Merchants Financial Group

October 23, 2020

Dear Shareholder,

Before providing a brief review of quarterly accomplishments, I want to thank you for your commitment to Merchants Bank. This year has been a challenge for all of us, but also an opportunity to appreciate all we have to be thankful for. As we continue to face the economic effects of the pandemic, we value your support and belief in our community bank. The Merchants team continues to show its dedication and adaptability as we embrace our role as trusted advisors in a changing world. This would not be possible without the loyalty of our Shareholders. I'm pleased to share that your loyalty will once again be rewarded in form of a semi-annual dividend, which the Board of Directors voted to retain at $.75/share. This dividend will be paid on December 18, 2020 to Shareholders of record as of November 20, 2020.

Despite the challenges we have encountered, consolidated net income was $14,717,981 through the end of the third quarter. This is ahead of plan by $821,640 and ahead of third-quarter earnings for 2019 by $250,000. This is significant given that we once again took a conservative approach by adding $3.2 million to our Allowance for Loan/Lease Loss Reserves (ALLR) during the third quarter. Year-to-date, we have reserved $8.9 million more than planned out of an abundance of caution due to possible future economic uncertainties.

Our business line diversification, and especially our residential mortgage lending operation, continues to drive our positive results. Our mortgage team has been simply amazing, working tirelessly to accommodate market demand created by the low interest rate environment. Through three quarters, we have booked $713.6 million of mortgage loan volume. We closed $538.5 million in all of 2019. The profit contribution coming from mortgage is $6.97 million ahead of plan.

Additional third quarter highlights include:

- Deposit growth continues to be extraordinary with year-over-year growth of 28% and total deposits of $2.3 billion.
- When we exclude Small Business Administration Paycheck Protection Program balances, loan growth through the end of the third quarter has been flat. We continue to await clear federal guidance associated with the critically important forgiveness application process for these loans.
- New commercial loan activity picked up a bit in the third quarter, with new originations of $69 million. Total new commercial loan activity for the year has been $150 million.
- We launched our strategic planning process to chart the course for the next 3-5 years. Our Board and management teams have absolute confidence in our ability to remain strong and relevant long into the future, and we are working to define the critical initiatives necessary to meet those objectives in a changing and competitive industry.

We know there is much left to do this year. We anticipate continued challenges in the fourth quarter, and again have detailed COVID-19 updates in the enclosed attachment. I remain confident the Merchants team will rise to the occasion and finish 2020 in a strong manner. Please accept my warmest wishes for a safe, healthy, and happy upcoming holiday season.

Very truly yours,

Gregory Evans

Gregory M. Evans
President and CEO

Balance Sheet Highlights

Period-end	September 30, 2020	June 30, 2020	Variance	December 31, 2019 *
Assets				
Cash & Fed Funds	$ 460,205,811	$ 229,607,528	100.43%	$ 94,783,266
Investments	119,640,677	127,523,898	-6.18%	143,203,122
Net Loans	1,876,471,611	1,903,472,135	-1.42%	1,727,364,482
Intangible assets	38,335,637	38,611,787	-0.72%	39,204,841
Other assets	120,050,236	117,350,210	2.30%	108,138,081
Liabilities & Equity				
Deposits	2,306,838,451	2,107,480,634	9.46%	1,815,195,552
Trust Preferred Securities	40,000,000	41,254,000	-3.04%	41,254,000
Other Liabilities	59,426,837	62,902,887	-5.53%	58,989,884
Equity	208,438,684	204,928,037	1.71%	197,254,356
	*Restated to align with audit reclassifications			

Income Statement Highlights

	Nine months ended			2019 -2020 Per Quarter Results			
	September 30, 2020	September 30, 2019					
	Actual	Actual	Variance	Third Quarter	Second Quarter	First Quarter	Fourth Quarter
Income							
Investments & Funds Sold	$ 2,671,881	$ 3,275,418	-18.43%	$ 683,974	$ 703,465	$ 1,284,442	$ 1,253,964
Loan Interest	64,609,036	58,666,669	10.13%	21,415,308	21,777,023	21,416,705	22,868,264
Total Interest Income	67,280,917	61,942,087	8.62%	22,099,282	22,480,488	22,701,147	24,122,228
Interest Expense	(10,347,827)	(10,216,836)	1.28%	(3,225,600)	(3,318,860)	(3,803,367)	(3,977,349)
Net Interest Income	56,933,090	51,725,251	10.07%	18,873,682	19,161,628	18,897,780	20,144,879
				-	-	-	
Non-interest Income	31,725,168	17,345,845	82.90%	13,476,325	12,340,178	5,908,665	7,115,782
Non-interest expense	(58,322,921)	(47,725,725)	22.20%	(19,768,425)	(19,863,699)	(18,690,797)	(18,723,076)
Provision expense	(10,325,355)	(1,711,909)	503.15%	(4,039,592)	(5,327,992)	(957,771)	(542,803)
Pretax Income	20,009,982	19,633,462	1.92%	8,541,990	6,310,115	5,157,877	7,994,782
Taxes	(5,292,000)	(5,175,000)	2.26%	(2,267,000)	(1,674,001)	(1,350,999)	(2,686,029)
Net Income	14,717,982	14,458,462	1.79%	6,274,990	4,636,114	3,806,878	5,308,753

Bank Yield and Margin Highlights

	September 30, 2020		June 30, 2020		December 31, 2019	
	Balances	Rate	Balances	Rate	Balances	Rate
Earning Assets						
Fed Funds Excess	$ 417,418,365	0.10%	$ 176,605,030	0.10%	$ 51,680,968	1.76%
Investments	$ 121,322,892	1.96%	$ 149,784,208	2.18%	$ 199,126,947	2.74%
Loans *	$ 1,653,435,509	3.54%	$ 1,862,457,601	3.67%	$ 1,675,345,449	4.29%
OREO & Non-accrual	$ 24,209,120	0.00%	$ 23,909,842	0.00%	$ 23,336,302	0.00%
Earning Assets Total	$ 2,216,385,886	2.76%	$ 2,212,756,681	3.23%	$ 1,949,489,666	4.19%
Paying Liabilities						
Non-interest deposits	$ 509,857,963	0.00%	$ 575,690,018	0.00%	$ 424,840,230	0.00%
Interest deposits	$ 1,563,915,586	0.57%	$ 1,532,637,921	0.69%	$ 1,389,996,422	0.95%
Non-core deposits	$ 16,262,826	0.66%	$ 17,245,485	0.90%	$ 9,453,637	1.17%
Borrowings	$ 14,000,000	2.07%	$ 20,000,000	2.30%	$ 25,000,000	2.17%
Fed Funds Purchased	$ -	0.00%	$ -	0.00%	$ -	0.00%
Paying Liabilities Total	$ 2,104,036,375	0.44%	$ 2,145,573,424	0.52%	$ 1,849,290,289	0.76%
Net Interest Spread		2.32%		2.71%		3.43%

* Paycheck Protection Loans reduce loan earning rate by 21 basis points.

Credit Quality Ratios

Period ended	September 30, 2020	June 30, 2020	March 31, 2020	December 31, 2019
Classified Loans to Total Loans	3.74%	3.02%	3.89%	4.51%
Criticized Loans to Total Loans	4.85%	4.35%	6.11%	7.50%
Classifed Loans to Capital	28.77%	23.93%	28.62%	34.17%
Criticized Loans to Capital	37.33%	34.50%	44.93%	56.83%
Non-accrual Loans to Total Loans *	1.21%	1.18%	1.32%	1.26%
Past Due > 90 days to Total Loans *	0.35%	0.38%	0.26%	0.23%
Net Charge-offs (Recoveries) to Total Loans *	0.05%	0.00%	-0.01%	0.08%
Loss Reserve to Total Loans *	1.49%	1.32%	1.19%	1.12%

* Total loans includes held for sale and operating leases

Key Ratios

Period-end	September 30, 2020	June 30, 2020	March 31, 2020	December 31, 2019
Internal Ratios				
Return on Average Assets	0.80%	0.74%	0.71%	0.94%
Return on Ending Equity	9.54%	8.30%	7.59%	10.04%
Efficiency Ratio	63.45%	66.19%	74.14%	67.65%
Net Interest Margin **	4.01%	4.22%	4.04%	3.88%
Common Equity Tier 1	9.58%	9.32%	9.11%	9.44%
Tier 1 Capital Ratio	11.72%	11.46%	11.19%	11.51%
Total Capital Ratio	13.23%	12.80%	12.25%	12.50%
Tier 1 Leverage Ratio	9.61%	10.13%	10.21%	10.68%
Investor Ratios				
Number of Shares Outstanding	2,726,247	2,726,247	2,726,247	2,726,247
YTD Earnings Per Share	5.40	3.10	1.40	7.25
Book Value Per Share	76.00	75.17	73.39	72.35
Tangible Book Value (TBV)	61.93	61.01	59.12	57.97
Share price	54.38	53.00	60.75	73.35
Price to EPS	7.55	8.56	10.88	10.12
Price to TBV	87.80%	86.88%	102.75%	126.52%

*Ratios with shares use outstanding shares versus GAAP weighted average shares

** Net Interest Margin is inflated due to Mortgage Fees being included in calculation

MERCHANTS FINANCIAL GROUP, INC. 2020 THIRD QUARTER UPDATE

Given the impact of the COVID-19 global health pandemic, we intend to remain transparent in our quarterly updates relative to the state of the Company. Here is an updated Q&A through the end of the 2020 third quarter:

1. COVID-19: Operations & Business Continuity Planning response update

We continue to operate with the health and safety of all stakeholders as an intense priority. As a result of our planned efforts and the tremendous discipline of our employees and our customers we have, thankfully, experienced minimal direct COVID case exposure within Merchants. Specific updates at end of Q3:

- All Bank facilities remain open for regular business hours as they have been since June 22
- We continue to communicate weekly updates and reminders about the importance of health protocols to our entire employee team
- We continue to operate with more than 50% our workforce being highly productive while working from home
- Our Executive Leadership Team continues to follow a schedule of work-from-home rotations to ensure appropriate health management and long-term continuity of leadership
- We are mindful of the need for accelerated staffing contingency planning in Q4 and into 2021 with the expected complications associated with a continued COVID surge and the onset of influenza as an additional health/safety concern

2. What's the current level of loan modification activity for Merchants in accommodating borrowers impacted most significantly by the pandemic?

As we communicated previously, in alignment with our community banking mission, we mobilized our entire lending team at the onset of the pandemic to position ourselves as a source of assistance for stakeholders hit hardest as a result of the pandemic. As economic activity rebounded at least moderately in Q3, most borrowing customers accommodated with early modifications have returned to "business as usual" in making their loan payments. Specific updates would include:

- We continue to service more than $200 million in SBA Paycheck Protection Program loans as originated to approximately 1,600 borrowers. New PPP loan origination activity was minimal in Q3 while we patiently awaited clear guidance from the federal government relative to processing the critically important loan forgiveness aspect of this relief program. It was expected that congressional action would be taken to expedite and streamline the loan forgiveness process, but the government failed to act. Thus, we mobilized within the last two weeks to begin processing loan forgiveness applications on behalf of our borrowers. As a result, it's likely that forgiveness of loan proceeds will not be formally approved for borrowers until sometime early in 2021. Upon forgiveness, we will accelerate the ability to recognize the modest fee income that banks were granted for the origination of these relief loans.
- As shared previously, we instituted loan modification and payment deferral program options across all lending product categories at the onset of the pandemic. Depending on loan category, deferral options extended were generally for periods of 30 to 90 days. Most customers we worked with in providing short-term relief are back to making full

principal & interest payments. We have worked with select borrowers in specific industries (most notably hospitality) in extending additional payment deferral options. Our concentration of loans in the hospitality industries is modest at 4.06% of total loans. Loan & Lease customers still on some form of payment modification relief represent total credit facility outstandings of $57.6 million, which is 3.09% of total loans and 23.71% of total equity capital. Along with granting additional extensions, we continue to engage directly with these borrowers in attempt to assess the longer-term projections associated with these businesses and the impact of the overall risk profile of our portfolio.

3. **What is the forecast for Allowance for Loan/Lease Loss Reserves (ALLR)?**

To date, we have not experienced any direct loss exposure attributed to COVID. As noted above, however, many of our borrowing customers have experienced business disruption to at least a moderate degree. The injection of significant capital and liquidity into the economy with PPP and enhanced unemployment benefits has helped, and for that reason we continue to expect it will be sometime in the first half of 2021 before we have a true and quantifiable assessment of loss exposure in our portfolio.

We continue to conduct intense stress testing of our loan portfolio and have begun assessing levels of risk at a granular level associated with any concentrations in selected industries. As we closed our books at the end of Q3, we provisioned an additional $3.2 million of Allowance for Loan/Lease Loss Reserves (ALLR). This increased ALLR to 1.49% of total loans (compared to 1.12% at year-end 2019). We fully expect this reserve analysis will result in making an additional provision to bolster ALLR at year-end. We will adjust in a prudent and conservative manner as we always have.

4. **What is the current risk profile associated with liquidity and the interest rate environment?**

The strength of the deposit franchise for Merchants remains outstanding and our liquidity ratios have probably never been stronger. Total deposits continued to grow through the third quarter to a total of $2.3 billion (up from $2.11 billion at the end of Q2). We have experienced deposit growth of 28% since year-end. We remain mindful of the critical importance of maintaining a healthy liquidity position at this time. The Bank Charter loan-to-deposit ratio of 81% compares to 98% a year ago, putting our balance sheet in a position of absolute strength. The downside of the excess liquidity in the current interest rate environment is that earnings on the excess is virtually non-existent. We continue to experience interest margin compression because of the current rate environment and lack of loan demand (a function of the pandemic and economic uncertainty). To date, margin erosion has been offset by our strong presence in residential mortgage lending, which has been bolstered by the interest rate environment. Through September 30, we had originated $713.6 million of mortgage loan volume compared to $538 million for all of 2019. The income component from these mortgage originations contributed significantly to offset the impact of increased provision to ALLR on our 2020 mid-year earnings.

5. **Could you give us a Northfield integration update?**

The successful merger of the First National Bank of Northfield into Merchants Bank continues to go very well. We continue to work very hard to manage any fallout and remain committed to earning trust and confidence from our new Northfield stakeholders. To date, we have experienced very little customer attrition because of the merger.

6. **What comment would you make associated with the volatility and decline in Merchants stock price?**

The market share price of MFGI stabilized in Q3 and was $54.38 per share on September 30. We continued to grow Tangible Book Value in Q3 from $61.01 on June 30 to $61.93 at the end of the third quarter. We remain focused on growing the fundamental value of the Company, and our absolute confidence in that regard is why your Board of Directors voted to retain our semiannual dividend at $.75/share for payment in December of this year.

7. **Do you have an updated earnings forecast for year-end, and what can I expect relative to the long-term value of my investment in Merchants?**

We expect to finish 2020 strong in terms of core earnings, largely because of the residential mortgage volume that remains active in our pipeline. At quarter-end, we still had more than $243 million of loans in the pipeline that had not yet been closed and delivered to the secondary market, and new home financing applications continue to be received at a brisk pace. The income opportunity associated with this line of business is likely to continue to contribute to earnings enhancements through at least the end of the first quarter in 2021. Our year-end earnings performance target will definitely be impacted by our fourth quarter ALLR analysis. Even with our assumed conservative position relative to ALLR, we are confident that earnings performance will be in alignment with the industry and/or above the level of our peers. We have also kicked off our budgeting and planning process for 2021. We are mindful of continued headwinds associated with COVID, the impact on margins of the low interest rate environment, and uncertainty in terms of the socio-political environment. As we always do, we will embrace challenges as opportunities and adapt to the environment as it unfolds.

Finally, we have mobilized a robust strategic planning exercise to chart the course for Merchants for the period between now and 2025. We are still early in the process, but we are very optimistic about our ability to continue to grow the business and earnings at a level that will drive enhanced shareholder value in alignment with our historic track record. The Board is intensely committed to its fiduciary responsibility to you and all stakeholders who will continue to benefit from having a strong community bank in the form of Merchants serving this footprint. It is gratifying to be doing this strategic work for our future from a position of absolute strength. We will look forward to providing additional transparency about our strategic priorities for the future at year-end and as we prepare for our Annual Shareholder Meeting next spring.

Additional statement regarding Forward Looking Statements

Statements in this letter regarding the Company that are not historical facts are "forward-looking statements" that involve risks and uncertainties. These statements may be identified by the use of forward-looking terminology, including the words “may,” “believe,” “will,” “expect,” “look,” “anticipate,” “estimate,” “continue,” or similar words.

There are a number of risks and uncertainties to which these forward-looking statements may be subject, including:

(i) changes in general economic, market and regulatory conditions;

(ii) the severity and duration of the COVID-19 coronavirus outbreak and the impact of the outbreak (including federal, state and local governments' response to the outbreak) on economic and financial markets, potential regulatory actions, and modifications to our operations, products, and services relating from these events;

(iii) disruptions in our and our customers' operations and loss of revenue due to widespread health emergencies, government-imposed travel/business restrictions, or outbreaks of infectious diseases such as the COVID-19 coronavirus, and the associated adverse impact on our financial position, liquidity, and our customers' abilities to repay their obligations to us or willingness to obtain financial services products from the Company;

(iv) the development of an interest rate environment that may adversely affect the Company's interest rate spread, other income or cash flow anticipated from the Company's operations, investment and lending activities;

(v) the fact that the price of our MFGI common stock may be affected by factors beyond our control;

(vi) changes in laws and regulations affecting banks and bank holding companies; and

(vii) the Company's ability to access financial resources in the amounts, at the times and on the terms required to support the Company's ongoing and future business.

These risks and uncertainties could cause actual results, performance or achievements to differ materially from those projected in the forward-looking statements. The forward-looking statements speak only as of the date of this letter.