

# 2020

## Annual Report



Proudly serving our community for 110 years

Peoples Bancorp, Inc.  
and Subsidiary  
The Peoples Bank,  
Fleetwood, Athey, Macbeth & McCown, Inc.  
Chestertown, Maryland

PEOPLES BANCORP, INC. AND SUBSIDIARY

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BANK SERVICES

ATM SERVICE	MOBILE BANKING & DEPOSIT
BILL PAYING SERVICE	MONEY MARKET ACCOUNTS
CERTIFICATES OF DEPOSIT	NIGHT DEPOSIT SERVICES
CHECKING ACCOUNTS	NOW ACCOUNTS
DEBIT CARDS	PERSON TO PERSON TRANSFERS
DIRECT DEPOSIT PAYROLL	REMOTE DEPOSIT CAPTURE
DRIVE-IN SERVICE	SAFE DEPOSIT BOXES
EXTERNAL TRANSFERS	SAVINGS ACCOUNTS
INDIVIDUAL RETIREMENT ACCOUNTS	SUPER NOW ACCOUNTS
INTERNET BANKING	TELEPHONE BANKING
LOANS, ALL TYPES	VISA TRAVEL & GIFT CARDS
MERCHANT CARD SERVICES	

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# PEOPLES BANCORP, INC. AND SUBSIDIARY

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## PEOPLES BANCORP, INC.

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### DIRECTORS

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**E. Jean Anthony**  
Chestertown, Maryland

**Robert W. Clark, Jr.**  
Bertterton, Maryland

**LaMonte E. Cooke**  
Chestertown, Maryland

**R. Allen Davis**  
Galena, Maryland

**Ralph W. Dowling**  
Chestertown, MD

**Corey N. Duncan**  
Easton, Maryland

**Gary B. Fellows**  
Millington, Maryland

**Herman E. (Trey) Hill, III**  
Rock Hall, Maryland

**Patricia Joan O. Horsey**  
Chestertown, Maryland

**Myles S. Loller**  
Worton, Maryland

**Megan B. Owings\***  
Chestertown, Maryland

**Stefan R. Skipp**  
Arnold, Maryland

**William G. Wheatley**  
Worton, Maryland

\* The Peoples Bank

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### OFFICERS

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**Gary B. Fellows**  
Chairman of Bank Board

**William G. Wheatley**  
Chairman of Bancorp Board

**Ralph W. Dowling**  
President & CEO

**Richard C. Fleetwood, Jr.**  
President of FAM & M, Inc.

**H. Lawrence Lyons**  
Executive Vice President & COO

**Randall M. Robey**  
Executive Vice President & CFO

**Stephanie L. Usilton**  
EVP & HRO & Board Secretary

**David A. Bowman**  
Senior Vice President & CLO

**Terri L. Garvey**  
Senior Vice President

**Nancy L. Greenwood**  
Senior Vice President

**Mary Chandler Obrecht**  
Senior Vice President & CCO

**Patricia A. Heinefield**  
Vice President

**James "Josh" Johnson, IV**  
Vice Pres. of FAM&M, Inc.

**S. Henrietta Maloney**  
Vice President

**Ina P. Reed**  
Vice President & Controller

**Heather M. Spofford**  
Vice Pres. of FAM&M, Inc.

**Cecil A. Unruh**  
Vice President

**L. Susan Barnhardt**  
Assistant Vice President

**Harriet P. Creighton**  
Assistant Vice President

**Katie E. DiSano**  
Assistant Vice President

**Sheila M. Dwyer**  
Assistant Vice President

**Eva W. Hickman**  
Assistant Vice President

**Jodi L. Richardson**  
Assistant Vice President

**Jacquelyn V. Shields**  
Assistant Vice President

**Carolyn L. Walls**  
Assistant Vice President

**M. Kay McHenry**  
Assistant Secretary

**Karen A. Burriss**  
Assistant Cashier

**Brandi C. Blyman**  
Assistant Cashier

**Donna H. Edwards**  
Assistant Cashier

**Grace M. Eyer**  
Assistant Cashier

**Evetta D. Hopkins**  
Assistant Cashier

**Mary Ann Landa**  
Assistant Cashier

**Jennifer J. Teat**  
Assistant Cashier

**Roni Lynn Thomas**  
Assistant Cashier

**Samantha M. Thompson**  
Assistant Cashier

### OTHER PERSONNEL

Kathleen E. Barnhart  
Kathleen M. Bigelow  
Brianna K. Boyle  
Kathleen F. Bozarth  
Kimberly Tanya Brilz  
Mary L. Burton  
Lori A. Goad  
Anjanette S. Graves  
Carolyn L. Greaves  
Bryan C. Greenwood  
Margaret K. Hammer

Anita T. Hayes  
Wilhelmina "Diena" Howard  
Lisa M. Jefferson  
Samantha Jo Kamm  
Susan M. Joyner  
Jamie L. LaFollette  
Melissa L. Leonard  
Donna M. Lins  
Meghan P. Livie  
Jennifer L. Mancuso  
Kathryn A. Mazur

Spencer M. McAllister  
Maleena E. "Liz" Meekins  
Lorraine Susan Molano  
Richard J. Newberry  
Lisa C. Nicholas  
Brittany A. Patchett-Rue  
Marcey G. Peet  
Wendy M. Pleasants  
Barbara A. Reinhardt  
Barbara J. Richardson  
Clara M. Ross

Lois L. Serio  
Sarah S. Sutton  
Sharon L. Sutton  
Noralene H. Thomas  
Stephanie L. Thomas  
Laurel A. Toth  
Deborah C. Voshell  
Grace A. Wheatley  
Kimberly S. Wood  
Daniel Zottarelli

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PEOPLES BANCORP, INC. AND SUBSIDIARY

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Greetings to our Shareholders,

We continue to deal with the fall-out of the COVID-19 epidemic and the resulting period of unprecedented interest rate challenges. Although our lobbies remain closed, we have been able to alter our processes to provide effective customer service. Our Pandemic Plan was designed with the health of the communities we serve, as well as the personal safety of our employees and asset protection of our clients in mind and has proven effective.

The changes of the interest rate environment remain a significant challenge. Our profitability is directly correlated to our interest rate margin, which is the difference between our cost of procuring deposits and our ability to maintain our loan levels and rates at a competitive level. This margin is nearing a historical low point and is impacting our core earning ability. Fortunately, our insurance operating results appear steady, allowing us to balance our earnings. We would expect this trend to continue into 2022.

Our organizational financial results in 2020 were satisfactory. Our profits totaled \$2,189,318 for the year, representing a modest decrease in net income from the prior year. Excluding loans, we continue to increase our market share. Deposits have increased substantially as a result of changes in customer spending habits with significant new accounts both from competitors and from the relocation of new customers from other areas. As to offered product and services, the conversion of our core processing system has enhanced our technology allowing us to provide a high level of customer service on a digital basis.

While enhancing shareholder value without compromising asset quality remains our top strategic objective, there are likely challenges on our horizon. That said, our loan underwriting standards have withstood the test of this current economic cycle and our portfolio performance appears to be on solid footings.

On a personal note, my role as CEO/President of The Peoples Bank will end May 19, 2021. I will move on to the next phase of my career; however, Patti and I have no plans for relocating. The past eight years have been extraordinary and Patti and I have been blessed by the many friendships that we've made in Chestertown and on the Eastern Shore. Thank you for your support of my leadership and our efforts in the community. My acknowledgement to the officers and employees of The Peoples Bank and Fleetwood Insurance Agency for the team support that has contributed to our organizational success. I will remember and honor my relationships with each of you!

I have confidence that our efforts here will not be forgotten and that the shareholders were well served during my tenure.



Ralph Dowling  
President and CEO

PEOPLES BANCORP, INC. AND SUBSIDIARY

**Financial Highlights**

**Five years ended December 31, 2020**

	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>
	(dollars in thousands except per share amounts)				
Investments, including stock	<b>\$ 21,307</b>	\$ 15,115	\$ 23,160	\$ 29,366	\$ 37,576
Loans (net of the allowance for loan losses)	<b>173,838</b>	185,294	191,755	181,155	156,306
Deposits	<b>269,222</b>	214,721	216,016	221,166	216,757
Stockholders' equity	<b>30,235</b>	28,672	26,474	24,527	23,574
Assets	<b>305,199</b>	249,191	246,543	250,273	254,661
Net income	<b>2,189</b>	2,563	2,108	1,518	1,317
Return on average assets	<b>0.80%</b>	1.03%	0.87%	0.62%	0.54%
Return on average equity	<b>7.44%</b>	9.11%	8.40%	6.36%	5.47%
Earnings per share	<b>3.00</b>	3.52	2.89	2.08	1.71
Dividends per share	<b>0.72</b>	0.70	0.49	0.47	0.68
Book value per share	<b>41.48</b>	39.34	36.32	33.65	32.34
Number of shares outstanding	<b>728,918</b>	728,918	728,918	728,918	728,918

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PEOPLES BANCORP, INC. AND SUBSIDIARY

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**COMMITTEES**

**AUDIT COMMITTEE**

Corey . Duncan, Chairperson  
E. Jean Anthony  
Robert W. Clark, Jr.  
Patricia Joan O. Horsey  
Stefan R. Skipp

**LOAN COMMITTEE**

William G. Wheatley, Chairperson  
E. Jean Anthony  
R. Allen Davis  
Herman E. (Trey) Hill, III  
Patricia Joan O. Horsey  
Megan B. Owings  
Stefan R. Skipp

**CAPITAL COMMITTEE**

Herman E. (Trey) Hill, III, Chairperson  
Ralph Dowling  
Myles S. Loller  
Stefan R. Skipp  
William G. Wheatley

**NOMINATING COMMITTEE**

Robert W. Clark, Jr., Chairperson  
LaMonte E. Cooke  
Gary G. Fellows  
Myles S. Loller  
William G. Wheatley

**COMMUNITY & EMPLOYEES RELATIONS  
COMMITTEE**

LaMonte E. Cooke, Chairperson  
Ralph Dowling  
Corey N. Duncan  
Gary B. Fellows  
Patricia Joan O. Horsey

**PERSONNEL/COMPENSATION COMMITTEE**

R. Allen Davis, Chairperson  
E. Jean Anthony  
LaMonte E. Cooke  
Corey N. Duncan  
Herman E. (Trey) Hill, III  
Megan B. Owings

**EXECUTIVE COMMITTEE**

Gary B. Fellows, Chairperson of Bank  
William G. Wheatley, Chairperson of Bancorp  
R. Allen Davis

**RISK MANAGEMENT COMMITTEE**

Robert W. Clark, Jr., Chairperson  
Corey N. Duncan  
Herman E. (Trey) Hill, III  
Patricia Joan O. Horsey  
Stefan R. Skipp

**GOVERNANCE COMMITTEE**

Gary B. Fellows, Chairperson  
Robert W. Clark, Jr.  
LaMonte E. Cooke  
R. Allen Davis  
Myles S. Loller  
Megan B. Owings\*

**TRUSTEES OF THE PEOPLES BANK  
DEFINED BENEFIT PLAN**

E. Jean Anthony  
H. Lawrence Lyons  
Randall M. Robey

\*The Peoples Bank

The Board of Directors and Stockholders  
Peoples Bancorp, Inc.  
Chestertown, Maryland

## **Report of Independent Auditors**

### ***Report on the Financial Statements***

We have audited the accompanying consolidated financial statements of Peoples Bancorp, Inc. and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2020 and 2019, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

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

### ***Auditor's Responsibility***

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

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

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

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Peoples Bancorp, Inc. and Subsidiary as of December 31, 2020 and 2019, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Rowles & Company, LLP*

Baltimore, Maryland  
March 22, 2021

PEOPLES BANCORP, INC. AND SUBSIDIARY

**CONSOLIDATED BALANCE SHEETS**

**ASSETS**

**DECEMBER 31,**

	2020	2019
Cash and due from banks	\$ 97,132,878	\$ 35,036,517
Investment securities available for sale	21,023,049	14,832,627
Federal Home Loan Bank and CBB Financial Corp. stock, at cost	284,400	282,000
Loans, less allowance for loan losses of \$3,248,248 and \$3,145,185	173,837,969	185,294,172
Premises and equipment	7,106,220	7,270,112
Accrued interest receivable	536,513	458,703
Deferred income taxes	336,241	310,878
Other real estate owned	351,214	511,829
Goodwill and other intangibles	3,612,066	3,835,639
Other assets	978,890	1,358,553
	<b>\$305,199,440</b>	<b>\$249,191,030</b>

**LIABILITIES AND STOCKHOLDERS' EQUITY**

	2020	2019
Deposits		
Noninterest bearing checking	\$105,257,312	\$ 75,980,111
Savings and NOW	92,325,289	71,911,550
Money market	21,594,795	17,864,878
Other time	50,044,267	48,964,509
	269,221,663	214,721,048
Securities sold under repurchase agreements	2,733,049	1,279,631
Other borrowings	-	1,296,000
Accrued interest payable	52,566	83,763
Other liabilities	2,956,826	3,138,090
	274,964,104	220,518,532
Stockholders' equity		
Common stock, par value \$10 per share; authorized 1,000,000 shares; issued and outstanding 728,918 shares	7,289,180	7,289,180
Additional paid-in capital	2,212,550	2,212,550
Retained earnings	21,772,039	20,107,542
Accumulated other comprehensive income (loss)		
Unrealized gain on securities available for sale	108,007	4,471
Unrecognized net actuarial loss	(1,146,440)	(941,245)
	30,235,336	28,672,498
	<b>\$305,199,440</b>	<b>\$249,191,030</b>

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

PEOPLES BANCORP, INC. AND SUBSIDIARY

**CONSOLIDATED STATEMENTS OF INCOME**

**YEARS ENDED DECEMBER 31,**

	<u>2020</u>	<u>2019</u>
<b>Interest and dividend revenue</b>		
Loans, including fees	\$ 8,593,615	\$8,735,767
U.S. government agency securities	181,350	300,576
Other	155,164	327,969
Total interest and dividend revenue	<u>8,930,129</u>	<u>9,364,312</u>
<b>Interest expense</b>		
Deposits	512,193	558,777
Borrowed funds	20,942	55,176
Total interest expense	<u>533,135</u>	<u>613,953</u>
Net interest income	8,396,994	8,750,359
<b>Provision for loan losses</b>	-	(600,000)
Net interest income after provision for loan losses	<u>8,396,994</u>	<u>9,350,359</u>
<b>Noninterest revenue</b>		
Service charges on deposit accounts	396,782	655,663
Insurance commissions	4,407,586	3,848,166
Gain on sale of other real estate owned	192,274	134,979
Loss on sale of assets	(3,677)	(12,144)
Other noninterest revenue	243,143	250,834
Total noninterest revenue	<u>5,236,108</u>	<u>4,877,498</u>
<b>Noninterest expense</b>		
Salaries	5,678,208	5,396,350
Employee benefits	1,214,774	1,339,814
Occupancy	581,097	664,548
Furniture and equipment	491,145	521,736
Data processing and correspondent fees	587,573	836,362
Other real estate owned expense	70,697	127,196
Professional fees	459,267	461,641
Other operating	1,585,922	1,638,647
Total noninterest expense	<u>10,668,683</u>	<u>10,986,294</u>
<b>Income before income taxes</b>	2,964,419	3,241,563
Income tax expense	<u>775,101</u>	<u>678,413</u>
<b>Net income</b>	<u>\$ 2,189,318</u>	<u>\$2,563,150</u>
Earnings per common share - basic and diluted	<u>\$ 3.00</u>	<u>\$ 3.52</u>

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

PEOPLES BANCORP, INC. AND SUBSIDIARY

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	<b>YEARS ENDED DECEMBER 31,</b>	
	<b>2020</b>	<b>2019</b>
<b>Net income</b>	<b><u>\$2,189,318</u></b>	<b><u>\$2,563,150</u></b>
<b>Other comprehensive income (loss)</b>		
Unrealized gain on investment securities available for sale	142,842	270,933
Income tax relating to unrealized gain on investment securities available for sale	<u>(39,306)</u>	<u>(74,554)</u>
	<b><u>103,536</u></b>	<b><u>196,379</u></b>
Change in unrecognized net actuarial loss for defined benefit plan	(283,096)	(69,518)
Income tax relating to change in underfunded status of defined benefit plan	<u>77,901</u>	<u>19,129</u>
	<b><u>(205,195)</u></b>	<b><u>(50,389)</u></b>
Total other comprehensive income (loss)	<b><u>(101,659)</u></b>	<b><u>145,990</u></b>
<b>Total comprehensive income</b>	<b><u><u>\$2,087,659</u></u></b>	<b><u><u>\$2,709,140</u></u></b>

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

PEOPLES BANCORP, INC. AND SUBSIDIARY

**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY  
YEARS ENDED DECEMBER 31, 2020 and 2019**

	Common stock		Additional	Retained	Accumulated	Total
	Shares	Par value	paid-in	earnings	other	stockholders'
			capital		comprehensive	equity
					income (loss)	
<b>Balance, December 31, 2018</b>	728,918	\$7,289,180	\$2,212,550	\$18,054,635	\$(1,082,764)	\$26,473,601
Net income	-	-	-	2,563,150	-	2,563,150
Change in unrecognized actuarial loss for defined benefit plan net of income taxes of \$19,129	-	-	-	-	(50,389)	(50,389)
Unrealized gain on investment securities available for sale net of income taxes of \$74,554	-	-	-	-	196,379	196,379
Cash dividend, \$0.70 per share	-	-	-	(510,243)	-	(510,243)
<b>Balance, December 31, 2019</b>	728,918	7,289,180	2,212,550	20,107,542	(936,774)	28,672,498
Net income	-	-	-	<b>2,189,318</b>	-	<b>2,189,318</b>
Change in unrecognized actuarial loss for defined benefit plan net of income taxes of <b>\$77,901</b>	-	-	-	-	<b>(205,195)</b>	<b>(205,195)</b>
Unrealized gain on investment securities available for sale net of income taxes of <b>\$39,306</b>	-	-	-	-	<b>103,536</b>	<b>103,536</b>
Cash dividend, <b>\$0.72</b> per share	-	-	-	<b>(524,821)</b>	-	<b>(524,821)</b>
<b>Balance, December 31, 2020</b>	<b><u>728,918</u></b>	<b><u>\$7,289,180</u></b>	<b><u>\$2,212,550</u></b>	<b><u>\$21,772,039</u></b>	<b><u>\$(1,038,433)</u></b>	<b><u>\$30,235,336</u></b>

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

PEOPLES BANCORP, INC. AND SUBSIDIARY

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**YEARS ENDED DECEMBER 31,**

	<b>2020</b>	2019
<b>Cash flows from operating activities</b>		
Interest received	<b>\$ 8,946,516</b>	\$ 9,813,444
Fees and commissions received	<b>5,047,511</b>	4,754,663
Interest paid	<b>(564,332)</b>	(581,730)
Cash paid to suppliers and employees	<b>(10,078,265)</b>	(9,732,028)
Income taxes paid	<b>(761,870)</b>	(439,598)
	<b>2,589,560</b>	3,814,751
<b>Cash flows from investing activities</b>		
Proceeds from maturities and calls of investment securities available for sale	<b>10,860,780</b>	18,620,085
Purchase of investment securities available for sale	<b>(17,099,794)</b>	(10,339,595)
Redemption (purchase) of Federal Home Loan Bank stock	<b>(2,400)</b>	3,400
Loans made, net of principal collected	<b>11,216,709</b>	4,417,970
Purchase of premises, equipment, and software	<b>(292,327)</b>	(1,717,533)
Proceeds from sale of premises and equipment	<b>1,000</b>	475
Proceeds from sale of other real estate owned	<b>689,621</b>	980,515
Cash paid for acquisition of insurance agency	<b>-</b>	(989,378)
	<b>5,373,589</b>	10,975,939
<b>Cash flows from financing activities</b>		
Net increase (decrease) in		
Time deposits	<b>1,079,758</b>	(3,734,455)
Other deposits	<b>53,420,857</b>	2,439,723
Securities sold under repurchase agreements	<b>1,453,418</b>	(403,129)
Advances under (repayments of) notes payable	<b>(1,296,000)</b>	-
Dividends paid	<b>(524,821)</b>	(510,243)
	<b>54,133,212</b>	(2,208,104)
Net increase (decrease) in cash and cash equivalents	<b>62,096,361</b>	12,582,586
Cash and cash equivalents at beginning of year	<b>35,036,517</b>	22,453,931
Cash and cash equivalents at end of year	<b>\$97,132,878</b>	\$35,036,517

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

PEOPLES BANCORP, INC. AND SUBSIDIARY

**CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**

**YEARS ENDED DECEMBER 31,**

	<u>2020</u>	<u>2019</u>
<b>Reconciliation of net income to net cash provided by operating activities</b>		
Net income	<b>\$ 2,189,318</b>	\$ 2,563,150
<b>Adjustments to reconcile net income to net cash provided by operating activities</b>		
Amortization of premiums and accretion of discounts	<b>191,434</b>	32,516
Provision for loan losses	-	(600,000)
Depreciation and software amortization	<b>457,442</b>	415,240
Amortization of intangible assets	<b>223,573</b>	223,573
Gain on sale of other real estate owned	<b>(192,274)</b>	(134,979)
Loss on sale and disposal of assets	<b>3,677</b>	12,144
Decrease (increase) in		
Accrued interest receivable	<b>(77,810)</b>	31,674
Deferred income taxes	<b>13,232</b>	238,815
Other assets	<b>373,763</b>	(133,083)
Deferred origination costs, net	<b>(97,237)</b>	384,942
Increase (decrease) in		
Accrued interest payable	<b>(31,197)</b>	32,223
Other liabilities	<b>(464,361)</b>	748,536
	<b><u>\$ 2,589,560</u></b>	<b><u>\$ 3,814,751</u></b>
<b>Non cash transactions</b>		
Transfer of foreclosed loans to other real estate owned	<b><u>\$ 336,732</u></b>	<b><u>\$ 614,075</u></b>

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. Summary of Significant Accounting Policies

The accounting and reporting policies reflected in the accompanying financial statements of Peoples Bancorp, Inc. and its subsidiary, The Peoples Bank, a Maryland commercial bank (the "Bank") and its subsidiaries, Fleetwood, Athey, MacBeth & McCown, Inc. (dba Fleetwood Insurance Group), an insurance agency (the "Insurance Subsidiary") and PB Land Trust, a trust to maintain foreclosed real estate owned by the company (the "Land Trust"), conform to accounting principles generally accepted in the United States of America ("GAAP") and to general practices within the banking industry. As used in these notes, unless the context requires otherwise, the term "the Company" refers collectively to Peoples Bancorp, Inc., the Bank, the Insurance Subsidiary, and the Land Trust.

#### **Principles of consolidation**

The consolidated financial statements include the accounts of the Peoples Bancorp, Inc. and the Bank, the Insurance Subsidiary, and the Land Trust. Intercompany balances and transactions have been eliminated.

#### **Nature of business**

Peoples Bancorp, Inc. and its subsidiary operate primarily in Kent, Cecil, Queen Anne's and Talbot Counties, Maryland. The Bank, which operates out of a main office and six branches, offers deposit services and loans to individuals, small businesses, associations, and government entities. Other services include direct deposit of payroll and social security checks, automatic drafts from accounts, automated teller machine services, cash management services, safe deposit boxes, money orders and on-line banking with bill payment service.

The Insurance Subsidiary operates from locations in Kent County and Talbot County. They provide a full range of insurance products to businesses and consumers. Product lines include property, casualty, life, marine, long-term care and health insurance.

#### **Use of estimates**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements. These estimates and assumptions may affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

#### **Cash and cash equivalents**

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, and federal funds sold. Generally, federal funds are sold for one-day periods.

#### **Investment securities**

As securities are purchased, management determines if the securities should be classified as held to maturity or available for sale. Securities which management has the intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost which is cost adjusted for amortization of premiums through the first call date and accretion of discounts to maturity, or over the expected life in the case of mortgage-backed securities. Amortization and accretion are recorded using the interest method. Securities which may be sold before maturity are classified as available for sale and carried at fair value with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

Gains and losses on the sale of securities are determined using the specific identification method.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. Summary of Significant Accounting Policies (Continued)

#### **Federal Home Loan Bank stock and CBB Financial Corp. stock**

Federal Home Loan Bank stock and CBB Financial Corp. stock are carried at cost. As a member of the Federal Home Loan Bank, the Bank is required to purchase stock based on its total assets. Additional stock is purchased and redeemed based on outstanding Federal Home Loan Bank advances to the Bank.

#### **Loans and allowance for loan losses**

Loans are stated at their outstanding unpaid principal balance adjusted for deferred origination costs, deferred origination fees, and the allowance for loan losses.

Interest on loans is accrued based on the principal amounts outstanding. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method. The accrual of interest is discontinued when it is not reasonable to expect collection of interest under the original terms. These loans are classified as nonaccrual even though the presence of collateral or the borrower's financial strength may be sufficient to provide for ultimate repayment. Interest on nonaccrual loans is recognized only when received. A loan is generally placed in nonaccrual status when it is specifically determined to be impaired or it becomes 90 days or more past due. When a loan is placed in nonaccrual status, all interest that had been accrued on the loan but remains unpaid is reversed and deducted from earnings as a reduction of reported interest revenue. No additional interest is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain. A loan will be returned to accrual status when all of the principal and interest amounts contractually due are brought current and management believes that future principal and interest amounts contractually due are reasonably assured, which belief is typically evidenced by a sustained period (at least six months) of repayment performance by the borrower.

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes a loan is uncollectible. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, changes in lending practices and policies, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the collateral value, if the loan is collateral dependent, or the discounted cash flows of the impaired loan is lower than the carrying value of that loan. The general component covers nonclassified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. Summary of Significant Accounting Policies (Continued)

#### **Loans and allowance for loan losses (Continued)**

A loan is considered impaired when, based on current information and events, management believes that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Impairment is measured on a loan-by-loan basis. Reserves are determined using the net present value of cash flows, or if the loan is collateral dependent, the fair value of the collateral less cost to sell.

As a general rule, a loan, or a portion thereof, is deemed uncollectible and is charged-off when the Company becomes aware of the loss. The Company becomes aware of a loss upon the occurrence of one or more triggering events, including, among other things, the receipt of new information about the borrower's intent and/or ability to repay the loan, the severity of delinquency, the borrower's bankruptcy, the detection of fraud, or the borrower's death.

During the year ended December 31, 2020, the Bank provided short-term deferrals of loan principal and/or interest payments up to 90 days for borrowers who were affected by the COVID-19 pandemic. Customers receiving deferral were required to meet certain criteria, such as being in good standing and not more than 30 days past due prior to the pandemic. As of December 31, 2020, all borrowers who were provided a short-term deferral during the year had returned to paying their loans in accordance with their loan agreements.

#### **Premises and equipment**

Land is carried at cost. Premises and equipment are recorded at cost less accumulated depreciation. Depreciation is computed using the straight-line method over estimated useful lives of three to ten years for furniture and equipment, ten to forty years for premises, and three years for software.

#### **Other real estate owned**

Real estate acquired through foreclosure is recorded at the lower of cost or fair value on the date acquired. In general, cost equals the Company's investment in the property at the time of foreclosure. Losses incurred at the time of acquisition of the property are charged to the allowance for loan losses. Subsequent reductions in the estimated value of the property are included in other operating expense.

#### **Goodwill and intangible assets**

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Other intangible assets represent purchased assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset or liability. Goodwill is not ratably amortized into the income statement over an estimated life, but rather is tested at least annually for impairment. The balance of goodwill was \$705,620 at December 31, 2020 and 2019.

Intangible assets that have finite lives are amortized over their estimated useful lives and are also subject to impairment testing. The Company's intangible assets have finite lives and are amortized on a straight-line basis over periods not exceeding 15 years.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. Summary of Significant Accounting Policies (Continued)

#### Income taxes

The provision for income taxes includes taxes payable for the current year and deferred income taxes. Deferred income taxes are provided for the temporary differences between financial and taxable income.

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

#### Per share data

Basic earnings per share is calculated by dividing net income available to common stockholders by the weighted-average number of common shares outstanding and does not include the effect of any potentially dilutive common stock equivalents. Diluted earnings per share is calculated by dividing net income by the weighted-average number of shares outstanding, adjusted for the dilutive effect of stock-based awards. The weighted average number of shares outstanding were 728,918 for 2020 and 2019. There were no dilutive common stock equivalents outstanding in 2020 or 2019.

#### Segment reporting

The Company conducts business in two operating segments - Community Banking and Insurance. Each of the operating segments is a strategic business unit that offers different products and services. The Insurance segment was a business that was acquired in a transaction where the management of the agency was retained. The accounting policies of the segment are the same as those of the Company. However, the segment data reflects inter-segment transactions and balances.

The Community Banking segment is conducted through The Peoples Bank and involves delivering a broad range of financial products and services, including various loan and deposit products to both individuals and businesses. The Community Banking segment income is included in the Parent Holding Company which is the top tier of the Company. Major revenue sources include net interest income and service charges on deposit accounts. Expenses include interest paid on deposits, personnel, occupancy, equipment, and other expenses.

The Insurance segment is conducted through Fleetwood Insurance Group, a subsidiary of the Bank, and offers a full range of insurance products to businesses and consumers. Fleetwood Insurance Group, a general insurance agency conducts business from two locations in Chestertown and Easton, Maryland. Major sources of revenue are insurance commissions from property, casualty, life, marine, long-term care, and health insurance. Expenses include personnel, occupancy, and support charges. Noncash charges associated with amortization of intangibles related to the acquired entities totaled \$223,573 for the years ended December 31, 2020 and 2019, respectively.

PEOPLES BANCORP, INC. AND SUBSIDIARY

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Summary of Significant Accounting Policies (Continued)**

**Segment reporting (Continued)**

Information for the operating segments and reconciliation of the information to the consolidated financial statements for the years ended December 31 is presented in the following tables:

<b>December 31, 2020</b>	Community banking	Insurance	Inter-segment elimination	Total
Interest income	\$ 8,930,129	\$ 10	\$ (10)	\$ 8,930,129
Interest expense	513,865	19,280	(10)	533,135
Provision for loan losses	-	-	-	-
Noninterest revenue	907,601	4,418,507	(90,000)	5,236,108
Noninterest expenses	<u>7,627,725</u>	<u>3,130,958</u>	<u>(90,000)</u>	<u>10,668,683</u>
Income before income taxes	1,696,140	1,268,279	-	2,964,419
Income tax expense	<u>422,591</u>	<u>352,510</u>	-	<u>775,101</u>
Net income	<u>\$ 1,273,549</u>	<u>\$ 915,769</u>	<u>\$ -</u>	<u>\$ 2,189,318</u>
Assets	<u>\$300,073,733</u>	<u>\$6,979,369</u>	<u>\$(1,853,662)</u>	<u>\$305,199,440</u>
<hr/>				
December 31, 2019				
Interest income	\$ 9,364,312	\$ 18	\$ (18)	\$ 9,364,312
Interest expense	563,621	50,350	(18)	613,953
Provision for loan losses	(600,000)	-	-	(600,000)
Noninterest revenue	1,005,570	3,871,928	-	4,877,498
Noninterest expenses	<u>8,011,327</u>	<u>2,974,967</u>	-	<u>10,986,294</u>
Income before income taxes	2,394,934	846,629	-	3,241,563
Income tax expense	<u>438,264</u>	<u>240,149</u>	-	<u>678,413</u>
Net income	<u>\$ 1,956,670</u>	<u>\$ 606,480</u>	<u>\$ -</u>	<u>\$ 2,563,150</u>
Assets	<u>\$240,112,304</u>	<u>\$7,364,285</u>	<u>\$(1,714,441)</u>	<u>\$ 249,191,030</u>

**Subsequent events**

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2020 through March 22, 2021, the date these financial statements were available to be issued, for items that should potentially be recognized or disclosed in these financial statements. No significant subsequent events were identified that would affect the presentation of the financial statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**2. Agency Acquisition**

On January 2, 2019, the Bank's wholly-owned subsidiary, Fleetwood, Athey, MacBeth, and McCown, Inc. (dba Fleetwood Insurance Group) purchased the assets of Bartlett, Griffin, & Vermilye, an insurance agency with an office located in Easton, Maryland. The operations are included in the results of Fleetwood, Athey, MacBeth, and McCown, Inc. The principals and shareholders of Bartlett, Griffin, & Vermilye, Inc. agreed to employment agreements with noncompete provisions as part of the acquisition. In conjunction with the asset purchase, Fleetwood, Athey, MacBeth, and McCown, Inc. also purchased from a related interest of the principals of Bartlett, Griffin, & Vermilye the agency's Easton office building.

The purchase price of \$1,045,944 for the real estate was paid in cash at settlement. The purchase price for the operations was \$3,900,000 with a partial payment of cash at settlement, and notes issued by Fleetwood, Athey, MacBeth, and McCown, Inc. for \$2,925,000 collectively. The original terms of the notes call for three annual payments of \$975,000 collectively plus interest on the anniversary date of the acquisition. The notes are at a rate of 3%, and are guaranteed by the Bank. The notes were modified on March 29, 2019 to allow for principal curtailment of \$1,629,000, restructuring the \$1,296,000 balance that matured June 30, 2020 with accrued interest paid at maturity. The Company recorded \$432,688 of goodwill and \$3,353,592 of other intangible assets as a result of the acquisition. The goodwill will not be amortized for financial statement purposes but will be reviewed annually for impairment. The intangible assets will be amortized over 15 years for financial statement and income tax purposes. A summary of the assets and liabilities of the agency acquired, excluding the real estate, is summarized below:

	Fair Value
Building improvements	\$ 100,000
Furniture and equipment	15,000
Other assets	13,738
Other liabilities	(640)
Note payable	(2,925,000)
Goodwill and intangibles	<u>3,786,280</u>
Net cash	<u>\$ 989,378</u>

**3. Cash and Due From Banks**

The Bank normally carries balances with other banks that exceed the federally insured limit. The average balances carried in excess of the limit, including unsecured federal funds sold to the same banks, were \$10,356,396 for 2020 and \$7,774,381 for 2019.

Deposits held in noninterest-bearing transaction accounts are aggregated with any interest bearing deposits the owner may hold in the same category. The combined total is insured up to \$250,000.

Banks are required to carry noninterest-bearing cash reserves at specified percentages of deposit balances. The Bank's normal amount of cash on hand and on deposit with other banks is sufficient to satisfy the reserve requirements.

PEOPLES BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. Investment Securities

Investment securities are summarized as follows:

<b>December 31, 2020</b>	Amortized cost	Unrealized gains	Unrealized losses	Fair value
<b>Available for sale</b>				
U.S. government agency	\$ 1,609,729	\$ -	\$ 5,425	\$ 1,604,304
Mortgage-backed securities	<u>19,264,309</u>	<u>167,767</u>	<u>13,331</u>	<u>19,418,745</u>
	<u>\$ 20,874,038</u>	<u>\$ 167,767</u>	<u>\$ 18,756</u>	<u>\$ 21,023,049</u>
<hr/>				
December 31, 2019				
<b>Available for sale</b>				
U.S. government agency	\$ 4,989,559	\$ 1,890	\$ 15,066	\$ 4,976,383
Mortgage-backed securities	<u>9,836,899</u>	<u>33,635</u>	<u>14,290</u>	<u>9,856,244</u>
	<u>\$ 14,826,458</u>	<u>\$ 35,525</u>	<u>\$ 29,356</u>	<u>\$ 14,832,627</u>

Contractual maturities and the amount of pledged securities are shown below. Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities are paid monthly.

<b>December 31, 2020</b>	Amortized cost	Available for sale Fair value
<b>Maturing</b>		
Within one year	\$ -	\$ -
Over one to five years	-	-
Over five to ten years	<u>1,609,729</u>	<u>1,604,304</u>
	<u>\$ 1,609,729</u>	<u>\$ 1,604,304</u>
Pledged securities	<u>\$ 5,934,750</u>	<u>\$ 5,983,994</u>
<hr/>		
December 31, 2019		
<b>Maturing</b>		
Within one year	\$ 3,004,500	\$ 3,006,390
Over one to five years	<u>1,985,059</u>	<u>1,969,993</u>
	<u>\$ 4,989,559</u>	<u>\$ 4,976,383</u>
Pledged securities	<u>\$ 5,216,664</u>	<u>\$ 5,217,062</u>

Investments are pledged to secure the deposits of federal and local governments and as collateral for repurchase agreements.

PEOPLES BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. Investment Securities (Continued)

Securities in a continuous unrealized loss position at December 31, 2020 and 2019, are as follows:

	Less than 12 months		12 months or longer		Total	
	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value
<b>December 31, 2020</b>						
<b>Available for sale</b>						
U.S. government agency	\$ -	\$ -	\$ 5,425	\$ 1,604,304	\$ 5,425	\$ 1,604,304
Mortgage-backed securities	<u>13,331</u>	<u>5,192,002</u>	<u>-</u>	<u>-</u>	<u>13,331</u>	<u>5,192,002</u>
	<u>\$13,331</u>	<u>\$5,192,002</u>	<u>\$ 5,425</u>	<u>\$ 1,604,304</u>	<u>\$18,756</u>	<u>\$ 6,796,306</u>
<u>December 31, 2019</u>						
<b>Available for sale</b>						
U.S. government agency	\$15,066	\$1,969,993	\$ -	\$ -	\$15,066	\$ 1,969,993
Mortgage-backed securities	<u>14,290</u>	<u>5,739,881</u>	<u>-</u>	<u>-</u>	<u>14,290</u>	<u>5,739,881</u>
	<u>\$29,356</u>	<u>\$7,709,874</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$29,356</u>	<u>\$ 7,709,874</u>

All unrealized losses on securities as of December 31, 2020 and 2019, are considered to be temporary losses. Each security will be redeemed at face value at, or prior to, maturity. In most cases, the temporary impairment in value is caused by market interest rate fluctuations.

There were no sales of securities in 2020 or 2019.

5. Loans and Allowance for Loan Losses

Major classifications of loans as of December 31, are as follows:

	<u>2020</u>	<u>2019</u>
Real estate		
Residential	\$ 77,464,787	\$ 87,245,406
Commercial	56,111,430	59,875,667
Other	22,670,234	24,994,095
Construction and land development	5,569,011	5,189,173
Commercial	15,131,436	10,726,355
Consumer	<u>496,315</u>	<u>862,894</u>
	177,443,213	188,893,590
Deferred (fees) costs, net	(356,996)	(454,233)
Allowance for loan losses	<u>(3,248,248)</u>	<u>(3,145,185)</u>
	<u>\$173,837,969</u>	<u>\$185,294,172</u>

The commercial loans in the table above include \$7,120,738 of loans issued under the Paycheck Protection Program (PPP) as of December 31, 2020, which are 100% guaranteed by the Small Business Administration (SBA). A substantial portion of these loans are expected to be forgiven by the SBA.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Loans and Allowance for Loan Losses (Continued)

*Loan Origination/Risk Management*

The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, loan delinquencies and nonperforming and potential problem loans.

The Company obtains an independent loan review from a third-party vendor that reviews and evaluates the credit risk program on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

Residential real estate loans are underwritten subject to the borrower's ability and willingness to repay, and a loan-to-value ratio of offered collateral of not more than 80% of the appraised value of the collateral.

Real Estate Loans

Real estate loans are broken into the following categories: Residential; Commercial; Construction and Land Development; and Other Loans.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans, in addition to those of real estate loans. These loans are assessed primarily based on cash flow and secondarily on the underlying real estate collateral. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. Management monitors and evaluates commercial real estate loans based on collateral and cash flow. With respect to loans to developers and builders that are secured by non-owner occupied properties that the Company may originate from time to time, the Company generally requires the borrower to have had an existing relationship with the Company and have a proven record of success.

Construction, including land development, loans are underwritten based on financial analyses of the developers and property owners, and estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are 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, governmental regulation of real property, general economic conditions and the availability of long-term financing.

PEOPLES BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Loans and Allowance for Loan Losses (Continued)

Commercial Loans

Commercial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and to prudently expand its business. The Company's management examines current and projected cash flows to determine the ability of the borrower to repay its obligations as agreed. Commercial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets, such as accounts receivable or inventory, and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis.

Consumer Loans

The Company originates consumer loans. To monitor and manage consumer loan risk, underwriting policies and procedures are developed and modified as needed. The Company believes that its monitoring activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk.

The rate repricing and maturity distribution of the loan portfolio at December 31, is as follows:

	<u>2020</u>
Within ninety days	\$ 9,644,824
Over ninety days to one year	16,412,491
Over one year to five years	90,733,026
Over five years	<u>60,652,872</u>
	<u>\$ 177,443,213</u>
Variable rate loans included in total above	<u>\$ 18,406,881</u>

PEOPLES BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Loans and Allowance for Loan Losses (Continued)

The following table illustrates total impaired loans segmented by those with and without a related allowance as of December 31, 2020 and 2019.

<b>Total Impaired Loans Segmented by With and Without a Related Allowance Recorded</b>						
<b>December 31, 2020</b>						
<b>Description of Loans</b>	<b>Number of loans</b>	<b>Recorded Investment</b>	<b>Unpaid Contractual Balance</b>	<b>Related Allowance</b>	<b>Interest Income Recognized</b>	<b>Average Recorded Investment</b>
<b>With Related Allowance Recorded</b>						
Residential real estate	3	\$ 364,478	\$ 380,671	\$ 27,053	\$ 19,637	\$ 382,952
Commercial real estate	1	391,255	423,466	24,042	24,653	427,662
Other real estate	3	431,576	431,576	5,862	21,196	432,222
Construction and land development	1	12,429	16,333	4,989	935	16,377
Commercial loans	-	-	-	-	-	-
Consumer loans	-	-	-	-	-	-
	<u>8</u>	<u>1,199,738</u>	<u>1,252,046</u>	<u>61,946</u>	<u>66,421</u>	<u>1,259,213</u>
<b>With No Related Allowance Recorded</b>						
Residential real estate	27	2,260,437	3,113,382	-	165,429	3,154,903
Commercial real estate	5	893,203	1,368,989	-	67,875	1,457,795
Other real estate	-	-	-	-	-	-
Construction and land development	1	22,137	29,294	-	1,647	29,375
Commercial loans	2	245,178	253,929	-	15,773	330,391
Consumer loans	-	-	-	-	-	-
	<u>35</u>	<u>3,420,955</u>	<u>4,765,594</u>	<u>-</u>	<u>250,724</u>	<u>4,972,464</u>
<b>TOTAL</b>						
Residential real estate	30	2,624,915	3,494,053	27,053	185,066	3,537,855
Commercial real estate	6	1,284,458	1,792,455	24,042	92,528	1,885,457
Other real estate	3	431,576	431,576	5,862	21,196	432,222
Construction and land development	2	34,566	45,627	4,989	2,582	45,752
Commercial loans	2	245,178	253,929	-	15,773	330,391
Consumer loans	-	-	-	-	-	-
Total impaired loans	<u>43</u>	<u>\$4,620,693</u>	<u>\$ 6,017,640</u>	<u>\$ 61,946</u>	<u>\$ 317,145</u>	<u>\$6,231,677</u>

PEOPLES BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Loans and Allowance for Loan Losses (Continued)

Total Impaired Loans Segmented by With and Without a Related Allowance Recorded						
December 31, 2019						
Description of Loans	Number of loans	Recorded Investment	Unpaid Contractual Balance	Related Allowance	Interest Income Recognized	Average Recorded Investment
<b>With Related Allowance Recorded</b>						
Residential real estate	4	\$ 456,681	\$ 482,043	\$ 31,484	\$ 26,388	\$ 484,089
Commercial real estate	2	389,805	495,297	6,950	30,210	500,348
Other real estate	3	435,246	435,246	84	24,284	436,579
Construction and land development	-	-	-	-	-	-
Commercial loans	-	-	-	-	-	-
Consumer loans	-	-	-	-	-	-
	<u>9</u>	<u>1,281,732</u>	<u>1,412,586</u>	<u>38,518</u>	<u>80,882</u>	<u>1,421,016</u>
<b>With No Related Allowance Recorded</b>						
Residential real estate	30	2,835,093	3,606,178	-	180,799	3,654,260
Commercial real estate	4	674,712	1,106,387	-	54,674	1,113,166
Other real estate	2	336,732	672,839	-	8,192	672,839
Construction and land development	2	37,866	46,344	-	3,082	46,702
Commercial loans	-	-	-	-	-	-
Consumer loans	-	-	-	-	-	-
	<u>38</u>	<u>3,884,403</u>	<u>5,431,748</u>	<u>-</u>	<u>246,747</u>	<u>5,486,967</u>
<b>TOTAL</b>						
Residential real estate	34	3,291,774	4,088,221	31,484	207,187	4,138,349
Commercial real estate	6	1,064,517	1,601,684	6,950	84,884	1,613,514
Other real estate	5	771,978	1,108,085	84	32,476	1,109,418
Construction and land development	2	37,866	46,344	-	3,082	46,702
Commercial loans	-	-	-	-	-	-
Consumer loans	-	-	-	-	-	-
Total impaired loans	<u>47</u>	<u>\$5,166,135</u>	<u>\$ 6,844,334</u>	<u>\$ 38,518</u>	<u>\$ 327,629</u>	<u>\$6,907,983</u>

PEOPLES BANCORP, INC. AND SUBSIDIARY

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**5. Loans and Allowance for Loan Losses (Continued)**

The following table summarizes activity in the allowance for loan losses and allocations based on loans that are individually evaluated for impairment and loan balances collectively evaluated for impairment.

<b>December 31, 2020</b>	Residential	Commercial	Other	Construction	Commercial	Consumer	Overdraft	Unallocated	Total
	Real Estate	Real Estate	Real Estate	and Land Development					
Allowance for loan losses									
Beginning balance	\$1,902,968	\$ 682,342	\$280,948	\$ 68,289	\$ 161,615	\$10,166	\$ 763	\$ 38,094	\$3,145,185
Charge-offs	(11,343)	-	-	-	-	-	(2,498)	-	(13,841)
Recoveries	55,520	35,160	-	6,096	19,880	-	248	-	116,904
Provision	(455,353)	148,967	67,196	25,665	81,561	(2,461)	2,877	131,548	-
Ending balance	<u>\$1,491,792</u>	<u>\$ 866,469</u>	<u>\$348,144</u>	<u>\$ 100,050</u>	<u>\$ 263,056</u>	<u>\$ 7,705</u>	<u>\$ 1,390</u>	<u>\$ 169,642</u>	<u>\$3,248,248</u>

Ending balance allocated to:

Loans individually evaluated for impairment	\$ 27,053	\$ 24,042	\$ 5,862	\$ -	\$ 4,989	\$ -	\$ -	\$ -	\$ 61,946
Loans collectively evaluated for impairment	<u>1,464,739</u>	<u>842,427</u>	<u>342,282</u>	<u>100,050</u>	<u>258,067</u>	<u>7,705</u>	<u>1,390</u>	<u>169,642</u>	<u>3,186,302</u>
	<u>\$1,491,792</u>	<u>\$ 866,469</u>	<u>\$348,144</u>	<u>\$ 100,050</u>	<u>\$ 263,056</u>	<u>\$ 7,705</u>	<u>\$ 1,390</u>	<u>\$ 169,642</u>	<u>\$3,248,248</u>

December 31, 2019	Residential	Commercial	Other	Construction	Commercial	Consumer	Overdraft	Unallocated	Total
	Real Estate	Real Estate	Real Estate	and Land Development					
Allowance for loan losses									
Beginning balance	\$1,281,256	\$ 546,257	\$329,238	\$ 65,795	\$ 284,904	\$11,839	\$ 482	\$ 887,167	\$3,406,938
Charge-offs	(48,371)	-	-	-	(87,075)	-	(2,354)	-	(137,800)
Recoveries	121,338	36,276	-	269,903	48,265	133	132	-	476,047
Provision	548,745	99,809	(48,290)	(267,409)	(84,479)	(1,806)	2,503	(849,073)	(600,000)
Ending balance	<u>\$1,902,968</u>	<u>\$ 682,342</u>	<u>\$280,948</u>	<u>\$ 68,289</u>	<u>\$ 161,615</u>	<u>\$10,166</u>	<u>\$ 763</u>	<u>\$ 38,094</u>	<u>\$3,145,185</u>

Ending balance allocated to:

Loans individually evaluated for impairment	\$ 31,484	\$ 6,950	\$ 84	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 38,518
Loans collectively evaluated for impairment	<u>1,871,484</u>	<u>675,392</u>	<u>280,864</u>	<u>68,289</u>	<u>161,615</u>	<u>10,166</u>	<u>763</u>	<u>38,094</u>	<u>3,106,667</u>
	<u>\$1,902,968</u>	<u>\$ 682,342</u>	<u>\$280,948</u>	<u>\$ 68,289</u>	<u>\$ 161,615</u>	<u>\$10,166</u>	<u>\$ 763</u>	<u>\$ 38,094</u>	<u>\$3,145,185</u>

PEOPLES BANCORP, INC. AND SUBSIDIARY

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**5. Loans and Allowance for Loan Losses (Continued)**

As part of the on-going monitoring of the quality of the Bank's loan portfolio, management tracks certain credit quality indicators. The Bank risk rates all loans. Loans are risk rated based on the scale below:

Grade 1 through 4 – Pass. These grades include "pass grade" loans to borrowers of acceptable credit quality and risk.

Grade 5 – Pass/Watch. This grade includes loans that are on Management's "watch list" and is intended to be utilized on a temporary basis for pass grade borrowers where a significant risk-modifying action is anticipated in the near future.

Grade 6 – Special Mention. This grade is intended to be temporary and includes loans to borrowers whose credit quality has clearly deteriorated and are at risk of further decline unless active measures are taken to correct the situation. This grade may include loans not fully secured where a specific valuation allowance may be necessary.

Grade 7 through 9 – Substandard. This grade includes loans, in accordance with regulatory guidelines, for which accrual of interest may have been discontinued. This grade includes loans that are past due or not fully secured where a specific valuation allowance may be necessary.

The following table illustrates loans classified by Risk Grades 5, 6, and 7 through 9.

<b>December 31, 2020</b>	Pass	Pass/Watch	Special Mention	Substandard	Total
Residential real estate	\$ 70,504,168	\$ 3,608,564	\$ 66,621	\$3,285,434	\$ 77,464,787
Commercial real estate	50,376,911	4,331,606	-	1,402,913	56,111,430
Other real estate	20,391,154	1,847,504	-	431,576	22,670,234
Construction and land development	5,271,200	263,245	-	34,566	5,569,011
Commercial	14,418,243	423,391	-	289,802	15,131,436
Consumer	458,006	-	-	38,309	496,315
	<u>\$161,419,682</u>	<u>\$10,474,310</u>	<u>\$ 66,621</u>	<u>\$5,482,600</u>	<u>\$177,443,213</u>

December 31, 2019	Pass	Pass/Watch	Special Mention	Substandard	Total
Residential real estate	\$ 78,778,671	\$ 3,200,042	\$1,516,540	\$3,750,153	\$ 87,245,406
Commercial real estate	54,580,328	3,745,349	388,996	1,160,994	59,875,667
Other real estate	22,337,302	1,884,814	-	771,979	24,994,095
Construction and land development	4,882,143	269,164	-	37,866	5,189,173
Commercial	10,214,486	199,357	3,336	309,176	10,726,355
Consumer	862,540	354	-	-	862,894
	<u>\$171,655,470</u>	<u>\$ 9,299,080</u>	<u>\$1,908,872</u>	<u>\$6,030,168</u>	<u>\$188,893,590</u>

PEOPLES BANCORP, INC. AND SUBSIDIARY

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**5. Loans and Allowance for Loan Losses (Continued)**

The following table analyzes the age of past due loans segregated by class of loans as of December 31, 2020 and 2019.

<b>December 31, 2020</b>	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans
Residential real estate	\$ 772,760	\$ 568,460	\$ 166,344	\$ 1,507,564	\$ 75,957,223	\$ 77,464,787
Commercial real estate	-	-	-	-	56,111,430	56,111,430
Other real estate	-	-	-	-	22,670,234	22,670,234
Construction and land development	-	-	-	-	5,569,011	5,569,011
Commercial loans	-	-	-	-	15,131,436	15,131,436
Consumer loans	388	-	-	388	495,927	496,315
Total	<u>\$ 773,148</u>	<u>\$568,460</u>	<u>\$ 166,344</u>	<u>\$1,507,952</u>	<u>\$175,935,261</u>	<u>\$177,443,213</u>

  

December 31, 2019	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans
Residential real estate	\$ 427,116	\$ 620,568	\$ 1,330,009	\$ 2,377,693	\$ 84,867,713	\$ 87,245,406
Commercial real estate	-	-	-	-	59,875,667	59,875,667
Other real estate	-	-	336,732	336,732	24,657,363	24,994,095
Construction and land development	33,991	-	-	33,991	5,155,182	5,189,173
Commercial loans	-	-	-	-	10,726,355	10,726,355
Consumer loans	-	-	-	-	862,894	862,894
Total	<u>\$ 461,107</u>	<u>\$620,568</u>	<u>\$1,666,741</u>	<u>\$2,748,416</u>	<u>\$186,145,174</u>	<u>\$188,893,590</u>

Loans on which the accrual of interest has been discontinued or reduced, and the interest that would have been accrued at December 31, are as follows:

	<u>2020</u>	<u>2019</u>
Residential real estate	<b>\$1,038,428</b>	\$2,001,454
Commercial real estate	<b>825,566</b>	518,926
Other real estate	-	336,732
Construction and land development	<b>34,567</b>	37,866
Commercial loans	-	-
Consumer loans	-	-
Total	<u><b>\$1,898,561</b></u>	<u>\$2,894,978</u>
Interest not accrued on nonaccrual loans	<u><b>\$ 17,675</b></u>	<u>\$ 82,722</u>

There were no loans over 90 days past due and accruing at December 31, 2020 and 2019.

PEOPLES BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Loans and Allowance for Loan Losses (Continued)

A loan will be returned to accrual status when all of the principal and interest amounts contractually due are brought current and management believes that future principal and interest amounts contractually due are reasonably assured, which belief is typically evidenced by a sustained period (at least six months) of repayment performance by the borrower.

The modification of terms on a loan (restructuring) is considered a "troubled debt restructuring" if it is done to accommodate a borrower who is experiencing financial difficulties. The Company may forgive principal, lower the interest rate or payment amount, or may modify the payment due dates or maturity date of the loan for a troubled borrower. The Company's troubled debt restructurings at December 31, 2019 and 2018, are set forth in the following tables:

Troubled Debt Restructurings					
	Number of	Recorded	Paying as	Number of	Past Due
	Contracts	Investment	Agreed Under	Past Due	30 Days
<b>December 31, 2020</b>	<b>Contracts</b>	<b>Investment</b>	<b>Modified Terms</b>	<b>Contracts</b>	<b>or More</b>
Troubled debt restructurings					
Residential real estate	25	\$1,649,402	\$ 1,594,967	1	\$ 54,435
Commercial real estate	5	999,714	999,714	-	-
Other real estate	3	431,576	431,576	-	-
Construction and land development	2	34,566	34,566	-	-
Commercial loans	1	40,448	40,448	-	-
Consumer loans	-	-	-	-	-
	<u>36</u>	<u>\$3,155,706</u>	<u>\$ 3,101,271</u>	<u>1</u>	<u>\$ 54,435</u>
December 31, 2019	Number of	Recorded	Paying as	Number of	Past Due
	Contracts	Investment	Agreed Under	Past Due	30 Days
	Contracts	Investment	Modified Terms	Contracts	or More
Troubled debt restructurings					
Residential real estate	29	\$2,273,463	\$ 1,919,955	4	\$353,508
Commercial real estate	6	1,064,517	1,064,517	-	-
Other real estate	3	435,246	435,246	-	-
Construction and land development	2	37,866	37,866	-	-
Commercial loans	-	-	-	-	-
Consumer loans	-	-	-	-	-
	<u>40</u>	<u>\$3,811,092</u>	<u>\$ 3,457,584</u>	<u>4</u>	<u>\$353,508</u>

There were no new troubled debt restructurings in 2020 and 2019.

At December 31, 2020, there were no formal foreclosure procedures in process due to the government moratorium enacted as the result of COVID 19. At December 31, 2019, formal foreclosure procedures were in process for four loans totaling \$473,642.

PEOPLES BANCORP, INC. AND SUBSIDIARY

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**5. Loans and Allowance for Loan Losses (Continued)**

Outstanding loan commitments, unused lines of credit, and letters of credit as of December 31, are as follows:

	<u>2020</u>	<u>2019</u>
Check loan lines of credit	\$ 420,367	\$ 385,823
Mortgage lines of credit and loan commitments	7,458,605	7,239,995
Other lines of credit and commitments	11,898,904	12,926,852
Undisbursed construction loan commitments	<u>4,359,865</u>	<u>1,041,114</u>
	<u>\$ 24,137,741</u>	<u>\$ 21,593,784</u>
Standby letters of credit	<u>\$ 1,022,791</u>	<u>\$ 1,164,947</u>

Loan commitments and lines of credit are agreements to lend to a customer as long as there is no violation of any condition to the contract. Loan commitments generally have interest rates fixed at current market rates, fixed expiration dates, and may require payment of a fee. Lines of credit generally have variable interest rates. Such lines do not represent future cash requirements because it is unlikely that all customers will draw upon their lines in full at any time.

Letters of credit are commitments issued to guarantee the performance of a customer to a third party.

Loan commitments, lines of credit, and letters of credit are made on the same terms, including collateral, as outstanding loans. The Bank's exposure to credit loss in the event of nonperformance by the borrower is represented by the contract amount of the commitment. Management is not aware of any fact that could cause the Bank to incur an accounting loss as a result of funding these commitments.

The Company lends to customers located primarily in and near Kent County, Queen Anne's County, Cecil County, and Talbot County, Maryland. Although the loan portfolio is diversified, its performance will be influenced by the economy of the region.

PEOPLES BANCORP, INC. AND SUBSIDIARY

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**6. Premises and Equipment**

A summary of premises and equipment and related depreciation expense as of December 31, is as follows:

	<u>2020</u>	<u>2019</u>
Land	\$ 3,100,510	\$ 3,100,510
Premises	5,625,760	5,604,431
Furniture and equipment	<u>2,768,876</u>	<u>2,567,701</u>
	11,495,146	11,272,642
Accumulated depreciation	<u>4,388,926</u>	<u>4,002,530</u>
Net premises and equipment	<u>\$ 7,106,220</u>	<u>\$ 7,270,112</u>
Depreciation expense	<u>\$ 451,542</u>	<u>\$ 404,500</u>

Computer software included in other assets and the related amortization are as follows:

	<u>2020</u>	<u>2019</u>
Cost	\$ 69,372	\$ 69,372
Accumulated amortization	<u>57,841</u>	<u>51,940</u>
Net computer software	<u>\$ 11,531</u>	<u>\$ 17,432</u>
Amortization expense	<u>\$ 5,900</u>	<u>\$ 10,740</u>

**7. Intangibles and Goodwill**

The Company recorded \$272,932 in goodwill in connection with the Insurance Subsidiary acquisition in 2007. As a result of the acquisition of Bartlett, Griffin, & Vermilye in 2019, the Company recorded \$432,688 of goodwill and \$3,353,592 of other intangible assets. The intangible assets will be amortized over 15 years for financial statement and income tax purposes. Goodwill is not amortized, but is annually evaluated for impairment. Total goodwill at December 31, 2020, was \$705,620.

PEOPLES BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. Goodwill and Intangible Assets (Continued)

Information relating to intangible assets at December 31, is as follows

	<u>2020</u>	<u>2019</u>
Intangible asset	\$ 3,353,592	\$ 3,353,592
Accumulated amortization	<u>(447,146)</u>	<u>(223,573)</u>
Net intangible asset	<u>\$ 2,906,446</u>	<u>\$ 3,130,019</u>
Amortization expense	<u>\$ 223,573</u>	<u>\$ 223,573</u>
Estimated amortization expense:		
2021	\$ 223,573	
2022	223,573	
2023	223,573	
2024	223,573	
2025	223,573	
Thereafter	1,788,581	

8. Other Time Deposits

Maturities of other time deposits as of December 31, are as follows:

	<u>2020</u>	<u>2019</u>
Within one year	\$10,752,429	\$11,138,273
Over one to two years	5,863,503	8,840,664
Over two to three years	8,434,886	5,889,589
Over three to four years	12,606,235	8,428,265
Over four to five years	11,990,434	14,164,489
Over five years	<u>396,780</u>	<u>503,229</u>
	<u>\$50,044,267</u>	<u>\$48,964,509</u>

Included in other time deposits are certificates of deposit in amounts of \$250,000 or more of \$6,114,658 and \$5,685,268 as of December 31, 2020 and 2019, respectively.

PEOPLES BANCORP, INC. AND SUBSIDIARY

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**9. Securities Sold Under Repurchase Agreements**

Securities sold under repurchase agreements represent borrowings from customers. The government agency securities that are the collateral for these agreements are owned by the Bank and are maintained in the custody of an unaffiliated bank. Additional information is as follows:

	<u>2020</u>	<u>2019</u>
Maximum amount outstanding	<b>\$2,924,038</b>	\$2,745,965
Average amount outstanding	<b>1,267,180</b>	1,525,841
Average rate paid during the year	<b>0.13%</b>	0.32%
Investment securities underlying agreements at year-end		
Book value	<b>2,610,299</b>	2,008,494
Fair value	<b>2,639,738</b>	2,007,999

**10. Borrowed Funds**

**Note Payable**

With the purchase of Bartlett, Griffin, & Vermilye, a note was issued by Fleetwood, Athey, MacBeth, and McCown, Inc. for \$2,925,000 collectively. The original terms of the notes called for three annual payments of \$975,000 collectively plus interest on the anniversary date of the acquisition. The notes were at a rate of 3%, and were guaranteed by the Bank. The notes were modified on March 29, 2019, to allow for principal curtailment of \$1,629,000, restructuring the \$1,296,000 balance to mature June 30, 2020, with accrued interest paid at maturity.

**Available Lines of Credit**

The Bank may borrow up to 30% of its assets from the Federal Home Loan Bank; however, the amount the Bank could borrow would be limited by the balance of qualified loans it could pledge to the FHLB. As of December 31, 2020, the Bank could borrow up to \$85,996,500 from the Federal Home Loan Bank subject to qualifying available collateral. The Bank had pledged loans that provided a borrowing capacity of \$16,079,637 as of December 31, 2020.

In addition to the borrowing capacity available from the FHLB, the Bank has a line of credit of \$8,000,000 in secured overnight federal funds at December 31, 2020. The Bank would be required to pledge securities for advances under this line of credit. As of December 31, 2020, the Bank had pledged mortgage loans totaling \$11,076,488 to the Federal Reserve Bank of Richmond to provide a borrowing capacity of \$7,071,361 under its discount window program.

PEOPLES BANCORP, INC. AND SUBSIDIARY

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**11. Income Taxes**

The components of income tax expense are as follows:

	<u>2020</u>	<u>2019</u>
Current		
Federal	\$ 626,745	\$ 375,657
State	135,124	63,941
	<u>761,869</u>	439,598
Deferred	13,232	238,815
	<u>\$ 775,101</u>	<u>\$ 678,413</u>

The components of the deferred income tax expense (benefit) are as follows:

Allowance for loan losses and bad debts	\$ -	\$ 165,105
Prepaid pension costs	(8,013)	(33,884)
Depreciation and amortization	24,125	161,923
Nonaccrual interest	6,091	27,482
Deferred compensation	(28,012)	(11,159)
Accrued separation liability	(71,546)	-
Foreclosed real estate impairment	7,784	8,379
Net operating loss carryover	82,803	(79,031)
	<u>\$ 13,232</u>	<u>\$ 238,815</u>

The components of the net deferred income tax asset are as follows:

	<u>2020</u>	<u>2019</u>
Deferred income tax assets		
Allowance for loan losses	\$ 174,236	\$ 174,236
Deferred compensation	115,251	87,239
Accrued separation liability	71,546	-
Pension liability	246,388	160,474
Nonaccrual interest	4,864	10,954
Foreclosed real estate impairment	64,370	72,154
Net operating loss carryover	-	82,803
	<u>676,655</u>	<u>587,860</u>
Deferred income tax liabilities		
Unrealized gain on investment securities available for sale	41,004	1,697
Depreciation and amortization	299,410	275,285
Net deferred income tax asset	<u>\$ 336,241</u>	<u>\$ 310,878</u>

PEOPLES BANCORP, INC. AND SUBSIDIARY

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**11. Income Taxes (Continued)**

A reconciliation of the provisions for income taxes from statutory federal rates to effective rates follows:

	2020	2019
Tax at statutory federal income tax rate	21.0 %	21.0 %
Tax effect of		
Tax-exempt income	(0.9)	(1.0)
State income taxes, net of federal benefit	5.9	5.2
Other, net	0.1	(4.3)
	26.1 %	20.9 %

The Company does not have material uncertain tax positions and did not recognize any adjustments for unrecognized tax benefits. The Company remains subject to examination of income tax returns for the years ending after December 31, 2016.

**12. Profit Sharing Plan**

The Company has a profit sharing plan qualifying under section 401(k) of the Internal Revenue Code that covers all of the Company's employees with one year of service who have attained age 21. The Company matches 50% of employee contributions to the Plan, up to a maximum of 6% of pay. The Company may make discretionary contributions to the Plan in amounts approved by its Board of Directors. Plan expenses, included in employee benefits expense for 2020 and 2019, were \$114,324 and \$98,637, respectively.

**13. Pension**

The Bank has a defined benefit pension plan that was frozen effective March 22, 2013. Participant benefits stopped accruing as of the date of the freeze. Prior to freezing the plan, it substantially covered all of the employees of the Bank. Benefits are based on years of service and the employee's highest average rate of earnings for five consecutive years during the final ten full years before retirement. The Bank's funding policy is to contribute annually the maximum amount that can be deducted for income tax purposes, determined using the projected unit credit cost method.

PEOPLES BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

13. Pension (Continued)

The following table sets forth the financial status of the plan at December 31:

	<u>2020</u>	<u>2019</u>
Change in plan assets		
Fair value of plan assets at beginning of year	\$3,722,626	\$3,820,460
Actual return on plan assets	434,017	389,926
Settlements	-	(468,216)
Employer contribution	-	60,000
Benefits paid	(79,544)	(79,544)
Fair value of plan assets at end of year	<u>4,077,099</u>	<u>3,722,626</u>
Change in benefit obligation		
Projected benefit obligation at beginning of year	4,305,798	4,210,977
Settlements	-	(468,216)
Interest cost	138,645	167,327
Benefits paid	(79,544)	(79,544)
Actuarial loss (gain)	607,589	475,254
Accumulated benefit obligation at end of year	<u>4,972,488</u>	<u>4,305,798</u>
Funded status	686,289	715,410
Unrecognized net loss	<u>(1,581,678)</u>	<u>(1,298,582)</u>
Prepaid pension expense included in other assets	<u>\$ (895,389)</u>	<u>\$ (583,172)</u>

Net pension expense includes the following components:

	<u>2020</u>	<u>2019</u>
Interest cost	\$ 138,645	\$ 167,327
Expected return on assets	(202,557)	(197,826)
Recognized actuarial loss (gain) due to settlements	-	131,609
Amortization of loss	93,033	82,027
Net periodic benefit cost included in employee benefits	<u>\$ 29,121</u>	<u>\$ 183,137</u>

PEOPLES BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**13. Pension (Continued)**

The amount expected to be recognized in net periodic benefit costs in 2021 is \$122,000 consisting of recognized losses.

Assumptions used in the accounting for net pension expense were:

	<u>2020</u>	<u>2019</u>
Discount rates	3.25%	4.25%
Rate of compensation increase	N/A	N/A
Long-term rate of return on assets	5.50%	5.50%

Assumptions used in determining the net benefit obligation were:

Discount rate	2.25%	3.25%
Rate of compensation increase	N/A	N/A

The Bank has not yet determined the amount of contributions to the plan for 2021.

The plan's assets are allocated as follows at December 31:

	<u>2020</u>	<u>2019</u>
Equity securities	8 %	44 %
Fixed income securities	<u>92 %</u>	<u>56 %</u>
	<u>100 %</u>	<u>100 %</u>

The fair value of plan assets are considered to be valued using level 1 inputs.

Projected benefits expected to be paid from the plan are as follows:

<u>Year</u>	<u>Amount</u>
2021	\$ 1,687,572
2022	428,228
2023	75,276
2024	633,505
2025	458,496
2026 - 2030	900,566

The long-term rate of return on assets assumption considers the current earnings on assets of the plan as well as the effects of asset diversification. The plan's investment strategy is to earn a reasonable return while safeguarding the benefits promised to employees. All assets of the plan are maintained in mutual funds with MML Investor services.

PEOPLES BANCORP, INC. AND SUBSIDIARY

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**14. Other Operating Expenses**

Other operating expenses consist of the following:

	<u>2020</u>	<u>2019</u>
Advertising	\$ 67,589	\$ 142,850
Amortization of intangibles	223,573	223,573
Deposit services	290,336	233,394
Directors' fees	180,490	144,347
Insurance	80,344	77,694
Office supplies and printing	85,875	101,410
Postage	83,632	109,526
Public relations and contributions	63,514	79,912
Regulatory assessments	93,793	49,569
Telephone	99,753	92,909
Other	<u>317,023</u>	<u>383,463</u>
	<u>\$ 1,585,922</u>	<u>\$ 1,638,647</u>

**15. Related-Party Transactions**

In the normal course of banking business, loans are made to officers and directors of the Company as well as to companies and individuals affiliated with those officers and directors. The terms of these transactions are substantially the same as the terms provided to other borrowers entering into similar loan transactions. In the opinion of management, these loans are consistent with sound banking practices, are within regulatory lending limitations, and do not involve more than normal credit risk.

A summary of these loans is as follows:

	<u>2020</u>	<u>2019</u>
Beginning loan balances	\$ 2,183,086	\$ 2,380,463
Advances	1,842,444	697,850
Repayments	(2,003,992)	(895,227)
Change in related parties	<u>3,107,622</u>	<u>-</u>
Ending loan balances	<u>\$ 5,129,160</u>	<u>\$ 2,183,086</u>

In addition to the outstanding balances listed above, the officers and directors and their related interests had \$937,956 and \$505,445 in unused loans committed but not funded as of December 31, 2020 and 2019, respectively.

Deposits from officers and directors and their related interests were \$2,801,607 and \$2,011,209 as of December 31, 2020 and 2019, respectively.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**16. Capital Standards**

The Company's primary regulator, the Federal Reserve, and the Bank's primary regulator, the Federal Deposit Insurance Corporation (FDIC) have adopted leverage and risk-based capital standards for their supervised banking institutions. These standards require ratios of capital to assets for minimum capital adequacy and to be classified as well capitalized under prompt corrective action provisions. Failure to meet minimum capital requirements can initiate certain mandatory, and possible additional, discretionary actions by the regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Effective January 1, 2020, the Company and the Bank opted into the Community Bank Leverage Ratio ("CBLR") framework which provides a simplified measure of capital adequacy for qualifying community banking organizations. To qualify for the CBLR framework, the Company and the Bank must have less than \$10 billion in total consolidated assets, a leverage ratio greater than 9%, and off-balance sheet exposures of 25% or less of total consolidated assets. Under the CBLR framework, the Company and the Bank will not be subject to other regulatory capital and leverage requirements and is deemed to have met the ratio requirements to be classified as well capitalized and be in compliance with applicable capital standards including minimum capital adequacy. If the Company or the Bank does not qualify for the CBLR framework or opts out of the framework in a future period they will become subject to the applicable leverage and risk-based capital standards adopted by their respective regulators.

Temporary changes were made to the CBLR framework in 2020 pursuant to Section 4012 of the CARES Act. Interim final rules adopted by the federal banking agencies, including the Federal Reserve and FDIC, temporarily lowered the minimum leverage ratio requirement under the CBLR framework to 8.0% as of December 31, 2020, 8.5% for calendar year 2021, and reinstating the 9.0% minimum leverage ratio for all periods subsequent to 2021.

As of December 31, 2020, the most recent notification from the FDIC has categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must meet the requirements of the CBLR framework including a leverage ratio greater than the required minimums. There have been no conditions or events since that notification that management believes have changed the Bank's classification as well capitalized. The regulators, through formal or informal agreement, have the authority to require an institution to maintain higher capital ratios than those provided by statute, to be categorized as well capitalized.

The following table presents actual and required regulatory capital amounts and ratios for the Company and Bank at year-end. The ratio for Tier 1 capital to average assets is computed using average assets for the quarter ending December 31.

(in thousands)	Actual		Minimum for CBLR Framework	
	Amount	Ratio	Amount	Ratio
<b>December 31, 2020</b>				
Tier 1 capital to average assets (leverage ratio)				
Company	\$27,662	10.00%	\$21,970	8.00%
Bank	\$27,407	9.20%	\$24,013	8.00%

PEOPLES BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

16. Capital Standards (Continued)

(in thousands)	Actual		Required for Capital Adequacy Purposes	
	Amount	Ratio	Amount	Ratio
<b>December 31, 2019</b>				
Tier 1 capital to average assets (leverage ratio)				
Company	\$25,691	10.50%	\$ 9,793	4.00%
Bank	\$25,413	10.30%	\$ 9,857	4.00%

17. Other Real Estate Owned

Activity in other real estate owned is as follows:

	2020	2019
Beginning of year balance	\$ 511,829	\$ 743,290
Additions and improvements	336,732	614,075
Write downs	-	-
Proceeds from sales	(689,621)	(980,515)
Gain (loss) on sales	192,274	134,979
End of year balance	<u>\$ 351,214</u>	<u>\$ 511,829</u>

18. Fair Value Measures

The fair value of an asset or a liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. In estimating fair value, the Company utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. FASB ASC valuation techniques include the assumptions that market participants would use in pricing an asset or a liability. FASB ASC Topic 820 establishes a fair value hierarchy for valuation inputs 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 quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are 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.

PEOPLES BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**18. Fair Value Measures (Continued)**

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 and the issuer'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. Although management believes the Company's valuation methodologies are appropriate and consistent with those used by other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. Furthermore, the reported fair value amounts have not been comprehensively revalued since the presentation dates, and, therefore, estimates of fair value after the balance sheet date may differ significantly from the amounts presented herein. Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstance that caused the transfer, which generally coincides with the Company's monthly and quarterly valuation process.

***Fair value measured on a recurring basis***

The Company measures securities available for sale at fair value on a recurring basis. The following table summarizes securities available for sale measured at fair value on a recurring basis, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value. If quoted prices are available in an active market for identical securities, securities are classified within Level 1 of the hierarchy. If quoted market prices are not available, the fair values are estimated using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. The Company has categorized its securities available for sale as follows:

<b>December 31, 2020</b>	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total
<b>Available for sale</b>				
U.S. government agency	\$ -	\$ 1,604,304	\$ -	\$ 1,604,304
Mortgage-backed securities	-	19,418,745	-	19,418,745
	<u>\$ -</u>	<u>\$ 21,023,049</u>	<u>\$ -</u>	<u>\$ 21,023,049</u>
<hr/>				
December 31, 2019				
<b>Available for sale</b>				
U.S. government agency	\$ -	\$ 4,976,383	\$ -	\$ 4,976,383
Mortgage-backed securities	-	9,856,244	-	9,856,244
	<u>\$ -</u>	<u>\$ 14,832,627</u>	<u>\$ -</u>	<u>\$ 14,832,627</u>

PEOPLES BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

18. Fair Value Measures (Continued)

*Fair values on a nonrecurring basis*

The Company's other real estate owned and impaired loans are measured at fair value on a nonrecurring basis, which means that the assets are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of reduced property value).

Other real estate owned measured at fair value on a nonrecurring basis is reported at the fair value of the property, assuming that the sale prices of the properties will be their current appraised values. Appraised values are estimated using Level 3 inputs based on observable market data and current property tax assessments. Impaired loans were measured at fair value during the same period and are reported at the fair value of the loan's collateral. Fair value is generally determined using Level 3 inputs based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds.

<b>December 31, 2020</b>	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total
Other real estate owned	\$ -	\$ -	\$ 351,214	\$ 351,214
Impaired loans	-	-	4,558,747	4,558,747
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,909,961</u>	<u>\$ 4,909,961</u>
<hr/>				
December 31, 2019				
Other real estate owned	\$ -	\$ -	\$ 511,829	\$ 511,829
Impaired loans	-	-	5,127,617	5,127,617
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,639,446</u>	<u>\$ 5,639,446</u>

FASB ASC Topic 825 requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or nonrecurring basis.

The estimated fair values of the Company's financial assets and liabilities that are not measured and reported at fair value on a recurring or non-recurring basis are summarized in the table below. The fair values of these financial instruments as of December 31, 2020 and 2019, are based on the exit price notion which is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between willing parties under current market conditions. Quoted market prices, where available, are shown as estimates of fair market value. The calculation of estimated fair values is based on market conditions at a specific point in time and may not reflect current or future fair values. Most financial instruments do not have quoted market prices and thus the fair value has been determined based on the amount and timing of future cash flows and estimated discount rates based on observable inputs ("Level 2") or unobservable inputs ("Level 3"). The fair values of cash and cash equivalents, accrued interest receivable, and accrued interest payable approximately equals their carrying values and thus are excluded from the table. The carrying amount and estimated fair values of financial instruments reported at amortized cost, segregated by level of valuation inputs within the fair value hierarchy utilized to measure fair value are presented in the following table.

PEOPLES BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

18. Fair Value Measures (Continued)

December 31, 2020					
	Carrying amount	Level 1	Level 2	Level 3	Total fair value
Financial assets					
Federal Home Loan Bank and CBB					
Financial Corp. stock	\$ 284,400	\$ -	\$ -	\$ -	N/A
Loans, net	173,837,969	-	173,372,969	-	173,372,969
Financial liabilities					
Non term deposits	\$219,177,396	\$219,177,396	\$ -	\$ -	\$219,177,396
Time deposits	50,044,267	-	49,595,409	-	49,595,409
Short-term borrowings	2,733,049	2,733,049	-	-	2,733,049
December 31, 2019					
	Carrying amount	Level 1	Level 2	Level 3	Total fair value
Financial assets					
Federal Home Loan Bank and CBB					
Financial Corp. stock	\$ 282,000	\$ -	\$ -	\$ -	N/A
Loans, net	185,294,172	-	186,608,093	-	186,608,093
Financial liabilities					
Non term deposits	\$165,756,539	\$165,756,539	\$ -	\$ -	\$165,756,539
Time deposits	48,964,509	-	48,180,509	-	48,180,509
Short-term borrowings	1,279,631	1,279,631	-	-	1,279,631
Other borrowings	1,296,000	1,296,000	-	-	1,296,000

Federal Home Loan Bank and CBB Financial Corp. stock carried at cost are included in the table above because they are considered to be financial instruments not measured and reported at fair value. The Company has not observed any price change from orderly transactions for these or similar investments that would require an adjustment to the carrying value and therefore a fair value cannot be determined.

PEOPLES BANCORP, INC. AND SUBSIDIARY

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**19. Parent Company Financial Information**

The balance sheets, statements of income, and statements of cash flows for Peoples Bancorp, Inc. (Parent Only) follow:

		December 31,	
		<u>2020</u>	<u>2019</u>
<b><i>Balance Sheets</i></b>			
	Assets		
Cash		\$ 251,602	\$ 278,707
Investment in Bank Subsidiary		29,980,870	28,395,002
Other assets		<u>5,372</u>	<u>2,397</u>
Total assets		<u>\$ 30,237,844</u>	<u>\$ 28,676,106</u>
	Liabilities and Stockholders' Equity		
Other liabilities		\$ 2,508	\$ 3,608
Total liabilities		<u>2,508</u>	<u>3,608</u>
Stockholders' equity			
Common stock		7,289,180	7,289,180
Additional paid-in capital		2,212,550	2,212,550
Retained earnings		21,772,039	20,107,542
Accumulated other comprehensive (loss)		<u>(1,038,433)</u>	<u>(936,774)</u>
Total stockholders' equity		<u>30,235,336</u>	<u>28,672,498</u>
Total liabilities and stockholders' equity		<u>\$ 30,237,844</u>	<u>\$ 28,676,106</u>
		Years Ended December 31,	
		<u>2020</u>	<u>2019</u>
<b><i>Statements of Income</i></b>			
Interest revenue		\$ 391	\$ 834
Dividends from Bank Subsidiary		522,000	506,000
Equity in undistributed income of Bank Subsidiary		<u>1,687,527</u>	<u>2,066,166</u>
		<u>2,209,918</u>	<u>2,573,000</u>
Expenses			
Stockholder services and other		<u>25,972</u>	<u>12,247</u>
		<u>25,972</u>	<u>12,247</u>
Income before income tax benefit		2,183,946	2,560,753
Income tax (benefit)		<u>(5,372)</u>	<u>(2,397)</u>
Net income		<u>\$ 2,189,318</u>	<u>\$ 2,563,150</u>

PEOPLES BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

19. Parent Company Financial Information (Continued)

<i>Statements of Cash Flows</i>	Years Ended December 31,	
	<u>2020</u>	<u>2019</u>
<b>Cash flows from operating activities</b>		
Interest and dividends received	\$ 522,391	\$ 506,834
Cash paid for operating expenses	<u>(18,725)</u>	<u>(10,881)</u>
	<u>503,666</u>	<u>495,953</u>
 <b>Cash flows from financing activities</b>		
Dividends paid	<u>(524,821)</u>	<u>(510,243)</u>
	<u>(524,821)</u>	<u>(510,243)</u>
 Net increase (decrease) in cash	 (27,105)	 (14,291)
 Cash at beginning of year	 <u>278,707</u>	 <u>292,998</u>
 Cash at end of year	 <u>\$ 251,602</u>	 <u>\$ 278,707</u>
 <b>Reconciliation of net income to net cash provided by operating activities</b>		
Net income	\$ 2,189,318	\$ 2,563,150
<b>Adjustments to reconcile net income to net cash provided by operating activities</b>		
Undistributed net income of subsidiary	(1,687,527)	(2,066,166)
(Increase) decrease in other assets	2,975	268
Increase (decrease) in other liabilities	<u>(1,100)</u>	<u>(1,299)</u>
	<u>\$ 503,666</u>	<u>\$ 495,953</u>



Established 1910

110 YEARS OF INDEPENDENT  
COMMUNITY BANKING

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