



2017 ANNUAL REPORT



1st STATE
FINANCIAL

What it means to be In town. In touch.

ACCESS



At 1st State Bank, the people who make decisions about your loans and deposits are the people you meet with, or if necessary, somebody just down the hall. You'll always be able to quickly get questions answered and problems resolved, by people who understand the specific needs of businesses in the Great Lakes Bay Region.



CONVENIENCE

1st State Bank has four offices in Saginaw and Bay City and one under construction in Midland. Which we think should make a lot of your banking pretty convenient. But "pretty convenient" isn't good enough. That's why we offer a free courier service that will pick up your deposits or remote deposit which allows you to securely scan your deposits from your desktop and a full complement of online services.



SERVICE



Every bank talks about "service" But they don't often tell you what it really means. We do. Service means that we're here to meet your needs. We don't have "products" that we're supposed to push, or sales quotas. We don't have a giant call center where you get lost everytime you have a question. We have a group of experienced business bankers ready to work with you to meet your needs. Backed by an amazing team of people who are empowered to offer you the help you need, when you need it.





To Our Shareholders,

2017 was a very good year for 1st State Financial, Ltd. Net Income from operations was \$2,055,000, a 20% increase over 2016's results. 13% growth in customer deposits helped to increase 1st State Bank's total assets by 15% year-over-year. Fueled by a 7% increase in loans, the Bank's net interest income in 2017 exceeded the prior year's total by \$987,000 or 12%, driving the bottom line results.

With the signing before year-end of the Tax Cuts and Jobs Act of 2017, the Bank was forced to revalue any deferred tax items at the new corporate tax rate of 21% in 2017. As a result, federal income tax expense was increased by \$230,000, thereby decreasing the reported net income in 2017 to \$1,825,000 which you will see in the accompanying financial reports. Despite this one-time accounting charge, we still exceeded 2016's results by 7% and will see the benefit of reduced corporate tax rates in 2018.

Our improving financial performance over the past few years has provided the opportunity for the Bank to continue to invest in long-term growth initiatives. While we currently have customers in Midland, it has always been a strategic desire to have a physical presence in the community. Construction has begun and we are excited about a projected late summer opening for our fifth branch location. We are fortunate to already have on staff our personnel for the Midland Office. Meleah Retzloff will be our Office Manager; Missie Freier our Business Lender; Sue Sweebe and Cassie Slayton our Personal Bankers. Combined these individuals have over 75 years of experience serving the Midland community. We are thrilled they will be helping us provide 1st State Bank's unique service to the Midland market.

During 2017, we strengthened our business lending staff to take advantage of opportunities created by a changing banking environment in the Great Lakes Bay Region. Early in 2017, Lori Martin, Senior Vice President & Business Lender, joined the Bank with over 25 years of experience. Jesse Kendall was promoted to Business Lender after working for over 5 years with us as a Credit Analyst. In addition, we added Todd Gregory, Senior Vice President to lead our team of business lending officers. Todd comes to the Bank with over 20 years of experience.

In 2017, 1st State Financial purchased 125,000 shares from a large shareholder. Absent this event, 24,909 shares were traded this year involving 11 transactions. Net book value per share was \$14.27 at year-end. The last trade of 2017 was at \$14.50 which equaled our third party stock valuation at December 31st. We are currently in the middle of a stock offering of 200,000 shares to replace the 125,000 shares repurchased during the year, as well as to provide future growth. We hope to attract new shareholders from the Midland community with this offering to further support our investment in this market.

To continue the performance we saw in 2017, we remain focused on growing 1st State Bank. We remain committed to providing value to our shareholders and we remain committed to being trusted advisors to our customers

Sincerely,

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

Rick Goedert
President & CEO

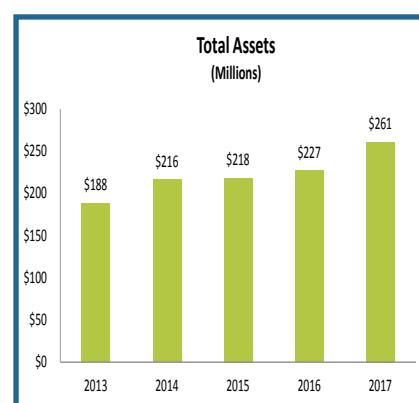
2017 FINANCIAL REPORT

Earnings for 1st State Financial, Ltd. improved in 2017 to \$1,825,000 from \$1,709,000, a 7% increase over 2016. Growth in earnings was achieved despite an additional \$230,000 of federal income tax expense being recorded as a result of the signing of the Tax Cuts and Jobs Act in 2017. With the Act, corporate income tax rates were reduced from 35% to 21%, creating an impairment of the Bank's deferred tax asset. Absent this one time charge, 1st State Financial's results in 2017 would have been \$2,055,000, a 20% increase over 2016. Growth in both loans and customer deposit balances combined with an increase in the prime rate were the primary contributors to the rise in earnings. 2017's net interest income increased by \$987,000 over 2016 due primarily to a \$13.3 million increase in the Company's average loan portfolio as well as a \$9.7 million increase in average customer deposit balances. The Company's return on average assets ratio remained at .76% in 2017.

Year-to-date total average assets were \$240 million in 2017. This represents an increase of 6.2% over 2016's total average assets of \$226 million. The growth in the balance sheet combined with the increase in the prime rate contributed to the increase in net interest income this year. All of 2017'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 helped to produce an overall increase in net interest income of 12.3% year-over-year. Please review the Consolidated Selected Financial Data for additional information regarding 1st State Financial's financial performance.

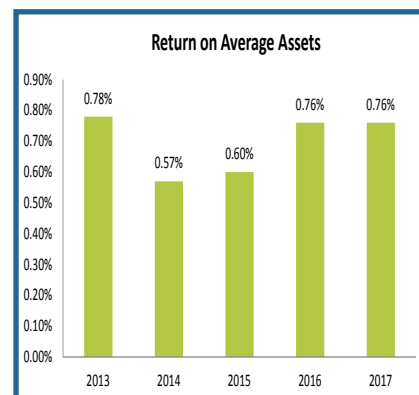
CONSOLIDATED BALANCE SHEET

	<u>12/31/2017</u>	<u>12/31/2016</u>
Assets		
Cash and cash equivalents	\$ 57,460,096	\$ 29,933,235
Investments	8,478,478	13,239,516
Loans, net of reserve for loan losses	180,140,893	168,467,996
Premises and equipment, net	11,890,114	11,620,394
Repossessed assets	703,466	929,065
Other assets	<u>2,170,153</u>	<u>2,371,717</u>
Total Assets	<u>\$260,843,200</u>	<u>\$226,561,923</u>
Liabilities and Shareholders' Equity		
Interest bearing deposits	\$131,247,820	\$122,596,969
Non-interest bearing deposits	86,275,190	69,919,529
Borrowed funds	20,450,000	11,000,000
Other liabilities	<u>1,377,874</u>	<u>1,936,098</u>
Total Liabilities	<u>239,350,884</u>	<u>205,452,596</u>
Total Shareholders' Equity	<u>21,492,316</u>	<u>21,109,327</u>
Total Liabilities and Shareholders' Equity	<u>\$260,843,200</u>	<u>\$226,561,923</u>



CONSOLIDATED STATEMENTS OF INCOME

	Year ended December 31	
	<u>2017</u>	<u>2016</u>
Interest Income	\$ 9,606,085	\$ 8,618,882
Interest Expense	<u>625,041</u>	<u>625,368</u>
Net Interest Income	8,981,044	7,993,514
Provision for loan losses	<u>430,000</u>	<u>360,000</u>
Net Interest Income After Provision for Loan Losses	8,551,044	7,633,514
Other Income	1,339,987	1,206,092
Other Expense	<u>6,774,158</u>	<u>6,242,135</u>
Income Before Federal Income Tax	3,116,873	2,597,471
Federal Income Tax Expense	<u>1,292,000</u>	<u>888,300</u>
Net Income	<u>\$ 1,824,873</u>	<u>\$ 1,709,171</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, 2017.

Dollars in thousands, except per share data	2017	2016	2015	2014	2013
Net Income	\$ 1,825	\$ 1,709	\$ 1,280	\$ 1,129	\$ 1,431
Net Income Available to Common Shareholders	1,825	1,709	1,272	1,110	1,411

BALANCE SHEET DATA (DECEMBER 31)

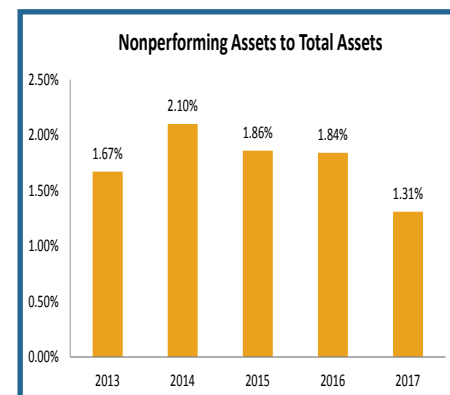
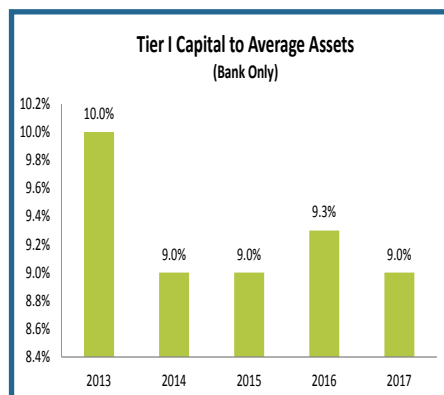
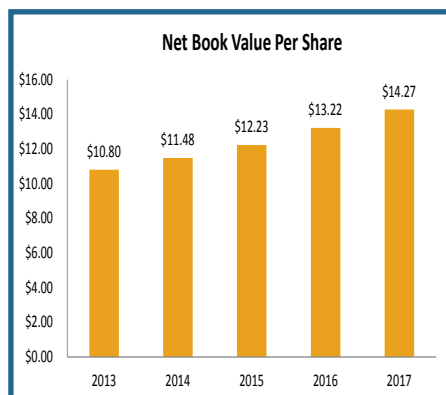
Total Assets	\$ 260,843	\$ 226,562	\$ 218,377	\$ 215,848	\$ 188,404
Total Loans	183,087	171,067	159,465	145,685	142,596
Total Deposits	217,523	192,516	187,396	186,180	154,804
Total Shareholders' Equity	21,492	21,109	19,476	19,205	19,040
Tier I Capital to Average Assets (Bank Only)	8.97%	9.34%	8.96%	9.04%	9.96%
Net Book Value per Common Share	\$ 14.27	\$ 13.22	\$12.23	\$ 11.48	\$10.80

PERFORMANCE RATIOS

Return on Average Assets	0.76%	0.76%	0.60%	0.57%	0.78%
Return on Average Common Equity	8.38%	8.41%	6.79%	6.41%	8.73%
Net Interest Margin	3.93%	3.66%	3.55%	3.56%	3.72%
Net Income per Average Common Share	\$ 1.16	\$ 1.07	\$ 0.80	\$ 0.71	\$ 0.91

ASSET QUALITY MEASURES

Net Loan Charge-offs (Recoveries)	\$ 83	\$ (88)	\$ 224	\$ 303	\$ 430
Net Loan Charge-offs to Average Total Loans	0.05%	(0.05%)	0.15%	0.21%	0.31%
Allowance for Loan Losses to Total Loans	1.61%	1.52%	1.35%	1.40%	1.43%
Non-performing Assets to Total Assets	1.31%	1.84%	1.86%	2.10%	1.67%



1ST STATE BANK STAFF

Julie Adams

Residential Mortgage Processor

Dean Anderson

Mortgage Loan Officer

Denise Avery

VP Deposit Operation Services

Holly Bass

Deposit Operations Specialist

Tania Beverly

Personal Banker

David Brown

VP Business Lender

Allison Caister

Marketing Coordinator

Jessica Callaghan

Personal Banker

Steve Canole

SVP Business Lender

Todd Clements

SVP Business Lender

Brenda Demo

BSA/ Compliance Officer

Dennis Dinauer

Mortgage Loan Officer

Angy Dixon

Bay City Office Manager

Kevin Fraser

VP Contoller

Missie Freier

VP Business Lender

Mary Gantner

Loan Specialist

Rick Goedert

President & CEO

Amy Grochowski

Personal Banker

Todd Gregory

SVP Business Lending Manager

Dan Gruzd

Credit Analyst

Kathy Hamel

Lending Office Professional

Tim Harrigan

IS Support Specialist

Cindy Holliday

Deposit Operations Specialist

Christine Juarez

Personal Banker

Ed Keating

SVP Business Lender

Jesse Kendall

Business Lender

Jessica Krause

Personal Banker

Tiffany Kukla

HR Generalist

Craig Loree

VP Information Systems Officer

Lori Martin

SVP Business Lender

Deb Mazur

Mortgage Loan Officer

Jim Milroy

EVP & CFO

Maria Ortega

Deposit Operations Specialist

Jim Papajesk

SVP Credit Manager

Kirsten Parks

Personal Loan Administration Manager

Vicki Pavlik

VP Public Funds Manager

Teresa Podgurski

Deposit Operations Specialist

Becke Popour

State Street Office Manager

Kelsey Primeau

Personal Banker

Emily Provenzano

Staff Accountant

Meleah Retzloff

Downtown Midland Office Manager

Markisha Rivers

Loan Specialist

Jennifer Shepard

Personal Banker

Abigail Skowronski

Personal Banker

Cassie Slayton

Personal Banker

Anne Smith

Main Office Manager

Jeff Southcott

SVP Personal Lending Manager

Hillary Stockel

Credit Department Supervisor

Sue Sweebe

Personal Banker

Audrey Thomas

Deposit Operations Specialist

Kim Van Tifflin

Loan Specialist

Dawn Walny

Personal Banker

Mary Weinstein

Mortgage Processor

Brittney Welke

Loan Administration Supervisor

Andrea Winberg

Credit Analyst

Bridget Windy

Accounting Specialist

Margo Winieckie

SVP Deposit Relationship Manager

Board of Directors

Phil List

Chairman of the Board

Mike Bierlein**Mitzi Dimitroff****Joe Fabiano****Rick Goedert****Mike Hanisko****Scott Holman****Terry Niederstadt****Jake Shiners****Lynn Wolgast****Dave Hall**

Director Emeritus

Richard Watson

Director Emeritus

LOCATIONS



4800 Fashion Square Boulevard
Saginaw, MI 48604
989-799-7500



5425 State Street
Saginaw, MI 48603
989-596-7500



601 N. Madison Avenue
Bay City, MI 48708
989-322-7500



3907 Wilder Road
Bay City, MI 48706
989-439-7500



Opening Summer 2018
400 Ashman Street
Midland, MI 48640





In town. In touch.



989-799-7500
1stStateBk.com

