periods indicated, a summary of changes in interest income and interest expense. The changes are based upon a tax equivalent basis resulting from changes in volume and changes in rates:

- Volume Variance – change in volume multiplied by the previous year's rate.
- Rate Variance – change in rate multiplied by the previous year's volume.
- Rate/Volume Variance – change in volume multiplied by the change in rate. This variance was allocated to volume variance and rate variance in proportion to the relationship of the absolute dollar amount of the change in each.

Table 2: Changes in Tax Equivalent Net Interest Income

(Dollars in Thousands)	2023 Compared to 2022 Increase (Decrease) Due To:			2022 Compared to 2021 Increase (Decrease) Due To:		
Interest income on:	**Rate**	**Volume**	**Combined**	**Rate**	**Volume**	**Combined**
Loans	$ 8,457	$ 9,845	$ 18,302	$ (451)	$ 4,447	$ 3,996
Taxable investment securities	2,018	(675)	1,343	1,231	387	1,618
Tax-exempt investment securities	(198)	(136)	(334)	252	109	361
Federal funds sold and other	2,410	(534)	1,876	1,104	(3)	1,101
Total interest earning assets	$ 12,687	$ 8,500	$ 21,187	$ 2,136	$ 4,940	$ 7,076
Interest expense on:						
Demand deposits	$ 8,515	$ (18)	$ 8,497	$ 1,471	$ 231	$ 1,702
Savings deposits	88	(4)	84	3	5	8
Time deposits	5,281	2,613	7,894	128	13	141
Securities sold under agreements to repurchase and overnight borrowings	34	(25)	9	7	(9)	(2)
Other borrowings	531	2,278	2,809	42	(144)	(102)
Subordinated debentures	163	3	166	1,520	(1,077)	443
Total interest-bearing liabilities	$ 14,612	$ 4,847	$ 19,459	$ 3,171	$ (981)	$ 2,190
Net interest income	$ (1,925)	$ 3,653	$ 1,728	$ (1,035)	$ 5,921	$ 4,886

Provision for Credit Losses

The provision for credit losses is based on an analysis of the required additions to the allowance for credit losses. The provision is charged to income to bring the allowance for credit losses to a level believed adequate by management to absorb expected credit losses. Some factors considered by management in determining the level at which the allowance is maintained include the following: specific credit reviews; historical loan loss experiences; current economic conditions and trends; results of examinations by regulatory agencies; and the volume, growth, and composition of the loan portfolio. The provision is adjusted quarterly to reflect changes in the factors above, as well as actual charge-off experience and any known losses. For further information, see "Allowance for Credit Losses."

The provision for credit losses was $950,000 in 2023, compared to $275,000 in 2022, and $1,500,000 in 2021. The provision recorded in 2023 was higher than in 2022 due to loan growth, partially offset by an improvement in the economic forecast. Southern adopted ASU 2016-13 as of January 1, 2023. The prior year amounts presented were calculated under the prior accounting method. The provision taken in 2022 was lower, as the qualitative increase made for COVID-19 related economic uncertainty was adjusted down to reflect the current portfolio strength. The provision taken in 2021 was related to loan growth.

Net loan charge-offs totaled $15,000 in 2023, compared to $7,000 in 2022 and net recoveries of $31,000 in 2021.

Non-Interest Income

Total non-interest income increased $358,000, or 4.9%, when comparing 2023 to 2022. The increase is attributed to increases in trust fees, earnings on life insurance assets, and service charges on deposit accounts. Trust fees increased $155,000, or 6.8%, due to higher trust assets under management. Earnings on life insurance assets increased $145,000, or 30.7%, due to additional policy purchases in 2023. Service charges on deposit accounts increased $154,000, or 10.2%. The increases offset a decline in loan sale gains of $301,000, or 49.7%.

Total non-interest income decreased $1,629,000, or 18.1%, when comparing 2022 to 2021. The decrease is a result of increased mortgage rates which reduced the number of mortgage loans sold to the secondary market. Loan sale gains decreased $1,687,000, or 73.6%, in 2022 as compared to 2021. Life insurance policies paying out death benefits in excess of recorded cash values increased income by $516,000. Service charges on deposit accounts increased $230,000, or 17.9%.

Total non-interest income increased $631,000, or 7.5%, when comparing 2021 to 2020. The increase is primarily attributed to a $312,000, or 81.5%, increase in earnings on life insurance assets from additional policy purchases in 2021, as well as death benefits received in excess of recorded cash values totaling $231,000. ATM and debit card fee income increased $280,000, or 18.2%; trust fees increased $219,000, or 10.7%. The increases offset modest declines in service charges on deposit accounts of $87,000, or 6.3%, and gains on loans sold to the secondary market of $96,000, or 4.0%.

To reduce the risk associated with changing interest rates, Southern regularly sells fixed-rate real estate mortgage loans to the secondary market. Southern recognizes a gain at the time of the sale to the extent proceeds exceed the basis of the loan, excluding any value assigned to capitalized servicing rights. Southern originated real estate mortgage loans for sale in the secondary market of $9,227,000 in 2023, compared to $14,405,000 in 2022 and $51,055,000 in 2021. Net gains on loan sales decreased $301,000 when comparing 2023 to 2022 and decreased $1,687,000 when comparing 2022 to 2021.

Service charges on deposit accounts increased $154,000, or 10.2%, in 2023 and $230,000, or 17.9%, in 2022 as the impact of the COVID-19 pandemic subsided.

There were no securities gains or losses recognized in 2023. Security losses of $666,000 were recorded in 2022 as Southern sold $19.8 million of securities to provide liquidity for loan growth and improve future earnings. Securities gains of $5,000 were booked in 2021 due to an investment being called which resulted in the modest gain.

Non-Interest Expense

Non-interest expense increased $4,286,000, or 14.7%, when comparing 2023 to 2022. Salary and employee benefit costs increased $2,452,000, or 13.5%. Full-time equivalent employees grew across departments to support growth, as well as from expansion into the Sturgis and Jackson markets. Occupancy and equipment expenses increased $293,000, or 9.9%, primarily due to expansion into the Sturgis and Jackson markets. Software maintenance increased $336,000, or 17.6%, as a result of growth and new product offerings. Professional and outside services increased $501,000, or 28.8%, due to various non-recurring items. FDIC insurance expense increased $407,000, or 120.1%, due to growth and an increase in the initial base deposit insurance assessment rate by two basis points beginning in the first quarterly assessment period of 2023.

Non-interest expense increased $2,426,000, or 9.1%, when comparing 2022 to 2021. Salary and employee benefit costs increased $1,642,000, or 10.0%. Full-time equivalent employees grew across departments to support growth and market expansion into the Sturgis and Jackson markets. Occupancy and equipment expenses increased $110,000, or 7.0%, with the opening of the Sturgis office and movement into the Jackson market. Software maintenance increased $234,000, or

14.0%, also as a result of growth and new product offerings. In 2022, advertising and marketing costs increased to more normalized levels after decreasing in 2021 and 2020 due to COVID.

Non-interest expense increased $3,042,000, or 12.9%, when comparing 2021 to 2020. Salary and employee benefit costs increased $1,912,000, or 13.1%, in 2021. Salaries increased as the volume of full-time equivalent employees grew across departments to ensure staffing levels were in place to support growth. In addition, health insurance costs increased 28.1%. Additional expense increases included professional and outside services ($282,000), advertising and marketing ($179,000), FDIC deposit assessments ($133,000), software maintenance ($125,000), ATM expenses ($92,000), and occupancy ($46,000). Telecommunication expense decreased $95,000, or 21.1%.

Income Taxes

Income tax provision was $2,443,000 in 2023, $2,582,000 in 2022, and $2,363,000 in 2021. Tax-exempt income continues to have an impact on Southern's income tax provision. The increase in the effective tax rate in 2023 was primarily attributed to a higher TEFRA disallowance on non-taxable municipal securities due to higher interest expense, as compared to 2022 and 2021. This resulted in tax-exempt securities providing a tax benefit of only $110,000 in 2023 as compared to $302,000 in 2022, and $234,000 in 2021. Furthermore, tax-exempt income from the captive insurance company provided a tax benefit of only $109,000 in 2023, compared to $166,000 in 2022, and $174,000 in 2021. Finally, tax-exempt income from life insurance assets provided a tax benefit of only $130,000 in 2023, compared to $256,000 in 2022, and $146,000 in 2021. Additional income tax information is reported in Note K of the consolidated financial statements.

Financial Condition

Total assets were $1,414,795,000 as of December 31, 2023, an increase of $138,272,000, or 10.8%, compared to December 31, 2022. Gross loans increased $149,960,000, or 16.9%, in 2023 with the growth occurring primarily in commercial loans. The securities portfolio decreased $16,475,000, or 6.6%, in 2023. Deposit balances increased $66,920,000, or 6.1%, during 2023. The deposit growth occurred from time deposits which increased $152,335,000, or 93.2%, partially offset by a decrease in non-maturity deposits. Other borrowings increased $66,900,000 in 2023 to support asset growth.

Cash and Cash Equivalents

Cash and cash equivalents at December 31, 2023, decreased $5,635,000, or 7.3%, compared to balances at December 31, 2022. This decrease was attributable to loan growth outpacing deposit growth and securities maturities and paydowns.

Federal Funds Sold

Federal funds sold totaled $1,468,000 at December 31, 2023, compared to $253,000 at December 31, 2022. The Bank sells excess overnight funds to its primary correspondent in lieu of maintaining the balances in interest-bearing deposit accounts when there is a higher interest rate being paid by correspondents. Southern continues to hold excess funds in interest-bearing deposit accounts due to the rate being paid.

Investment Securities

Securities are classified as available-for-sale or held-to-maturity based upon management's intent. In 2023, the available-for-sale portfolio decreased $8,414,000, or 4.7%, primarily attributable to improvement in unrealized losses and maturities and paydowns of mortgage-collateralized and asset-backed securities. The held-to-maturity portfolio decreased $8,061,000 as a result of maturities.

In 2022, management made a strategic decision to move $66.4 million of the available-for-sale portfolio to the held-to-maturity portfolio. The unrealized loss on these securities, amounting to $7,761,000 at time of transfer, is being accreted over the remaining lives of the individual securities. The majority of securities transferred represent local municipals that Southern has no intent to sell prior to maturity. This transfer, along with the unrealized loss in fair value occurring throughout 2022 as a result of rising interest rates, resulted in the available-for-sale securities portfolio decreasing $67.7 million, or 27.5%, from December 31, 2021, to December 31, 2022. The available-for-sale securities portfolio had an unrealized loss of $14,589,000 at December 31, 2023, and an unrealized loss of $20,656,000 at December 31, 2022. At December 31, 2023, Southern had no investment in securities of issuers outside of the United States.

Loans

Substantially all loans are granted to customers located in Southern's service area, which is primarily southwest Michigan. Gross loans increased $149,960,000, or 16.9%, in 2023. Gross loans increased $144,0728,000, or 19.4%, in 2022.

Loan commitments, consisting of unused credit card and home equity lines, available amounts on revolving lines of credit, and other approved loans that have not been funded, were $194,492,000 and $261,303,000 at December 31, 2023, and 2022, respectively. The 2023 commitments consist of $58,571,000 in fixed-rate commitments and $135,921,000 in variable rate commitments.

Nonperforming Assets

Nonperforming assets include non-accrual loans, accruing loans past due 90 days or more, and other real estate owned, which includes real estate acquired through foreclosures and deeds in lieu of foreclosure.

A loan generally is classified as non-accrual when full collectability of principal or interest is doubtful, or a loan becomes 90 days past due as to principal or interest, unless management determines that the estimated net realizable value of the collateral is sufficient to cover the principal balance and accrued interest. When interest accruals are discontinued, unpaid interest is reversed. Nonperforming loans are returned to performing status when the loan is brought current and has performed in accordance with contract terms for a period of time.

In the course of working with borrowers, Southern may choose to restructure the contractual terms of certain loans. In certain circumstances, Southern attempts to work out an alternative payment schedule with the borrower in order to optimize collectability of the loan. Terms may be modified to fit the ability of the borrower to repay in line with their current financial status; the restructuring of the loan may include the transfer of assets from the borrower to satisfy the debt, a modification of loan terms, or a combination of the two.

The following table sets forth the aggregate amount of nonperforming assets in each of the following categories:

	December 31, 2023	December 31, 2022	December 31, 2021
	(Dollars in thousands)		
Non-accrual loans:			
Commercial, commercial real estate, and agriculture	$ 833	$ 961	$ 1,079
Real estate mortgage	56	82	244
Consumer	-	-	-
	889	1,043	1,323
Loans contractually past due 90 days or more and still on accrual:			
Commercial, commercial real estate, and agriculture	-	-	-
Real estate mortgage	-	-	-
Consumer	-	-	-
	-	-	-
Accruing loans modified under troubled debt restructurings:			
Commercial, commercial real estate, and agriculture	-	86	131
Real estate mortgage	-	-	67
Consumer	-	-	-
	-	86	198
Total nonperforming loans	889	1,129	1,521
Other real estate owned	-	-	-
Total nonperforming assets	$ 889	$ 1,129	$ 1,521
Nonperforming loans to year-end loans	0.08%	0.13%	0.21%
Nonperforming assets to total assets	0.06%	0.09%	0.13%

The balance of non-accrual restructured loans, which is included in non-accrual loans, was $0 at December 31, 2023, and December 31, 2022.

Nonperforming loans are subject to continuous monitoring by management and estimated losses are specifically allocated in the allowance for credit losses, where appropriate. Nonperforming loans decreased from December 31, 2022, to December 31, 2023.

Southern held no other real estate owned assets at December 31, 2023 or December 31, 2022. During 2023, $17,000 of loans were transferred to other real estate owned and subsequently sold. In 2022, no loans were transferred to other real estate owned.

In management's evaluation of the loan portfolio risks, any significant future increases in nonperforming loans are dependent largely on the economic environment. In a deteriorating or uncertain economy, management applies assumptions that are more conservative when assessing the future prospects of borrowers and when estimating collateral values. This may result in a higher number of loans being classified as nonperforming.

Allowance for Credit Losses

On January 1, 2023, Southern adopted ASU 2016-13 *Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments* (ASC 326), as amended, which replaces the incurred loss methodology with an expected loss methodology commonly referred to as the current expected credit loss (CECL) methodology. The measurement of expected credit losses under the CECL methodology is applicable to financial assets measured at amortized cost, including loan receivables and held-to-maturity debt securities. It also applies to off-balance sheet credit exposures.

Southern adopted ASC 326 using the modified retrospective method for all financial assets measured at amortized cost, and off-balance-sheet credit exposures. Results for reporting periods beginning after January 1, 2023, are presented under ASC

326 while prior period amounts continue to be reported in accordance with previously applicable GAAP. The adoption of ASC 326 resulted in Southern recording an increase of $1,100,000 to the allowance for credit losses and the establishment of a $500,000 reserve for unfunded commitments. A one-time, cumulative effect adjustment to capital for these amounts, net of tax, of $1,264,000 was recognized as of January 1, 2023.

The allowance for credit losses was $11,697,000, or 1.13%, of total loans at December 31, 2023, as compared to $9,588,000, or 1.08%, of total loans at December 31, 2022.

Deposits

Deposits have traditionally represented Southern's principal funding source. Total deposits increased 6.1%, or $66,920,000, in 2023 compared to 2022, and increased 12.0%, or $116,699,000, in 2022 compared to 2021. The majority of deposits are derived from core client sources, relating to long-term relationships with local individuals, businesses, and public clients. Brokered deposits totaled $76,534,000 at December 31, 2023, and $19,483,000 at December 31, 2022. Attracting and keeping traditional deposit relationships will continue to be a focus of Southern.

Other Borrowings

As another funding source, Southern obtains advances from the Federal Home Loan Bank (FHLB). The advances are secured by a blanket collateral agreement with the FHLB, giving them an unperfected security interest in select 1-4 family mortgage and commercial real estate loans. FHLB advances are used as an alternative funding source to paying a premium for long-term deposits. At December 31, 2023, Southern had $47,900,000 in FHLB advances with interest rates between 1.96% and 4.75%, and a weighted average rate of 3.70%.

At December 31, 2023, Southern had $59,000,000 in borrowings outstanding under the Federal Reserve's Bank Term Funding Program with a weighted average borrowing rate of 4.73% with scheduled principal reductions in 2024. See Note H to the consolidated financial statements for more information on other borrowings.

Subordinated Debentures

On April 16, 2021, Southern completed a private placement of $30 million in aggregate principal amount of 3.75% Fixed-to-Floating Rate Subordinated Notes due April 16, 2031 (the "Notes"). The Notes initially bear interest at a fixed rate of 3.75% through April 16, 2026, after which time, until maturity, the interest rate will reset quarterly to an annual floating rate equal to the then-current 3-month SOFR, plus 302 basis points. The Notes are redeemable by Southern at its option, in whole or in part, on or after April 16, 2026. The Notes are not subject to redemption at the option of the holders.

In March 2004, Southern Michigan Bancorp Capital Trust I, a trust formed by Southern, closed a pooled private offering of 5,000 trust preferred securities with a liquidation amount of $1,000 per security. Southern issued $5,155,000 of subordinated debentures to the trust in exchange for ownership of all common securities of the trust and the proceeds of the preferred securities sold by the trust. Southern is not considered the primary beneficiary of this trust, therefore the trust is not consolidated in Southern's financial statements. Rather, the subordinated debentures are shown as a liability. Southern may redeem the subordinated debentures, subject to the receipt by Southern of the proper approval of the Federal Reserve, if such approval is required under applicable capital guidelines or policies of the Federal Reserve. The subordinated debentures may be redeemed on January 7, April 7, July 7, and October 7 of each year and may occur either in whole or in integrals of $1,000 at 100% of the principal amount, plus accrued and unpaid interest. The subordinated debentures mature on April 6, 2034. The subordinated debentures are also redeemable in whole, but not in part, from time to time upon the occurrence of specific events defined within the trust indenture. Southern has the option to defer interest payments on the subordinated debentures from time to time for a period, not to exceed 20 consecutive quarterly periods. Southern's investment in the common stock of the trust is $155,000 and is included in other assets.

The $5,000,000 in trust preferred securities is included in Tier I capital (with certain limitations applicable) under current regulatory guidelines and interpretations. The trust preferred securities and subordinated debentures have a variable rate of interest equal to the three-month CME Term SOFR plus a spread adjustment of 0.26161% and a margin adjustment of 2.75%, as defined. The aggregate borrowing rate on December 31, 2023, was 8.41%.

Capital Resources

Southern obtains funds for operating expenses and dividends to shareholders through dividends from the Bank. In general, the Bank pays only those amounts required to meet the liquidity requirements of Southern, while maintaining appropriate capital levels at the Bank. Capital is maintained at the Bank to support its current operations and projected future growth. See additional discussion under the section titled “Liquidity”.

Shareholders’ equity increased $11,666,000, or 13.5%, from December 31, 2022, to December 31, 2023, and decreased $11,585,000, or 11.9%, from December 31, 2021, to December 31, 2022. The increase in 2023 was primarily attributable to net income in excess of dividends declared in 2023 and an improvement in the accumulated other comprehensive loss of $5,467,000 related to the investment securities portfolio. During 2022, the decrease in the fair market value of available-for-sale securities, net of tax in 2022, was partially offset by an $11.1 million increase in retained earnings resulting from net income in excess of dividends.

The Federal Reserve Board uses capital adequacy guidelines in its examination and regulation of bank holding companies. If capital falls below minimum guidelines, a bank holding company may, among other items, be denied approval to acquire or establish additional banks or non-bank businesses.

The FDIC Improvement Act of 1991 established a system of prompt corrective actions to resolve the problems of undercapitalized banks. Under this system, federal banking regulators have established five capital categories in which all institutions are placed: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. The FDIC has also specified by regulation the relevant capital levels for each of the categories.

The FDIC is required to take specified mandatory supervisory actions and is authorized to take other discretionary actions with respect to banks in the three undercapitalized categories. The severity of the action depends upon the capital category in which a bank is placed. Subject to a narrow exception, the FDIC must generally appoint a receiver or conservator for a bank that is critically undercapitalized. A bank in any of the under-capitalized categories is required to submit an acceptable capital restoration plan to its appropriate federal banking agency. An undercapitalized bank is also generally prohibited from paying any dividends, increasing its average total assets, making acquisitions, establishing any branches, or engaging in any new line of business, except under an accepted capital restoration plan or with FDIC approval.

Failure to meet capital guidelines could subject a bank to a variety of enforcement remedies, including issuance of a capital directive, the termination of deposit insurance by the FDIC, a prohibition on accepting brokered deposits, and other restrictions on its business. In addition, such a bank would generally not receive regulatory approval of any application that requires the consideration of capital adequacy, such as a branch or merger application, unless the bank could demonstrate a reasonable plan to meet the capital requirement within a reasonable time period.

With the implementation of BASEL III in 2015, regulatory agencies granted banks a one-time election to determine whether the capital component created by the net unrealized gain or loss on available-for-sale securities is included in Tier 1 capital. Southern elected not to include the net unrealized gain or loss on available-for-sale investments in Tier 1 capital. Therefore, the net unrealized gain or loss is not included in the capital ratios listed in Note U to the consolidated financial statements.

As of December 31, 2023, the capital ratios of the Bank exceeded the minimum thresholds to be categorized as “well-capitalized” under applicable regulations. Note U of the consolidated financial statements provides additional information regarding capital ratios.

Liquidity

Liquidity management involves the ability to meet the cash flow requirements of customers who may be either depositors wanting to withdraw funds or borrowers needing assurance that sufficient funds will be available to meet their credit needs. Southern maintains certain levels of liquid assets (the most liquid of which are cash and cash equivalents, federal funds sold, and investment securities) in order to meet these demands. Cash and equivalents, maturing loans, and investment securities are the principal sources of asset liquidity. Liquidity is monitored and closely managed by the Asset/Liability Committee (ALCO), whose members are comprised of senior management.

Southern maintains correspondent accounts with regional and national banks for various purposes. Historically, cash sufficient to meet the operating needs of the Bank's branches is maintained at its lowest practical level.

From time to time, Southern is a participant in the federal funds market. Federal funds are generally borrowed or sold for one-day periods. The average balance of federal funds sold was $265,000 in 2023 and $255,000 in 2022. During 2023 and 2022, Southern averaged $57,955,000 and $87,300,000, respectively, on deposit at the Federal Reserve.

In the past, Southern has used overnight federal funds lines of credit with correspondent banks as a short-term source of liquidity. As of December 31, 2023, Southern had $113 million in line-of-credit availability with four correspondent banks, including $83 million in overnight federal funds lines, $20 million in a line of credit with the Federal Home Bank, and $10 million in a line of credit at the holding company from United Bankers Bank. Southern also has the ability to borrow $130 million from the Federal Home Loan Bank based on collateral pledged.

Southern's principal source of funds to pay cash dividends comes from dividends paid by the Bank from its earnings. Dividend amounts are restricted under current banking laws and regulations. Capital guidelines adopted by federal and state regulatory agencies, as well as restrictions imposed by law, limit the amount of cash dividends the Bank can pay to Southern. At December 31, 2023, using the most restrictive of these conditions, the aggregate cash dividends the Bank could pay Southern without prior regulatory approval was $27.0 million.

Impact of Inflation and Changing Prices

The majority of assets and liabilities of a financial institution are monetary in nature and differ greatly from most commercial and industrial companies that have significant investments in fixed assets or inventories. However, inflation does have an important impact on the growth of total assets in the banking industry and the resulting need to increase equity capital at higher-than-normal rates in order to maintain an appropriate equity-to-assets ratio. Other expenses are also significantly affected by inflation, tending to rise during periods of general inflation.

Commitments and Off-Balance Sheet Risk

Southern maintains off-balance sheet financial instruments in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, letters of credit, and standby letters of credit. Loan commitments to extend credit are agreements to lend to customers at any time, as the customers' needs vary, as long as there is no violation of any condition established in the contract. Letters of credit are used to facilitate customers' trade transactions. Under standby letters of credit agreements, Southern agrees to honor certain commitments in the event that its customers are unable to do so. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Because many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. At December 31, 2023, Southern had loan commitments of $194,492,000; $7,933,000 in standby letters of credit; and no commitments under commercial letters of credit outstanding.

These arrangements have credit risk similar to that involved in extending loans to customers and are subject to Southern's normal credit policies. Collateral generally consists of receivables, inventory, and equipment and is obtained based on management's credit assessment of the customer. These financial instruments are recorded when they are funded.

Interest Rate Sensitivity

Net interest income is the largest component of Southern's earnings. Net interest income is the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities. Management of interest rate sensitivity seeks to avoid fluctuating net interest margins and enhance consistent growth of net interest income through periods of changing interest rates.

Interest rate risk arises when the maturity or repricing characteristics of assets differ significantly from the maturity or repricing characteristics of liabilities. Accepting this risk can be an important source of profitability and shareholder value. However, excessive levels of interest rate risk could pose a significant threat to Southern's earnings and capital base. Accordingly, effective risk management that maintains interest rate risk at prudent levels is essential to Southern's safety and soundness.

A number of tools are used to monitor and manage interest rate risk, including income simulation and market value of equity analyses. The income simulation model is used to estimate the effect that specific interest rate changes would have on net interest income. The changes include ramped and shocked increases and decreases of 1%, 2%, 3%, and 4% to interest rates on both a static and dynamic balance sheet over 12- and 24-month timeframes. Assumptions in the simulation are based on management's estimates and are inherently uncertain. As a result, the models cannot precisely predict the impact of higher or lower interest rates on net interest income.

The simulation's effect on net interest income is shown in the table below:

Ramp Change/ Dynamic	12 Month % Change	24 Month % Change	Ramp Change/ Static	12 Month % Change	24 Month % Change
+400	-0.27%	-0.73%	+400	0.15%	0.45%
+300	-0.13%	-0.43%	+300	0.17%	0.45%
+200	-0.04%	-0.21%	+200	0.17%	0.38%
+100	0.00%	-0.05%	+100	0.10%	0.24%
-100	-0.06%	-0.09%	-100	-0.16%	-0.39%
-200	-0.38%	-0.58%	-200	-0.58%	-1.20%
-300	-1.17%	-1.56%	-300	-1.49%	-2.51%
-400	-1.78%	-2.36%	-400	-2.17%	-3.59%

Shock Change/ Dynamic	12 Month % Change	24 Month % Change	Shock Change/ Static	12 Month % Change	24 Month % Change
+400	-0.87%	-2.27%	+400	0.24%	-0.78%
+300	-0.54%	-1.55%	+300	0.30%	-0.43%
+200	-0.26%	-0.92%	+200	0.31%	-0.18%
+100	-0.03%	-0.36%	+100	0.26%	0.02%
-100	-0.23%	0.10%	-100	-0.53%	-0.29%
-200	-1.08%	-0.39%	-200	-1.69%	-1.22%
-300	-2.60%	-1.58%	-300	-3.55%	-2.89%
-400	-4.10%	-2.81%	-400	-5.40%	-4.59%

The market value of equity analysis estimates the change in the market value of equity using interest rate change scenarios from +4% to -4% in 1% increments. The following table illustrates the percent change in equity based on changes in market interest rates:

	Change in market value of equity
4% increase in market rates	3.68%
3% increase in market rates	2.84%
2% increase in market rates	1.87%
1% increase in market rates	1.09%
No change	0.00%
1% decrease in market rates	-1.74%
2% decrease in market rates	-4.35%
3% decrease in market rates	-8.30%
4% decrease in market rates	-17.21%

Management continues to monitor the ratios and report the results to the Board of Directors on a quarterly basis.

Critical Accounting Policies

The discussion and analysis of the financial condition and results of operations are based upon Southern's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires Southern to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and potentially could result in materially different results under different assumptions and conditions. A summary of significant accounting policies of Southern are detailed in Note A to the consolidated financial statements.

Allowance for Credit Losses

The allowance for credit losses on loans and leases ("ACL") replaces the allowance for loan and lease losses as a credit accounting estimate, as of January 1, 2023, with the adoption of ASU 2016–13, *Financial Instruments–Credit Losses: Measurement of Credit Losses on Financial Instruments* (ASC 326). The ACL represents management's best estimate of current expected credit losses over the life of the portfolio of loans and leases. Estimating credit losses requires judgment in determining loan-specific attributes impacting the borrower's ability to repay contractual obligations. Other factors such as economic forecasts used to determine a reasonable and supportable forecast, prepayment assumptions, the value of underlying collateral, and changes in size composition and risks within the portfolio are also considered. The ACL is assessed quarterly and adjustments are recorded in the provision for credit losses. The allowance is estimated based on loan level characteristics using historical loss rates, and a reasonable and supportable economic forecast. Loan losses are estimated using the fair value of collateral for collateral-dependent loans, or when the borrower is experiencing financial difficulty such that repayment of the loan is expected to be made through the operation or sale of the collateral. Loan balances considered uncollectible are charged-off against the ACL. Management believes that the ACL is adequate to absorb the expected life-of-loan credit losses on the portfolio of loans and leases as of the balance sheet date. Actual losses incurred may differ materially from such estimates.

Allowance for Credit Losses on Off–Balance Sheet Credit Exposures

Southern estimates expected credit losses over the contractual period in which Southern is exposed to credit risk via a contractual obligation to extend credit unless that obligation is unconditionally cancellable by Southern. Southern determines the estimated amount of expected credit extensions based on historical usage to calculate the amount of exposure for a loss estimate and has recorded an allowance.

Allowance for Credit Losses on Available-for-Sale Securities

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

Allowance for Credit Losses on Held-to-Maturity Securities

For held-to-maturity securities, Southern conducts an assessment of its held-to-maturity securities at the time of purchase and on at least an annual basis to ensure such investment securities remain within appropriate levels of risk and continue to perform satisfactorily in fulfilling its obligations. Southern considers, among other factors, the nature of the securities and credit ratings or financial condition of the issuer. If available, Southern obtains a credit rating for issuers from the Nationally Recognized Statistical Rating Organization ("NRSRO") for consideration.

If this assessment indicates that a material credit loss exists, the present value of cash flows expected to be collected from the security are compared to the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis, a credit loss exists and an ACL is recorded for the credit loss.

Fair Value Measurements

Southern uses fair value measurements to record certain financial instruments and to determine fair value disclosures. Available-for-sale securities are financial instruments recorded at fair value on a recurring basis. Additionally, Southern may be required to record at fair value other financial assets on a nonrecurring basis. These nonrecurring fair value adjustments typically involve write-downs of, or specific reserves against, individual assets. ASC 820-10-55 establishes a three-level hierarchy for disclosure of assets and liabilities recorded at fair value. The classification of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used in the measurement are observable or unobservable. Observable inputs reflect market-driven or market-based information obtained from independent sources, while unobservable inputs reflect management's estimates about market data.

The degree of management's judgment involved in determining the fair value of a financial instrument is dependent upon the availability of quoted market prices or observable market data. For financial instruments that trade actively and have quoted market prices or observable market data, there is minimal subjectivity involved in measuring fair value. When observable market prices and data are not fully available, management's judgment is necessary to estimate fair value. In addition, changes in the market conditions may reduce the availability of quoted prices or observable data. When market data is not available, management uses valuation techniques that require more judgment to estimate the appropriate fair value measurement. Fair value is discussed further in Note A under the heading "Fair Values of Financial Instruments" and in Note T, "Fair Value Measurements", of the notes to the consolidated financial statements.

Mortgage Servicing Rights

Mortgage servicing rights represent the allocated value of servicing loans that are sold with servicing retained by Southern. Servicing rights are expensed in proportion to, and over the period of, estimated net servicing revenues. Management's accounting treatment of loan servicing rights is estimated utilizing a discounted cash flow model to determine the value of its servicing rights. The valuation model utilizes mortgage prepayment speeds, the remaining life of the mortgage pool, delinquency rates, cost to service loans, and other factors to determine the cash flow to be received from servicing each grouping of loans. These cash flows are then discounted based on current interest rate assumptions to arrive at the fair value for the right to service those loans.

Acquisition Intangibles

Generally accepted accounting principles require a determination of the fair value of all assets and liabilities of an acquired entity, and a recording of their fair value on the date of acquisition. A variety of means are employed in determination of fair value, including the use of discounted cash flow analyses, market comparisons, and projected future revenue streams. Once valuations have been adjusted, the net difference between the price paid for the acquired company and the value of its balance sheet is recorded as goodwill. Goodwill is subject to an impairment analysis, performed at least annually. Southern has elected to perform its annual goodwill impairment test as of November 30 each year. No material issues were noted during December 2023 that would have impacted the analysis within the goodwill impairment test.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

Management of Southern has prepared and is responsible for the accompanying consolidated financial statements and for their integrity and objectivity. In the opinion of management, the financial statements, which necessarily include amounts based on management's estimates and judgments, have been prepared in conformity with accounting principles generally accepted in the United States of America on a consistent basis. Management also prepared the other information in the Annual Report and is responsible for its accuracy and consistency with the financial statements.

Southern maintains a system of internal accounting controls designed to provide reasonable assurance that assets are safeguarded and transactions are executed in accordance with Southern's authorizations and policies. Further, such a system provides reasonable assurances as to the integrity and reliability of the financial statements which fairly present financial position and results of operations in conformity with accounting principles generally accepted in the United States of America. Internal accounting controls are augmented by written policies covering standards of personal and business conduct and an organizational structure providing for division of responsibility and authority.

Management monitors the effectiveness of and compliance with established control systems through a continuous program of internal audit and credit examinations and recommends possible improvements thereto. Management believes that, as of December 31, 2023, Southern's system of internal controls has prevented or detected on a timely basis any occurrences that could be material to the financial statements and that timely corrective actions have been initiated when appropriate.

The Board of Directors exercises its responsibility for the financial statements and related information through the Audit Committee, which is composed entirely of outside directors. The Audit Committee meets regularly with management and CliftonLarsonAllen LLP. CliftonLarsonAllen LLP has direct and confidential access to the Audit Committee to discuss the results of their audit.

The 2023 consolidated financial statements have been audited by the independent accounting firm of CliftonLarsonAllen LLP, which was given unrestricted access to all financial records and related data, including minutes of all meetings of shareholders, the Board of Directors, and committees of the Board. Management believes all representations made to the independent auditors during their audit were valid and appropriate. CliftonLarsonAllen LLP's Auditor's Report is presented on the following page.

John R. Waldron
President and Chief Executive Officer

Kevin A. Twardy
Chief Financial Officer

March 7, 2024

Coldwater Main Office
History Wall

SOUTHERN MICHIGAN BANCORP, INC.
INDEPENDENT AUDITORS' REPORT

Shareholders and Board of Directors
Southern Michigan Bancorp, Inc.
Coldwater, Michigan

Report on the Audit of the Consolidated Financial Statements

Opinion

We have audited the accompanying consolidated financial statements of Southern Michigan Bancorp, Inc. and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2023 and 2022, and the related consolidated statements of income, comprehensive income (loss), changes in shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2023, and the related notes to the consolidated financial statements.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Southern Michigan Bancorp, Inc. and its subsidiaries as of December 31, 2023 and 2022, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2023 in accordance with accounting principles generally accepted in the United States of America.

We have also audited in accordance with auditing standards generally accepted in the United States of America, Southern Michigan Bancorp, Inc. and its subsidiaries' internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income (call report instructions) and the Board of Governors of the Federal Reserve System Instructions for Preparation of Parent Company Only Financial Statements for Small Holding Companies (FR Y-9SP instructions) as of December 31, 2023, based on criteria established in *Internal Control – Integrated Framework (2013)*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 7, 2024, expressed an unqualified opinion.

Basis for Opinion

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

Change in Accounting Principle

As discussed in Note A to the consolidated financial statements, effective January 1, 2023, Southern Michigan Bancorp, Inc. and its subsidiaries adopted new accounting guidance for the measurement of credit losses on financial instruments through a cumulative-effect adjustment to retained earnings. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Consolidated Financial Statements

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

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about Southern Michigan Bancorp, Inc. and its subsidiaries' ability to continue as a going concern for one year after the date the consolidated financial statements are available to be issued.

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about Southern Michigan Bancorp, Inc. and its subsidiaries' ability to continue as a going concern for a reasonable period of time.

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

Other Information Included in the Southern Michigan Bancorp, Inc.'s Annual Report

Management is responsible for the other information included in Southern Michigan Bancorp, Inc.'s Annual Report. The other information comprises the message to shareholders, client profiles, financial summary, SMB&T officers & board of directors, shareholder information, management's discussion and analysis, selected financial data, and common stock market prices and dividends but it does not include the consolidated financial statements and our auditor's report thereon. Our opinion on the consolidated financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

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

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP

Toledo, Ohio
March 7, 2024

SOUTHERN MICHIGAN BANCORP, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	December 31, 2023	December 31, 2022
ASSETS		
Cash	$ 7,164	$ 6,792
Due from banks	64,456	70,463
Cash and cash equivalents	71,620	77,255
Federal funds sold	1,468	253
Securities available-for-sale, at fair value	169,740	178,154
Securities held-to-maturity, at amortized cost	61,600	69,661
Loans held-for-sale	169	-
Loans, net of allowance for credit losses of $11,697 – 2023 ($9,588 – 2022)	1,024,720	877,038
Premises and equipment, net	23,114	16,545
Cash surrender value of life insurance	22,472	18,124
Goodwill	13,422	13,422
Other intangible assets, net	147	183
Other assets	26,323	25,888
Total Assets	$ 1,414,795	$ 1,276,523
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits		
Non-interest bearing	$ 226,178	$ 268,704
Interest bearing	931,793	822,347
Total deposits	1,157,971	1,091,051
Securities sold under agreements to repurchase and overnight borrowings	1,738	11,179
Accrued expenses and other liabilities	15,703	13,545
Other borrowings	106,900	40,000
Subordinated debentures, net	34,653	34,584
Total Liabilities	1,316,965	1,190,359
Shareholders' Equity:		
Preferred stock, 100,000 shares authorized: none issued or outstanding	-	-
Common stock, $2.50 par value:		
Authorized – 10,000,000 shares		
Issued and outstanding – 4,533,637 shares in 2023 (4,519,179 shares in 2022)	11,330	11,294
Additional paid-in capital	13,126	14,066
Retained earnings	89,808	82,705
Accumulated other comprehensive loss	(16,434)	(21,901)
Total Shareholders' Equity	97,830	86,164
Total Liabilities and Shareholders' Equity	$ 1,414,795	$ 1,276,523

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

SOUTHERN MICHIGAN BANCORP, INC.
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)

	Year Ended December 31, 2023	2022	2021
Interest income:			
Loans, including fees	$ 54,887	$ 36,583	$ 32,593
Securities:			
Taxable	6,291	4,948	3,330
Tax-exempt	1,265	1,354	1,069
Other	3,125	1,249	148
Total interest income	65,568	44,134	37,140
Interest expense:			
Deposits	20,593	4,118	2,268
Other	4,995	1,914	1,553
Total interest expense	25,588	6,032	3,821
Net Interest Income	39,980	38,102	33,319
Provision for credit losses	950	275	1,500
Net Interest Income After Provision for Credit Losses	39,030	37,827	31,819
Non-interest income:			
Service charges on deposit accounts	1,670	1,516	1,286
Trust fees	2,419	2,264	2,267
Net securities gains (losses)	-	(666)	5
Net gains on loan sales	305	606	2,293
Earnings on life insurance assets	617	472	464
Gain from life insurance	-	747	231
ATM and debit card fees	1,786	1,749	1,823
Other	941	692	640
Total non-interest income	7,738	7,380	9,009
Non-interest expense:			
Salaries and employee benefits	20,586	18,134	16,492
Occupancy, net	1,813	1,675	1,565
Equipment	1,449	1,294	1,174
Printing, postage, and supplies	437	413	390
Telecommunication	376	303	356
Professional and outside services	2,243	1,742	1,814
Software maintenance	2,247	1,911	1,677
Amortization of other intangibles	36	36	36
ATM expenses	803	755	670
Advertising and marketing	670	583	397
FDIC Insurance	746	339	296
Other	2,014	1,949	1,841
Total non-interest expense	33,420	29,134	26,708
Income before income taxes	13,348	16,073	14,120
Income tax provision	2,443	2,582	2,363
Net Income	$ 10,905	$ 13,491	$ 11,757
Basic Earnings Per Common Share	$ 2.40	$ 2.98	$ 2.59
Diluted Earnings Per Common Share	$ 2.40	$ 2.97	$ 2.58

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

SOUTHERN MICHIGAN BANCORP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME/(LOSS)
(In thousands)

	Year Ended December 31,		
	2023	2022	2021
Net Income	$ 10,905	$ 13,491	$ 11,757
Other Comprehensive Income (Loss):			
Change in unrealized gain (loss) on available-for-sale securities	6,067	(30,166)	(4,434)
Reclassification adjustments for net realized securities (gains) losses included in net income	-	666	(5)
Net unrealized loss on securities transferred from available-for-sale to held-to-maturity	-	7,761	-
	6,067	(21,739)	(4,439)
Income tax effect	(1,274)	4,565	933
Unrealized gain (loss) on available-for-sale Securities, net of tax	4,793	(17,174)	(3,506)
Reclassification of unrealized loss upon transfer of available-for-sale securities to held-to-maturity	-	(7,761)	-
Less accretion of net unrealized loss on securities transferred from available-for-sale to held-to-maturity	853	694	-
	853	(7,067)	-
Income tax effect	(179)	1,484	-
Unrealized gain (loss) on securities transferred from available-for-sale to held-to-maturity, net of tax	674	(5,583)	-
Other comprehensive income (loss)	5,467	(22,757)	(3,506)
Total Comprehensive Income (Loss)	$ 16,372	$ (9,266)	$ 8,251

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

SOUTHERN MICHIGAN BANCORP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(In thousands, except number of shares and per share data)

Years Ended December 31, 2023, 2022, and 2021:

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net	Unearned ESOP Shares	Total
Balance at January 1, 2021	$ 5,748	$ 15,416	$ 67,741	$ 4,362	$ (290)	$ 92,977
Net income for 2021			11,757			11,757
Other comprehensive loss				(3,506)		(3,506)
Cash dividends declared – $0.48 per share			(2,186)			(2,186)
Stock dividend declared (2,292,376 shares)	5,731		(5,731)			-
Issuance of restricted stock (23,650 shares of common stock at $17.05 per share)	59	(59)				-
Vesting of restricted stock		957				957
Restricted stock forfeiture (2,483 shares)	(5)	5				-
Stock options exercised (3,450 shares)	9	35				44
Repurchase of common stock (101,885 shares)	(255)	(2,180)				(2,435)
Net decrease in ESOP obligation					80	80
Stock option expense		61				61
Balance at December 31, 2021	11,287	14,235	71,581	856	(210)	97,749
Net income for 2022			13,491			13,491
Other comprehensive loss				(22,757)		(22,757)
Cash dividends declared – $0.52 per share			(2,367)			(2,367)
Issuance of restricted stock (45,719 shares of common stock at weighted average $17.23 per share)	114	(114)				-
Vesting of restricted stock		643				643
Restricted stock forfeiture (2,455 shares)	(6)	6				-
Stock options exercised (2,200 shares)	6	28				34
Repurchase of common stock (42,662 shares)	(107)	(817)				(924)
Net decrease in ESOP obligation					210	210
Stock option expense		85				85
Balance at December 31, 2022	11,294	14,066	82,705	(21,901)	-	86,164
Adoption of ASC 326, net of tax			(1,264)			(1,264)
Net income for 2023			10,905			10,905
Other comprehensive income				5,467		5,467
Cash dividends declared – $0.56 per share			(2,538)			(2,538)
Issuance of restricted stock (113,780 shares of common stock at weighted average $17.82 per share)	284	(284)				-
Vesting of restricted stock		1,085				1,085
Restricted stock forfeiture (4,534 shares)	(11)	11				-
Stock options exercised (3,000 shares)	7	37				44
Repurchase of common stock (97,788 shares)	(244)	(1,986)				(2,230)
Stock option expense		197				197
Balance at December 31, 2023	$ 11,330	$ 13,126	$ 89,808	$ (16,434)	$ -	$ 97,830

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

SOUTHERN MICHIGAN BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year ended December 31, 2023	2022	2021
Operating Activities			
Net income	$ 10,905	$ 13,491	$ 11,757
Adjustments to reconcile net income to net cash from operating activities:			
Provision for credit losses	950	275	1,500
Depreciation of premises and equipment	1,486	1,367	1,353
Deferred income taxes	87	(64)	(354)
Amortization of other intangible assets	36	36	36
Amortization of subordinated debt issuance costs	69	70	52
Net amortization of securities	1,190	561	1,392
Stock option and restricted stock grant compensation expense	1,282	728	1,018
Net losses (gains) on security calls and sales	-	666	(5)
Loans originated for sale	(9,227)	(14,405)	(51,055)
Proceeds from loans sold	9,363	15,922	53,893
Net gains on loan sales	(305)	(606)	(2,293)
Gain from life insurance	-	(747)	(231)
Net gain from sale or write down of other real estate owned	(22)	(2)	(7)
Net gain on disposal of premises and equipment	(45)	(14)	(6)
Net change in ESOP obligation	-	210	80
Net change in cash surrender value	(617)	(471)	(464)
Net change in other assets	(744)	(2,581)	(285)
Net change in accrued expenses and other liabilities	1,830	269	133
Net cash from operating activities	16,238	14,705	16,514
Investing Activities			
Activity in available-for-sale securities:			
Proceeds from securities sold	-	19,807	-
Proceeds from maturities and calls	16,744	17,151	24,733
Purchases	(3,368)	(67,344)	(68,025)
Activity in held-to-maturity securities:			
Proceeds from maturities and calls	15,509	8,732	-
Purchases	(6,680)	(10,348)	-
Net change in federal funds sold	(1,215)	18	(40)
Loan originations and payments, net	(149,823)	(145,225)	(105,507)
Proceeds from sale of other real estate owned	39	2	7
Purchase of life insurance	(3,731)	-	(3,000)
Purchase of Federal Home Loan Bank Stock	(1,031)	(855)	-
Redemption of Federal Home Loan Bank Stock	-	180	-
Proceeds from life insurance	-	1,765	1,040
Proceeds from sale of premises and equipment	325	48	11
Additions to premises and equipment	(8,335)	(4,831)	(775)
Net cash from investing activities	(141,566)	(180,900)	(151,556)
Financing Activities			
Net change in deposits	66,920	116,699	136,054
Net change in securities sold under agreements to repurchase and overnight borrowings	(9,441)	(9,430)	526
Proceeds from other borrowings	86,900	84,000	-
Proceeds from subordinated debt, net of issuance costs	-	-	29,307
Repayments of other borrowings	(20,000)	(64,000)	(6,500)
Stock options exercised	44	34	44
Cash dividends paid	(2,500)	(2,318)	(2,175)
Repurchase of common stock	(2,230)	(924)	(2,435)
Net cash from financing activities	119,693	124,061	154,821
Net Change in Cash and Cash Equivalents	(5,635)	(42,134)	19,779
Beginning cash and cash equivalents	77,255	119,389	99,610
Ending Cash and Cash Equivalents	$ 71,620	$ 77,255	$ 119,389

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

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE A – NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations and Industry Segments: Southern Michigan Bancorp, Inc. (the Company) is a Michigan corporation and registered financial holding company. The Company's principal activity is the ownership and management of its wholly-owned subsidiary bank, Southern Michigan Bank & Trust (the Bank). The Bank offers individuals, businesses, institutions, and government agencies a full range of commercial banking services. The customer base is located primarily in the southwest Michigan communities in which the Bank has branches and in areas immediately surrounding these communities. The Bank makes commercial and consumer loans to customers. The majority of loans are secured by business assets, commercial and residential real estate, and consumer assets. There are no foreign loans.

Principles of Consolidation: The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries: SMB Risk Management, Inc.; 27 Marshall Street, LLC; and the Bank. On November 18, 2015, 27 Marshall Street, LLC was formed as a wholly-owned subsidiary of the Company which owns and operates a multi-family property. On May 31, 2016, SMB Risk Management, Inc., a captive insurance company incorporated in Nevada, was formed as a wholly-owned subsidiary of the Company. During 2004, the Company formed a special purpose trust, Southern Michigan Bancorp Capital Trust I, for the sole purpose of issuing trust preferred securities. Under generally accepted accounting principles, the trust is not consolidated into the financial statements of the Company. All inter-company transactions and balances are eliminated in consolidation.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosure of contingent liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Estimates that are more susceptible to change in the near term include the allowance for credit losses and fair values of securities.

Securities: If management has the intent and the Company has the ability at the time of purchase to hold securities until maturity, they are classified as held-to-maturity and carried at the amortized historical cost. Securities to be held for an undeterminable period of time are classified as available-for-sale and carried at fair value, with unrealized gains and losses reported in other comprehensive income or loss, net of tax. Securities classified as available-for-sale include securities that management intends to use as part of its asset/liability management strategy and that may be sold in response to changes in interest rates, prepayment risk, and other factors. Management determines the appropriate classification of securities at the time of purchase but may reassess the classification. Effective April 1, 2022, the Bank transferred certain debt securities from the available-for-sale category to the held-to-maturity category, as more fully described in Note C, with the related unrealized losses at the date of transfer continuing to be reported as a separate component of other comprehensive income (loss) in shareholders' equity. Such unrealized losses are being accreted over the remaining life of the individual securities.

Premiums and discounts on securities are recognized in interest income using the level yield method over the estimated life of the security. Premiums are amortized to the earliest call date. Gains and losses on the sale of available-for-sale securities are determined using the specific identification method.

Effective January 1, 2023, with the adoption of ASU 2016–13, *Financial Instruments–Credit Losses: Measurement of Credit Losses on Financial Instruments* (ASC 326), for available-for-sale debt securities in an unrealized loss position, the Company first assesses whether it intends to sell, or is more likely than not that it will be required to sell, the security before recovery of its amortized cost basis. If either criteria is met, the security's amortized cost basis is written down to fair value through income. If neither criteria is met, the Company evaluates whether the decline in fair value has resulted from credit losses or other factors. In making this assessment, management considers the extent to which fair value is less than amortized cost, any changes in the underlying credit rating of the security, and adverse conditions specifically related to the security, among other factors. If it is determined a credit loss exists, the present value of cash flows expected to be collected from the security are compared to the amortized cost basis of the security. If the present value of the cash flows expected to be collected is less than the amortized cost basis, a credit loss exists and an allowance for credit losses is recorded, which is limited by the amount that the fair value is less than the amortized costs basis. Any impairment that has not been recorded through an allowance for credit losses is recognized as a component of other comprehensive income. Changes in the allowance for credit losses are recorded as a provision for credit loss.

NOTE A – NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Effective January 1, 2023, with the adoption of ASC 326, management measures expected credit losses for held-to-maturity debt securities on a collective basis by major security type.

Prior to the adoption of ASC 326, the Company used an other than temporary impairment model. As of December 31, 2023, no allowance for credit losses was required for securities.

Loans Held for Sale: Loans held for sale are reported at the lower of cost or market value in the aggregate. Net unrealized losses are recorded in a valuation allowance by charges to income.

Loans: Loans are reported at the principal balance outstanding, net of unearned interest, deferred loan fees and costs, and an allowance for credit losses. Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term.

Interest income is not reported when full loan repayment is in doubt, typically when payments are past due over 90 days, unless the loan is both well secured and in the process of collection. Past due status is based on the contractual terms of the loan. All interest accrued, but not received, for these loans is reversed against interest income. Payments received on such loans are reported as principal reductions until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest contractually due are brought current and future payments are reasonably assured.

Allowance for Credit Losses on Loans: With the adoption of ASC 326, the allowance for credit losses on loans and leases ("ACL") replaces the allowance for loan and lease losses as a credit accounting estimate. The ACL on loans is a valuation account that is deducted from the amortized cost basis of loans to present the net amount expected to be collected. The ACL on loans is adjusted through the provision for credit losses to the amount of amortized cost basis not expected to be collected at the balance sheet date. Loan losses are charged off against the ACL on loans when the Company determines the loan balance to be uncollectible. Cash received on previously charged off amounts is recorded as a recovery to the ACL on loans.

The Company utilizes the Discounted Cash Flow (DCF) method in determining expected future credit losses for each of the loan categories except for auto loans and overdraft loans. The DCF method discounts expected cash flows at the effective interest rate of the loan. The allowance for credit losses reflects the difference between the amortized cost basis and the present value of the expected cash flows. The Company segments the loan portfolio into pools based on call report code. The Company's expected loss estimate is anchored in historical credit loss experience, with an emphasis on all available portfolio data. However, the Company's historical credit loss experience is currently not sufficient to calculate the expected loss estimate for its loan portfolio. As a result, the Company is utilizing external models or data with a look-back period that generally includes January 2004 through December 2023, excluding certain periods during the pandemic.

Additionally, the weighted average remaining maturity (WARM) method is used for the auto and overdraft loans. The WARM method considers an estimate of expected credit losses over the remaining life of the financial assets and uses average annual charge-off rates to estimate the allowance for credit losses. For amortizing assets, the remaining contractual life is adjusted by the expected scheduled payments and prepayments. The average annual charge-off rate is applied to the amortization-adjusted remaining life to determine the unadjusted lifetime historical charge-off rate.

Qualitative reserves reflect management's overall estimate of the extent to which current expected credit losses on collectively evaluated loans will differ from historical loss experience. The analysis takes into consideration other analytics performed within the organization, including concentration management, along with other credit related analytics, as deemed appropriate. Management attempts to quantify qualitative reserves whenever possible. The current expected credit loss (CECL) methodology applied focuses on evaluation of qualitative and environmental factors, including but not limited to: (i) change in lending policies and procedures including underwriting standards; (ii) change in national, regional, and local economic conditions; (iii) change in nature and volume of the portfolio and terms of loans (iv) change in experience, depth, and ability of lending management (v) change in volume and severity of past due loans and other similar conditions; (vi) change in quality of the loan review system; (vii) change in value

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE A – NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

of underlying collateral value for collateral dependent loans; (viii) existence and impact of any concentrations of credit and changes in levels of concentrations; and (ix) effect of other external factors on the level of estimated credit losses.

The allowance for credit losses on loans estimate incorporates a reasonable and supportable economic forecast through the use of externally developed macroeconomic scenarios applied in the model. The model includes both current and forecasted U.S. gross domestic product and U.S. unemployment rates. The length of the reasonable and supportable forecast period is evaluated at each reporting period and adjusted if deemed necessary. Currently, the Company uses a two-year reasonable and supportable forecast period in estimating the allowance for credit losses on loans. After the reasonable and supportable forecast period, the models effectively revert to historical averages.

<u>Collateral Dependent Loans:</u>
A loan is considered to be collateral dependent when, based upon management's assessment, the borrower is experiencing financial difficulty and repayment is expected to be provided substantially through the operation or sale of the collateral. For collateral dependent loans, expected credit losses are based on the estimated fair value of the collateral at the balance sheet date, with consideration for estimated selling costs if satisfaction of the loan depends on the sale of the collateral.

Collateral dependent commercial real estate loans, both owner occupied and non-owner occupied, are valued by independent external appraisals. These external appraisals are prepared using the sales comparison approach and income approach valuation techniques. Estimated fair values are reduced to account for sales commissions, broker fees, unpaid property taxes, and additional selling expenses to arrive at an estimated net realizable value.

Management may make subsequent unobservable adjustments to the collateral dependent loan appraisals. Collateral dependent loans other than commercial real estate are not considered material.

<u>Allowance for Credit Losses – Unfunded Commitments:</u>
In addition to ACL - loans, the Company has established an ACL - unfunded commitments, classified in other liabilities on the consolidated balance sheets. Unfunded commitments include commercial and residential real estate loans that have been approved but not yet closed, commercial letters of credit, and unfunded commercial and residential lines of credit. This reserve is maintained at a level management believes is sufficient to absorb losses arising from unfunded loan commitments.

Premises and Equipment: Premises and equipment are stated at cost, less accumulated depreciation. Depreciation is computed principally, using straight-line or accelerated methods over their estimated useful lives. The estimated useful lives are 10 to 40 years for buildings and improvements and 3 to 10 years for furniture and equipment. These assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. Maintenance, repairs, and minor alterations are charged to current operations as expenditures occur. Major improvements are capitalized. Land is carried at cost.

Mortgage Servicing Rights: Mortgage servicing rights, included in other assets, represent the allocated fair value of mortgage servicing rights retained on loans sold. Mortgage servicing rights are amortized to expense in proportion to, and over the period of, estimated net servicing revenues.

Impairment is evaluated based on the fair value of the rights, using groupings of the underlying loans as to interest rates and then, secondarily, as to geographic and prepayment characteristics. Any impairment of a grouping is reported as a valuation allowance.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank; (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets; and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

NOTE A – NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The transfer of a participating interest in a financial asset must have all of the following characteristics: (1) from the date of transfer, it must represent a proportionate ownership interest in the financial asset; (2) from the date of transfer, all cash flows received, except cash flows allocated as compensation for servicing or other services performed, must be divided proportionately among participating interest holders in the amount equal to their share of ownership; (3) the rights of each participating interest holder must have the same priority; and (4) no party has the right to pledge or change the entire financial asset unless all participating interest holders agree to do so.

Cash Surrender Value of Life Insurance: The Bank has purchased life insurance policies on certain directors, key executives, and other members of management. Bank-owned life insurance is recorded at its net cash surrender value, or the amount that can be realized.

Goodwill and Other Intangible Assets: Goodwill resulting from acquisitions is not amortized but is tested for impairment annually. As part of its testing, the Company first assesses the qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the Company determines the fair value of a reporting unit is less than its carrying amount using these qualitative factors, the Company compares the fair value of the goodwill with its carrying amount, and then measures impairment loss by comparing the implied fair value of goodwill with the carrying amount of that goodwill.

Significant judgment is applied when goodwill is assessed for impairment. If qualitative factors indicate the potential for impairment, then further analysis includes developing cash flow projections, selecting appropriate discount rates, identifying relevant market comparisons, incorporating general economic and market conditions, and selecting an appropriate control premium. At December 31, 2023, the Company believes the Bank does not have any indicators of potential impairment.

Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on the Company's balance sheet. Other intangible assets consist of acquired customer relationships which are amortized on an accelerated method over their estimated useful lives of 10 years.

Other Real Estate Owned: Other real estate owned is comprised of properties acquired through a foreclosure proceeding or acceptance of a deed in lieu of foreclosure. These properties are initially recorded at fair value, less estimated cost to sell at the date of foreclosure, establishing a new cost basis. After foreclosure, valuations are periodically performed by management; other real estate owned is carried at the lower of the carrying amount or fair value, less the estimated cost to sell. Expenses, gains and losses on disposition, and reductions in carrying value are reported as non-interest expense. There was no Other Real Estate Owned as of December 31, 2023 or 2022.

At December 31, 2023, there were no consumer mortgage loans in the process of foreclosure. The recorded investment of consumer mortgage loans secured by residential properties for which formal foreclosure proceedings are in process was $16,000 as of December 31, 2022.

Stock-Based Compensation: The Company follows the requirements of "share-based payment transactions" using the modified prospective transition method. Under this method, the Company recognizes compensation cost for stock-based compensation for all new or modified grants.

See Note M regarding the various assumptions used in computing the compensation expense.

Advertising Costs: Advertising costs are expensed as incurred.

Leases: Leases are classified as operating or finance leases at the lease commencement date. The Company leases certain locations and equipment. The Company records leases on the balance sheet in the form of a lease liability for the present value of future minimum payments under the lease terms and a right-of-use asset equal to the lease liability. The discount rate used in determining the lease liability is based upon incremental borrowing rates the Company could

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE A – NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

obtain for similar loans as of the date of commencement or renewal. The Company does not record leases on the consolidated balance sheets that are classified as short term (less than one year).

At lease inception, the Company determines the lease term by considering the minimum lease term and all optional renewal periods the Company is reasonably certain to renew. The lease term is also used to calculate straight line rent expense. The depreciable life of leasehold improvements is limited by the estimated lease term, including renewals if they are reasonably certain to be renewed.

Operating lease expense consists of a single lease cost allocated over the remaining lease term on a straight-line-basis. Rent expense and variable lease expense are included in occupancy and equipment expense of the Company's consolidated statements of income. The Company's variable lease expense includes rent escalators that are based on market conditions.

Income Taxes: The income tax provision is the total of the current year's income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized. Benefits from tax positions taken, or expected to be taken, in a tax return are not recognized if the likelihood that the tax positions would be sustained upon examination by a taxing authority is considered to be 50% or less. Any interest and penalties resulting from the filing of the income tax returns are included in the provision for income taxes.

Cash Flow Definition: For purposes of the consolidated statements of cash flows, the Company considers cash and due from banks as cash and cash equivalents. The Company reports net cash flows for customer loan transactions, deposit transactions, and short-term borrowings with a maturity of one year or less.

Earnings and Dividends Per Common Share: Basic earnings per common share is based on net income divided by the weighted average number of common shares outstanding during the period. Employee Stock Ownership Plan shares are considered outstanding for this calculation, unless unearned. Diluted earnings per common share reflects the dilutive effect of any additional, potential common shares issuable under stock options. Earnings and dividends per share are restated for all stock splits and stock dividends through the date of issuance of the consolidated financial statements.

Comprehensive Income (Loss): Comprehensive income (loss) consists of net income and other comprehensive income or loss. Other comprehensive income or loss includes the net change in unrealized gains and losses on securities available-for-sale and the accretion of the net unrealized loss on securities transferred from available-for-sale to held-to-maturity.

Employee Stock Ownership Plan (ESOP): Compensation expense is based on the market price of shares as they are committed to be released to participants' accounts. Dividends on allocated ESOP shares reduce retained earnings; dividends on unearned ESOP shares reduce debt and accrued interest.

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

Concentrations of Credit Risk: The Company grants commercial, real estate, and installment loans to customers mainly in southwest Michigan. Commercial loans include loans collateralized by commercial real estate, business assets, and agricultural loans collateralized by crops and farm equipment. Commercial loans made up approximately 93% of the loan portfolio at December 31, 2023, and December 31, 2022; repayment is expected with cash flow from operations of businesses. Residential mortgage loans made up approximately 7% of the loan portfolio at December 31, 2023, and December 31, 2022, and are collateralized by mortgages on residential real estate. Consumer loans

NOTE A – NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

made up less than 1% of the loan portfolio at December 31, 2023, and 2022, and are primarily collateralized by consumer assets.

Operating Segments: While the chief decision makers monitor the revenue streams of the various products and services, operations are managed, and financial performance is evaluated on a Company-wide basis. Operating segments are aggregated into one, as operating results for all segments are similar. Accordingly, all the financial service operations are considered by management to be aggregated in one reportable operating segment: commercial banking.

Restrictions on Cash: The Bank is a party to an offsetting interest rate swap with a notional amount totaling $9,938,000 as of December 31, 2023, and $10,258,000 as of December 31, 2022. This swap between the Bank, commercial borrower, and financial intermediary (counterparty) provides for the Bank to receive interest on the underlying commercial loan at a variable rate of interest and for the commercial borrower to receive a fixed rate of interest during the term of the loan. The Bank is required to post collateral with the counterparty to cover any financial exposure of the commercial borrower to the counterparty if the commercial borrower terminates the swap before the stated maturity of the underlying loan. The Bank posted cash as collateral for the financial exposure of the commercial borrower in the amount of $1,810,000 as of December 31, 2022. No cash collateral was required as of December 31, 2023. See Note Y for further information.

Financial Instruments with Off-Balance-Sheet Risk: Financial instruments include off-balance-sheet credit instruments, such as commitments to make loans and standby letters of credit issued to meet customer needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded. Commitments may include interest rates determined prior to funding the loan (rate lock commitments). Rate lock commitments on loans intended to be sold are considered derivatives. Such commitments were not material at December 31, 2023, and 2022.

Cash Balances: The Company maintains deposits with other correspondent banks. These deposits may exceed FDIC insured limits.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are any such matters outstanding as of December 31, 2023, that will have a material future adverse effect on the consolidated financial statements.

Stock Dividends: The Company issued 2,292,376 common shares in connection with a 100% stock dividend effected in 2021.

Subsequent Events: Management evaluated subsequent events through March 7, 2024, the date the consolidated financial statements were available to be issued. Events or transactions occurring after December 31, 2023, but prior to when the consolidated financial statements were available to be issued, that provided additional evidence about conditions that existed at December 31, 2023, have been recognized in the consolidated financial statements for the year ended December 31, 2023. Events or transactions that provided evidence about conditions that did not exist at December 31, 2023, but arose before the consolidated financial statements were available to be issued, have not been recognized in the consolidated financial statements for the year ended December 31, 2023.

Adoption of New Accounting Standards:
On January 1, 2023, the Company adopted ASC 326, as amended, which replaces the incurred loss methodology with an expected loss methodology referred to as the current expected credit loss (CECL) methodology. The measurement of expected credit losses under the CECL methodology is applicable to financial assets measured at amortized cost, including loan receivables and held-to-maturity debt securities. It also applies to off-balance sheet credit exposures not accounted for as insurance (loan commitments, standby letters of credit, financial guarantees, and other similar instruments). In addition, the Accounting Standards Codification (ASC) made changes to the accounting for available-for-sale debt securities. One such change is to require credit losses to be presented as an allowance rather than as a write-down on available-for-sale securities management does not intend to sell or believes it is more like than not they will be required to sell.

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE A – NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Company adopted ASC 326 using the modified retrospective method for all financial assets measured at amortized cost and off-balance-sheet credit exposures. Results for reporting periods beginning after January 1, 2023 are presented under ASC 326 while prior period amounts continue to be reported in accordance with previously applicable GAAP. The adoption of ASC 326 resulted in the Company recording an increase of $1,100,000 to the allowance for credit losses and the establishment of a $500,000 reserve for unfunded commitments. A one-time, cumulative effect adjustment to capital for these amounts, net of tax, of $1,264,000 was recognized as of January 1, 2023.

On March 31, 2022, FASB issued ASU 2022-02, *Financial Instruments—Credit Losses (Topic 326) Troubled Debt Restructurings and Vintage Disclosures*, which eliminates the troubled debt restructuring ("TDR") accounting model for creditors that have adopted Topic 326, *Financial Instruments – Credit Losses*. In addition, on a prospective basis, entities will be subject to new disclosure requirements covering modifications of receivables to borrowers experiencing financial difficulty. Upon adoption of this guidance, the Company no longer establishes a specific reserve for modifications made on or after January 1, 2023, to borrowers experiencing financial difficulty. Instead, these modifications are included in their respective loan segment in the allowance for credit losses on loans. The Company has adopted ASU 2022-02 effective on January 1, 2023. The adoption of this standard did not have a material effect on the Company's operating results or financial condition.

ASU No. 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*, as amended. On March 12, 2020, the FASB issued Update 2020-04 to ease the potential burden in accounting for reference rate reform. The amendments in Update 2020-04 are elective and apply to entities that have contracts, hedging relationships, and other transactions that reference LIBOR or another reference rate expected to be discontinued due to reference rate reform. The new guidance provides optional expedients that reduce costs and the complexity of accounting for reference rate reform.

In January 2021, the FASB issued ASU 2021-01 which clarified that all derivative instruments affected by the changes to interest rates used for discounting, margining, or contract price alignment, regardless of whether they reference LIBOR or another rate expected to be discontinued as a result of reference rate reform, an entity may apply certain practical expedients in Topic 848. ASU 2022-06 was issued in December 2022 to defer the sunset of Topic 848 from December 31, 2022 to December 31, 2024, after which entities will no longer be permitted to apply the relief in Topic 848. The adoption of this standard did not have a material effect on the Company's operating results or financial condition.

Reclassifications: Certain reclassifications of 2022 and 2021 amounts have been made to conform with the 2023 presentation.

NOTE B – BASIC AND DILUTED EARNINGS PER COMMON SHARE

A reconciliation of the numerators and denominators of basic and diluted earnings per common share for the years ended December 31, 2023, 2022, and 2021 is presented below:

	2023	2022	2021
Basic Earnings Per Common Share			
Net income (in thousands)	$ 10,905	$ 13,491	$ 11,757
Weighted average common shares outstanding	4,537,786	4,538,493	4,558,352
Less: Weighted average unallocated ESOP shares	-	(9,102)	(13,538)
Weighted average common shares outstanding for basic earnings per common share	4,537,786	4,529,391	4,544,814
Basic Earnings Per Common Share	$ 2.40	$ 2.98	$ 2.59
Diluted Earnings Per Common Share			
Net income (in thousands)	$ 10,905	$ 13,491	$ 11,757
Weighted average common shares outstanding for basic earnings per common share	4,537,786	4,529,391	4,544,814
Add: Dilutive effects of assumed exercises of stock options	3,407	15,605	6,322
Average shares and dilutive potential of common shares outstanding	4,541,193	4,544,996	4,551,136
Diluted Earnings Per Common Share	$ 2.40	$ 2.97	$ 2.58

In 2023, 2022, and 2021, stock options totaling 180,600, 5,800, and 1,000, respectively, were not considered in computing diluted earnings per share because they were anti-dilutive.

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE C – SECURITIES

On April 1, 2022, the Company reassessed and transferred, at fair value $66,387,000 of securities classified as available-for-sale to the held-to-maturity classification. As a result, the unrealized after-tax loss of the securities of $6,131,000 as of the transfer date will remain in equity as accumulated other comprehensive loss and will be accreted over the remaining life of the individual securities. No gain or loss was recorded as a result of the transfer.

Year-end investment securities were as follows (in thousands):

Available-for-sale, December 31, 2023	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
US Government	$ 21,506	$ -	$ (857)	$ 20,649
State and political subdivisions	91,657	30	(9,826)	81,861
Mortgage-backed securities	55,330	-	(3,486)	51,844
Asset-backed securities	13,786	21	(189)	13,618
Corporate securities	2,050	-	(282)	1,768
Total available-for-sale	$ 184,329	$ 51	$ (14,640)	$ 169,740
Held-to-maturity, December 31, 2023				
State and political subdivisions	$ 61,600	$ 404	$ (5,410)	$ 56,594
Total held-to-maturity	$ 61,600	$ 404	$ (5,410)	$ 56,594

Available-for-sale, December 31, 2022	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
US Government	$ 21,824	$ -	$ (1,330)	$ 20,494
State and political subdivisions	92,555	-	(14,099)	78,456
Mortgage-backed securities	65,029	-	(4,634)	60,395
Asset-backed securities	17,352	20	(392)	16,980
Corporate securities	2,050	-	(221)	1,829
Total available-for-sale	$ 198,810	$ 20	$ (20,676)	$ 178,154
Held-to-maturity, December 31, 2022				
State and political subdivisions	$ 69,661	$ 473	$ (7,190)	$ 62,944
Total held-to-maturity	$ 69,661	$ 473	$ (7,190)	$ 62,944

Available-for-sale securities with unrealized losses at December 31, 2023, and 2022, that have not been recognized in income are as follows (in thousands):

2023	**Continued Unrealized Loss for Less than 12 Months**		**Continued Unrealized Loss for 12 Months or More**		**Total**	
Description of securities	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
US Government	$ -	$ -	$ 20,649	$ (857)	$ 20,649	$ (857)
State and political subdivisions	-	-	79,899	(9,826)	79,899	(9,826)
Mortgage-backed securities	-	-	51,844	(3,486)	51,844	(3,486)
Asset-backed securities	2,556	(5)	7,735	(184)	10,291	(189)
Corporate securities	-	-	1,768	(282)	1,768	(282)
Total temporarily impaired	$ 2,556	$ (5)	$ 161,895	$ (14,635)	$ 164,451	$ (14,640)

NOTE C – SECURITIES (CONTINUED)

2022	Continued Unrealized Loss for Less than 12 Months		Continued Unrealized Loss for 12 Months or More		Total	
Description of securities	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
US Government	$ 20,494	$ (1,330)	$ -	$ -	$ 20,494	$ (1,330)
State and political subdivisions	47,687	(6,419)	30,769	(7,680)	78,456	(14,099)
Mortgage-backed securities	41,700	(1,735)	18,695	(2,899)	60,395	(4,634)
Asset-backed securities	5,250	(85)	8,412	(307)	13,662	(392)
Corporate securities	-	-	1,829	(221)	1,829	(221)
Total temporarily impaired	$ 115,131	$ (9,569)	$ 59,705	$ (11,107)	$ 174,836	$ (20,676)

As of December 31, 2023, the Company's available-for-sale securities portfolio consisted of 104 securities, 101 of which were in an unrealized loss position. The majority of the unrealized losses are related to the Company's state and political subdivisions and mortgage-backed securities, as discussed below:

<u>State and Political Subdivision Securities</u>
The Company monitors the credit quality of state and political subdivision securities classified as available-for-sale through the use of a credit rating. The Company monitors the credit rating monthly to determine if a credit loss exists. As of December 31, 2023, the Company believes that no allowance for credit losses is required.

<u>Mortgage-backed Securities</u>
At December 31, 2023, approximately 82.7% of the mortgage-backed securities held by the Company were issued by U.S. government-sponsored entities and agencies. The Company's mortgage-backed securities portfolio includes non-agency collateralized mortgage obligations with a fair value of $8,951,000 which had unrealized losses of $94,000 at December 31, 2023. These non-agency mortgage-backed securities were not rated at purchase. The Company does not have the intent to sell these mortgage-backed securities and it is likely that it will not be required to sell the securities before their anticipated recovery. The issuer continues to make timely principal and interest payments. The Company evaluates if a credit loss exists by monitoring to ensure it has adequate credit support. As of December 31, 2023, the Company believes no allowance for credit losses is required.

Held-to-maturity securities with unrealized losses at December 31, 2023, and December 31, 2022, that have not been recognized in income are as follows (in thousands):

2023	Continued Unrealized Loss for Less than 12 Months		Continued Unrealized Loss for 12 Months or More		Total	
Description of securities	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
State and political subdivisions	$ 4,411	$ (73)	$ 43,758	$ (5,337)	$ 48,169	$ (5,410)
Total temporarily impaired	$ 4,411	$ (73)	$ 43,758	$ (5,537)	$ 48,169	$ (5,410)

2022	Continued Unrealized Loss for Less than 12 Months		Continued Unrealized Loss for 12 Months or More		Total	
Description of securities	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
State and political subdivisions	$ 21,757	$ (1,181)	$ 31,378	$ (6,009)	$ 53,135	$ (7,190)
Total temporarily impaired	$ 21,757	$ (1,181)	$ 31,378	$ (6,009)	$ 53,135	$ (7,190)

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE C – SECURITIES (CONTINUED)

The Company monitors the credit quality of debt securities held-to-maturity. The frequency of monitoring depends on whether the debt security has a CUSIP number. Debt securities (comprised of state and political subdivision securities) with a CUSIP number totaled $39,817,000 at December 31, 2023. These are monitored on a monthly basis through the use of credit ratings. Debt securities without a CUSIP number totaled $21,783,000 at December 31, 2023. These represent state and political subdivisions in the Bank's market area which are monitored on an annual basis. As of December 31, 2023, no allowance for credit losses was required for held-to-maturity securities.

The proceeds from sale/call of securities and the associated gains/(losses) are listed below (in thousands):

	2023	2022	2021
Proceeds	$ -	$ 19,807	$ 1,274
Net gains/(losses)	-	(666)	5

The tax provision (credit) related to net realized gains (losses) was ($140,000) for 2022 and $1,000 for 2021.

The amortized cost and fair value of the available-for-sale investment securities portfolio are shown by contractual maturity. Contractual maturities of debt securities at year-end 2023 were as follows (in thousands):

	Amortized Cost	Fair Value
Due in one year or less	$ 1,820	$ 1,819
Due from one to five years	21,694	20,728
Due from five to ten years	44,694	39,305
Due after ten years	47,005	42,426
Mortgage-backed securities	55,330	51,844
Asset-backed securities	13,786	13,618
Total	$ 184,329	$ 169,740

The amortized cost and fair value of the held-to-maturity investment securities portfolio are shown by contractual maturity. Contractual maturities of debt securities at year-end 2023 were as follows (in thousands):

	Amortized Cost	Fair Value
Due in one year or less	$ 4,220	$ 4,210
Due from one to five years	12,042	11,897
Due from five to ten years	14,225	13,280
Due after ten years	31,113	27,207
Total	$ 61,600	$ 56,594

Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Securities with a market value of $94,449,000 and $53,213,000, respectively, were pledged as collateral at the Federal Reserve and for other purposes on December 31, 2023, and 2022.

At December 31, 2023, and 2022, the fair value of securities issued by the State of Michigan and all its political subdivisions totaled $49,590,000 and $56,805,000, respectively. No other securities of any single issuer were greater than 10% of shareholders' equity.

Investments in the Federal Home Loan Bank of Indianapolis stock totaled $3,731,000 at December 31, 2023, and $2,700,000 at December 31, 2022, and are included in other assets because such investments are considered restricted. Such investments are recorded at cost and evaluated for impairment. Cash dividends received are recorded in taxable securities interest income.

The Company had no investment in securities of issuers outside of the United States as of December 31, 2023, or 2022.

NOTE D – LOANS AND ALLOWANCE FOR CREDIT LOSSES

Loans at year end were as follows (in thousands):

	2023	2022
Commercial real estate	$ 666,559	$ 544,398
Commercial	126,686	127,888
Agriculture	75,629	65,741
Real estate mortgage	162,867	145,541
Consumer	4,676	3,058
	1,036,417	886,626
Less allowance for credit losses	(11,697)	(9,588)
Loans, net	$ 1,024,720	$ 877,038

The Company has elected to exclude accrued interest receivable from the amortized cost basis of loans. Accrued interest receivable on loans amounted to $6,664,000 and $5,535,000 at December 31, 2023 and 2022, respectively and is included in other assets in the accompanying consolidated balance sheets.

Credit Risk Elements – Commercial Real Estate, Commercial, and Agriculture:
Loans to commercial real estate, commercial, and agricultural borrowers are underwritten based on the Bank's examination of current and projected cash flows to determine the ability of each borrower to repay obligations as agreed. This underwriting includes the evaluation of cash flows of the borrower, the underlying collateral when applicable, and the borrower's ability to manage its business activities. The cash flows of borrowers and the collateral securing these loans may fluctuate in value after the initial evaluation.

Commercial real estate loans are also subject to underwriting standards unique to real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Loan-to-value is generally 75% of the lower of the cost or appraised value of the assets. Appraisals on properties securing these loans are generally performed by fee appraisers approved by the Commercial Loan Committee. Because payments on commercial real estate loans are often dependent on the successful operation or management of the properties, repayment of such loans may be subject to adverse conditions in the real estate market or the economy. Management monitors and evaluates commercial real estate loans based on collateral and risk rating criteria. The Bank typically requires personal guarantees on these loans. The Bank's commercial real estate loans are secured largely by properties located in its primary market area.

Commercial operating loans are underwritten with an emphasis on cash flow analysis and are generally secured by a first priority lien on the general assets of the business. Loan-to-value limits vary and are dependent upon the nature and type of the underlying collateral, as well as the financial strength of the borrower. Commercial loans are generally guaranteed by the principal(s). The Bank's commercial lending is principally done in its primary market area.

Agricultural loans are primarily made for real estate or operating purposes. Agricultural real estate loans are evaluated based upon cash flow first, then as loans secured by real estate. Loan-to-value is generally 75% of the lower of the cost or appraised value of the assets. Appraisals on properties securing these loans are generally performed by fee appraisers. Agricultural operating loans are underwritten with reliance upon current and projected cash flows. Security for the operating loans is generally provided through first priority liens on agricultural assets. Guaranty of the principal(s) is required for most agricultural borrowers. The Bank's agricultural lending is done primarily in its operating area.

Construction loans are underwritten utilizing independent appraisals, sensitivity analysis of absorption, vacancy and lease rates, and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with completion of the project. Construction loans are included in commercial real estate and real estate mortgage categories. Construction loans often involve the disbursement of funds with repayment substantially dependent on the success of the ultimate project. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, general economic conditions, and the availability of long-term financing. The

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE D – LOANS AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

Bank typically requires personal guarantees on these loans. The Bank's construction loans are secured predominantly by properties located in its primary market area.

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act):
The CARES Act was signed into law on March 27, 2020, providing economic relief to businesses and individuals. During the year ended December 31, 2021, Second Draw Paycheck Protection Program (PPP) loans were originated by the Bank totaling $44,286,000 under the Economic Aid Hard-Hit Small Businesses, Nonprofits, & Venues Act. Outstanding borrowings are guaranteed by the U.S. Small Business Administration (SBA) and subject to partial or full forgiveness by the SBA, based on the Bank's borrowers meeting certain requirements, as stipulated in the PPP loan agreement.

The PPP loans have terms of 60 months, bear interest at the rate of 1.0% and are payable in monthly installments. These loans are included in commercial loans. Through December 31, 2023 and 2022, all but $71,000 (seven loans) and $115,000 (eight loans), respectively had been forgiven by the SBA. The Bank received specified fees on the amount of each PPP loan originated. Such fees, net of estimated origination costs, have been deferred and are being amortized to interest income over the term of the loans. Amortization of deferred PPP loan fees amounted to $6,000 in 2023, $460,000 in 2022, and $3,645,000 in 2021. Deferred fees on PPP loans amounted to $9,000 as of December 31, 2023, and $15,000 as of December 31, 2022.

Credit Risk Elements – Real Estate Mortgage and Consumer:
The Bank originates 1-4 family real estate and consumer loans utilizing credit reports to supplement the underwriting process. The Bank's manual underwriting standards for 1-4 family loans are generally in accordance with Federal Home Loan Mortgage Corporation and loan policy manual underwriting guidelines. Properties securing 1-4 family real estate loans are appraised by fee appraisers, which are independent of the loan origination function and have been approved by management. The loan-to-value ratios normally do not exceed 80% without credit enhancements, such as mortgage insurance. The Bank will lend up to 100% of the lesser of the appraised value or purchase price for conventional 1-4 family real estate loans, provided private mortgage insurance is obtained. The underwriting standards for consumer loans include a determination of the applicant's payment history on other debts and an assessment of their ability to meet existing obligations and payments on the proposed loan. To monitor and manage loan risk, policies and procedures are developed and modified by management, as needed. This activity, coupled with smaller loan amounts spread across many individual borrowers, minimizes risk. Additionally, market conditions are reviewed by management on a regular basis. The Bank's 1-4 family real estate loans are secured predominantly by properties located in its primary market area.

The Bank's internal credit analysis staff reviews and validates credit risk on a periodic basis. In addition, an independent loan review is performed annually. Credit analysts' results are presented to management. The independent loan review is presented to management and the Audit Committee. The credit analysts' results and loan review processes complement and reinforce the risk identification and assessment decisions made by lenders and credit personnel, as well as the Bank's policies and procedures.

At December 31, 2023, 2022, and 2021, certain directors and executive officers of the Company, including their associates and companies in which they are principal owners, were indebted to the Bank. The table below summarizes the aggregate loan activity (in thousands) for these individuals and their associates. All of these loans were made in the ordinary course of business, were made on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable loans with persons not related to the Company and did not involve more than the normal risk of collectability or present other unfavorable features. None of these loans were in default at December 31, 2023. Other changes include adjustments for loans applicable to one reporting period that are excludable from the other reporting period, including changes in the directorate.

NOTE D – LOANS AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

	2023	2022	2021
Balance at January 1	$ 27,803	$ 21,689	$ 22,529
New loans, including renewals	18,331	12,278	12,474
Repayments	(7,953)	(6,513)	(8,458)
Other changes	-	349	(4,856)
Balance at December 31	$ 38,181	$ 27,803	$ 21,689

The unpaid principal balance of mortgage loans serviced for others, which are not included on the consolidated balance sheet, was $169,882,000 and $180,884,000 at December 31, 2023, and 2022, respectively. Custodial escrow balances maintained in connection with serviced loans were $996,000 and $1,193,000 at December 31, 2023, and 2022, respectively.

Activity for capitalized mortgage servicing rights, included in other assets, was as follows (in thousands):

	2023	2022	2021
Balance at January 1	$ 1,368	$ 1,534	$ 1,377
Additions	106	235	584
Amortization	(334)	(401)	(427)
Balance at December 31	$ 1,140	$ 1,368	$ 1,534

The fair value of servicing rights was $2,135,000 and $2,100,000 at year-end 2023 and 2022. Fair value at year-end 2023 was determined using a discount rate of 11.0%; prepayment speeds ranging from 6.33% to 6.85%, depending on the stratification of the specific right; and a weighted average default rate of zero. Fair value at year-end 2022 was determined using a discount rate of 10%; prepayment speeds ranging from 6.67% to 7.58%, depending on the stratification of the specific right; and a weighted average default rate of zero. No valuation allowance for capitalized mortgage servicing rights was considered necessary at December 31, 2023, or 2022, because the estimated fair value of such rights exceeded the carrying value.

Provision for Credit Losses: The provision for credit losses is determined by the Company as the amount to be added to the ACL for various types of financial instruments including loans, investment securities, and unfunded commitment credit exposures after net charge-offs have been deducted to bring the ACL to a level that, in management's judgment, is necessary to absorb expected credit losses over the lives of the respective financial instruments. The provision recorded in 2023 was higher than in 2022 due to loan growth, partially offset by an improvement in the economic forecast. See Note A Nature of Operations and Significant Accounting Policies for additional information regarding the ACL related to investment securities. The following table presents the components of the provision for credit losses (in thousands):

	2023	2022	2021
Provision (credit) for credit losses(1) on:			
Loans	$ 1,024	$ 275	$ 1,500
Unfunded commitments	(74)	-	-
Investment securities	-	-	-
Total	$ 950	$ 275	$ 1,500

(1) The Company adopted ASC 326 as of January 1, 2023. The prior year amounts presented were calculated under the prior accounting method.

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE D – LOANS AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

A summary of the activity for the years ended December 31, 2023, 2022 and 2021 in the allowance for credit losses – loans follows (in thousands):

December 31, 2023	Commercial Real Estate	Commercial	Agriculture	Real Estate Mortgage	Consumer	Total
Balance at January 1	$ 6,710	$ 1,259	$ 632	$ 928	$ 59	$ 9,588
Adoption of ASC 326	(138)	759	(494)	948	25	1,100
Provision (credit) for credit losses (1)	1,177	(305)	10	63	79	1,024
Loans charged off	-	-	-	-	(106)	(106)
Recoveries	-	-	-	46	45	91
Balance at December 31	$ 7,749	$ 1,713	$ 148	$ 1,985	$ 102	$ 11,697
December 31, 2022						
Balance at January 1	$ 6,321	$ 1,271	$ 698	$ 971	59	$ 9,320
Provision (credit) for loan losses	389	(12)	(66)	(99)	63	275
Loans charged off	-	-	-	-	(110)	(110)
Recoveries	-	-	-	56	47	103
Balance at December 31	$ 6,710	$ 1,259	$ 632	$ 928	$ 59	$ 9,588
Ending balance individually evaluated for impairment	$ 3	$ 272	$ -	$ 19	$ -	$ 294
Ending balance collectively evaluated for impairment	6,707	987	632	909	59	9,294
Total	$ 6,710	$ 1,259	$ 632	$ 928	$ 59	$ 9,588
December 31, 2021						
Balance at January 1	$ 5,220	$ 943	$ 739	$ 778	$ 109	$ 7,789
Provision (credit) for loan losses	1,101	328	(41)	153	(41)	1,500
Loans charged off	-	-	-	-	(102)	(102)
Recoveries	-	-	-	40	93	133
Balance at December 31	$ 6,321	$ 1,271	$ 698	$ 971	$ 59	$ 9,320
Ending balance individually evaluated for impairment	$ 59	$ 309	$ -	$ 32	$ -	$ 400
Ending balance collectively evaluated for impairment	6,262	962	698	939	59	8,920
Total	$ 6,321	$ 1,271	$ 698	$ 971	$ 59	$ 9,320

(1) The Company adopted ASC 326 as of January 1, 2023. The prior year amounts presented were calculated under the prior accounting method.

NOTE D – LOANS AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

In 2023, 2022, and 2021, consumer loans also included overdraft charge-offs and recoveries. These amounted to $106,000 and $45,000, respectively, for the year ended December 31, 2023; $109,000 and $45,000, respectively, for the year ended December 31, 2022; and $102,000 and $86,000, respectively, for the year ended December 31, 2021.

The following is a summary of the allowance for credit losses and the recorded investment for collateral dependent loans as of December 31, 2023 (in thousands):

December 31, 2023	Commercial Real Estate	Commercial	Agriculture	Real Estate Mortgage	Consumer	Total
Allowance related to collateral dependent loans	$ -	$ 231	$ -	$ -	$ -	$ 231
Collateral dependent loans	$ 8,852	$ 231	$ -	$ 56	$ -	$ 9,139

The following is a summary of the recorded investment in loans, by portfolio segment, and based on evaluation method, as of December 31, 2022 (in thousands):

December 31, 2022	Commercial Real Estate	Commercial	Agriculture	Real Estate Mortgage	Consumer	Total
Ending balance individually evaluated for impairment	$ 758	$ 272	$ 86	$ 681	$ -	$ 1,797
Ending balance collectively evaluated for impairment	543,640	127,616	65,655	144,860	3,058	884,829
Ending balance	$ 544,398	$ 127,888	$ 65,741	$ 145,541	$ 3,058	$ 886,626

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE D – LOANS AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

The following table presents loans individually evaluated for impairment by class of loans, as of December 31, 2022 (in thousands):

December 31, 2022	Unpaid Principal Balance	Recorded Investment	Allowance for Credit Losses Allocated
With no related allowance recorded:			
Commercial Real Estate	$ 690	$ 690	$ -
Commercial	-	-	-
Agriculture	86	86	-
Real Estate Mortgage	221	221	-
Consumer	-	-	-
With an allowance recorded:			
Commercial Real Estate	68	68	3
Commercial	272	272	272
Agriculture	-	-	-
Real Estate Mortgage	460	460	19
Consumer	-	-	-
Total	$ 1,797	$ 1,797	$ 294

Information regarding impaired loans at December 31 follows (in thousands):

	2022	2021
Average balance of impaired loans during the year	$ 1,988	$ 3,802
Cash basis interest income recognized during the year	$ 129	$ 120
Interest income recognized during the year	$ 128	$ 108

Modifications to borrowers experiencing financial difficulty may include interest rate reductions, principal or interest forgiveness, forbearances, term extensions, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of collateral. The following table presents the amortized cost basis of loan modifications made to borrowers experiencing financial difficulty during the year ended December 31, 2023 (in thousands):

	Type of Concession				
December 31, 2023	Payment Delay	Interest Rate Reduction	Term Extension	Total	% of Total Segment of Loans
Commercial Real Estate	$ 8,182	$ -	$ -	$ 8,182	1.3%
Commercial	-	-	-	-	-
Agriculture	-	-	-	-	-
Real Estate Mortgage	-	-	-	-	-
Consumer	-	-	-	-	-
Total	$ 8,182	$ -	$ -	$ 8,182	1.3%

NOTE D – LOANS AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

For the year ended December 31, 2023, payment delays included six-month interest only payments for these commercial real estate borrowers.

The following table summarizes the number and volume of TDRs the Company has recorded in its loan portfolio, as of December 31, 2022. It also shows the number of TDR loans added during the year and the amount of specific reserves in the allowance for credit losses relating to TDRs (dollars in thousands):

	Total			Added During the Year		
December 31, 2022	**Number of Loans**	**Amount**	**Specific Reserves Allocated**	**Number of Loans**	**Amount**	**Specific Reserves Allocated**
Commercial Real Estate	-	$ -	$ -	-	$ -	$ -
Commercial	-	-	-	-	-	-
Agriculture	1	86	-	-	-	-
Real Estate Mortgage	1	77	-	-	-	-
Consumer	-	-	-	-	-	-
Total	2	$ 163	$ -	-	$ -	$ -

The modification of loan terms that resulted in a TDR included one or more of the following: a reduction of the stated interest rate of the loan, an extension of the maturity date, and/or an extension of the amortization period. The post-modified loan balance for TDRs was essentially the same as the pre-modified balance. No loans modified in 2023 and 2022 subsequently defaulted.

The following table presents the aging of the recorded investment in past due and nonaccrual loans, as of December 31, 2023, and 2022. It is shown by class of loans (in thousands):

	Loans Past Due Accruing Interest						
December 31, 2023	**30-59 Days**	**60-89 Days**	**Over 90 Days**	**Total**	**Loans on Non-Accrual**	**Loans Not Past Due or Non-Accrual**	**Total**
Commercial Real Estate	$ -	$ -	$ -	$ -	$ 602	$ 665,957	$ 666,559
Commercial	-	-	-	-	231	126,455	126,686
Agriculture	-	-	-	-	-	75,629	75,629
Real Estate Mortgage	166	-	-	166	56	162,645	162,867
Consumer	-	-	-	-	-	4,676	4,676
Total	$ 166	$ -	$ -	$ 166	$ 889	$ 1,035,362	$ 1,036,417

	Loans Past Due Accruing Interest						
December 31, 2022	**30-59 Days**	**60-89 Days**	**Over 90 Days**	**Total**	**Loans on Non-Accrual**	**Loans Not Past Due or Non-Accrual**	**Total**
Commercial Real Estate	$ -	$ -	$ -	$ -	$ 690	$ 543,708	$ 544,398
Commercial	-	-	-	-	271	127,617	127,888
Agriculture	-	-	-	-	-	65,741	65,741
Real Estate Mortgage	20	127	-	147	82	145,312	145,541
Consumer	-	-	-	-	-	3,058	3,058
Total	$ 20	$ 127	$ -	$ 147	$ 1,043	$ 885,436	$ 886,626

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE D – LOANS AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

The amortized cost basis for loans on nonaccrual status for which there is no related allowance for credit losses was $658,000 and $749,000 for the years ended December 31, 2023 and 2022, respectively.

Credit Quality Indicators:
The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt, such as current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying them based upon each loan's credit risk. This analysis includes all loans originated by the commercial loan department and is performed at least annually. A small number of loans listed as commercial loans in the Call Report which were originated by the retail loan department, as well as a portion of the remaining PPP loans were not assigned a loan grade. The Company uses the following definitions for risk ratings:

Pass: Loans classified as pass have no existing or known potential weaknesses deserving of management's close attention.

Special Mention: Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Company's credit position at some future date.

Substandard: Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make the full collection or liquidation highly questionable and improbable, based on the currently existing facts, conditions, and values.

NOTE D – LOANS AND ALLOWANCE FOR CREDIT LOSSES (CONTINUED)

The following table presents loans by risk category and origination year at December 31, 2023 (in thousands):

December 31, 2023	2023	2022	2021	Prior	Revolving	Total
Commercial Real Estate						
Pass	$ 127,047	$ 152,461	$ 161,106	$ 213,805	$ 1,661	$ 656,080
Special Mention	-	457	67	1,103	-	1,627
Substandard	-	-	-	8,852	-	8,852
Doubtful	-	-	-	-	-	-
Total commercial real estate	$ 127,047	$ 152,918	$ 161,173	$ 223,760	$ 1,661	$ 666,559
Current period gross charge-offs	$ -	$ -	$ -	$ -	$ -	$ -
Commercial						
Pass	$ 15,570	$ 38,128	$ 8,093	$ 19,297	$ 43,608	$ 124,696
Special Mention	20	210	44	1,485	-	1,759
Substandard	-	-	231	-	-	231
Doubtful	-	-	-	-	-	-
Total commercial	$ 15,590	$ 38,338	$ 8,368	$ 20,782	$ 43,608	$ 126,686
Current period gross charge-offs	$ -	$ -	$ -	$ -	$ -	$ -
Agriculture						
Pass	$ 19,240	$ 8,624	$ 9,566	$ 23,649	$ 12,913	$ 73,992
Special Mention	-	-	474	1,107	-	1,581
Substandard	-	-	-	-	-	56
Doubtful	-	-	-	-	-	-
Total agriculture	$ 19,240	$ 8,624	$ 10,040	$ 24,812	$ 12,913	$ 75,629
Current period gross charge-offs	$ -	$ -	$ -	$ -	$ -	$ -
Real Estate Mortgage						
Pass or not rated	$ 27,098	$ 55,348	$ 28,791	$ 38,192	$ 12,729	$ 162,158
Special Mention	-	95	448	133	-	676
Substandard	-	-	-	33	-	33
Doubtful	-	-	-	-	-	-
Total real estate mortgage	$ 27,098	$ 55,443	$ 29,239	$ 38,358	$ 12,729	$ 162,867
Current period gross charge-offs	$ -	$ -	$ -	$ -	$ -	$ -
Consumer						
Performing	$ 2,622	$ 910	$ 381	$ 430	$ 333	$ 4,676
Non-performing	-	-	-	-	-	-
Total consumer	$ 2,622	$ 910	$ 381	$ 430	$ 333	$ 4,676
Current period gross charge-offs	$ -	$ -	$ -	$ -	$ 106	$ 106

As of December 31, 2022, the risk category of loans by class of loans was as follows (in thousands):

December 31, 2022	Pass	Special Mention	Substandard	Doubtful	Not Risk Rated	Total
Commercial Real Estate	$ 539,986	$ 1,465	$ 758	$ -	$ 2,189	$ 544,398
Commercial	125,738	1,825	272	-	53	127,888
Agriculture	60,466	5,105	108	-	62	65,741
Real Estate Mortgage	88,656	712	58	-	56,115	145,541
Consumer	-	-	-	-	3,058	3,058
Total	$ 814,846	$ 9,107	$ 1,196	$ -	$ 61,477	$ 886,626

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE E – PREMISES AND EQUIPMENT, NET

Premises and equipment, net at December 31, consisted of (in thousands):

	2023	2022
Land	$ 2,964	$ 3,124
Buildings and improvements	28,892	22,162
Furniture and equipment	11,144	10,068
	43,000	35,354
Less accumulated depreciation	(19,886)	(18,809)
Totals	$ 23,114	$ 16,545

NOTE F – OTHER INTANGIBLE ASSETS

Acquired intangible assets as of December 31 were as follows (in thousands):

	2023		2022	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Other acquired relationship intangibles	$ 360	$ 213	$ 360	$ 177

Amortization expense for each of the years ended December 31, 2023, 2022, and 2021, was $36,000.

Amortization expense for the five years subsequent to December 31, 2023, is $36,000 for 2024 through 2027 and $3,000 for 2028.

NOTE G – DEPOSITS

The carrying amount of domestic deposits at year end follows (in thousands):

	2023	2022
Noninterest-bearing checking	$ 226,178	$ 268,704
Interest-bearing checking	359,328	403,039
Savings	99,708	118,795
Money market accounts	156,985	137,076
Time deposits	315,772	163,437
Totals	$ 1,157,971	$ 1,091,051

The carrying amount of time deposits over $250,000 at December 31, 2023, and 2022, was $119,737,000 and $76,552,000, respectively. Interest expense on these deposits was $3,720,000, $657,000, and $510,000 for the years ended December 31, 2023, 2022, and 2021, respectively.

At December 31, 2023, scheduled maturities of time deposits were as follows for the years ending December 31 (in thousands):

2024	$ 112,036
2025	123,405
2026	73,650
2027	6,311
2028	370
Total	$ 315,772

Related party deposits were $15,226,000 and $8,268,000 at December 31, 2023, and 2022, respectively.

NOTE H – OTHER BORROWINGS

Other borrowings at December 31, 2023, and 2022, include borrowings from the Federal Home Loan Bank (FHLB) of Indianapolis and the Federal Reserve. FHLB borrowings at December 31, 2023 and 2022, consisted of $47,900,000 and $40,000,000, respectively, in advances. Principal is due at maturity unless callable by the issuer. Advances outstanding at December 31, 2023, have fixed interest rates ranging from 1.96% to 4.75%, with a weighted average rate of 3.70%. Advances from the FHLB are secured by a blanket collateral agreement, which gives the FHLB an unperfected security interest in certain 1-4 family mortgage, home equity, and commercial real estate loans. Eligible FHLB loan collateral at December 31, 2023, and 2022, was approximately $324,038,000 and $290,580,000, respectively.

In March 2023, the Federal Reserve established the Bank Term Funding Program ("BTFP") to make available funding to eligible depository institutions in order to help assure they have the ability to meet the needs of their depositors following recent events in the banking industry. The program allows for advances for up to one year secured by eligible high-quality securities at par value extending at the one-year overnight index swap ("OIS") rate plus 10 basis points, as of the day the advance is made. The interest rate is fixed for the term of the advance and there are no prepayment penalties. At December 31, 2023, the Bank had outstanding borrowings of $59,000,000 under the BTFP at fixed interest rates ranging from 4.61% to 4.83% and at a weighted average borrowing rate of 4.73% with scheduled principal reductions in 2024.

At December 31, 2023, scheduled principal reductions on other borrowings were as follows (in thousands):

2024	$ 59,000
2025	-
2026	10,000
2027	22,000
2028	5,900
2029	10,000
Total	$ 106,900

NOTE I – SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE AND OVERNIGHT BORROWINGS

Securities sold under agreements to repurchase (repurchase agreements) are direct obligations and are secured by securities held in safekeeping at a correspondent bank. Repurchase agreements are offered primarily to certain large deposit customers as deposit equivalent investments. Information relating to securities sold under agreements to repurchase is as follows (in thousands):

	2023	**2022**
At December 31:		
Outstanding balance	$ 1,738	$ 11,179
Average interest rate	1.71%	0.25%
Daily average for the year:		
Outstanding balance	$ 4,349	$ 11,467
Average interest rate	0.83%	0.23%
Maximum outstanding at any month end	$ 10,659	$ 12,525

At December 31, 2023, and 2022, the Bank has $83,000,000 in line-of-credit arrangements available to purchase federal funds, with no outstanding borrowings.

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE J – SUBORDINATED DEBENTURES AND TRUST PREFERRED SECURITIES

In March 2004, Southern Michigan Bancorp Capital Trust I, a trust formed by the Company, closed a pooled, private offering of 5,000 trust-preferred securities with a liquidation amount of $1,000 per security. The Company issued $5,155,000 of subordinated debentures to the trust in exchange for ownership of all the common securities of the trust and the proceeds of the preferred securities sold by the trust. The Company is not considered the primary beneficiary of this trust, therefore the trust is not consolidated in the Company's financial statements. Rather the subordinated debentures are shown as a liability. The Company may redeem the subordinated debentures, subject to the receipt by the Company of the proper approval of the Federal Reserve, if such approval is required under applicable capital guidelines or policies of the Federal Reserve. The subordinated debentures may be redeemed on January 7, April 7, July 7, and October 7 of each year, either in whole or in integrals of $1,000 at 100% of the principal amount, plus accrued and unpaid interest. The subordinated debentures mature on April 6, 2034. The subordinated debentures are also redeemable in whole, but not in part, from time to time upon the occurrence of specific events defined within the trust indenture. The Company has the option to defer interest payments on the subordinated debentures from time to time for a period not to exceed 20 consecutive quarters.

The $5,000,000 in trust preferred securities may be included in Tier I capital (with certain limitations applicable) under current regulatory guidelines and interpretations. The trust preferred securities and subordinated debentures have a variable rate of interest. Prior to July 3, 2023, the rate of interest was equal to the three-month London Interbank Offered Rate (LIBOR), plus 2.75%. After July 3, 2023, the rate of interest converted to the three-month CME Term SOFR plus a spread adjustment of 0.26161% and a margin adjustment of 2.75%, as defined. The aggregate borrowing rate on December 31, 2023, was 8.41%. Interest expense related to the subordinated debentures amounted to $409,000 in 2023, $243,000 in 2022, and 148,000 in 2021. The Company's investment in the common stock of the trust is $155,000 and is included in other assets.

On April 16, 2021, the Company completed a private placement of $30,000,000 in aggregate principal amount of 3.75% Fixed-to-Floating Rate Subordinated Notes due April 16, 2031 (the "Notes"). The Notes initially bear interest at a fixed rate of 3.75% through April 16, 2026, after which time, until maturity, the rate will reset quarterly to an annual floating rate equal to the then-current 3-month SOFR plus 302 basis points. The Notes are redeemable by the Company at its option, in whole or in part, on or after April 16, 2026. The Notes are not subject to redemption at the option of the holders. The balance of the Notes, net of unamortized issuance costs of $502,000, amounted to $29,498,000 at December 31, 2023. The balance of the Notes amounted to $29,429,000 at December 31, 2022, net of unamortized issuance costs of $571,000. Amortization of debt issuance costs, which is included in interest expense, will be $69,000 for each of the five years subsequent to December 31, 2023.

NOTE K – INCOME TAXES

Income tax provision consists of the following (in thousands):

	2023	2022	2021
Current	$ 2,356	$ 2,646	$ 2,717
Deferred	87	(64)	(354)
Total income tax provision	$ 2,443	$ 2,582	$ 2,363

Income tax provision calculated at the statutory federal income tax rate of 21% for 2023, 2022, and 2021, differs from actual income tax provision as follows (in thousands):

	2023	2022	2021
Income tax at statutory rate	$ 2,803	$ 3,375	$ 2,965
Tax-exempt interest income, net	(110)	(302)	(234)
Earnings on life insurance assets	(130)	(256)	(146)
Low-income housing partnership tax credits	(97)	(97)	(98)
Captive insurance	(109)	(166)	(174)
Stock-based compensation	5	(37)	(15)
Other items, net	81	65	65
Totals	$ 2,443	$ 2,582	$ 2,363

Deferred tax assets and liabilities consist of the following at December 31 (in thousands):

	2023	2022
Deferred tax assets:		
Allowance for credit losses - loans	$ 2,456	$ 2,014
Allowance for credit losses - unfunded commitments	89	-
Deferred compensation and supplemental retirement liability	1,286	1,243
Nonaccrual loan interest	72	54
Stock-based compensation	304	229
Lease liability	672	724
Deferred loan fees	577	567
Accrued expense	240	322
Net unrealized loss on available-for-sale securities	3,064	4,338
Net unrealized loss on held-to-maturity securities	1,305	1,484
Other	36	11
Total deferred tax assets	10,101	10,986
Deferred tax liabilities:		
Mortgage servicing rights	(239)	(287)
Goodwill	(130)	(130)
Purchase accounting adjustments	(12)	(16)
Depreciation	(711)	(463)
Prepaid expenses	(312)	(173)
Right-of-use asset	(635)	(694)
Other	(156)	(113)
Total deferred tax liabilities	(2,195)	(1,876)
Net deferred tax assets included in other assets	$ 7,906	$ 9,110

The Company and its subsidiaries file U.S. federal and certain state tax returns. In general, tax returns are no longer subject to tax examinations by tax authorities for years before 2020.

SMB Risk Management, Inc. has elected, under IRC Section 831(b), to be taxed only on its investment income, which excludes the premium payments received under its insurance contracts from taxable income.

The Company believes that it had no significant uncertain tax positions as of December 31, 2023, and 2022.

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE L – BENEFIT PLANS

Employee Stock Ownership Plan/401(k) Plan: The Company has an employee stock ownership plan (ESOP) for substantially all full-time employees. The ESOP includes a 401(k) provision that allows employee contributions which are matched equal to 100% of the first 3% and 50% of the next 2% of the compensation contributed. Prior to 2023, the Company's matching contribution was provided in Company stock. Effective January 1, 2023, the Company's matching contribution is made in cash. The Board of Directors determines the Company's contribution level annually. Expense charged to operations for contributions to the ESOP totaled \$606,000, \$440,000, and \$415,000 in 2023, 2022, and 2021, respectively.

Shares held by the ESOP at year end are as follows:

	2023	2022
Allocated shares	176,510	212,502
Unallocated shares	-	-
Total ESOP shares	176,510	212,502

The fair value of allocated shares held by the ESOP was \$2,807,000 and \$4,091,000 at December 31, 2023, and 2022, respectively. Upon distribution of shares to a participant, the participant has the right to require the Company to purchase shares at fair value, in accordance with the terms and conditions of the plan.

Deferred Compensation Plan: Directors and certain officers of the Bank may defer a portion of their director fees or compensation in a non-qualified deferred compensation plan. An account is established for each participant in the plan and credited with the participant's annual deferred compensation, plus interest, based on the stated rate determined annually. Upon retirement, participants receive the balance in their account over 15 years. Participants also continue to earn interest during retirement based on their remaining account balance. Participants are immediately vested in their account balances. The plan is intended to be funded by certain bank-owned life insurance contracts. The interest rate paid on deferred compensation balances as of December 31, 2023, was 5.35%. Deferred compensation expense was \$424,000, \$387,000, and \$328,000 in 2023, 2022, and 2021, respectively. The liability for deferred compensation benefits was \$4,082,000 and \$3,798,000 at December 31, 2023, and 2022, respectively, and is included in accrued expenses and other liabilities in the accompanying consolidated balance sheets.

Supplemental Retirement Plans: In December 2011, the Board of Directors approved the Defined Contribution Supplemental Executive Retirement Plan (2011 SERP), which is intended to provide select executive officers with a retirement benefit that is competitive with industry practices for bank executives when combined with the executive's other employer-funded retirement benefits. The 2011 SERP is a defined contribution arrangement which gives the Bank the discretion to make a specific annual, nonqualified, deferred compensation contribution to the account of participating executives. Whether an annual deferred compensation contribution will be made to the account balance of a participating executive, as well as the amount of the contribution, is at the discretion of the Bank's Board of Directors. The contribution that will be made by the Bank to the account of each executive is determined based on a percentage of base salary. Participants are generally entitled to receive payment of the benefit in their account in 120 equal monthly installments, commencing at age 65. Expense associated with the 2011 SERP amounted to \$162,000 in 2023, \$113,000 in 2022, and \$212,000 in 2021. Liabilities associated with the 2011 SERP totaled \$2,040,000 and \$2,119,000 at December 31, 2023, and 2022, respectively, and are included in accrued expenses and other liabilities in the accompanying consolidated balance sheets.

NOTE M – STOCK-BASED COMPENSATION

The Company has stock-based compensation plans as described below. Total compensation cost charged against income for those plans, was $1,282,000, $728,000, and $1,018,000 in 2023, 2022, and 2021, respectively.

The Southern Michigan Bancorp, Inc. Stock Incentive Plan of 2014 was created to advance the interest of the Company and its shareholders by affording to directors, officers, and other employees of the Company an opportunity for increased stock ownership. The plan permits the grant and award of stock options, stock appreciation rights, restricted stock, and stock awards. A maximum of 800,000 shares of common stock were available under the plan as a result of the May 2021 100% stock dividend. The plan was terminated on May 11, 2023, when shareholders approved the Southern Michigan Bancorp, Inc. Stock Incentive Plan of 2023. The 2023 plan allows for up to 800,000 shares of common stock, with 734,520 available at December 31, 2023.

The fair value of each option award is estimated on the date of grant, using a Black-Scholes option valuation model that uses the weighted average assumptions noted in the following table. The expected volatility and life assumptions are based on historical experience. The interest rate is based on the U.S. Treasury yield curve and the dividend yield assumption is based on the Company's history and expected dividend payouts. Forfeitures are recognized as they occur.

	2023	2022	2021
Risk-free interest rate	4.37%	1.01%	0.11%
Expected option life	8 years	8 years	8 years
Expected stock price volatility	19.06%	18.88%	18.78%
Dividend yield	2.74%	2.67%	2.55%
Weighted-average fair value of options granted during year	$ 3.92	$ 2.72	$ 3.87

A summary of the activity in the stock-based compensation plans for 2023 follows:

Stock Options

	Shares Subject to Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning of year	178,400	$ 18.49		
Granted	65,400	18.38		
Exercised	(3,000)	14.76		
Forfeited	(1,600)	19.73		
Outstanding at end of year	239,200	$ 18.50	6.81	$ 21,000
Exercisable at year end	129,400	$ 17.90	5.15	$ 21,000

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE M – STOCK-BASED COMPENSATION (CONTINUED)

	2023	2022	2021
Intrinsic value of options exercised	$ 12,000	$ 13,000	$ 30,000
Cash received from options exercised	44,000	34,000	44,000
Tax benefit realized from options exercised	5,000	37,000	15,000

As of December 31, 2023, there was $128,000 of total, unrecognized compensation cost related to non-vested stock options granted under the plans. The cost is expected to be recognized over a weighted-average period of seventeen months.

Restricted Stock – Restricted shares may be issued under the 2023 plan described above. Compensation expense is recognized over the vesting period of the shares, based on the market value of the shares on the issue date. The total fair value of shares vested during the years ended December 31, 2023, 2022, and 2021 was $888,000, $1,036,000, and $973,000, respectively. As of December 31, 2023, there was $2,247,000 of total unrecognized compensation cost related to unvested shares granted under the plan. The cost is expected to be recognized over a weighted-average period of 3.6 years.

A summary of activity for restricted stock for 2023 follows:

	Shares	Weighted Average Grant Date Fair Value
Non-vested at January 1, 2023	101,440	$ 18.96
Granted	113,780	17.82
Vested	(46,446)	18.83
Forfeited	(4,534)	19.09
Non-vested at December 31, 2023	164,240	$ 18.21

NOTE N – COMMITMENTS

Various commitments arise in the normal course of business, such as commitments under commercial letters of credit, standby letters of credit, and commitments to extend credit. These arrangements have credit risk essentially the same as that involved in extending loans to customers and are subject to the Bank's normal credit policies. Collateral generally consists of receivables, inventory, and equipment and is obtained based on management's credit assessment of the customer.

Under standby letter of credit agreements, the Company agrees to honor certain commitments in the event that its customers are unable to do so. At December 31, 2023, and 2022, commitments under outstanding standby letters of credit were $7,933,000 and $16,316,000, respectively.

Loan commitments outstanding to extend credit are detailed below (in thousands):

	2023	2022
Fixed rate	$ 58,571	$ 97,753
Variable rate	135,921	163,550
Totals	$ 194,492	$ 261,303

NOTE N – COMMITMENTS (CONTINUED)

The fixed rate commitments have stated interest rates ranging from 2.00% to 15.00%. The terms of the above commitments range from 1 to 360 months.

Management does not anticipate any losses due to these transactions; however, the above amounts represent the maximum exposure to credit loss for loan commitments, as well as commercial and standby letters of credit.

Certain executives of the Bank have employment contracts containing change of control clauses. The employment contracts provide for the payment of up to 2.99 times the officers' base salaries and bonuses, should the officers be terminated in the event of a change of control.

NOTE O – RESTRICTIONS ON TRANSFERS FROM SUBSIDIARIES

Capital guidelines adopted by federal and state regulatory agencies and restrictions imposed by law, limit the amount of cash dividends the Bank can pay to the Company. At December 31, 2023, using the most restrictive of these conditions, the aggregate cash dividends the Bank could pay the Company without prior regulatory approval was approximately $27.0 million.

NOTE P – ACCUMULATED OTHER COMPREHENSIVE LOSS

Accumulated other comprehensive loss amounted to $16,434,000 at December 31, 2023, and $21,901,000 at December 31, 2022, consisting of the following (in thousands):

	2023	2022
Unrealized loss on available-for-sale securities, net of income tax benefit of $3,064 in 2023, and $4,338 in 2022	$ 11,525	$ 16,318
Unrealized loss on held-to-maturity securities, net of income tax benefit of $1,305 in 2023, and $1,484 in 2022	$ 4,909	$ 5,583

NOTE Q – SOUTHERN MICHIGAN BANCORP, INC. (PARENT COMPANY ONLY) FINANCIAL INFORMATION

Condensed financial statements of Southern Michigan Bancorp, Inc. follow (in thousands):

Balance Sheets	**December 31,**	
	2023	**2022**
Assets		
Cash and cash equivalents	$ 4,348	$ 8,518
Investment in subsidiary bank	123,357	108,391
Investment in non-bank subsidiaries	4,003	2,112
Premises and equipment, net	505	1,343
Other assets	1,007	1,068
Total Assets	$ 133,220	$ 121,432
Liabilities and Shareholders' Equity		
Dividends payable	$ 629	$ 591
Other liabilities	108	93
Subordinated debentures	34,653	34,584
Shareholders' equity	97,830	86,164
Total Liabilities and Shareholders' Equity	$ 133,220	$ 121,432

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE Q – SOUTHERN MICHIGAN BANCORP, INC. (PARENT COMPANY ONLY) FINANCIAL INFORMATION (CONTINUED)

Statements of Income	**Year ended December 31,**		
	2023	**2022**	**2021**
Dividends from subsidiary bank	$ 1,910	$ 3,962	$ 3,885
Dividends from non-bank subsidiaries	735	765	710
Interest income	-	5	7
Interest expense	(1,604)	(1,438)	(1,057)
Rental income from subsidiary bank	137	137	137
Other expenses	(1,473)	(972)	(1,330)
	(295)	2,459	2,352
Federal income tax credit	(618)	(477)	(471)
	323	2,936	2,823
Equity in net income, less dividends received from:			
Subsidiary bank	10,768	10,508	8,800
Non-bank subsidiaries	(186)	47	134
Net Income	$ 10,905	$ 13,491	$ 11,757

Statements of Cash Flows	**Year ended December 31,**		
	2023	**2022**	**2021**
Operating Activities			
Net income	$ 10,905	$ 13,491	$ 11,757
Adjustments to reconcile net income to net cash from operating activities:			
Equity in net income, less dividends received from:			
Subsidiary bank	(10,768)	(10,508)	(8,800)
Non-bank subsidiaries	186	(47)	(134)
Stock option and restricted stock grant compensation expense	1,282	728	1,018
Depreciation of premises and equipment	13	16	31
Amortization of subordinated debt issuance costs	69	70	52
Decrease in ESOP obligation	-	210	80
Other, net	76	37	(90)
Net cash from operating activities	1,763	3,997	3,914
Investing Activities			
Additions to premises and equipment	(2)	(755)	-
Proceeds from sale of premises to non-bank subsidiary	755	-	-
Capital contribution to bank subsidiary	-	-	(15,000)
Capital contribution to non-bank subsidiary	(2,000)	-	-
Net cash from investing activities	(1,247)	(755)	(15,000)
Financing Activities			
Repayments of other borrowings	-	-	(6,500)
Proceeds from subordinated debt, net of issuance costs	-	-	29,307
Cash dividends paid	(2,500)	(2,318)	(2,175)
Stock options exercised	44	34	44
Repurchase of common stock	(2,230)	(924)	(2,435)
Net cash from financing activities	(4,686)	(3,208)	18,241
Net change in cash and cash equivalents	(4,170)	34	7,155
Beginning cash and cash equivalents	8,518	8,484	1,329
Ending cash and cash equivalents	$ 4,348	$ 8,518	$ 8,484

During 2023, the Company contributed land of $72,000 to a non-bank subsidiary.

NOTE R – SUPPLEMENTAL CASH FLOW DISCLOSURES

The following supplemental cash flow disclosures are provided for the years ended December 31, 2023, 2022, and 2021 (in thousands):

	2023	2022	2021
Cash paid during the year for:			
Interest	$ 23,926	$ 5,731	$ 3,916
Income taxes	2,650	2,470	3,610
Supplemental non-cash disclosures:			
Change in deferred income taxes on net unrealized gain (loss) on available-for-sale securities	1,274	(4,565)	(933)
Change in deferred income taxes on net unrealized gain (loss) on held-to-maturity securities	179	(1,484)	-
Increase in ACL – loans ($1,100,000) and unfunded commitments ($500,000), net of deferred income taxes ($336,000) as a result of adoption of ASC 326.	1,264	-	-
Lease liabilities arising from obtaining right-of-use assets	207	773	-
Derecognition of lease liability and right-of-use asset from purchase of leased premises	(322)	-	-
Change in unrealized gain (loss) on available-for-sale securities	6,067	(29,500)	(4,439)
Accretion of unrealized loss on held-to-maturity securities	853	694	-
Transfers from loans to other real estate owned	17	-	-
Transfers of securities from available-for-sale to held-to-maturity	-	66,387	-

NOTE S – FAIR VALUE INFORMATION

The following methods and assumptions were used by the Company in estimating fair values for financial instruments, as well as for gaining an indication of where the instruments fall within the fair value hierarchy. This is described in greater detail in Note T.

Cash and cash equivalents: The carrying amount reported in the balance sheet approximates fair value and results in a Level 1 classification.

Securities available-for-sale and held-to-maturity: Fair values for securities are based on quoted market prices, where available. For all other securities, the Company obtains a current price from a broker trade desk. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and bond terms and conditions, among other things. Securities are classified as either Level 1, 2, or 3. See Note T for the hierarchy level breakdown for available-for-sale securities.

Loans, net: For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values and result in a Level 3 classification. The fair values for other loans are estimated using discounted cash flows analyses and interest rates currently offered for loans with similar terms to borrowers of similar credit quality. Such loans result in a Level 3 classification.

Loans held for sale: The fair value of loans held for sale is estimated based upon binding contracts and quotes from third party investors and results in a Level 2 classification.

Accrued interest receivable: The carrying amount reported in the balance sheet approximates fair value.

Off-balance-sheet financial instruments: The estimated fair value of off-balance-sheet financial instruments is based on current fees or costs that would be charged to enter or terminate the arrangements. The estimated fair value is not considered significant for this presentation.

Deposits: The fair values disclosed for demand deposits (e.g., interest and non-interest checking, savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts) and result in a Level 2 classification. Fair values for fixed-rate

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE S – FAIR VALUE INFORMATION (CONTINUED)

certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates based on the FHLB yield curve, resulting in a Level 2 classification.

Securities sold under agreements to repurchase, overnight borrowings, and federal funds sold: The carrying amount reported in the balance sheet approximates fair value and results in a Level 2 classification.

Other borrowings: The fair value of other borrowings is estimated using discounted cash flows analyses using the FHLB yield curve. This results in a Level 2 classification.

Subordinated debentures: The carrying amount reported in the balance sheet approximates fair value of the variable-rate subordinated debentures. The fair value for the fixed rate subordinated debentures is estimated using discounted cash flow analyses. Such analyses are based on the current borrowing rates for similar types of borrowing arrangements. This results in a Level 3 classification.

Accrued interest payable: The carrying amount reported in the balance sheet approximates fair value.

While these estimates of fair value are based on management's judgment of appropriate factors, there is no assurance that if the Company had disposed of such items at December 31, 2023, and 2022, the estimated fair values would have been achieved. Market values may differ depending on various circumstances not taken into consideration in this methodology. The estimated fair values at December 31, 2023, and 2022, should not necessarily be considered to apply at subsequent dates.

In addition, other assets and liabilities not defined as financial instruments are not included in the following disclosures, such as property and equipment. Furthermore, non-financial instruments typically not recognized in financial statements may have value but are not included in the following disclosures. These include, among other items, the estimated earnings power of core deposit accounts, the trained work force, customer goodwill, and similar items.

The estimated fair values of the Company's financial instruments at year end are as follows (in thousands):

	Fair Value Hierarchy	2023 Carrying Amount	2023 Fair Value	2022 Carrying Amount	2022 Fair Value
Financial assets:					
Cash and cash equivalents	Level 1	$ 71,620	$ 71,620	$ 77,255	$ 77,255
Federal funds sold	Level 2	1,468	1,468	253	253
Securities available-for-sale	See Note T	169,740	169,740	178,154	178,154
Securities held-to-maturity	Level 2 or 3	61,600	56,594	69,661	62,944
Loans held for sale	Level 2	169	169	-	-
Loans, net of allowance for credit losses	Level 3	1,024,720	971,786	877,038	847,987
Accrued interest receivable	Level 1	6,664	6,664	5,535	5,535
Financial liabilities:					
Deposits	Level 2	$ (1,157,971)	$ (1,039,268)	$ (1,091,051)	$ (1,086,897)
Securities sold under agreements to repurchase and overnight borrowings	Level 2	(1,738)	(1,738)	(11,179)	(11,179)
Other borrowings	Level 2	(106,900)	(106,832)	(40,000)	(39,428)
Subordinated debentures	Level 3	(34,653)	(30,470)	(34,584)	(31,896)
Accrued interest payable	Level 1	(1,917)	(1,917)	(323)	(323)

The preceding table does not include net cash surrender value of life insurance, interest rate swaps, and dividends payable, which are also considered financial instruments. The estimated fair value of such items is considered to be their carrying amount.

NOTE T – FAIR VALUE MEASUREMENTS

The Company also has unrecognized financial instruments related to commitments to extend credit and standby letters of credit, as described in Note N. The contract amount of such instruments is considered to be the fair value.

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

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

The fair value hierarchy is as follows:

Level 1 Inputs – Unadjusted, quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 Inputs – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include: 1) quoted prices for similar assets or liabilities in active markets; 2) quoted prices for assets or liabilities which are identical or similar in markets that are not active; 3) inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.); or 4) inputs derived principally from, or corroborated by, market data by correlation or other means.

Level 3 Inputs – Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments, pursuant to the valuation hierarchy, follows. These valuation methodologies were applied to all the Company's financial and non-financial assets and liabilities carried at fair value.

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality, the company's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Company's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. While management believes the Company's valuation methodologies are appropriate and consistent with other market participants, the use of different methodologies or assumptions to

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE T – FAIR VALUE MEASUREMENTS (CONTINUED)

determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

Securities Available-for-Sale: Securities classified as available-for-sale are reported at fair value utilizing Level 1, Level 2, and Level 3 inputs. Unadjusted, quoted prices in active markets for identical assets are utilized to determine fair value at the measurement date for Level 1 securities. For all other securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and bond terms and conditions, among other things. When there are unobservable inputs, such securities are classified as Level 3.

Collateral Dependent Loans: From time to time, certain collateral dependent loans will have an ACL established. When the fair value of the collateral is based on an appraised value or when an appraised value is not available, the collateral dependent loans are recorded as nonrecurring Level 3.

Other Real Estate Owned (OREO): The Company values OREO at the fair value of the underlying collateral, less expected selling costs. Collateral values are estimated primarily using discounted appraisals and reflect a market value approach. These discounts generally range from 25% to 55%. Due to the significance of unobservable inputs used in estimating fair value, OREO has been classified as Level 3. The Company held no OREO at December 31, 2023 and 2022.

Interest Rate Swaps: Interest rate swap valuations are determined using proprietary pricing models with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. The valuations utilize certain Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by the Company and its counterparties. These credit valuation adjustments do not significantly impact the overall valuation of swap positions and the swap valuations are classified as Level 2 in the fair value hierarchy.

NOTE T – FAIR VALUE MEASUREMENTS (CONTINUED)

The following table summarizes financial and non-financial assets, as well as non-financial liabilities, measured at fair value as of December 31, 2023, and 2022. Information is segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (in thousands):

2023	**Level 1 Inputs**	**Level 2 Inputs**	**Level 3 Inputs**	**Total Fair Value**
Recurring:				
Assets				
Securities available-for-sale:				
US Government	$ 20,649	$ -	$ -	$ 20,649
Mortgage-backed securities	-	51,844	-	51,844
States and political subdivisions	-	81,861	-	81,861
Corporate securities	-	1,768	-	1,768
Asset-backed securities	-	13,618	-	13,618
Total available-for-sale	$ 20,649	$ 149,091	$ -	$ 169,740
Interest rate swaps	$ -	$ 333	$ -	$ 333
Liabilities				
Interest rate swaps	$ -	$ 333	$ -	$ 333
Nonrecurring assets:				
Collateral dependent loans	$ -	$ -	$ -	$ -

2022	**Level 1 Inputs**	**Level 2 Inputs**	**Level 3 Inputs**	**Total Fair Value**
Recurring:				
Assets				
Securities available-for-sale:				
US Government	$ 20,494	$ -	$ -	$ 20,494
Mortgage-backed securities	-	60,395	-	60,395
States and political subdivisions	-	78,456	-	78,456
Corporate securities	-	1,829	-	1,829
Asset-backed securities	-	16,980	-	16,980
Total available-for-sale	$ 20,494	$ 157,660	$ -	$ 178,154
Interest rate swaps	$ -	$ 447	$ -	$ 447
Liabilities				
Interest rate swaps	$ -	$ 447	$ -	$ 447
Nonrecurring assets:				
Collateral dependent loans	$ -	$ -	$ 506	$ 506

Collateral dependent loans are reported net of an allowance for credit losses of $231,000 at December 31, 2023, and $294,000 at December 31, 2022.

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE T – FAIR VALUE MEASUREMENTS (CONTINUED)

The following is a reconciliation of the beginning and ending balances of securities available-for-sale measured at fair value on a recurring basis, using significant unobservable (Level 3) inputs during the year ended December 31, 2022 (in thousands):

Balance at January 1	$ 33,299
Net maturities and calls and transfers	(33,299)
Balance at December 31	$ -

Level 3 available-for-sale securities were transferred to held-to-maturity during 2022 and are carried at amortized cost.

NOTE U – REGULATORY MATTERS

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action that could have a direct, material adverse effect on the consolidated financial statements. Prompt corrective action provisions are not applicable to bank holding companies.

The prompt corrective action regulations provide five capital categories, including well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized or worse, regulatory approval is required to, among other things, accept brokered deposits. If undercapitalized, capital distributions and asset growth are limited while plans for capital restoration are required.

Under the amended Small Bank Holding Company Policy Statement (Regulation Y, Appendix C) (the "Policy Statement") the Company qualifies for treatment as a small bank holding company and is no longer subject to consolidated capital rules.

NOTE U – REGULATORY MATTERS (CONTINUED)

At year end, actual capital levels and minimum required levels were as follows (in thousands):

	Actual		Minimum Required For Capital Adequacy Purposes		Minimum Required To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2023						
Total Capital to risk-weighted assets:						
Consolidated	$ 147,973	13.3%	N/A	N/A	N/A	N/A
Bank	138,347	12.4	$ 89,116	8.0%	$ 111,395	10.0%
Tier 1 (Core) Capital to risk-weighted assets:						
Consolidated	105,850	9.5	N/A	N/A	N/A	N/A
Bank	126,224	11.3	66,837	6.0	89,116	8.0
Common Tier 1 Capital to risk-weighted assets (CET1):						
Consolidated	105,850	9.5	N/A	N/A	N/A	N/A
Bank	126,224	11.3	50,128	4.5	72,407	6.5
Tier 1 (Core) Capital to average assets:						
Consolidated	105,850	7.6	N/A	N/A	N/A	N/A
Bank	126,224	9.0	56,137	4.0	70,171	5.0
2022						
Total Capital to risk-weighted assets:						
Consolidated	$ 139,048	13.3%	N/A	N/A	N/A	N/A
Bank	126,270	12.2	$ 83,164	8.0%	$ 103,955	10.0%
Tier 1 (Core) Capital to risk-weighted assets:						
Consolidated	99,460	9.5	N/A	N/A	N/A	N/A
Bank	116,682	11.2	62,373	6.0	83,164	8.0
Common Tier 1 Capital to risk-weighted assets (CET1):						
Consolidated	99,460	9.5	N/A	N/A	N/A	N/A
Bank	116,682	11.2	46,780	4.5	67,570	6.5
Tier 1 (Core) Capital to average assets:						
Consolidated	99,460	8.1	N/A	N/A	N/A	N/A
Bank	116,682	9.4	49,809	4.0	62,261	5.0

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE V – QUALIFIED AFFORDABLE HOUSING PROJECT INVESTMENTS

The Company invests in qualified investment housing projects. At December 31, 2023, and 2022, the balance of the investment for qualified affordable housing projects was $401,000 and $494,000, respectively. These balances are reflected in other assets in the consolidated balance sheets. Total unfunded commitments related to the investments in qualified affordable housing projects totaled $27,000 and $29,000 at December 31, 2023 and 2022. The Company expects to fulfill these commitments by the year ending 2036.

During the years ended December 31, 2023, 2022, and 2021, the Company recognized amortization expense of $93,000, $84,000, and $97,000, respectively, which was included in the income tax provision in the consolidated statements of income.

Additionally, during the years ended December 31, 2023, 2022, and 2021, the Company recognized tax credits and other benefits from its investment in affordable housing tax credits of $97,000, $97,000, and $98,000, respectively.

NOTE W – REVENUE FROM CONTRACTS WITH CUSTOMERS

The Company's primary sources of revenue include net interest income, service charges and fees, trust fees, gains on the sale of loans, earnings on life insurance assets, and ATM and debit card fee income. Net interest income, gains on the sale of loans, securities and other assets, as well as earnings on life insurance assets are outside of the scope of ASC 606, *Revenue from Contracts with Customers*. Other sources of revenue fall within the scope of ASC 606 and are primarily recognized within "Non-interest income" in the consolidated statements of income.

The Company recognizes revenue when the performance obligations related to the transfer of goods or services under the terms of a contract are satisfied. Some obligations are satisfied at a point in time, while others are satisfied over a period of time. Revenue is recognized as the amount of consideration expected to be received in exchange for transferring goods or services to a customer; it is segregated based on the nature of products and services offered as part of contractual arrangements. Generally, these sources of revenue are earned at the time the service is delivered or over the course of a monthly period; they do not result in any contract asset or liability balance at any given period end. As a result, there were no contract assets or liabilities recorded. Revenue within the scope of ASC 606 is discussed in the following paragraphs.

Service charges on deposit accounts include fees and other charges the Company receives to provide various services. The charges include, but are not limited to, monthly service fees, account analysis fees, overdraft fees, and stop-payment fees. The consideration includes both fixed (e.g., monthly service fees) and transaction fees (e.g., stop-payment fees). Fixed fees are recognized over the period of time the service is provided while transaction fees are recognized when a specific service is rendered to the customer.

Trust fees include fee income generated from investment management services. Services are rendered over a period of time, over which revenue is recognized.

ATM and debit card fees primarily include debit card interchange and network revenues. Debit card interchange and network revenues are earned on debit card transactions conducted through payment networks such as MasterCard and Pulse. Interchange income is recognized concurrently with the delivery of services on a daily basis. Interchange and network revenues are presented gross of interchange expenses, which are presented separately as a component of non-interest expense.

Other non-interest income includes check orders, wire transfer fees, check cashing fees, cash management fees, and other service charges totaling $644,000, $625,000, and $558,000 during 2023, 2022, and 2021, respectively. The Company's performance obligation for cash management fees is generally satisfied, and therefore, revenue is recognized over the period in which the service is provided. Check orders, wire transfer fees, check cashing fees, and other deposit account related fees are largely transaction based. Therefore, the performance obligation is satisfied and related revenue is recognized at a point in time. These fees are included in the Other category of "Non-interest income".

NOTE W - REVENUE FROM CONTRACTS WITH CUSTOMERS (CONTINUED)

Contract Balances
A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The Company's non-interest income streams are largely based on transactional activity or standard month-end revenue accruals, such as asset management fees based on month-end market values. Consideration is most often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of December 31, 2023, and 2022, the Company did not have a material amount of contract balances.

NOTE X – LEASES

The Company enters into leases in the normal course of business primarily for business development offices and bank branches. The Company’s leases have remaining terms ranging from 7 to 20 years, some of which include renewal options to extend the lease for up to 10 years. The weighted average remaining lease term at December 31, 2023, was 16.35 years.

The Company includes lease extension options in the lease term if, after considering relevant economic factors, it is reasonably certain the Company will exercise the option.

Lease expense for operating leases is recognized on a straight-line basis over the lease term. Right-of-use assets represent the right to use an underlying asset for the lease term. Lease liabilities represent the Company’s obligation to make lease payments arising from the lease. Right-of-use assets and lease liabilities are recognized at the lease commencement date based on the estimated present value of lease payments over the lease term.

The Company uses its incremental borrowing rate at lease commencement to calculate the present value of lease payments when the rate implicit in a lease is not known. The Company’s incremental borrowing rate is based on the prime rate. The weighted average discount rate was 4.59% and 4.45% at December 31, 2023 and December 31, 2022, respectively.

Right-of-use assets are included in other assets and lease liabilities are included in accrued expenses and other liabilities in the consolidated balance sheets. At December 31, 2023, and 2022, the right-of-use assets totaled $3,023,000 and $3,305,000, respectively, and lease liabilities totaled $3,250,000 and $3,488,000, respectively.

Rent expense under operating leases amounted to $293,000, $221,000, and $188,000 in 2023, 2022, and 2021, respectively. Amortization of right-of-use assets totaled $167,000, $117,000, and $90,000 in 2023, 2022 and 2021, respectively.

Lease commitments under non-cancelable operating leases at December 31, 2023, were as follows (in thousands):

2024	$ 272
2025	283
2026	288
2027	292
2028	297
Thereafter	3,153
Total future minimum lease payments	4,585
Amounts representing interest	(1,335)
Total lease liabilities	$ 3,250

SOUTHERN MICHIGAN BANCORP, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE Y – DERIVATIVE FINANCIAL INSTRUMENTS

The Bank has entered into an interest rate swap agreement with a commercial customer to accommodate their borrowing needs. To offset exposure and manage its own interest rate risk, the Bank simultaneously entered into an interest rate swap agreement with a correspondent bank counterparty with offsetting terms. By definition, these agreements are considered to be derivative instruments but are not designated as accounting hedges. As a result, any changes in the net fair value of the instruments are recognized in non-interest income or expense. Due to the nature of the offset in value between the agreements with the customer and the counterparty, the Bank does not expect to have any interest rate risk relating to these agreements and no amount was recognized as non-interest income or expense in 2023 or 2022. The fair value of the instruments, amounting to $333,000 and $447,000 are included in other assets and accrued expense and other liabilities in the 2023 and 2022 consolidated balance sheets.

The following tables present the derivative financial instruments as of December 31, 2023, and December 31, 2022, (Notional Amount and Fair Value in thousands):

December 31, 2023	Notional Amount	Fixed Rate	Floating Rate	Maturity	Fair Value
Customer interest rate swap Receive fixed/pay floating	$ 9,938	4.5%	1 Month SOFR + 1.70%	4.2 yrs.	$ (333)
Correspondent interest rate swap Pay fixed/receive floating	9,938	4.5%	1 Month SOFR + 1.70%	4.2 yrs.	333

December 31, 2022	Notional Amount	Fixed Rate	Floating Rate	Maturity	Fair Value
Customer interest rate swap Receive fixed/pay floating	$ 10,258	4.5%	1 Month LIBOR +1.70%	5.2 yrs.	$ (447)
Correspondent interest rate swap Pay fixed/receive floating	10,258	4.5%	1 Month LIBOR + 1.70%	5.2 yrs.	447

NOTE Z – QUARTERLY FINANCIAL DATA (IN THOUSANDS, EXCEPT PER SHARE DATA) (UNAUDITED)

	Interest Income	Net Interest Income	Provision for Credit Losses	Net Income	Earnings Per Share Basic	Earnings Per Share Fully Diluted
2023						
First Quarter	$ 14,333	$ 9,854	$ 275	$ 3,005	$ 0.66	$ 0.66
Second Quarter	15,991	9,861	650	2,696	0.59	0.59
Third Quarter	17,231	9,935	25	2,767	0.61	0.61
Fourth Quarter	18,013	10,330	-	2,437	0.54	0.54
2022						
First Quarter	$ 9,213	$ 8,264	$ -	$ 2,933	$ 0.65	$ 0.65
Second Quarter	10,164	9,120	-	3,361	0.74	0.74
Third Quarter	11,537	10,098	-	3,613	0.80	0.79
Fourth Quarter	13,220	10,620	275	3,584	0.79	0.79

SOUTHERN MICHIGAN BANCORP, INC.

SELECTED FINANCIAL DATA
(in thousands, except per share data)

	Year Ended December 31				
	2023	2022	2021	2020	2019
Total interest income	$ 65,568	$ 44,134	$ 37,140	$ 31,818	$ 32,553
Net interest income	39,980	38,102	33,319	26,677	26,126
Provision for credit losses	950	275	1,500	2,600	225
Net income	10,905	13,491	11,757	7,386	8,622
Per share data (1):					
Basic earnings per share	2.40	2.98	2.59	1.61	1.87
Cash dividends declared	0.56	0.52	0.48	0.46	0.46
Balance sheet data:					
Gross loans	1,036,417	886,626	741,408	635,870	562,864
Deposits	1,157,971	1,091,051	974,352	838,298	655,762
Subordinated debentures	34,653	34,584	34,514	5,155	5,155
Other borrowings	106,900	40,000	20,000	26,500	37,500
Equity	97,830	86,164	97,749	92,977	83,345
Total assets	1,414,795	1,276,523	1,161,154	997,574	809,716
Return on average assets	0.80%	1.10%	1.06%	0.82%	1.09%
Return on average equity (2)	11.94	15.68	12.32	8.36	10.74
Dividend payout ratio (3)	23.27	17.55	18.60	28.82	24.47
Average equity to average assets (2)	6.70	7.04	8.62	9.80	10.20

(1) Per share data for years 2019 and 2020 has been restated for the 2021 100% stock dividend.
(2) Average equity in the above table includes common shares subject to a repurchase obligation held in the Company's ESOP plan and includes average, unrealized appreciation, or depreciation on securities available-for-sale and held-to-maturity.
(3) Dividends declared, divided by net income.

COMMON STOCK MARKET PRICES AND DIVIDENDS

The Company's common stock is regularly quoted on the OTC Pink under the symbol SOMC. The sale prices described below are quotations reflecting inter-dealer prices without retail markups, markdowns, or commissions; they may not necessarily represent actual transactions. As of March 11, 2024, there were 4,521,106 shares of Southern common stock, issued and outstanding, held by 284 holders of record.

The following table sets forth the range of high and low closing sales prices and dividends declared on the Company's common stock for the two most recent fiscal years:

	2023			2022		
	Closing Price		Cash Dividends	Closing Price		Cash Dividends
Quarter Ended	High	Low	Declared	High	Low	Declared
March 31	$ 22.00	$ 18.20	$ 0.14	$ 21.49	$ 20.00	$ 0.13
June 30	20.50	15.55	0.14	23.00	21.07	0.13
September 30	18.70	16.50	0.14	23.99	20.50	0.13
December 31	17.48	15.15	0.14	22.25	19.25	0.13

There are restrictions that currently limit the Company's ability to pay cash dividends. Information regarding dividend payment restrictions is described in Note O to the consolidated financial statements.

Our Locations

BATTLE CREEK BRANCH
5350 E BECKLEY RD
BATTLE CREEK, MI 49015

CENTREVILLE BRANCH
235 E MAIN ST
CENTREVILLE, MI 49032

COLDWATER MAIN OFFICE
51 W PEARL ST
COLDWATER, MI 49036

COLDWATER WEST CHICAGO
2 W CHICAGO ST
COLDWATER, MI 49036

COLDWATER EAST CHICAGO
*DRIVE THRU LOCATION ONLY
441 E CHICAGO ST
COLDWATER, MI 49036

CONSTANTINE BRANCH
345 N WASHINGTON ST
CONSTANTINE, MI 49042

HILLSDALE BRANCH
10 E CARLETON RD
HILLSDALE, MI 49242

JACKSON DOWNTOWN BRANCH
200 N JACKSON ST
JACKSON, MI 49201

JACKSON LOAN PRODUCTION OFFICE
113 W MICHIGAN AVE
JACKSON, MI 49201

MARSHALL BRANCH
1110 W MICHIGAN AVE
MARSHALL, MI 49068

MENDON BRANCH
136 N NOTTAWA ST
MENDON, MI 49072

PORTAGE BRANCH
531 W KILGORE RD
PORTAGE, MI 49024

PORTAGE TRADE CENTRE
650 TRADE CENTRE WAY, STE 120
PORTAGE, MI 49002

STURGIS BRANCH
200 JOHN ST
STURGIS, MI 49091

TEKONSHA BRANCH
202 N MAIN ST
TEKONSHA, MI 49092

THREE RIVERS BRANCH
225 US 131
THREE RIVERS, MI 49093

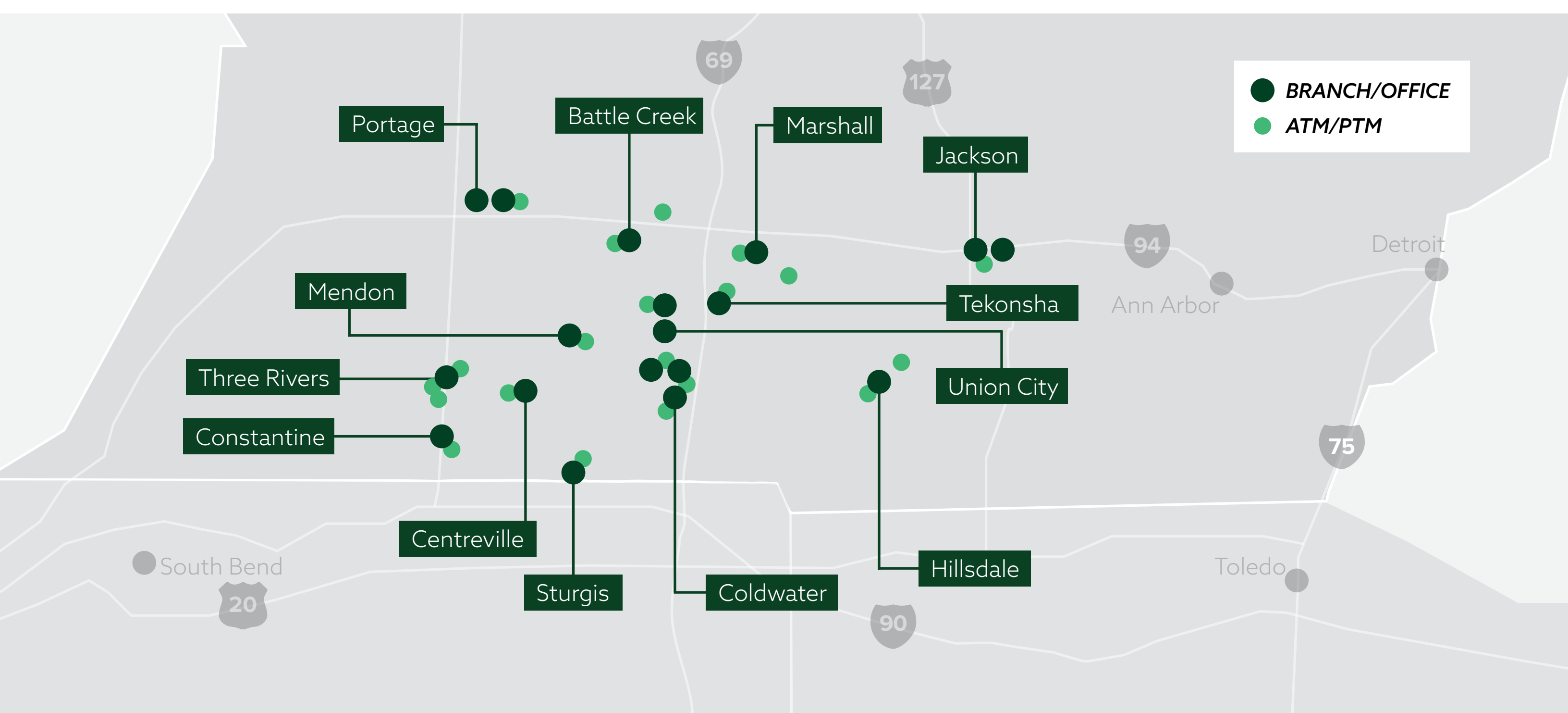
UNION CITY BRANCH
225 N BROADWAY ST
UNION CITY, MI 49094

Coming Soon

JACKSON BRANCH
CORNER OF HORTON RD
& WEATHERWAX DR
JACKSON, MI 49201

STURGIS BRANCH
711 S CENTREVILLE RD
STURGIS, MI 49091

Scan the QR Code to find a location near you



Continuous Banking Since 1872

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