

July 22, 2022

Dear Shareholder,

With the second quarter of 2022 coming to a close, I am pleased to announce year-to-date net income of \$13.81 million for Merchants Financial Group, Inc. While earnings performance is \$4.35 million behind mid-year earnings of 2021, it's gratifying that earnings have exceeded our plan by \$3.33 million even though performance headwinds have materialized as we had projected going into the year.

The most significant core business contributor to our mid-year performance has been the generation of commercial loan fee income. While commercial loan demand overall remains relatively soft, our Commercial Bankers have generated \$260 million in new commercial loan activity during the first half of the year. Commercial loan origination fee income has been \$1.25 million and that has been the primary contributor for all three bank regions exceeding plan during the first half of the year. Additionally, Merchants Bank Equipment Finance contributed \$2.3 million of net income during the first half of the year, more than double its plan.

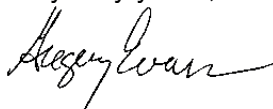
Additional performance and strategic Company highlights include:

- The increase in interest rates during the first half of the year has resulted in an improved net interest margin to 3.20%, an improvement of 56 basis points from mid-year 2021.
- On the flip side, residential mortgage loan activity has been impacted significantly by the dramatic change in the interest rate environment, as we had anticipated entering the year. Total mortgage volume through six months has been \$243.17 million, compared to \$483.87 million in 2021. Current year volume is below our plan by \$63.12 million.
- During the first half of the year, we were successful at recruiting two outstanding leaders to our Executive Team in anticipation of retirements. Chief Credit Officer Mark McGroary retired in May after 35 years of dedicated service to your Company. We were thrilled to promote from within and name Cindy Harrison as Mark's successor. Cindy has worked with Mark and contributed to our strong credit culture over a tenure of 30 years with Merchants. Also retiring at the end of the second quarter was Chief Human Resource Officer Beth Ede, and we recently announced the hiring of Catherine "Cat" Breet to fill this important role. Cat has already relocated from the Twin Cities to make Winona her new home after owning/operating her own HR Recruitment & Consulting business for 16 years.

This summer it has been wonderful to welcome back community events and celebrations that we missed over the last two years. I'm proud to see so many of my Merchants teammates embracing the responsibility that comes with being a community leader by volunteering at dozens of festivals and fund-raising activities. I personally welcome the opportunity to see many of our Shareholders out in our communities during this time of the year.

I hope you are able to enjoy the rest of the summer. We are lucky to have such a beautiful region to call home. Thank you, as always, for your support, loyalty and belief in our mission.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Gregory Evans', written in a cursive style.

Gregory M. Evans
President and CEO

Merchants Financial Consolidated

Consolidated Statements of Financial Condition

Unaudited

(\$ in thousands, except share data)

	<u>June 30, 2022</u>	<u>December 31, 2021</u>
<u>ASSETS</u>		
Cash and cash equivalents	541,865	845,680
Federal funds sold	331	413
Available-for-sale securities	224,751	197,372
Held-to-maturity securities	39,371	10,440
Loans held for sale	14,947	24,071
Loans and direct financing leases, net	1,649,896	1,579,275
Operating lease assets	16,290	13,024
Premises and equipment	26,975	27,666
Investment in restricted stock	7,167	6,880
Other real estate and other personal property owned	1,034	1,123
Accrued interest receivable and other assets	13,175	14,191
Cash value of life insurance	57,418	48,986
Mortgage servicing rights, net	16,947	16,268
Goodwill	35,665	35,665
Intangibles	1,118	1,494
Total assets	<u><u>2,646,951</u></u>	<u><u>2,822,549</u></u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
<u>Liabilities</u>		
Deposits		
Noninterest-bearing	618,167	620,988
Interest-bearing	1,722,831	1,897,575
Total deposits	<u>2,340,998</u>	<u>2,518,564</u>
Federal funds purchased	-	-
Repurchase agreements	14,923	1,700
Notes payable	12,040	14,540
Subordinated debentures	41,254	41,254
Deferred taxes, net	(2,053)	3,370
Accrued interest payable and other liabilities	9,554	12,483
Total liabilities	<u>2,416,716</u>	<u>2,591,910</u>
<u>Stockholders' Equity</u>		
Common stock, par value \$.025 per share	68	68
Additional paid-in-capital	10,135	10,135
Retained earnings	239,993	228,632
Accumulated other comprehensive gain	(12,627)	(791)
Unearned ESOP shares	(7,335)	(7,405)
Total stockholders' equity	<u>230,234</u>	<u>230,640</u>
Total liabilities and stockholders' equity	<u><u>2,646,951</u></u>	<u><u>2,822,549</u></u>

Merchants Financial Consolidated

Consolidated Statements of Income

Unaudited

(\$ in thousands, except share data)

	<u>June 30, 2022</u>	<u>June 30, 2021</u>
<u>INTEREST INCOME:</u>		
Loan interest	33,032	32,955
Loan fees	5,141	9,073
Securities	1,961	1,048
Direct financing leases	1,301	1,675
Other income	<u>2,243</u>	<u>874</u>
Total interest income	43,678	45,625
<u>INTEREST EXPENSE:</u>		
Deposits	2,350	3,585
Notes payable, federal funds purchased and repurchase agreement:	127	217
Subordinated debentures	<u>868</u>	<u>620</u>
Total interest expense	<u>3,345</u>	<u>4,422</u>
Net interest income	40,333	41,203
Provision for loan and lease losses	<u>(1,390)</u>	<u>(1,277)</u>
Net interest income after provision for loan and lease losses	41,724	42,480
<u>NON-INTEREST INCOME:</u>		
Trust department	1,027	920
Service charges and other fees	2,573	2,489
Loan servicing fees	3,611	3,509
Net gain on sale of available-for sale securities	-	-
Net gain on sale of loans	1,607	9,847
Net gain(loss) on sale of other real estate & other personal prop.	0	269
Other income	<u>3,422</u>	<u>3,406</u>
Total Non-interest income	12,240	20,440
<u>NON-INTEREST EXPENSE:</u>		
Salaries and employee benefits	19,414	20,928
Occupancy	7,902	7,311
Net loss on disposal of premises and equipment	15	-
Mortgage servicing rights	1,774	2,961
Other expense	<u>6,010</u>	<u>6,861</u>
Total non-interest expense	<u>35,116</u>	<u>38,061</u>
Income before income taxes	18,848	24,859
Provision for income taxes	<u>5,034</u>	<u>6,694</u>
Net income	<u>13,814</u>	<u>18,165</u>

Merchants Financial Consolidated

Consolidated Financial Highlights

Second Quarter 2022

Unaudited

	Quarterly					Year to Date	
	2nd Qtr 2022	1st Qtr 2022	4th Qtr 2021	3rd Qtr 2021	2nd Qtr 2021	June 30, 2022	June 30, 2021
(\$ in thousands, except share data)							
\$ Earnings							
Net Interest Income	\$ 20,829	19,504	19,493	21,391	19,753	40,333	41,203
Provision (Reversal) for loan loss	\$ 206	(1,596)	(293)	(641)	(1,563)	(1,390)	(1,277)
Other non-interest income	6,198	6,042	7,698	8,044	9,292	12,240	20,440
Security gains/losses	\$ -	-	-	-	-	-	-
Other non-interest expense	18,018	17,098	23,260	19,991	18,984	35,116	38,061
Pre-tax income	\$ 8,805	10,044	4,225	10,084	11,623	18,848	24,859
Taxes	\$ 2,339	2,695	1,016	2,680	3,125	5,034	6,694
Net Income	\$ 6,466	7,349	3,209	7,404	8,498	13,814	18,165
Pre-tax, pre-provision earnings	\$ 9,010	8,448	3,932	9,443	10,061	17,458	23,582
Earnings per share	\$ 0.79	0.90	0.39	0.91	1.04	1.69	2.22
Performance Ratios							
Return on average assets	0.95%	1.06%	0.45%	1.08%	1.07%	1.00%	1.17%
Return on average equity	11.26%	12.88%	5.46%	12.81%	7.09%	12.07%	7.63%
Yield on earning assets	3.54%	3.28%	3.10%	3.54%	3.11%	3.41%	3.33%
Cost of funds (inc non-int bearing deposits)	0.33%	0.37%	0.40%	0.42%	0.43%	0.35%	0.44%
Net interest margin	3.20%	2.94%	2.70%	3.10%	2.47%	3.20%	2.64%
Efficiency ratio	65.31%	65.97%	84.78%	66.50%	63.73%	65.63%	59.81%
Net overhead ratio	2.49%	2.35%	3.08%	2.73%	2.22%	2.42%	2.26%
Capital							
Tier 1 leverage capital ratio	9.43%	9.19%	9.05%	9.34%	9.14%	9.43%	9.14%
Common equity risk-based capital ratio	12.40%	11.09%	10.81%	10.87%	10.82%	12.40%	10.82%
Tier 1 risk-based capital ratio	14.69%	13.18%	12.92%	12.99%	13.01%	14.69%	13.01%
Total risk-based capital ratio	15.94%	14.43%	14.17%	14.24%	14.26%	15.94%	14.26%
Tangible capital to tangible assets	7.34%	6.93%	6.89%	7.20%	7.03%	7.34%	7.03%
Book value per share	\$ 28.15	28.32	28.20	28.43	27.65	28.15	27.65
Tangible book value per share	\$ 21.58	21.75	21.62	21.94	21.15	21.58	21.15
Outstanding shares	8,178,741	2,726,247	2,726,247	2,726,247	2,726,247	8,178,741	2,726,247
Asset Quality							
Net charge-offs (recoveries)	\$ (30)	26	(760)	(677)	(448)	(30,092)	(448,469)
Net charge-offs (recoveries) to average loans	0.00%	0.00%	-0.05%	-0.04%	-0.02%	0.00%	-0.02%
Allowance for loan losses	\$ 27,230	27,080	28,650	29,026	29,895	27,230	29,895
Allowance to total loans	1.61%	1.67%	1.76%	1.79%	1.78%	1.61%	1.78%
Allowance to total loans (excluding PPP loans)	1.61%	1.68%	1.78%	1.83%	1.86%	1.61%	1.86%
Nonperforming loans (Non-accrual & 90 days Past Due)	\$ 12,874	12,717	15,820	17,177	16,168	12,874	16,168
Other real estate owned	\$ 1,034	1,123	1,123	2,345	2,529	1,034	2,529
Nonperforming loans to total loans	0.76%	0.78%	0.97%	1.06%	0.96%	0.76%	0.96%
Nonperforming assets to total assets	0.53%	0.49%	0.60%	0.71%	0.69%	0.53%	0.69%
End of Period Balances							
Assets	\$ 2,647,781	2,823,191	2,822,549	2,737,846	2,709,234	2,647,781	2,709,234
Earning Assets	\$ 2,440,300	2,629,824	2,716,064	2,622,584	2,593,602	2,440,300	2,593,602
Total investments	\$ 328,707	293,943	263,678	218,724	219,685	328,707	219,685
Total loans	\$ 1,692,173	1,622,246	1,631,837	1,621,726	1,681,637	1,692,173	1,681,637
Paycheck Protection Program loans	\$ 3,307	10,112	20,486	33,787	75,431	3,307	75,431
Intangible assets	\$ 53,730	53,771	53,805	53,121	53,178	53,730	53,178
Deposit	\$ 2,340,997	2,522,497	2,518,563	2,416,784	2,392,003	2,340,997	2,392,003
Customer repurchase agreements	\$ 14,923	2	1,700	12,369	15,004	14,923	15,004
Borrowings	\$ 12,040	14,540	14,540	14,920	14,920	12,040	14,920
Shareholders' Equity	\$ 230,234	231,661	230,640	232,553	226,134	230,234	226,134
Average Balances							
Assets	\$ 2,729,126	2,820,266	2,818,012	2,725,744	3,191,132	2,774,444	3,131,483
Earning Assets	\$ 2,528,827	2,628,463	2,701,256	2,609,615	2,823,595	2,577,192	2,752,304
Total investments	\$ 305,710	286,201	245,478	219,235	195,524	296,009	190,489
Total loans	\$ 1,660,766	1,620,556	1,612,873	1,644,148	1,899,609	1,640,772	1,929,229
Paycheck Protection Program loans	\$ 6,709	15,299	27,136	54,609	114,100	6,709	114,100
Intangible assets	\$ 53,615	53,320	53,077	52,997	52,683	53,468	52,378
Deposit	\$ 2,422,069	2,511,768	2,496,254	2,408,889	2,439,208	2,466,671	2,373,865
Customer repurchase agreements	\$ 9,935	7,779	10,803	12,047	14,528	8,863	14,498
Borrowings	\$ 14,265	14,540	14,916	14,920	17,145	14,402	17,282
Shareholders' Equity	\$ 230,280	231,334	232,978	229,369	480,723	230,804	480,057
Stock Valuation							
Closing Market Price (OTCPink)	\$ 25.50	79.50	75.25	73.00	72.50	25.50	72.50
Multiple of Tangible Book Value	1.18	3.66	3.48	3.33	3.43	1.18	3.43

**Previous quarter per share data restated to reflect May 13, 2022 Stock Split