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HSB Bancorp, Inc.

HSB Bancorp, Inc.
& Subsidiary

2023
Annual Report

Our Mission

Our mission is to be the premier independent community bank within our market area. We are committed to being a reliable business partner and leader in the community, supporting our customers' financial objectives, empowering our employees, and increasing shareholder value.

Hebron Savings Bank
Est. 1910

Dear Fellow Shareholders,

HSB Bancorp, Inc. and its wholly-owned subsidiary, Hebron Savings Bank, had another remarkable year in 2023, continuing to achieve outstanding financial performance in an extremely challenging market. Despite the economic uncertainty, continual interest rate adjustments, and mounting inflation, we are proud to share that we have achieved record earnings, marking the most profitable year in our 113-year history. While issues plagued our industry this year, such as the failure of Silicon Valley Bank, Signature Bank, and First Republic Bank, we proved to our customers, shareholders, and community that Hebron Savings Bank is a safe, sound, and secure financial partner on the Eastern Shore. The underlying factors that contributed to our success were outstanding loan growth and low-cost core deposits.

On December 31, 2023, total assets were $723.9 million, down from $807.5 million the prior year, attributed to decreased deposits and securities available for sale. The deposit outflows were due to the customer utilization of deposits on hand for their cash needs versus borrowing at higher costs in a high-interest rate environment. Deposit volumes normalized in the last quarter of 2023 and ended the year at $628.9 million compared to $722.4 million on December 31, 2022. Our deposit base remains strong, well above pre-pandemic levels of $521 million.

Loan demand was steady, and balances increased to $529.7 million at year-end compared to $508.7 million on December 31, 2022. This increase of $21.0 million well exceeded our budgeted loan growth of $10.0 million.

Consolidated net income of $12.9 million increased by $3.4 million, or 36% year-over-year, due to robust net interest income. As a result of the decrease in assets and increase in net income, our Tier 1 Capital Ratio increased year-over-year from 9.0% to 11.6%. The Bank's internal on-balance sheet liquidity ratio remains strong at 19.0%, well above our internal target threshold.

Operationally, we spent 2023 strengthening internal processes and controls, refining our product offerings, enhancing technology, empowering our employees to provide service excellence, and increasing employee development. We implemented several process improvements to increase efficiencies and reduce operational costs, all in the spirit of enhancing the customer experience. Launching our new and improved online banking platform offered our customers a competitive program that can stand up against even the largest banks.

To promote our brand image, we created new television commercials to reach a wider audience and developed a social media presence to provide customer education, product and service awareness, and promote community involvement activities. Our employees engaged in financial education outreach programs to positively impact our youth, such as Teach Children to Save Day, Junior Achievement, and $5 Fridays – a program to encourage children to earn quarters through household chores and convert them to $5 bills each Friday. Finally, we conducted multiple community focus groups to understand the financial needs of our customers and prospective customers to ensure that we are providing the products and services that meet their needs.

We are proud to say that out of the 12 remaining community banks on the Delmarva Peninsula, we are the third largest in total assets and hold the highest amount of customer deposits of any bank, large or small, in our three-county branch area of Wicomico, Dorchester, and Somerset Counties. We are looking forward to expanding that footprint into Worcester County in 2024.

As shareholders, your support and investment in our Bank are greatly appreciated, and we are proud to share our achievements with you. We remain focused on creating long-term value for our shareholders and delivering on our strategic priorities to ensure the continued success of our Bank. With the increase in profit, shareholder dividends increased from $1.00 per share in 2022 to $1.25 per share in 2023. The total cash payout to our shareholders in 2023, totaling $2.0 million, was the highest in our company's history. The book value of the stock on December 31, 2023, was approximately $47 per share, an increase of $7 per share year-over-year. Earnings per share were $8.00 and $5.85, respectively, for 2023 and 2022.

In 2023, we celebrated the retirement of our Chief Executive Officer, Donna Defino, who had dedicated 24 years to Hebron Savings Bank. Under Donna's leadership, we achieved several years of record earnings, have been a dedicated community partner, and were recognized as one of America's Best Banks by Newsweek Magazine. These achievements were due to Donna's focus, passion, and strong strategic execution.

Lastly, I would be remiss if I didn't acknowledge our employees' hard work and dedication. Through a year of internal change and industry disruptions, our employees have worked tirelessly to continue to make Hebron Savings Bank the premier independent community bank on the shore. They are committed to providing true community bank service to each person they have the honor to serve, and they recognize their role as good stewards of the Bank and the communities we serve.

On behalf of the Directors, Officers, and Employees, we thank you for your support and partnership. We look forward to remaining one of the few independent community banks on the Delmarva Peninsula and representing you in the coming years.

Sincerely,

Jennifer A. Poulsen
CEO and President

CONTENTS

INDEPENDENT AUDITORS' REPORT

Board of Directors
HSB Bancorp, Inc. & Subsidiary
Hebron, Maryland

Opinion

We have audited the accompanying consolidated financial statements of HSB Bancorp, Inc. and subsidiary, which comprise the consolidated balance sheets as of December 31, 2023 and 2022, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of HSB Bancorp, Inc. and subsidiary as of December 31, 2023 and 2022, 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.

Basis for Opinion

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

Change in Accounting Principle

As discussed in Note 1 to the financial statements, effective January 1, 2023, the Bank adopted Accounting Standards Update No. 2016-13, *Financial Instruments - Credit Losses (Topic 326)*. This standard replaced the incurred loss methodology with an expected loss methodology that is referred to as the current expected credit loss ("CECL") methodology. The Company adopted the new credit loss standard using the modified retrospective method such that prior period amounts are not adjusted and continue to be reported in accordance with previously applicable generally accepted accounting principles. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Consolidated Financial Statements

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

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about

HSB Bancorp, Inc. and subsidiary's ability to continue as a going concern within one year after the date that the consolidated financial statements are available to be issued.

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

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

In performing an audit in accordance with generally accepted auditing standards, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of HSB Bancorp Inc. and subsidiary's internal control. Accordingly, no such opinion is expressed.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about HSB Bancorp Inc. and subsidiary's ability to continue as a going concern for a reasonable period of time.

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

UHY LLP

Salisbury, Maryland
February 5, 2024

HSB BANCORP, INC. & SUBSIDIARY

CONSOLIDATED BALANCE SHEETS
December 31, 2023 and 2022

	2023	2022
ASSETS		
Cash and cash equivalents		
Cash and due from banks	**$ 10,480,421**	$ 11,177,228
Interest-bearing deposits in other banks	**15,843,429**	112,330,979
Total cash and cash equivalents	**26,323,850**	123,508,207
Debt securities available-for-sale, at fair value	**127,069,615**	136,292,691
Equity securities, at fair value	**4,004,314**	3,949,229
Loans, less allowance for credit losses		
2023 $8,600,000; 2022 $8,600,000	**529,713,514**	508,710,799
Accrued interest receivable on investment securities and loans	**2,374,385**	1,950,195
Bank premises and equipment, at cost,		
less accumulated depreciation	**10,462,126**	10,643,676
Federal Home Loan Bank stock, at cost	**1,130,100**	1,019,300
Common stock in the HSB Statutory Trust I	**93,000**	93,000
Operating lease right-of-use assets	**834,735**	911,949
Net deferred income tax benefits	**5,415,681**	5,556,248
Other real estate owned	**-**	174,975
Bank owned life insurance	**15,454,733**	13,604,142
Other assets	**1,055,118**	1,075,690
Total assets	**$ 723,931,171**	$ 807,490,101
LIABILITIES		
Deposits:		
Non-interest bearing demand	**$ 252,220,343**	$ 270,772,868
NOW and Super NOW	**33,308,774**	48,566,717
Money market	**47,759,523**	74,036,390
Savings	**128,185,373**	149,903,540
Time, more than $250,000	**25,832,024**	28,424,182
Other time	**141,573,969**	150,665,151
	628,880,006	722,368,848
Accrued interest payable on deposits and borrowings	**666,572**	263,169
Short-term borrowings	**-**	34,833
Long-term borrowings	**11,012,363**	13,560,596
Junior subordinated debentures owed to unconsolidated		
subsidiary trust	**3,093,000**	3,093,000
Operating lease liabilities	**851,075**	921,662
Other liabilities	**3,416,131**	2,558,688
Total liabilities	**647,919,147**	742,800,796
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Common stock, par value $.01, authorized 10,000,000 shares, issued		
and outstanding 2023 1,617,069 shares and 2022 1,617,069 shares	**16,171**	16,171
Surplus	**6,201,001**	6,201,001
Retained earnings	**77,526,860**	66,619,209
Accumulated other comprehensive loss, net of deferred		
tax benefit 2023 $2,935,405; 2022 $3,092,984	**(7,732,008)**	(8,147,076)
Total stockholders' equity	**76,012,024**	64,689,305
Total liabilities and stockholders' equity	**$ 723,931,171**	$ 807,490,101

The Notes to Consolidated Financial Statements are an integral part of these statements.

HSB BANCORP, INC. & SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME
Years Ended December 31, 2023 and 2022

	2023	2022
INTEREST INCOME ON		
Loans, including fees	$ **29,259,300**	$ 25,026,291
Investment securities:		
Taxable	**3,921,099**	2,261,057
Exempt from Federal income tax	**232,100**	197,689
Deposits in other banks	**3,821,654**	2,752,675
	37,234,153	30,237,712
INTEREST EXPENSE ON		
Deposits	**2,887,863**	2,966,319
Borrowings	**284,033**	321,959
Junior subordinated debentures	**222,710**	112,196
	3,394,606	3,400,474
NET INTEREST INCOME	**33,839,547**	26,837,238
Provision for credit losses	**209,741**	116,671
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	**33,629,806**	26,720,567
NON-INTEREST INCOME		
Service charges on deposit accounts	**1,303,452**	1,198,335
Visa debit income	**1,211,395**	1,166,159
Earnings of investment in life insurance	**350,591**	323,865
Gains on disposal of other assets, net	**-**	35,912
Unrealized gains (losses) on equity securities	**55,085**	(516,958)
Other	**106,982**	99,771
	3,027,505	2,307,084
NON-INTEREST EXPENSES		
Salaries and benefits	**11,832,040**	9,853,237
Occupancy	**2,534,865**	2,365,902
Losses on disposal of other assets, net	**33,923**	-
Losses on other real estate owned, net	**25,213**	698
Other expenses	**4,771,047**	4,090,229
	19,197,088	16,310,066
INCOME BEFORE TAXES ON INCOME	**17,460,223**	12,717,585
Federal and State income taxes	**4,531,236**	3,253,951
NET INCOME	$ **12,928,987**	$ 9,463,634

The Notes to Consolidated Financial Statements are an integral part of these statements.

HSB BANCORP, INC. & SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31, 2023 and 2022

		2023		2022
NET INCOME	**$**	**12,928,987**	$	9,463,634
Other comprehensive income (loss), net of tax:				
Unrealized holding gain (loss) on debt securities available-for-sale arising during the period		**572,647**		(11,037,435)
Deferred income tax (liabilities) benefits		**(157,579)**		3,037,226
Other comprehensive income (loss), net of tax		**415,068**		(8,000,209)
Total other comprehensive income (loss)		**415,068**		(8,000,209)
Comprehensive income	**$**	**13,344,055**	$	1,463,425

The Notes to Consolidated Financial Statements are an integral part of these statements.

HSB BANCORP, INC. & SUBSIDIARY

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Years Ended December 31, 2023 and 2022

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balances, January 1, 2022	$ 16,171	$ 6,201,001	$ 58,772,644	$ (146,867)	$ 64,842,949
Net income	-	-	9,463,634	-	9,463,634
Other comprehensive loss, net of tax	-	-	-	(8,000,209)	(8,000,209)
Cash dividends paid, $1.00 per share	-	-	(1,617,069)	-	(1,617,069)
Balances, December 31, 2022	16,171	6,201,001	66,619,209	(8,147,076)	64,689,305
Net income	**-**	**-**	**12,928,987**	**-**	**12,928,987**
Other comprehensive income, net of tax	**-**	**-**	**-**	**415,068**	**415,068**
Cash dividends paid, $1.25 per share	**-**	**-**	**(2,021,336)**	**-**	**(2,021,336)**
Balances, December 31, 2023	**$ 16,171**	**$ 6,201,001**	**$ 77,526,860**	**$ (7,732,008)**	**$ 76,012,024**

The Notes to Consolidated Financial Statements are an integral part of these statements.

HSB BANCORP, INC. & SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2023 and 2022

	2023	2022
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	**$ 12,928,987**	$ 9,463,634
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses, net	**209,741**	116,671
Depreciation	**605,551**	636,775
Amortization and accretion	**(670,080)**	(223,368)
Income on investment in life insurance	**(350,591)**	(323,865)
Losses on other real estate owned	**25,213**	698
Losses (gains) on sale of other assets	**33,923**	(35,912)
Deferred income (benefits) taxes	**(17,012)**	407,113
Fair value adjustment on equity securities	**(55,085)**	516,958
Non-cash lease expense	**6,627**	9,713
Changes in assets and liabilities:		
Increase in accrued interest receivable	**(424,190)**	(340,582)
Increase (decrease) in deferred loan origination fees, net	**191,604**	(685,645)
Decrease in other assets	**20,572**	304,420
Increase (decrease) in accrued interest payable	**403,403**	(167,703)
Increase in other liabilities	**857,443**	567,697
Net cash provided by operating activities	**13,766,106**	10,246,604
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase available-for-sale investment securities	**-**	(92,667,535)
Proceeds from maturities and paydowns of available-for-sale investment securities	**10,465,802**	9,606,176
Purchase of life insurance	**(1,500,000)**	-
Purchase of stock in Federal Home Loan Bank	**(110,800)**	(51,200)
Increase in loans, net	**(21,462,534)**	(10,090,232)
Proceeds from sale of other real estate owned	**208,237**	59,302
Proceeds from sale of other assets	**-**	856,802
Purchase premises and equipment	**(457,924)**	(629,145)
Net cash used by investing activities	**(12,857,219)**	(92,915,832)
CASH FLOWS FROM FINANCING ACTIVITIES		
(Decrease) increase in demand, NOW, SUPER NOW, money market, and savings deposits, net	**(81,805,502)**	20,068,390
Decrease in time deposits, net	**(11,683,340)**	(34,047,309)
Repayment of borrowings	**(2,583,066)**	(2,611,614)
Cash dividends paid	**(2,021,336)**	(1,617,069)
Net cash used by financing activities	**(98,093,244)**	(18,207,602)
Net decrease in cash and cash equivalents	**(97,184,357)**	(100,876,830)
Cash and cash equivalents, beginning	**123,508,207**	224,385,037
Cash and cash equivalents, ending	**$ 26,323,850**	$ 123,508,207

The Notes to Consolidated Financial Statements are an integral part of these statements.

HSB BANCORP, INC. & SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2023 and 2022

	2023	2022
SUPPLEMENTARY CASH FLOW INFORMATION		
Interest paid	**$ 2,991,203**	$ 3,568,177
Income taxes paid	**4,656,843**	2,693,421
Right-of-use assets and corresponding lease liabilities	**-**	987,580
Unrealized appreciation (depreciation) on debt securities available-for sale	**572,647**	(11,037,435)
SUPPLEMENTARY NON-CASH INVESTING ACTIVITIES		
Leases arising from right-of-use assets	**$ -**	$ 987,580
Loans converted to other real estate owned	**58,475**	-

The Notes to Consolidated Financial Statements are an integral part of these statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

Hebron Savings Bank provides financial services to individuals and corporate customers, and is subject to competition from other financial institutions. The Bank is also subject to the regulations of certain Federal and State agencies and undergoes periodic examinations by those regulatory authorities. The accounting policies of the Bank conform, in all material respects, to U.S. generally accepted accounting principles and general practices within the banking industry.

Significant accounting policies not disclosed elsewhere in the consolidated financial statements are as follows:

Principles of Consolidation

The consolidated financial statements include the accounts of HSB Bancorp, Inc., (the "Company") and its wholly owned subsidiary, Hebron Savings Bank (the "Bank"). All significant intercompany accounts and transactions have been eliminated. The Parent Only financial information of the Company (see Note 17) accounts for the Bank using the equity method of accounting.

The Bank determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity under accounting principles generally accepted in the United States. Voting interest entities are entities in which the total equity investment at risk is sufficient to enable the entity to finance itself independently and provides the equity holders with the obligation to absorb losses, the right to receive residual returns and the right to make decisions about the entity's activities. The Company consolidates voting interest entities in which it has all, or at least a majority of, the voting interest. As defined in applicable accounting standards, variable interest entities (VIEs) are entities that lack one or more of the characteristics of a voting interest entity. A controlling financial interest in an entity is present when an enterprise has a variable interest, or a combination of variable interest, that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both. The enterprise with a controlling financial interest, known as the primary beneficiary, consolidates the VIE. The Company's wholly owned subsidiary, HSB Statutory Trust I is a VIE for which the Company is not the primary beneficiary. Accordingly, the accounts of this entity are not included in the Company's consolidated financial statements.

Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Certain of the critical accounting estimates are more dependent on such judgment and in some cases may contribute to volatility in the Company's reported financial performance should the assumptions and estimates used change over time due to changes in circumstances. Actual results could differ from those estimates. The more significant areas in which management of the Company applies critical assumptions and estimates that are most susceptible to change in the short term include the calculation of the allowance for credit losses, the valuation of individually evaluated loans that do not fit within a portfolio segment, and the unrealized gain or loss on investment securities available-for-sale.

Securities Held-to-Maturity

Bonds, notes, and debentures for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using methods approximating the interest method over the periods to maturity. Securities transferred into held-to-maturity from the available-for-sale portfolio are recorded at fair value at time of transfer with unrealized gains or losses reflected in equity and amortized over the remaining life of the security.

Note 1. Summary of Significant Accounting Policies (Continued)

Securities Available-for-Sale

Securities designated as available-for-sale are stated at estimated fair value as determined by quoted market prices. They represent those securities, which management may decide to sell as part of the Bank's asset/liability strategy, or that may be sold in response to changing interest rates or liquidity needs. Changes in unrealized appreciation (depreciation) on securities available-for-sale are reported in other comprehensive income. Realized gains (losses) on securities available-for-sale are included in other income (expense) and, when applicable, are reported as a reclassification adjustment, net of tax, in other comprehensive income. The gains and losses on securities sold are determined by the specific identification method. Premiums and discounts are recognized in interest income using the interest method over the period to maturity. Additionally, declines in the fair value of the individual investment securities below their cost that are other than temporary are reflected as realized losses in the consolidated statements of income.

Equity Securities

Equity securities with readily determinable fair values are carried at fair value, with changes in fair value reported in net income. Any equity securities without readily determinable fair values are carried at cost, minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for identical or similar investments. The entirety of any impairment on equity securities is recognized in earnings.

Other Securities

Federal Home Loan Bank ("FHLB") stock is an equity interest in the FHLB, which does not have a readily determinable fair value because its ownership is restricted and it lacks a market. FHLB stock can be sold back only at its par value of $100 per share and only to the FHLB or another member institution. FHLB stock is carried at cost and is periodically evaluated based on ultimate recovery of par.

Allowance for Credit Losses

Loans are generally carried at the amount of unpaid principal, adjusted for unearned loan fees, which are amortized over the term of the loan using the effective interest rate method. Interest on loans is accrued based on the principal amounts outstanding. When principal or interest is delinquent for ninety days or more, the Bank evaluates the loan for nonaccrual status. When a loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Interest income generally is not recognized on individually evaluated loans unless the likelihood of further loss is remote. Cash collections on such loans are applied as reductions of the loan principal balance, and no interest income is recognized on those loans until the principal balance has been collected. Interest income on other nonaccrual loans is recognized only to the extent of interest payments received. The carrying value of nonaccrual loans is based on the present value of the loan's expected future cash flows or, alternatively, the observable market price of the loan or the fair value of the collateral, less any applicable selling costs.

The allowance for credit losses ("ACL") is maintained at a level believed adequate by management to absorb expected losses inherent in the loan portfolio and is based on the size and current risk characteristics of the loan portfolio, an assessment of individual problem loans, actual loss experience, the value of the underlying collateral, current economic events in specific industries and geographical areas, and other pertinent factors, including regulatory guidance and general economic conditions.

Note 1. Summary of Significant Accounting Policies (Continued)

Allowance for Credit Losses (Continued)

Determination of the ACL is inherently subjective, as it requires significant estimates, including the amounts and timing of historical loss experience and consideration of current economic trends, all of which may be susceptible to significant change. Loan losses are charged off against the ACL, while recoveries of amounts previously charged off are credited to the ACL. A provision for credit losses is charged to operations based on management's periodic evaluation of the factors previously mentioned, as well as other relevant factors. The amount of the ACL is based on ongoing, quarterly assessments by management.

Effective January 1, 2023, the Bank adopted ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This standard replaced the incurred loss methodology with an expected loss methodology that is referred to as the current expected credit loss ("CECL") methodology. The Bank maintains an ACL for the expected credit losses of the loan portfolio as well as unfunded loan commitments. The CECL methodology requires an estimate of the credit losses over the life of a loan, or pooled loan segment, and replaced the previous "incurred" loss methodology's threshold that delayed the recognition of a credit loss until it was probable that a loss event had incurred. Results for reporting periods beginning after January 1, 2023 are presented under ASU 2016-13 while prior period amounts continue to be reported in accordance with previously applicable GAAP. The Company was not required to record an adjustment to retained earnings as of January 1, 2023 as the cumulative effect of adopting ASU 2016-13 was $0.

The ACL consists of the "allowance for credit losses – loans" and the "reserve for unfunded commitments". The estimate of expected credit losses under the CECL methodology requires an estimate of credit losses for the remaining expected life of the financial asset using historical experience, current conditions, and reasonable and supportable forecasts and generally applies to financial assets measured at amortized cost, including loan receivables and some off-balance sheet credit exposures such as unfunded commitments to extend credit. An ACL is a valuation account that is deducted from or added to the amortized cost basis of financial assets to present the net amount expected to be collected over the contractual term of the assets.

The ACL reflects expected losses resulting from analyses developed through specific reserve allocations for individual loans and adjusted historical loss experience for each pooled loan segment. Portfolio segmentation is the process by which loans of similar risk characteristics are pooled together and is defined as the level at which the Bank develops and documents a systematic methodology to determine its ACL. The Bank segments its portfolio by FDIC Call Report codes. The historical loss experience is then determined for each pooled loan segment by annualizing the Bank's net charge-offs from 2007, the beginning of the last economic cycle, through the most recent quarter. Consideration is then given as to whether the historical loss experience for each pooled loan segment should be adjusted for specific risks or current conditions at the reporting date that did not exist over the period for which it was determined. Nine qualitative factors and reasonable and supportable forecasts, made about future economic conditions or changes in collateral values, are used to determine these adjustments.

Note 1. Summary of Significant Accounting Policies (Continued)

Allowance for Credit Losses (Continued)

The Bank uses the Weighted Average Remaining Life ("WARM") method to determine the historical loss experience for each pooled loan segment. The WARM method tracks charge-offs over the lives of the loans to determine an average historical charge-off rate for each pooled loan segment. The charge-off rate is then applied to future expected outstanding balances over the remaining lives of the loans to serve as a quantitative baseline for the historical loss rate. The Bank also considers qualitative adjustments to the historical loss rate for each pooled loan segment. The qualitative adjustments for each pooled loan segment consider the conditions over the look-back period for which the historical loss experience was based, and are split into two components: 1) pooled loan segment-specific risk characteristics or current conditions at the reporting date related to portfolio credit quality, remaining payments, volume and nature of the portfolio, credit culture and management, business environment, or other management factors; and 2) reasonable and supportable forecasts of future economic conditions and collateral values.

When management deems it to be appropriate, the Bank establishes a specific reserve for individually evaluated loans that do not share similar risk characteristics with the loans included in each respective pooled loan segment. These individually evaluated loans are removed from their respective pools and typically represent nonaccrual or other nonperforming loans.

Other Real Estate Owned (OREO)

OREO comprises properties acquired in partial or total satisfaction of problem loans. The properties are recorded at the lower of cost or fair value (appraised value) at the date acquired. Losses arising at the time of acquisition of such properties are charged against the allowance for credit losses. Subsequent write-downs and losses realized from the sale of OREO totaled **$25,213** and $698 for 2023 and 2022, respectively. Expenses of operation are included in other expenses as detailed in Note 11. Property acquired through foreclosure proceedings totaled **$58,475** and $0 at December 31, 2023 and 2022, respectively. The Bank did not finance any sales of OREO during 2023 or 2022. At December 31, 2023 and 2022, loans secured by residential real estate properties in process of foreclosure totaled approximately **$336,000** and $554,000, respectively.

Reserve for Unfunded Commitments

The reserve for unfunded commitments is established through a provision for unfunded commitments charged to other expenses. The reserve is calculated by utilizing the same methodology and factors as the allowance for credit losses. The reserve, based on evaluations of the collectability of loans and prior loan loss experience, is an amount that management believes will be adequate to absorb possible losses on unfunded commitments (off-balance sheet financial instruments) that may become uncollectible in the future.

Long-Lived Assets

The carrying value of long-lived assets and certain identifiable intangibles, including goodwill, is reviewed by the Bank for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, as prescribed in *ASC Topic 360 Property, Plant and Equipment.*

Note 1. Summary of Significant Accounting Policies (Continued)

Premises, Equipment, and Depreciation

Land is carried at cost. Other premises and equipment are carried at cost net of accumulated depreciation. Depreciation is computed using the straight-line and accelerated methods over the estimated useful lives of the assets. Maintenance and repairs are expensed as incurred while major additions and improvements are capitalized. Gains and losses on dispositions are included in current operations.

Income Taxes

The provision for federal and state income taxes is based upon the results of operations, adjusted for tax exempt income. Deferred income taxes are provided for the temporary differences between carrying amounts and tax basis of assets and liabilities and are measured at the enacted tax rates that will be in effect when the differences reverse.

Temporary differences, which give rise to deferred tax benefits, relate principally to the allowance for credit losses, lease liabilities, net of right-of-use assets, OREO property, accrued supplemental retirement benefits, accrued vacation, unearned income on loans and net unrealized depreciation on securities available-for-sale. Temporary differences, which give rise to deferred tax liabilities, relate principally to accumulated depreciation and net unrealized appreciation on securities available-for-sale.

The benefit of an uncertain tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination by the applicable taxing authority, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. Interest and penalties associated with unrecognized tax benefits are recognized as a component of income tax expense.

Revenue Recognition

Revenue from contracts with customers are presented under ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606),* and all subsequent ASUs that modified Topic 606. Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. Topic 606 is applicable to noninterest revenue streams such as deposit related fees, interchange fees and merchant income. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all of the Company’s revenue is generated from contracts with customers. Noninterest revenue streams in-scope of Topic 606 are discussed below.

Service Charges on Deposit Accounts. Service charges on deposit accounts consist of monthly service fees, check orders, and other deposit account related fees. The Company’s performance obligation for monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Check orders and other deposit account related fees are largely transactional based, and therefore, the Company’s performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or at the end of the month through a direct charge to customers’ accounts.

Note 1. Summary of Significant Accounting Policies (Continued)

Revenue Recognition (Continued)

Other Noninterest Income. Other noninterest income consists of: fees, other service charges, safety deposit box rental fees, and other miscellaneous revenue streams. Fees and other service charges are primarily comprised of debit card income, ATM fees, merchant services income, and other service charges. Debit card income is primarily comprised of interchange fees earned whenever the Company's debit cards are processed through card payment networks. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM. Merchant services income mainly represents fees charged to merchants to process their debit card transactions, in addition to account management fees. Other service charges include revenue from processing wire transfers, cashier's checks, and other services. The Company's performance obligation for fees and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month. Safe deposit box rental fees are charged to the customer on an annual basis and recognized upon receipt of payment.

Credit Risk

The Bank has deposits in other financial institutions in excess of amounts insured by the Federal Deposit Insurance Corporation (FDIC). At December 31, 2023 and 2022, the balances carried in excess of the limit, including unsecured federal funds sold, were **$3,475,163** and $22,238,683, respectively.

Cash and Cash Equivalents

The Bank has included cash and due from banks, Federal funds sold, and interest-bearing deposits in other banks with maturities less than three months as cash and cash equivalents for the purposes of reporting cash flows.

The Bank had **$13,566,312** and $91,562,725 of cash on hand and on deposit with the Federal Reserve Bank as of December 31, 2023 and 2022, respectively. The amounts on deposit at the Federal Reserve Bank earn interest.

The Bank is required to maintain a non-interest bearing cash reserve at one of its correspondent banks against its corporate credit card account. Such reserve amounted to **$100,000** during the years ended December 31, 2023 and 2022.

Dividend Restriction

Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the Company or by the Company to shareholders.

Other Comprehensive Income (Loss)

The Bank records unrealized gains and losses on available for sale securities in accumulated other comprehensive income, net of taxes. Unrealized gains and losses on available for sale securities are reclassified into earnings as the gains or losses are realized upon sale of the securities. The credit component of unrealized losses on available for sale securities that are determined to be other-than-temporary impaired are reclassified into earnings at the time the determination is made.

Advertising Costs

The Bank expenses advertising costs for the period in which they are incurred. The Bank incurred advertising costs totaling **$146,027** and $120,473, for the years 2023 and 2022, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies (Continued)

Financial Statement Presentation

Certain amounts in the prior year's financial statements have been reclassified to conform to the current year's presentation.

Note 2. Debt and Equity Securities

Securities available-for-sale are as follows:

	December 31, 2023			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury and obligations of U.S. government agencies	**$ 43,014,676**	**$ 101,185**	**$ 3,046,248**	**$ 40,069,613**
Obligations of States and political subdivisions	**12,629,719**	**52,318**	**585,826**	**12,096,211**
Mortgage-backed securities and CMOs	**82,092,633**	**93,742**	**7,282,584**	**74,903,791**
	$ 137,737,028	**$ 247,245**	**$ 10,914,658**	**$ 127,069,615**

	December 31, 2022			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury and obligations of U.S. government agencies	$ 42,564,290	$ 136,199	$ 3,609,683	$ 39,090,806
Obligations of States and political subdivisions	13,642,570	294	759,873	12,882,991
Mortgage-backed securities and CMOs	91,325,890	181,419	7,188,415	84,318,894
	$ 147,532,750	$ 317,912	$ 11,557,971	$ 136,292,691

Note 2. Debt and Equity Securities (Continued)

The following is a summary of gross unrealized losses and fair values, aggregated by investment category and length of time that individual securities have been in continuous unrealized loss position:

	December 31, 2023					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and obligations of U.S. government agencies	$ 1,762,530	$ 17,435	$ 31,893,390	$ 3,028,813	$ 33,655,920	$ 3,046,248
Obligations of States and political subdivisions	237,461	1,692	9,018,106	584,134	9,255,567	585,826
Mortgage-backed securities and CMOs	8,311,628	148,972	62,408,608	7,133,612	70,720,236	7,282,584
Total securities with unrealized losses	$ 10,311,619	$ 168,099	$ 103,320,104	$ 10,746,559	$ 113,631,723	$ 10,914,658

	December 31, 2022					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and obligations of U.S. government agencies	$ 18,591,785	$ 1,333,201	$ 14,125,579	$ 2,276,482	$ 32,717,364	$ 3,609,683
Obligations of States and political subdivisions	11,018,327	489,244	984,370	270,629	12,002,697	759,873
Mortgage-backed securities and CMOs	52,062,053	2,885,508	23,679,319	4,302,907	75,741,372	7,188,415
Total securities with unrealized losses	$ 81,672,165	$ 4,707,953	$ 38,789,268	$ 6,850,018	$ 120,461,433	$ 11,557,971

For individual securities classified as either available-for-sale or held-to-maturity, the Bank must determine whether a decline in fair value below the amortized cost basis is other than temporary. If the decline in fair value is considered to be other than temporary, the cost basis of the individual security shall be written down to the fair value as a new cost basis and the amount of the write-down shall be included in earnings (that is, accounted for as a realized loss). At December 31, 2023, the Bank held 32 obligations of U.S. government agencies, 16 U.S. Treasuries, 22 obligations of States and political subdivisions, 78 mortgage-backed securities, and 87 CMOs having continuous unrealized loss positions for more than 12 months. Management has reviewed the investment and determined through various valuation methods that the unrealized loss position as of December 31, 2023 is a temporary unrealized loss relating primarily to changes in market interest rates over the yields available at the time the underlying security was purchased and that the loss is not due to reasons of credit quality.

In addition to the above analysis, management feels it has the ability and intent to hold the securities for a period of time sufficient for a recovery of their amortized cost basis.

The Company recorded a gain of **$55,085** and a loss of $516,958 on equity securities during the years ended December 31, 2023 and 2022, respectively, related to changes in the fair value on equity securities.

Note 2. Debt and Equity Securities (Continued)

Contractual maturities of investment securities at December 31, 2023 and December 31, 2022 are shown below. Actual maturities may differ from contractual maturities because debtors may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities have no stated maturity and primarily reflect investments in various Pass-through and Participation Certificates issued by the Federal National Mortgage Association and the Government National Mortgage Association. Repayment of mortgage-backed securities is affected by the contractual repayment terms of the underlying mortgages collateralizing these obligations and the current level of interest rates.

The following is a summary of maturities of securities available-for-sale:

	December 31, 2023	
	Securities Available-for-Sale	
Amounts maturing:	**Amortized Cost**	**Fair Value**
One year or less	**$ 32,228,734**	**$ 30,002,280**
After one year through five years	**70,372,849**	**65,824,079**
After five years through ten years	**34,694,931**	**30,902,310**
After ten years	**440,514**	**340,946**
	$ 137,737,028	**$ 127,069,615**

	December 31, 2022	
	Securities Available-for-Sale	
Amounts maturing:	Amortized Cost	Fair Value
One year or less	$ 27,867,323	$ 25,580,669
After one year through five years	67,816,135	64,240,429
After five years through ten years	51,849,292	46,471,593
After ten years	-	-
	$ 147,532,750	$ 136,292,691

The Bank has pledged certain debt securities as collateral for deposits of certain government agencies and municipalities. The carrying value of these securities totaled **$8,701,314** and $11,535,942 at December 31, 2023 and 2022, respectively.

Note 3. Bank Owned Life Insurance

The Bank has purchased bank owned life insurance policies on certain current and former employees as a means to generate tax-exempt income which is used to offset a portion of current and future employee benefit costs. Bank owned life insurance is recorded at the cash surrender value of the policies. Changes in the cash surrender value are included in noninterest income. The cash surrender value of the bank owned life insurance policies totaled **$15,454,733** and $13,604,142 at December 31, 2023 and 2022, respectively.

Note 4. Loans and Allowance for Credit Losses

The Bank makes loans to customers primarily throughout the Lower Eastern Shore of Maryland and Lower Sussex County of Delaware. The principal categories of the loan portfolio are as follows:

	2023	2022
Real estate loans:		
Construction	**$ 91,821,530**	$ 93,783,831
Residential Mortgages	**167,702,090**	167,909,006
Commercial Mortgages	**233,138,622**	207,185,161
	492,662,242	468,877,998
Commercial & industrial loans	**42,210,966**	46,664,735
Consumer loans	**3,777,923**	1,914,079
	538,651,131	517,456,812
Less: unearned income on loans	**337,617**	146,013
	538,313,514	517,310,799
Less: allowance for credit losses	**8,600,000**	8,600,000
	$ 529,713,514	$ 508,710,799

Management has an established methodology to determine the adequacy of the ACL that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the ACL, the Bank segments its loan portfolio by FDIC Call Report codes. For reporting purposes, these loan segments are aggregated by the following product types: Real Estate Loans, Commercial and Industrial, and Consumer. Real estate loans are further divided into the following three classes: Construction (which includes construction, land development, and other land loans), Residential Mortgages, and Commercial Mortgages. Pooled loan segments are reviewed and analyzed quarterly using the Bank's annualized net charge-offs from January 1, 2007, to the most recent quarter-end. The quantitative historical loss rate is then adjusted for reasonable and supportable economic forecasts and the following qualitative factors:

1. Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices.
2. Changes in the experience, depth, and ability of management.
3. Changes in the quality of the loan review system.
4. Changes in the concentrations of credit within the pool.
5. Changes in the nature, volume, and growth rate of the loan portfolio.
6. Trends in past due, non-accrual, and adversely classified loans not captured in the pools.
7. Changes in the value of the underlying collateral for collateral-dependent loans.
8. Changes in competition, legal, and regulatory factors.
9. Imprecision risk of the economic outlook and model.

In accordance with ASU 2016-13 individually evaluated loans that do not fit within a portfolio segment are specifically identified and individually analyzed to determine the amount of their expected loss. All nonaccrual loans are individually analyzed to determine their valuation and reserve amounts. Other loans risk rated substandard, doubtful or loss and with a balance of $75,000 or greater are individually evaluated. The establishment of a specific reserve does not necessarily mean that the loan with the specific reserve will definitely incur loss at the reserve level. It is only an estimation of potential loss based upon anticipated events. A specific reserve will not be established unless loss elements can be determined and quantified based on known facts.

The total ACL reflects management's estimate of loan losses inherent in the loan portfolio as of December 31, 2023 and 2022.

Note 4. Loans and Allowance for Credit Losses (Continued)

In the normal course of loan portfolio management, loan originators are responsible for the continuous assessment of credit risk arising from the individual borrowers within their portfolio and for assigning appropriate risk ratings. Credit Administration is responsible for the subsequent review and approval of the risk ratings and for ensuring the integrity and operation of the risk rating system and maintenance of the Bank's Watch List. The Bank contracts with an independent third-party loan review firm that reviews and validates the internal credit risk program on a quarterly basis. Results of these reviews and management's responses are presented to the Bank's Audit Committee for review and approval. The loan review process complements and reinforces the risk identification and assessment decisions made by loan originators and credit personnel as well as the Bank's policies and procedures.

Note 4. Loans and Allowance for Credit Losses (Continued)

The activity in the ACL for 2023 and 2022 is as follows:

	December 31, 2023						
	Real Estate Loans			Commercial and Industrial	Consumer	Immaterial Difference	Total
	Construction	Residential Mortgages	Commercial Mortgages				
Beginning Balance	**$ 1,539,089**	**$ 2,727,928**	**$ 3,303,099**	**$ 854,869**	**$ 70,672**	**$ 104,343**	**$ 8,600,000**
Charge-offs	**(6,097)**	**(93,897)**	**-**	**(115,000)**	**(97,080)**	**-**	**(312,074)**
Recoveries	**10,501**	**65,997**	**162**	**20,884**	**4,789**	**-**	**102,333**
Provision	**408,239**	**264,212**	**(539,012)**	**292,713**	**54,872**	**(271,283)**	**209,741**
Ending Balance	**1,951,732**	**2,964,240**	**2,764,249**	**1,053,466**	**33,253**	**(166,940)**	**8,600,000**
Ending Balance of:							
Individually evaluated for impairment:							
Related loan balance	**891,965**	**1,020,942**	**2,805,218**	**2,553,557**	**-**	**-**	**7,271,682**
Balance in allowance	**-**	**-**	**-**	**638,380**	**-**	**-**	**638,380**
Collectively evaluated for impairment:							
Related loan balance	**90,929,565**	**166,681,148**	**230,333,404**	**39,657,409**	**3,777,923**	**-**	**531,379,449**
Balance in allowance	**1,951,732**	**2,964,240**	**2,764,249**	**415,086**	**33,253**	**(166,940)**	**7,961,620**
Total							
Related loan balance	**91,821,530**	**167,702,090**	**233,138,622**	**42,210,966**	**3,777,923**	**-**	**538,651,131**
Balance in allowance	**1,951,732**	**2,964,240**	**2,764,249**	**1,053,466**	**33,253**	**(166,940)**	**8,600,000**

	December 31, 2022						
	Real Estate Loans			Commercial and Industrial	Consumer	Immaterial Difference	Total
	Construction	Residential Mortgages	Commercial Mortgages				
Beginning Balance	$ 1,459,118	$ 3,065,360	$ 2,926,511	$ 1,605,411	$ 149,662	$ 93,938	$ 9,300,000
Charge-offs	(38,008)	(289,273)	(154,367)	(304,021)	(92,203)	-	(877,872)
Recoveries	390	38,411	-	13,808	8,592	-	61,201
Provision	117,589	(86,570)	530,955	(460,329)	4,621	10,405	116,671
Ending Balance	1,539,089	2,727,928	3,303,099	854,869	70,672	104,343	8,600,000
Ending Balance of:							
Individually evaluated for impairment:							
Related loan balance	233,659	6,834,524	1,169,126	311,423	63,649	-	8,612,381
Balance in allowance	-	334,824	-	44,110	18,354	-	397,288
Collectively evaluated for impairment:							
Related loan balance	93,550,172	161,074,482	206,016,035	46,353,312	1,850,430	-	508,844,431
Balance in allowance	1,539,089	2,393,104	3,303,099	810,759	52,318	104,343	8,202,712
Total							
Related loan balance	93,783,831	167,909,006	207,185,161	46,664,735	1,914,079	-	517,456,812
Balance in allowance	1,539,089	2,727,928	3,303,099	854,869	70,672	104,343	8,600,000

Estimating the appropriate ACL involves a high degree of management judgment. The Bank's process for determining the appropriate ACL may result in a range of estimates for expected credit losses. As such, the Bank has established a tolerance level between the ACL calculation and the actual balance in the allowance. As of December 31, 2023 and 2022, the ACL included an immaterial difference of (**$166,940)** and $104,343, respectively, which were within the tolerance level established by Bank policy.

Note 4. Loans and Allowance for Credit Losses (Continued)

Following is an aging analysis by loan class and amount as of December 31, 2023 and 2022:

	December 31, 2023					
	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
30-89 Days Past Due	**$ -**	**$ 495,198**	**$ -**	**$ 51,372**	**$ 5,971**	**$ 552,541**
Greater than 90 Days Past Due	**-**	**-**	**-**	**-**	**-**	**-**
Nonaccrual loans - non current	**-**	**1,025,424**	**-**	**-**	**-**	**1,025,424**
Total Past Due	**-**	**1,520,622**	**-**	**51,372**	**5,971**	**1,577,965**
Current nonaccrual loans	**-**	**157,364**	**-**	**-**	**-**	**157,364**
Current accrual loans	**91,821,530**	**166,024,104**	**233,138,622**	**42,159,594**	**3,771,952**	**536,915,802**
Total Loans	**$ 91,821,530**	**$ 167,702,090**	**$ 233,138,622**	**$ 42,210,966**	**$ 3,777,923**	**$ 538,651,131**

	December 31, 2022					
	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
30-89 Days Past Due	$ -	$ 554,387	$ -	$ -	$ 10,311	$ 564,698
Greater than 90 Days Past Due	-	-	-	-	-	-
Nonaccrual loans - non current	-	1,125,678	283,404	-	-	1,409,082
Total Past Due	-	1,680,065	283,404	-	10,311	1,973,780
Current nonaccrual loans	233,659	425,338	-	-	-	658,997
Current accrual loans	93,550,172	165,803,603	206,901,757	46,664,735	1,903,768	514,824,035
Total Loans	$ 93,783,831	$ 167,909,006	$ 207,185,161	$ 46,664,735	$ 1,914,079	$ 517,456,812

Note 4. Loans and Allowance for Credit Losses (Continued)

The Bank's policies, consistent with regulatory guidelines, provide for the classification of loans that are considered to be of lesser quality as special mention, substandard, or doubtful assets. Special mention is a warning or watch classification, which portrays one or more deficiencies in the credit quality of the borrower or the pledged collateral. Substandard loans include loans with a high loan-to-value ratio or credits that are unable to adjust due to unfavorable industry or economic conditions. Loans classified as doubtful are critical credits with an element of probable loss and insufficient collateral. The risk ratings are adjusted, as necessary, if loans become delinquent, if significant adverse information is discovered regarding the underlying credit, and/or if the normal periodic reviews of the underlying credits indicate that a change in risk rating is appropriate. A summary of the risk rating of loans receivable as of December 31, 2023 and 2022 is as follows:

	December 31, 2023					
	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
Pass	**$ 88,950,002**	**$ 162,133,563**	**$ 206,864,294**	**$ 36,333,005**	**$ 3,777,923**	**$ 498,058,787**
Special Mention	**1,389,806**	**2,769,699**	**22,965,801**	**679,325**	**-**	**27,804,631**
Substandard	**1,481,722**	**2,798,828**	**3,308,527**	**5,198,636**	**-**	**12,787,713**
Doubtful	**-**	**-**	**-**	**-**	**-**	**-**
	$ 91,821,530	**$ 167,702,090**	**$ 233,138,622**	**$ 42,210,966**	**$ 3,777,923**	**$ 538,651,131**

	December 31, 2022					
	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
Pass	$ 92,624,180	$ 155,800,916	$ 189,312,559	$ 41,950,412	$ 1,910,930	$ 481,598,997
Special Mention	507,918	7,845,737	16,475,061	1,590,257	3,149	26,422,122
Substandard	651,733	4,262,353	1,397,541	3,124,066	-	9,435,693
Doubtful	-	-	-	-	-	-
	$ 93,783,831	$ 167,909,006	$ 207,185,161	$ 46,664,735	$ 1,914,079	$ 517,456,812

Note 4. Loans and Allowance for Credit Losses (Continued)

When management identifies a loan to be individually evaluated, the impairment is measured based on the fair value of the collateral, less applicable selling costs, or the present value of expected future cash flows, discounted at the loan's effective interest rate. If management determines that the value of the loan to be individually evaluated is less than the carrying value of the loan, impairment is recognized through a reserve amount or charge-off to the ACL. The total ACL reflects management's estimate of loan losses inherent in the loan portfolio as of December 31, 2023 and 2022.

Individually evaluated loans as of December 31, 2023 and 2022, are as follows:

	December 31, 2023					
	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
Recorded Investment with a related allowance	$ -	$ -	$ -	$ 2,553,557	$ -	$ 2,553,557
Recorded Investment with no related allowance	891,965	1,020,942	2,805,218	-	-	4,718,125
Total Recorded Investment	$ 891,965	$ 1,020,942	$ 2,805,218	$ 2,553,557	$ -	$ 7,271,682
Unpaid Principal Balance	$ 891,965	$ 1,026,255	$ 2,959,585	$ 2,553,557	$ -	$ 7,431,362
Related Allowance	-	-	-	638,380	-	638,380
Average Recorded Investment	927,504	1,025,380	2,848,802	2,731,271	-	7,532,957
Interest Income Recognized	39,209	21,518	202,326	145,753	-	408,806

	December 31, 2022					
	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
Recorded Investment with a related allowance	$ -	$ 2,525,801	$ -	$ 173,436	$ 63,649	$ 2,762,886
Recorded Investment with no related allowance	233,659	4,308,723	1,169,126	137,987	-	5,849,495
Total Recorded Investment	$ 233,659	$ 6,834,524	$ 1,169,126	$ 311,423	$ 63,649	$ 8,612,381
Unpaid Principal Balance	$ 233,659	$ 8,065,618	$ 1,323,493	$ 311,423	$ 63,649	$ 9,997,842
Related Allowance	-	334,824	-	44,110	18,354	397,288
Average Recorded Investment	874,527	7,198,300	1,281,718	327,721	69,166	9,751,432
Interest Income Recognized	64,044	297,299	51,089	10,290	2,121	424,843

The Bank generally places loans on nonaccrual status when the full and timely collection of interest or principal becomes uncertain, part of the principal balance has been charged off and no restructuring has occurred, or the loan reaches 90 days past due. When a loan is placed on nonaccrual status, the accrued unpaid interest receivable is reversed against interest income, and future payments are applied to principal. Loans are returned to accrual status when the borrower makes at least six regularly scheduled payments and the collectability is no longer doubtful. Information regarding these loans as of December 31, 2023 and 2022 is summarized as follows:

	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
December 31, 2023	$ -	$ 1,182,788	$ -	$ -	$ -	$ 1,182,788
December 31, 2022	$ 233,659	$ 1,551,016	$ 283,404	$ -	$ -	$ 2,068,079

Note 4. Loans and Allowance for Credit Losses (Continued)

Management strives to identify borrowers in financial difficulty early and work with them to modify their loan to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal or interest forgiveness, or other actions intended to minimize the loss and to avoid foreclosure or repossession of the collateral.

On January 1, 2023, the Bank adopted *ASU 2022-02, Financial Instruments—Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures,* which eliminates Troubled Debt Restructuring ("TDR") recognition and measurement guidance and instead requires loan refinancing and restructuring guidance to determine whether a modification results in a new loan or a continuation of an existing loan. If a loan is modified for a borrower who is experiencing financial difficulties and the modifications are considered to be more than minor, the loan is subject to certain disclosure requirements outlined in ASU 2022-02. During 2023 the Bank did not modify any loans for borrowers which met the disclosure requirements outlined in ASU 2022-02.

Prior to the adoption of ASU 2022-02, in situations where, for economic or legal reasons related to a borrower's financial difficulties, the Bank may have granted a concession for other than an insignificant period of time to the borrower that would not otherwise be considered, the related loan was classified as a TDR. Under the incurred loss methodology, prior to the adoption of CECL on January 1, 2023, a TDR was considered to be an impaired loan to be individually analyzed for purposes of determining the ACL. For TDRs with interest rates modified below market, the "specific" valuation allowance amounts were determined by comparing the discounted future expected present value of cash flows under the modified agreements against the carrying value of the original loan and a separate reserve in the ACL was established and identified for TDRs. TDRs with principal reductions were individually evaluated for impairment and charged off to their net realizable value through the ACL.

The following table includes the recorded investment and number of modifications for TDRs as of December 31, 2022. The Bank reported the recorded investment in the loans prior to a modification and also the recorded investment in the loans after the loans were restructured.

	December 31, 2022					
	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
Number of modifications	1	44	3	6	4	58
Recorded investment prior to modification	$ 1,478,206	$ 8,163,578	$ 1,965,580	$ 485,953	$ 104,367	$ 12,197,684
Recorded investment after modification	$ 233,659	$ 5,911,204	$ 1,169,126	$ 298,021	$ 63,649	$ 7,675,659

TDRs, included in impaired loans, which were not performing as agreed as December 31, 2022 were as follows:

	December 31, 2022					
	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
Number of modifications	1	5	1	-	-	7
Recorded investment	$ 233,659	$ 627,695	$ 283,404	$ -	$ -	$ 1,144,758

Troubled debt restructurings (TDRs) with a commitment to lend additional funds were $0 at December 31, 2022.

Note 4. Loans and Allowance for Credit Losses (Continued)

In the normal course of banking business, loans are made to senior officers and directors and their affiliated interests. In the opinion of management, these loans are consistent with sound banking practices, are within regulatory lending limitations, and do not involve more than the normal risk of collectability.

Loans to senior officers, directors, and their affiliates at December 31, 2023 and 2022 are summarized as follows:

	2023	2022
Loans, beginning	**$ 11,029,000**	$ 10,058,000
Additions	**11,404,000**	4,208,000
Repayments/eliminations	**(6,777,000)**	(3,237,000)
Loans, ending	**$ 15,656,000**	$ 11,029,000

Outstanding loan commitments and unused lines and letters of credit were approximately as follows:

	2023	2022
Loan commitments, including approved loans and unused lines of credit	**$ 148,168,000**	$ 163,036,000
Letters of credit	**3,912,000**	3,629,000

Loan commitments and lines of credit are agreements to lend to customers as long as there is no violation of any conditions of the contracts. Loan commitments generally have interest rates fixed at current market amounts, fixed expiration dates, and may require payment of a fee. Lines of credit generally have variable interest rates. Many of the loan commitments and lines of credit are expected to expire without being drawn upon; accordingly, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral or other security obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include deposits held in financial institutions, U.S. Treasury securities, other marketable securities, accounts receivable, inventory, property and equipment, personal residences, income-producing commercial properties, and land under development. Personal guarantees are also obtained to provide added security for certain commitments.

Letters of credit are commitments issued to guarantee the performance of a customer to a third party. Loan commitments and letters of credit are made on the same terms, including collateral, as outstanding loans. The Bank has accrued credit losses of **$375,000**, related to these financial instruments with off-balance sheet risk in other liabilities at December 31, 2023 and 2022.

Note 5. Premises, Equipment, and Depreciation

Bank premises and equipment are as follows:

	December 31, 2023		
	Cost	Accumulated Depreciation	Net
Land and construction in progress	**$ 4,334,552**	**$ -**	**$ 4,334,552**
Buildings and land improvements	**9,439,937**	**4,151,348**	**5,288,589**
Furniture and equipment	**9,182,213**	**8,343,228**	**838,985**
	$ 22,956,702	**$ 12,494,576**	**$ 10,462,126**

	December 31, 2022		
	Cost	Accumulated Depreciation	Net
Land and construction in progress	$ 4,262,843	$ -	$ 4,262,843
Buildings and land improvements	9,439,938	3,924,668	5,515,270
Furniture and equipment	9,010,959	8,145,396	865,563
	$ 22,713,740	$ 12,070,064	$ 10,643,676

Depreciation expense totaled **$605,551** and $636,775 for the years ended December 31, 2023 and 2022, respectively.

Note 6. Income Taxes

Components of income tax expense for the years ended December 31, 2023 and 2022 are as follows:

		2023		2022
Currently payable				
Federal	$	3,202,396	$	2,002,263
State		1,345,853		844,576
Total current		4,548,249		2,846,839
Deferred income (benefits) taxes				
Federal		(11,912)		285,056
State		(5,101)		122,056
Total deferred		(17,013)		407,112
	$	4,531,236	$	3,253,951

A reconciliation of tax computed at the federal statutory tax rate of 21% for the years ended December 31, 2023 and 2022 to the actual tax expense is as follows:

		2023		2022
Tax at federal statutory rate	$	3,667,706	$	2,670,694
Tax effect of:				
Tax exempt income		(201,803)		(185,896)
Other		6,139		5,514
State income taxes, net of federal benefit		1,059,194		763,639
	$	4,531,236	$	3,253,951

Income taxes included in other assets on the balance sheet are as follows:

		2023		2022
Federal income tax refund (payable) claims	$	51,638	$	(92,285)
State income tax refund (payable) claims		58,015		(61,132)
Deferred tax benefits:				
Allowance for credit losses	$	2,366,505	$	2,366,504
Lease liabilities, net of right-of-use assets		4,496		-
OREO property		-		48,492
Accrued supplemental retirement benefits		9,904		-
Accrued vacation		155,156		159,382
Unearned income on loans		54,361		16,842
Net unrealized depreciation on securities available-for-sale		2,935,405		3,092,984
		5,525,827		5,684,204
Deferred tax liabilities:				
Accumulated depreciation		110,146		127,956
		110,146		127,956
Net deferred income tax benefits	$	5,415,681	$	5,556,248

Management has determined that no valuation allowance is required as it believes it is more likely than not that all of the deferred tax assets will be fully realizable in the future. At December 31, 2023 and 2022, management believes there are no uncertain tax positions under ASC Topic 740 Income Taxes. The Bank's federal and state income tax returns for 2020, 2021, and 2022 are subject to examination by the IRS and/or state tax authorities, generally for three years after they were filed. The 2023 income returns will be filed in 2024.

Note 7. Junior Subordinated Debentures owed to Unconsolidated Subsidiary Trust

The Company sponsored a trust, HSB Statutory Trust I, of which 100% of the common equity is owned by the Company. Trust I was formed for the purpose of issuing Company-obligated mandatorily redeemable capital securities (the capital securities) to third-party investors and investing the proceeds from the sale of such capital securities solely in junior subordinated debt securities of the Company (the debentures). The debentures held by the trust are the sole assets of that trust. Trust I is a variable interest entity (VIE), however, since the Company is not the primary beneficiary of this arrangement, the accounts of this entity are not included in the consolidated financial statements. Distributions on the capital securities issued by the trust are payable quarterly at a 5.95% rate per annum for 5 years until June 2010, then floating at the 3-month LIBOR plus 1.85% thereafter. Effective July 3, 2023 the 3-month LIBOR was replaced with the 3-month SOFR plus .26161%. The capital securities are subject to mandatory redemption, in whole or in part, upon repayment of the debentures. The Company has entered into agreements which, taken collectively, fully and unconditionally guarantee the capital securities subject to the terms of each of the guarantees. Both the capital securities of the statutory trust and the junior subordinated debentures are scheduled to mature on June 2035, unless called by the Company.

Despite the fact that HSB Statutory Trust I is not included in the Company's consolidated financial statements, the trust preferred securities issued by these subsidiary trusts are included in the Tier 1 capital of the Company for regulatory capital purposes. Federal Reserve Board rules limit the aggregate amount of restricted core capital elements (which includes trust preferred securities, among other things) that may be included in the Tier 1 capital of most bank holding companies to 25% of all core capital elements, including restricted core capital elements, net of goodwill less any associated deferred tax liability. Amounts of restricted core capital elements in excess of these limits generally may be included in Tier 2 capital. The current quantitative limits do not preclude the Company from including the $3.0 million in trust preferred securities outstanding in Tier 1 capital.

Note 8. Deposits

Time deposits and their remaining maturities at December 31, 2023 are approximately as follows:

2024	$	110,492,000
2025		21,605,000
2026		17,730,000
2027		10,701,000
2028		6,878,000
	$	167,406,000

Interest expense on deposits for the years ended December 31, 2023 and 2022 is as follows:

		2023		2022
NOW, Super NOW and money market	**$**	**226,275**	$	142,669
Savings		**144,313**		109,610
Time, more than $250,000		**476,248**		497,570
Other time		**2,041,027**		2,216,470
	$	**2,887,863**	$	2,966,319

Deposit balances of senior officers and directors and their affiliated interests totaled **$12,597,840** and $13,931,044 at December 31, 2023 and 2022, respectively.

Overdraft deposit balances, included in loans, totaled **$138,220** and $135,133 at December 31, 2023 and 2022, respectively.

Note 8. Deposits (Continued)

The Bank began offering time deposits through the Certificate of Deposit Account Registry Service (CDARS) in 2019 through a third-party provider. These deposits totaled **$17,728,996** and $15,508,972 at December 31, 2023 and 2022, respectively, and are included in other time deposits on the balance sheet.

Note 9. Benefit Plans

The Bank has a 401(k) profit sharing plan covering substantially all full-time employees. The plan requires the Bank to match employee contributions up to 5% of compensation, as defined under the plan, and permits additional contributions at the discretion of management.

Expense under this plan totaled **$271,313** and $259,162 for the years ended December 31, 2023 and 2022, respectively.

The Bank entered into a Supplemental Executive Retirement Plan ('SERP") agreement in 2023 with an executive of the Bank. The plan is designed to provide post-retirement benefits to supplement other sources of retirement income such as social security and 401(k) benefits. The benefits will be paid for a period of 20 years after retirement. The annual amount of the benefits is based upon the executive's years of completed service. In order to receive the full annual benefit, by the executive's separation from service, they must complete at least ten years of service. The Bank accrues the cost of this post-retirement benefit during the working career of the executive. At December 31, 2023, the accumulated liability for this benefit totaled **$35,994**. Expense recognized for this plan was **$35,994** in 2023. Benefits expected to be paid in 2024 are $0 thousand.

Note 10. Lease Commitments

The Company adopted ASU 2016-02, *Leases (Topic 842) ("ASC 2016-02")*, on January 1, 2022, using a modified-retrospective approach, whereby comparative periods were not restated. No cumulative effect adjustment to the opening balance of retained earnings was required. The Company also elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things allowed the Company to carry forward the historical lease classifications. Additionally, the Company elected the hindsight practical expedient to determine the lease term for existing leases.

The Bank leases one of its branch facilities, the land on which one of the Bank's branch facilities resides, a portion of a parking lot at one of its branch facilities and a portion of a parking lot adjacent to one of its branch facilities. The leases are classified as operating leases. Leases with an initial term of 12 months or less as well as leases with a discounted present value of future cash flows below $25,000 are not recorded on the balance sheet and the related lease expense is recognized over the lease term. The Company elected to use the practical expedient to not recognize short-term leases on the consolidated balance sheet and instead account for them as executory contracts.

Note 10. Lease Commitments (Continued)

Certain leases include options to renew, with renewal terms that can extend the lease term, typically for five years. Lease assets and liabilities include related renewal options that are reasonably certain of being exercised. The Company has determined that it will place a limit on exercises of available lease renewal options that would extend the lease term up to a maximum of fifteen years, from the adoption date of ASU 2016-02. The depreciable life of leased assets are limited by the expected lease term. Variable payments for the Company's proportionate share of property taxes are not included in lease payments used to determine lease liability and are recognized as variable costs when incurred.

Adoption of this standard in 2022 resulted in the Company recognizing a right of use asset and a corresponding lease liability of $987,580.

The following tables present information about the Company's leases for the years ended December 31, 2023 and December 31, 2022:

		2023		2022
Balance Sheet				
Operating Lease Amounts				
Right-of-use asset	**$**	**834,735**	$	911,949
Lease liability		**851,075**		921,662
Income Statement				
Operating lease cost classified as premises and equipment	**$**	**108,830**	$	102,569
Weighted average lease term - Operating Leases (Yrs.)		**10.36**		11.30
Weighted average discount rate - Operating Leases (1)		**2.14%**		2.14%
Operating outgoing cash flows from operating leases	**$**	**102,203**	$	92,856

(1) The discount rate was developed by using the fixed rate credit advance borrowing rate at the Federal Home Loan Bank of Atlanta for a term correlating to the remaining term of each lease. Management believes this rate closely mirrors its incremental borrowing rate for similar terms.

Minimum lease payments for the next five years and thereafter, assuming renewal options are exercised, are as follows:

Operating Leases:		
2024	**$**	**90,084**
2025		**91,832**
2026		**93,442**
2027		**94,660**
2028		**98,237**
2029 and thereafter		**478,951**
Total undiscounted cash flows		**947,206**
Less: Discount		**(96,131)**
Lease Liabilities	**$**	**851,075**

Note 11. Other Operating Expenses

Other operating expenses include the following:

		2023		2022
Advertising and marketing	**$**	**201,890**	$	155,219
ATM and debit card processing		**728,910**		644,007
Bank service charges		**91,758**		91,600
Courier and travel		**197,432**		175,838
Data processing outsourced		**468,655**		416,321
Directors' fees		**419,364**		362,884
Donations		**66,325**		70,707
Dues and subscriptions		**106,368**		93,052
FDIC and Maryland assessments		**705,832**		546,054
Insurance		**174,761**		159,397
Loan collection and OREO operating		**52,039**		114,088
Long and short		**120,859**		28,176
Other fees		**50,987**		44,156
Postage		**167,437**		168,126
Professional services		**482,724**		408,883
Seminars		**29,740**		36,616
Stationery, printing, and supplies		**371,796**		264,091
Telephone		**334,170**		311,014
	$	**4,771,047**	$	4,090,229

Note 12. Borrowings and Credit Facilities

The Bank has borrowings from the FHLB totaling **$11,012,363** and $13,595,429 at December 31, 2023 and 2022, respectively. Interest rates on the borrowings are fixed and range from .63% to 5.94%, maturing at various dates through August 2038. Based on lendable collateral value, the Bank has available for future borrowings approximately **$60,000,000** and $61,000,000 at December 31, 2023 and 2022, respectively. The Bank has pledged approximately **$108,000,000** and $105,000,000 at December 31, 2023 and 2022, respectively, of its wholly owned residential (1-4 units) first mortgage loan portfolio, as collateral for this credit facility. The Bank has purchased stock of the FHLB as a condition for obtaining a credit facility from the FHLB.

At December 31, 2023, the scheduled maturities of borrowings are approximately as follows:

2024	$	-
2025		1,074,000
2026		1,390,000
2027		3,918,000
2028		2,237,000
2029 and thereafter		2,393,000
	$	11,012,000

Additionally, the Bank has unsecured credit availability of $10,000,000 with one correspondent bank and secured credit availability of $8,000,000 with another correspondent bank for short-term liquidity needs, if necessary. The secured credit facility must be collateralized with securities at the time of usage. At December 31, 2023 and 2022, there were no borrowings outstanding under any of the credit facilities. At December 31, 2023, securities pledged under the secured credit facility had an amortized cost and fair value of **$71,826** and **$65,684,** respectively. At December 31, 2022, securities pledged under the secured credit facilities had an amortized cost and fair value of $92,187 and $85,177, respectively.

Note 13. Regulatory Capital Requirements

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

The Common Equity Tier 1, Tier 1 and Total capital ratios are calculated by dividing the respective capital amounts by risk-weighted assets. Risk-weighted assets are calculated based on regulatory requirements and include total assets, with certain exclusions, allocated by risk weight category, and certain off-balance-sheet items, among other things. The leverage ratio is calculated by dividing Tier 1 capital by adjusted quarterly average total assets, which exclude goodwill and other intangible assets, among other things.

The Bank is subject to the Basel III Capital Rules. The Basel III Capital Rules require the Bank to maintain (i) a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% Common Equity Tier 1 capital ratio, effectively resulting in a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of at least 7.0%), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio, effectively resulting in a minimum Tier 1 capital ratio of 8.5%), (iii) a minimum ratio of Total capital (that is, Tier 1 plus Tier 2) to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% Total capital ratio, effectively resulting in a minimum Total capital ratio of 10.5%) and (iv) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to average quarterly assets.

The capital conservation buffer is designed to absorb losses during periods of economic stress and, as detailed above, effectively increases the minimum required risk-weighted capital ratios. The Basel III Capital Rules also provide for a "countercyclical capital buffer" that is applicable to only certain covered institutions and does not have any current applicability to the Company or Bank. Banking institutions with a ratio of Common Equity Tier 1 capital to risk-weighted assets below the effective minimum (4.5% plus the capital conservation buffer and, if applicable, the countercyclical capital buffer) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

Management believes, as of December 31, 2023 and 2022, that the Company and Bank meet all capital adequacy requirements to which it is subject. The most recent notification from the FDIC categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized" the Bank must maintain minimum Common Equity Tier 1, Tier 1 and Total capital to risk-weighted assets and Tier I leverage ratios. There have been no conditions or events since that notification that management believes have changed the Bank's category.

As discussed in Note 7, the capital securities held by the HSB Statutory Trust I qualifies as Tier 1 capital for the Company under Federal Reserve Board guidelines.

Note 13. Regulatory Capital Requirements (Continued)

A comparison of capital as of December 31, 2023 and 2022 for the Company and Bank is presented below. The minimum required capital amounts presented include the minimum required capital levels as of December 31, 2023 and December 31, 2022. Capital amounts and ratios for minimum capital adequacy presented in the following table do not include capital conservation buffers. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules.

As of December 31, 2023	**Actual**		**For Minimum Adequacy Purposes**		**To Be Well Capitalized Under Prompt Corrective Action Provisions**	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Total Capital (to Risk-Weighted Assets)						
Company	**$ 94,241,000**	**15.6%**	**$ 48,236,000**	**8.0%**	**$ -**	**N/A**
Bank	**94,178,000**	**15.6%**	**48,235,000**	**8.0%**	**60,293,000**	**10.0%**
Tier I Capital (to Risk-Weighted Assets)						
Company	**86,688,000**	**14.4%**	**36,170,000**	**6.0%**	**-**	**N/A**
Bank	**86,625,000**	**14.4%**	**36,169,000**	**6.0%**	**48,225,000**	**8.0%**
Common Equity Tier I Capital (to Risk-Weighted Assets)						
Company	**83,688,000**	**13.9%**	**27,132,000**	**4.5%**	**-**	**N/A**
Bank	**86,625,000**	**14.4%**	**27,127,000**	**4.5%**	**39,183,000**	**6.5%**
Tier I Capital (to Average Assets)						
Company	**86,688,000**	**11.6%**	**29,918,000**	**4.0%**	**-**	**N/A**
Bank	**86,625,000**	**11.6%**	**29,922,000**	**4.0%**	**37,403,000**	**5.0%**

As of December 31, 2022	Actual		For Minimum Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to Risk-Weighted Assets)						
Company	$ 83,223,000	14.0%	$ 47,522,000	8.0%	$ -	N/A
Bank	83,187,000	14.0%	47,501,000	8.0%	59,377,000	10.0%
Tier I Capital (to Risk-Weighted Assets)						
Company	75,780,000	12.8%	35,633,000	6.0%	-	N/A
Bank	75,746,000	12.8%	35,617,000	6.0%	47,490,000	8.0%
Common Equity Tier I Capital (to Risk-Weighted Assets)						
Company	72,780,000	12.3%	26,714,000	4.5%	-	N/A
Bank	75,746,000	12.8%	26,713,000	4.5%	38,585,000	6.5%
Tier I Capital (to Average Assets)						
Company	75,780,000	9.0%	33,568,000	4.0%	-	N/A
Bank	75,746,000	9.0%	33,553,000	4.0%	41,941,000	5.0%

Note 13. Regulatory Capital Requirements (Continued)

According to FDIC capital guidelines, the Bank is considered to be "Well Capitalized."

Under Maryland banking law, the Board of Directors may declare cash dividends from undivided profits after providing for expenses, losses, interest and taxes accrued or due.

Note 14. Fair Values of Financial Instruments

Disclosure about Fair Value of Financial Instruments ("ASC Topic 825") requires the disclosure of the estimated fair values of financial instruments. Quoted market prices, where available, are shown as estimates of fair values. Because no quoted market prices are available for a significant part of the Company's financial instruments, the fair values of such instruments have been derived based on the amount and timing of future cash flows and estimated discount rates.

Present value techniques used in estimating the fair value of many of the Company's financial instruments are significantly affected by the assumptions used. Fair values derived from using present value techniques are not substantiated by comparisons to independent markets and, in many cases, could not be realized in immediate settlement of the instruments.

ASC Topic 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

Note 14. Fair Values of Financial Instruments (Continued)

The following table shows the estimated fair values and the related carrying values of the Bank's financial instruments at December 31, 2023 and 2022. Items that are not financial instruments are not included.

	2023		2022	
	Carrying Amount	**Estimated Fair Value**	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and due from banks	**$ 10,480,421**	**$ 10,480,421**	$ 11,177,228	$ 11,177,228
Interest-bearing deposits in other banks	**15,843,429**	**15,843,429**	112,330,979	112,330,979
Debt securities available-for-sale	**127,069,615**	**127,069,615**	136,292,691	136,292,691
Equity securities	**4,004,314**	**4,004,314**	3,949,229	3,949,229
Loans, net of allowance for credit losses	**529,713,514**	**523,763,519**	508,710,799	505,118,800
Accrued interest receivable	**2,374,385**	**2,374,385**	1,950,195	1,950,195
Federal Home Loan Bank stock	**1,130,100**	**1,130,100**	1,019,300	1,019,300
Common stock-Statutory Trust I	**93,000**	**93,000**	93,000	93,000
Cash value of life insurance	**15,454,733**	**15,454,733**	13,604,142	13,604,142
Financial liabilities:				
Deposits	**$ 628,880,006**	**$ 585,110,005**	$ 722,368,848	$ 668,341,859
Accrued interest payable	**666,572**	**666,572**	263,169	263,169
Short-term borrowings	**-**	**-**	34,833	34,833
Long-term borrowings	**11,012,363**	**10,491,346**	13,560,596	12,917,615
Junior subordinated debentures owed to unconsolidated subsidiary trust	**3,093,000**	**2,783,875**	3,093,000	1,869,933
Unrecognized financial instruments:				
Commitments to extend credit	**148,168,000**	**148,168,000**	163,036,000	163,036,000
Standby letters of credit	**3,912,000**	**3,912,000**	3,629,000	3,629,000

For purposes of the above disclosures of estimated fair value, the following assumptions were used:

Cash and cash equivalents

The estimated fair value for cash and due from banks, interest-bearing deposits in other banks, and Federal funds sold is considered to approximate cost because of their short-term nature.

Investment Securities

Fair values for securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. See Note 15 for further discussion.

Note 14. Fair Values of Financial Instruments (Continued)

Loans

The estimated fair value for certain homogeneous categories of loans, such as residential mortgages, is based on the quoted market price for securities backed by similar loans, adjusted for differences in loan characteristics. The estimated fair value of other loans is determined by discounting future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Deposits

The estimated fair value of deposits with no stated maturity, such as non-interest-bearing demand deposits, savings, NOW and super NOW accounts and money market accounts, is equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The fair value of certificates of deposit is based on the rates currently offered for deposits of similar maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

Borrowings

The estimated fair value approximates carrying value for short-term borrowings. The fair value of long-term fixed rate borrowings is estimated by discounting future cash flows using current interest rates currently offered for similar financial instruments.

Junior Subordinated Debentures

Fair value is usually estimated based on quoted market prices of similar instruments. If quoted market prices are not available the fair value is determined by using the discounted value of expected cash flows using market rates.

Other Assets and Liabilities

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

Note 14. Fair Values of Financial Instruments (Continued)

The following table presents the carrying amount, fair value, and placement in the fair value hierarchy of the Bank's financial instruments not disclosed elsewhere as of December 31, 2023 and 2022. This table excludes financial instruments for which the carrying amount approximates fair value.

	December 31, 2023				
	Carrying Amount	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Financial Assets:					
Loans, net	**$ 529,713,514**	**$ 523,763,519**	**$ -**	**$ -**	**$ 523,763,519**
Financial Liabilities:					
Deposits	**628,880,006**	**585,110,005**	**-**	**585,110,005**	**-**
Long-term borrowings	**11,012,363**	**10,491,346**	**-**	**10,491,346**	**-**
Junior subordinated debentures owed to unconsolidated subsidiary trust	**3,093,000**	**2,783,875**	**-**	**2,783,875**	**-**

	December 31, 2022				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Loans, net	$ 508,710,799	$ 505,118,800	$ -	$ -	$ 505,118,800
Financial Liabilities:					
Deposits	722,368,848	668,341,859	-	668,341,859	-
Long-term borrowings	13,560,596	12,917,615	-	12,917,615	-
Junior subordinated debentures owed to unconsolidated subsidiary trust	3,093,000	1,869,933	-	1,869,933	-

Note 15. Fair Value Measurements

ASC Topic 820 Fair Value Measurements and Disclosures provides a framework for measuring and disclosing fair value under generally accepted accounting principles. ASC Topic 820 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, individually evaluated loans and OREO).

ASC Topic 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC Topic 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value.

Note 15. Fair Value Measurements (Continued)

Fair Value Hierarchy

Level 1 – Valuation is based on quoted prices in active markets for identical assets or liabilities.

Level 2 – Valuation is based on observable inputs including quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 – Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

In determining the appropriate levels, the Bank performs a detailed analysis of assets and liabilities that are subject to ASC Topic 820.

The following table presents fair value measurements on a recurring basis as of December 31, 2023 and 2022:

	December 31, 2023			
	Level 1	**Level 2**	**Level 3**	**Fair Value**
Securities available-for-sale:				
U.S. Treasury and obligations of U.S. government agencies	**$ -**	**$ 40,069,613**	**$ -**	**$ 40,069,613**
Obligations of States and political subdivisions	**-**	**12,096,211**	**-**	**12,096,211**
Mortgage-backed securities and CMOs	**-**	**74,903,791**	**-**	**74,903,791**
	-	**127,069,615**	**-**	**127,069,615**
Equity	**-**	**4,004,314**	**-**	**4,004,314**
Total	**$ -**	**$ 131,073,929**	**$ -**	**$ 131,073,929**

	December 31, 2022			
	Level 1	Level 2	Level 3	Fair Value
Securities available-for-sale:				
U.S. Treasury and obligations of U.S. government agencies	$ -	$ 39,090,806	$ -	$ 39,090,806
Obligations of States and political subdivisions	-	12,882,991	-	12,882,991
Mortgage-backed securities and CMOs	-	84,318,894	-	84,318,894
	-	136,292,691	-	136,292,691
Equity	-	3,949,229	-	3,949,229
Total	$ -	$ 140,241,920	$ -	$ 140,241,920

Note 15. Fair Value Measurements (Continued)

Level 1 securities are based on quoted market prices. When quoted market prices are not available, Level 2 securities are based on the data provider's logic matrix table for quoted market prices of comparable instruments. Level 3 securities are valued by default matrix pricing. The Company obtains fair value measurements from an independent pricing service.

The Bank had no significant transfers of available-for-sale securities in which the fair value measurements are valued on a recurring basis between Level 1 and Level 2 during the periods ending December 31, 2023 or 2022.

The Bank may also be required, from time to time, to measure certain other financial assets and liabilities at fair value on a non-recurring basis in accordance with GAAP. The following table presents fair value measurements on a non-recurring basis as of December 31, 2023 and 2022:

	December 31, 2023			
	Level 1	**Level 2**	**Level 3**	**Fair Value**
Individually evaluated loans	**$ -**	**$ -**	**$ 6,633,302**	**$ 6,633,302**
OREO	**-**	**-**	**-**	**-**
Total	**$ -**	**$ -**	**$ 6,633,302**	**$ 6,633,302**

	December 31, 2022			
	Level 1	Level 2	Level 3	Value
Individually evaluated loans	$ -	$ -	$ 8,215,093	$ 8,215,093
OREO	-	174,975	-	174,975
Total	$ -	$ 174,975	$ 8,215,093	$ 8,390,068

The Bank is predominantly a cash flow lender with real estate serving as collateral on a majority of loans. In accordance with ASC Topic 310 Receivables, individually evaluated loans are primarily valued on a nonrecurring basis at the fair values of the underlying real estate collateral. The Bank determines such fair values from independent appraisals. When appropriate, management may also reduce the independent appraised value based on the current listing price of real estate for sale, prior experience in selling similar real estate or other factors not considered in the independent appraisal. In addition, on non-collateral dependent individually evaluated loans the impairment is measured as the present value of expected future cash flows. All individually evaluated loans are classified as Level 3 inputs.

Non-Financial Assets and Non-Financial Liabilities:

The Corporation has no non-financial assets or non-financial liabilities measured at fair value on a recurring basis. Certain non-financial assets and non-financial liabilities typically measured at fair value on a non-recurring basis include foreclosed assets (upon initial recognition or subsequent impairment), non-financial assets and non-financial liabilities measured at fair value in the second step of a goodwill impairment test, and intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment.

In accordance with ASC Topic 360 Property, Plant and Equipment, foreclosed real estate (OREO) is adjusted to fair value, resulting in an impairment charge, which is included in earnings for the year. Foreclosed real estate, which is considered to be a non-financial asset, is valued using a market approach. The values are determined using current market prices of similar real estate assets, less costs to sell, which the Bank considers to be Level 2 inputs.

Note 16. Date of Management's Review

In preparing the financial statements, the Bank has evaluated events and transactions for potential recognition or disclosure through February 5, 2024, the date that the financial statements were available to be issued.

Note 17. Parent Company Financial Information

Comparative Balance Sheets, Statements of Income, and Statements of Cash Flows for HSB Bancorp, Inc. (Parent Only) are presented below:

BALANCE SHEETS
December 31, 2023 and 2022

		2023		2022
ASSETS				
Cash and due from banks	**$**	**79,442**	$	72,003
Investment in Bank		**78,892,582**		67,599,052
Investment in the HSB Statutory Trust I		**93,000**		93,000
Other assets		**49,661**		26,780
Total assets	**$**	**79,114,685**	$	67,790,835
LIABILITIES				
Borrowed funds from subsidiary	**$**	**3,093,000**	$	3,093,000
Accrued interest payable on borrowed funds		**9,661**		8,530
Total liabilities		**3,102,661**		3,101,530
STOCKHOLDERS' EQUITY				
Common stock		**16,171**		16,171
Surplus		**6,201,001**		6,201,001
Retained earnings		**77,526,860**		66,619,209
Accumulated other comprehensive loss		**(7,732,008)**		(8,147,076)
Total stockholders' equity		**76,012,024**		64,689,305
Total liabilities and stockholders' equity	**$**	**79,114,685**	$	67,790,835

Note 17. Parent Company Financial Information (Continued)

The borrowed funds from subsidiary balance represents the junior subordinated debt securities payable to the wholly owned subsidiary trust that was deconsolidated as a result of applying the provisions of FIN 46. The Company continues to guarantee the capital securities issued by the trust, which totaled **$3,000,000** at December 31, 2023 (see Note 7 for further discussions on FIN 46R).

STATEMENTS OF INCOME
Years Ended December 31, 2023 and 2022

	2023	2022
Dividend income from bank	**$ 2,236,254**	$ 1,720,184
Undistributed net income of bank	**10,878,461**	7,843,231
Other operating income	**6,697**	3,372
Other operating expenses	**(241,796)**	(129,677)
Income before taxes	**12,879,616**	9,437,110
Income tax benefits (*)	**(49,371)**	(26,524)
NET INCOME	**$ 12,928,987**	$ 9,463,634

(*) Benefits from filing a consolidated federal income tax return.

STATEMENTS OF CASH FLOWS
Years Ended December 31, 2023 and 2022

	2023	2022
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	**$ 12,928,987**	$ 9,463,634
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in undistributed net income of subsidiary	**(10,878,461)**	(7,843,231)
Changes in assets or liabilities:		
Increase in other assets	**(22,881)**	(7,947)
Increase in liabilities	**1,130**	5,885
Net cash provided by operating activities	**2,028,775**	1,618,341
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends paid	**(2,021,336)**	(1,617,069)
Net cash used in financing activities	**(2,021,336)**	(1,617,069)
Net increase in cash	**7,439**	1,272
Cash, beginning of year	**72,003**	70,731
Cash, end of year	**$ 79,442**	$ 72,003

Officers & Directors

Pictured top row from left : Victor H. Laws III, Brent C. Miller, Joseph L. Gast, Charles W. Kelly
Pictured bottom row from left: Susan Wilgus-Murphy, Melanie B. Tawes

Directors - HSB Bancorp, Inc. & Hebron Savings Bank

Victor H. Laws III, Chairman of the Board
Joseph L. Gast
Charles W. Kelly
Brent C. Miller
Melanie B. Tawes
Susan Wilgus-Murphy

Honorary Directors - HSB Bancorp, Inc. & Hebron Savings Bank

Robert E. Holloway
Mark S. Holloway
E. Scott Tawes
Thomas C. Thompson
Edward Q. Wilgus
Edward C. Wright

Officers - HSB Bancorp, Inc.

Jennifer A. Poulsen, Chief Executive Officer and President
Kimberly T. Thomas, CPA, Vice-President & Secretary / Treasurer
Cathy D. Brinsfield, Vice-President & Assistant Secretary

Senior Officers - Hebron Savings Bank

Jennifer A. Poulsen, Chief Executive Officer and President
Kimberly T. Thomas, CPA, Executive Vice-President & Chief Financial Officer
Cathy D. Brinsfield, Executive Vice-President & Chief Regulatory Compliance Officer
Lorance J. Rohlfing, Executive Vice-President & Chief Credit Officer
Brian C. Gottschalk, Executive Vice-President & Chief Lending Officer
John A. Craig, Senior Vice-President & Chief Technology Officer

A Reflection of our 113th Year in Business

Business Appreciation Day

Our offices recognized local business customers by displaying their marketing materials to make others aware of their excellent products and services.

20th Anniversary of Our Mt. Hermon Rd. Office

We celebrated the 20th anniversary of our office located on Mt. Hermon Road with a gathering of customers and community members. In honor of this milestone, we made a donation to Operation WeCare!

Teach Children to Save Day

Our staff visited local elementary schools, teaching financial literacy lessons to approximately 800 students in the three county area!

Customer Appreciation Cook-out

Customers were provided with hot dogs, chips, drinks and desserts just because they made us their bank of choice!

More Than 113 Years of Personal Banking Services

Branch Locations

HEBRON
101 N. Main Street • P.O. Box 59 • Hebron, MD 21830
410.749.1185 • Fax 410.543.0703

SALISBURY
415 E. Carroll Street • Salisbury, MD 21804
410.742.8526 • Fax 410.742.8630

Quantico Square • 1008 W. Main Street • Salisbury, MD 21801
410.543.9183 • Fax 410.543.9401

1310 Mt. Hermon Road • Salisbury, MD 21804
410.546.8118 • Fax 410.546.8050

543C Riverside Drive • Salisbury, MD 21801
410.341.6670 • Fax 410.341.6678

2730 North Salisbury Boulevard • Salisbury, MD 21801
410.548.2233 • Fax 410.548.9706

FRUITLAND
108 E. Cedar Lane • Fruitland, MD 21826
410.860.4884 • Fax 410.860.2662

SHARPTOWN
303 Main Street • P.O. Box 236 • Sharptown, MD 21861
410.883.3121 • Fax 410.883.2322

VIENNA
100 Market & Race Streets • P.O. Box 158 • Vienna, MD 21869
410.376.3186 • Fax 410.376.0343

CAMBRIDGE
6 Cedar Street • Cambridge, MD 21613
410.228.9202 • Fax 410.228.5787

2801 Ocean Gateway • Cambridge, MD 21613
410.228.2440 • Fax 410.228.2446

PRINCESS ANNE
30499 Mount Vernon Road • Princess Anne, MD 21853
410.651.1722 • Fax 410.749.5528

CRISFIELD
57 Richardson Avenue • Crisfield, MD 21817
410.968.0500 • Fax 410.968.0550

Visit us at our website: www.HebronSavingsBank.com