

ANNUAL REPORT

2016



In town. In touch.

Member
FDIC  EQUAL
HOUSING
LENDER



1st STATE
FINANCIAL



To Our Shareholders,

As you'll see in the 2016 financial reports, 1st State Bank had a record breaking year in earnings. This allowed us to begin paying dividends as well as create sufficient capital for continued growth.

In anticipation of paying dividends and to facilitate increasing stock value and liquidity, the Holding Company made operational modifications and additions to the stock trading process. We began by hiring an independent third party to perform quarterly stock valuations. We implemented a Dividend Reinvestment Program, a Self Directed IRA, and also upgraded our technology. To better align with the brand image created with 1st State Bank, we changed our Holding Company's name to 1st State Financial, Ltd.

Stock transactions in 2016 totaled 10 trades with 114,188 shares changing hands. The average price of shares traded was \$11.05 with the last trade in 2016 at \$11.50. Book value at year-end was \$13.22 compared to \$12.23 at year-end 2015; an 8.1% increase. As of December 31, 2016, our third party valuation was \$12.90 per share.

During 2016, 1st State Bank invested in technology upgrades as you can see on the next page. Online Banking updates, a new website, and updates to our bill payment service provide customers more efficient, customer friendly service. In addition to those projects, we made operational changes to improve efficiency and strengthen fraud protection. The Bank's growth necessitated centralization of our mortgage department, and a move to the second floor for our accounting and deposit operations departments.

The Bank completed the purchase of the remaining three floors of our Main Office building on Fashion Square Boulevard. The original seven offices of Plaza Suites, our turn key professional office rental space, reached 100% occupancy in 2016. Five additional offices were constructed during the year.

As we look forward to 2017, we plan for continued growth; upgrading our services; rolling out a new account statement format; more fully automate our wire services; implementing instant issue of our debit cards at branch offices and updating our customer's online banking experience. We look forward to a future of consistent quarterly dividends and sustained growth.

Please plan to attend the annual meeting on May 10, to hear more details about the future for 1st State Bank.

Best regards,

A handwritten signature in black ink that reads "Rick Goedert". The signature is written in a cursive, flowing style.

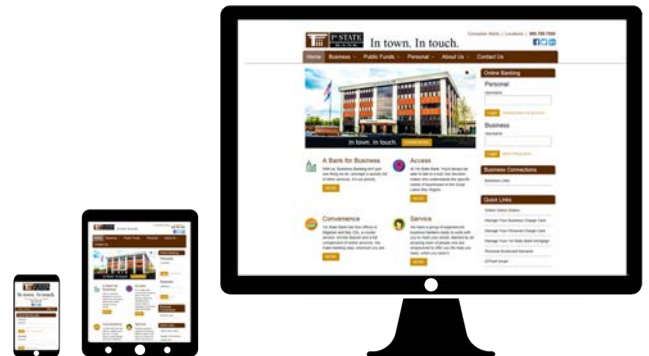
Rick Goedert
President & CEO



ALL OF OUR 2016 CHANGES WERE UPGRADES



Mobile Deposit



Updated 1stStateBk.com



Mobile Banking

popmoney



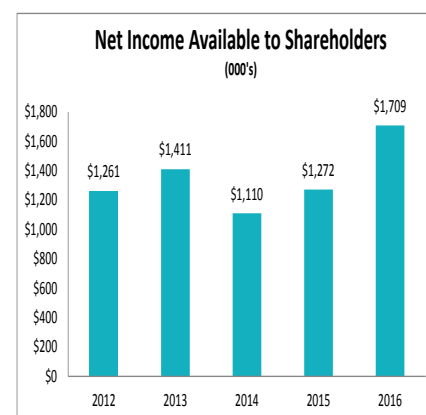
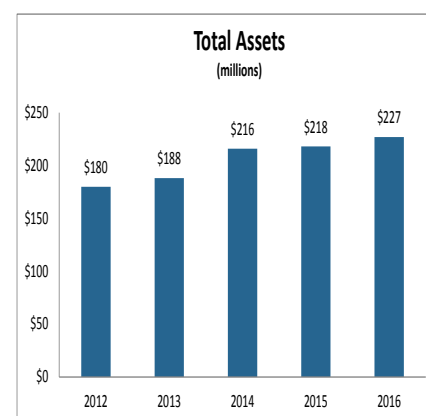
2016 FINANCIAL REPORT

Earnings for 1st State Financial, Ltd. improved significantly in 2016 to \$1,709,000 from \$1,272,000 in 2015, a 34% increase. Strong growth in both loans and transaction deposit balances along with increased mortgage origination and loan fee income were the primary contributors to the rise in earnings. 2016's net interest income increased by \$765,000 over 2015 due primarily to a \$13.4 million increase in the Company's average loan portfolio as well as a \$17.8 million increase in average transaction deposit balances. In addition, gains from mortgage loans originated for sale increased \$160,000 in 2016 and loan fee income grew by \$54,000 year-over-year. The Company's return on average assets ratio was .76% versus .60% in 2015.

Year-to-date total average assets were \$226 million in 2016. This represents an increase of 6.8% over 2015's total average assets of \$212 million. The growth in the balance sheet was a significant contributor to increased net interest income this year. In addition, a positive change in the mix of the balance sheet also contributed to the increase. All of 2016's growth in average earning assets was seen in higher yielding loans versus investments. Growth in the funding side of the balance sheet was dominated by lower costing transaction deposit balances versus higher costing certificates of deposits or other borrowed funds. Combined, the changes in the balance sheet help to produce an overall increase in net interest income of 10.5% year-over-year. Please review the Consolidated Selected Financial Data for additional information regarding 1st State Financial's financial performance.

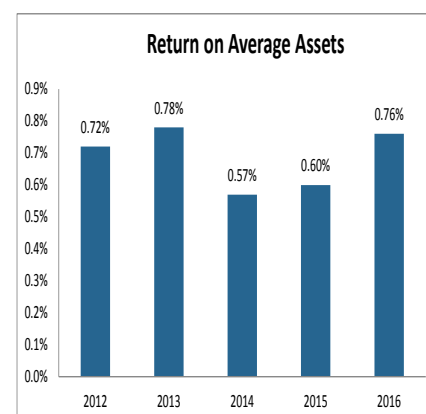
CONSOLIDATED BALANCE SHEETS

	<u>12/31/2016</u>	<u>12/31/2015</u>
Assets		
Cash and cash equivalents	\$ 29,933,235	\$ 33,211,870
Investments	13,239,516	16,616,109
Loans, net of reserve for loan losses	168,467,996	157,313,674
Premises and equipment, net	11,620,394	7,265,664
Repossessed assets	929,065	2,007,691
Other assets	<u>2,371,717</u>	<u>1,962,381</u>
Total Assets	<u>\$226,561,923</u>	<u>\$218,377,389</u>
Liabilities and Shareholders' Equity		
Interest bearing deposits	\$ 122,596,969	\$ 115,035,533
Non-interest bearing deposits	69,919,529	72,360,024
Borrowed funds	11,000,000	9,500,000
Other liabilities	<u>1,936,098</u>	<u>2,006,272</u>
Total Liabilities	205,452,596	198,901,829
Total Shareholders' Equity	<u>21,109,327</u>	<u>19,475,560</u>
Total Liabilities and Shareholders' Equity	<u>\$226,561,923</u>	<u>\$218,377,389</u>



CONSOLIDATED STATEMENTS OF INCOME

	Year ended December 31	
	<u>2016</u>	<u>2015</u>
Interest Income	\$ 8,708,082	\$ 8,044,274
Interest Expense	<u>625,368</u>	<u>726,874</u>
Net Interest Income	8,082,714	7,317,400
Provision for loan losses	<u>360,000</u>	<u>330,000</u>
Net Interest Income After Provision for Loan Losses	7,722,714	6,987,400
Other Income	1,116,893	1,001,532
Other Expense	<u>6,242,135</u>	<u>6,039,585</u>
Income Before Federal Income Tax	2,597,472	1,949,347
Federal Income tax expense	<u>888,300</u>	<u>669,700</u>
Net Income	<u>\$ 1,709,172</u>	<u>\$ 1,279,647</u>
Preferred stock dividends	0	7,222
Net Income Available to Common Shareholders	<u>\$ 1,709,172</u>	<u>\$ 1,272,425</u>



SELECTED FINANCIAL DATA

This unaudited table sets forth selected historical consolidated financial information derived from our audited consolidated financial statements for the five years ended December 31, 2016.

Dollars in thousands, except per share data

	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Net Income	\$ 1,709	\$ 1,280	\$ 1,129	\$ 1,431	\$ 1,281
Net Income Available to Common Shareholders	1,709	1,272	1,110	1,411	1,261

Balance Sheet Data (December 31)

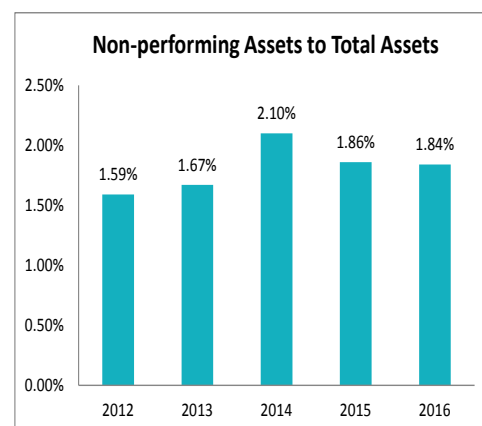
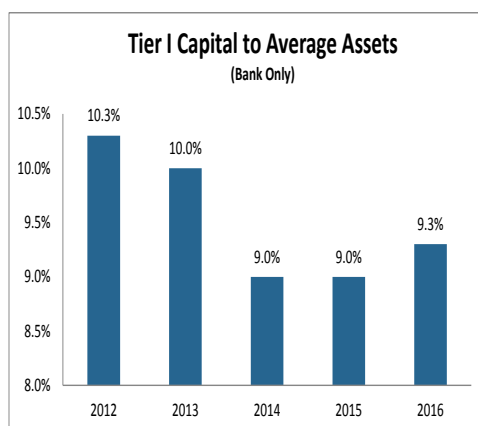
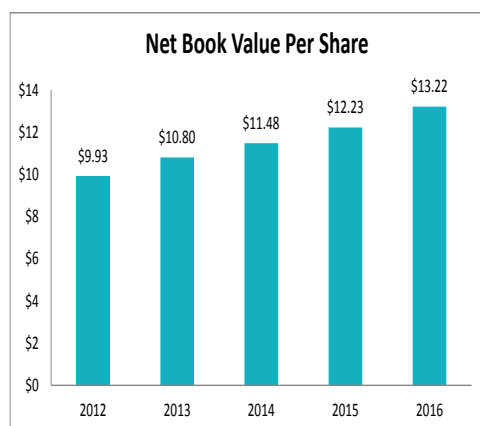
Total Assets	\$ 226,596	\$ 218,377	\$ 215,848	\$ 188,404	\$ 180,168
Total Loans	171,067	159,465	145,685	142,596	137,305
Total Deposits	192,516	187,396	186,180	154,804	141,652
Total Shareholders' Equity	21,109	19,476	19,205	19,040	17,655
Tier I Capital to Average Assets (Bank Only)	9.34%	8.96%	9.04%	9.96%	10.26%
Net Book Value per Common Share	\$ 13.22	\$ 12.23	\$ 11.48	\$ 10.80	\$ 9.93

Performance Ratios

Return on Average Assets	0.76%	0.60%	0.57%	0.78%	0.72%
Return on Average Common Equity	8.41%	6.79%	6.41%	8.73%	8.37%
Net Interest Margin	3.66%	3.55%	3.56%	3.72%	3.77%
Net Income per Average Common Share	\$1.07	\$0.80	\$0.71	\$0.91	\$0.80

Asset Quality Measures

Net Loan Charge-offs	\$(88)	\$224	\$303	\$430	\$206
Net Loan Charge-offs to Average Total Loans	(0.05%)	0.15%	0.21%	0.31%	0.15%
Allowance for Loan Losses to Total Loans	1.52%	1.35%	1.40%	1.43%	1.52%
Non-performing Assets to Total Assets	1.84%	1.86%	2.10%	1.67%	1.59%



BOARD OF DIRECTORS

Michael D. Bierlein – Bierlein Companies, Inc.

Mitzi M. Dimitroff – RDS Management

Joseph R. Fabiano II – Fabiano Brothers, Inc.

David M. Hall – Crimiel Publications

Michael L. Hanisko – Weinlander Fitzhugh

Scott L. Holman – Bay Cast, Inc.

Phillip L. List – Chairman of the Board – On Line Realtors

Terry R. Niederstadt – 1st State Bank (Retired)

James J. Shinnors – Shinnors & Cook

Lynn R. Wolgast – Wolgast Development, LLC

Rick Goedert – 1st State Bank

Richard T. Watson – Director Emeritus

STAFF

Julie Adams

Residential Mortgage Processor

Dean Anderson

Mortgage Loan Officer

Denise Avery

Vice President

Deposit Operations Services

Tania Beverly

Personal Banker

David Brown

Vice President

Business Lender

Allison Caister

Marketing Coordinator

Jessica Callaghan

Personal Banker

Steve Canole

Senior Vice President

Business Lender

Celina Harrell-Christopher

Personal Banker

Todd Clements

Senior Vice President

Business Lender

Brenda Demo

BSA/ Compliance Officer

Risk Management Specialist

Dennis Dinauer

Mortgage Loan Officer

Downtown Bay City Office Manager

Angela Dixon

Wilder Road Office Manager

Samantha Dore

Mortgage Processor & Personal Banker

Kevin Fraser

Vice President

Controller

Mary Gantner

Loan Specialist

Rick Goedert

President

Chief Executive Officer

Amy Granroth

Mortgage Processor

Amy Grochowski

Personal Banker

Kathy Hamel

Lending Office Professional

Tim Harrigan

Information Systems

Support Specialist

Christine Juarez

Personal Banker

Ed Keating

Senior Vice President

Business Lender

Jesse Kendall

Business Lender

Jessica Krause

Personal Banker

Tiffany Kukla

HR Generalist

Barbara Kwapis

Personal Banker

Craig Loree

Vice President

Information Systems Officer

Lori Martin

Senior Vice President

Business Lender

Debra Mazur

Mortgage Loan Officer

James Milroy

Executive Vice President

Chief Financial Officer

Teresa Mitchell

Deposit Operations Specialist

Jamie Myers

Personal Banker

Maria Ortega

Deposit Operations Specialist

James Papajesk

Senior Vice President

Credit Manager & Business Lender

Kirsten Parks

Personal Loan Administration Manager

Vicki Pavlik

Public Funds Relationship Manager

Becke Popour

State Street Office Manager

Kelsey Primeau

Personal Banker

Markisha Rivers

Loan Specialist

Jennifer Shepard

Personal Banker

Abigail Skowronski

Personal Banker

Anne Smith

Main Office Manager

Jeff Southcott

Senior Vice President

Personal Lending Manager

Hillary Stockel

Senior Credit Analyst

Audrey Thomas

Deposit Operations Specialist

Kimberly Van Tifflin

Loan Specialist

Dawn Walny

Personal Banker

Mary Weinstein

Mortgage Processor

Brittney Welke

Senior Loan Specialist

Andrea Winberg

Credit Analyst

Bridget Windy

Accounting Specialist

Margo Winiackie

Senior Vice President

Deposit Relationships & Marketing Director

LOCATIONS



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