

**BUILDING**  
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**FUTURE TODAY.**

2019 ANNUAL REPORT



**EMBASSY  
BANCORP, INC.**

# Corporate Information

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*Owner & Principal, Boyer Financial Group*

**John G. Englesson**

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President, zAxis Corporation*

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**David M. Lobach, Jr.**

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Embassy Bancorp, Inc. and  
Embassy Bank for the Lehigh Valley*

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**John T. Yurconic**

*President, The Yurconic Agency  
President, Insurance Premium Financing, Inc.*

## Executive Officers

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**Judith A. Hunsicker**

*First Executive Officer, COO, CFO, Secretary, & Treasurer*

**James R. Bartholomew**

*Sr. Executive Vice President  
SLO Commercial Lending, Commercial Services,  
& Private Banking*

**Diane M. Cunningham**

*Executive Vice President  
Consumer Lending, Branch Administration & Marketing*

**Lynne M. Neel**

*Executive Vice President & Assistant Secretary  
Deposit Operations, Finance, Investor Relations,  
& Loan Operations*

## Officers

### Senior Vice Presidents

**David C. Arner**, *Electronic Banking & Security*

**Tracy A. Barker**, *Bank Secrecy Officer*

**Desty A. Bonstein**, *Private Banking*

**Mark A. Casciano**, *Strategic Initiatives*

**Scott A. Karwacki**, *Credit Analysis*

**Michael B. Macy**, *Commercial Lending*

**Tracy L. McCarthy**, *Loan Operations*

**Jeffrey C. Skumin**, *CPA-Finance*

**Brandi L. Stefanov**, *Branch Administration*

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**Kristin A. Wannisky**, *Marketing*

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**John T. Dittbrenner, Jr.**, *Commercial Lending*

**Gary H. Guthrie**, *Commercial Lending*

**Mark Haldaman**, *Commercial Lending*

**Michael N. Lahanas**, *Commercial Lending*

**Bryan D. Lobach**, *Business Development*

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**Jason S. Sickels**, *Information Security & Technology*

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**Timothy P. Woodbridge**, *Commercial Lending*

### Assistant Vice Presidents

**Taryn M. Burgess**, *Consumer Lending*

**Janelle D. Creveling**, *Branch Administration*

**Antonio A. Dias**, *Deposit Operations*

**Shannon M. Emmert**, *CRA & Team Culture*

**Gina P. Franco**, *Consumer Lending*

**Lori L. Herman**, *Branch Administration*

**Christine L. Pierce**, *Branch Administration*

**Krystal A. Salce**, *Credit Analysis*

**Maria P. Smith**, *Branch Administration*

**Sarah E. Stuber**, *Branch Administration*

**Debra A. Young**, *Commercial Services*

### Assistant Treasurers

**Julian Chimelis-Lora**, *Bank Secrecy*

**Megan Curry**, *Loan Operations*

**Michael Geiger**, *Branch Administration*

**Jamie L. Lambert**, *Credit Analysis*

**Maria McGill**, *Electronic Banking*

**Amanda Pruzinsky**, *Credit Analysis*

**Lisa A. Rex**, *Consumer Lending*

**Mirta Rodriguez**, *Consumer Lending*

**Heather Seifert**, *Branch Administration*

**Karissa Stewart**, *Commercial Services*

**Lori A. Weber**, *Branch Administration*

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year end December 31, 2019

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 000-53528

**Embassy Bancorp, Inc.**

(Exact name of registrant as specified in its charter)

**Pennsylvania**

(State of incorporation)

**26-3339011**

(I.R.S. Employer Identification No.)

**One Hundred Gateway Drive, Suite 100**

**Bethlehem, PA**

(Address of principal executive offices)

**18017**

(Zip Code)

**(610) 882-8800**

(Registrant's Telephone Number)

Securities registered under Section 12(b) of the Exchange Act:

**None**

(Title of each class)

**None**

(Trading symbol)

**None**

(Name of each exchange on which registered)

Securities registered under section 12(g) of the Exchange Act:

**Common Stock, Par Value \$1.00 per share**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [ ] No [ **X** ]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. Yes [ ] No [ **X** ]

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to filing requirements for the past 90 days. Yes [ **X** ] No [ ]

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes [ **X** ] No [ ]

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer   
Non-accelerated filer   
Emerging growth company

Accelerated filer   
Smaller reporting company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 or the Exchange Act.) Yes  No

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold as of the last business day of the registrant’s most recently completed second fiscal quarter was \$93,734,640.

(APPLICABLE ONLY TO CORPORATE REGISTRANTS)

Indicate the number of shares outstanding of each of the registrant’s classes of common equity, as of the latest practicable date:

**COMMON STOCK**

**Number of shares outstanding as of March 6, 2020**

**(\$1.00 Par Value)**  
(Title Class)

**7,438,477**  
(Outstanding Shares)

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s definitive proxy statement for the 2020 annual meeting of shareholders are incorporated by reference into Part III of this report.

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## PART I

### Item 1. BUSINESS.

#### General

Embassy Bancorp, Inc. (the “Company”) is a Pennsylvania corporation organized in 2008 and registered as a bank holding company pursuant to the Bank Holding Company Act of 1956, as amended (the “BHC Act”). The Company was formed for purposes of acquiring Embassy Bank For The Lehigh Valley (the “Bank”) in connection with the reorganization of the Bank into a bank holding company structure, which was consummated on November 11, 2008. The reorganization enabled the Company to better compete and grow in its competitive and rapidly changing marketplace. Accordingly, the Company owns all of the capital stock of the Bank, giving the organization more flexibility in meeting its capital needs as the Company continues to grow.

The Bank, which is the Company’s principal operating subsidiary, was originally incorporated as a Pennsylvania bank on May 11, 2001 and opened its doors on November 6, 2001. It was formed by a group of local business persons and professionals with significant prior experience in community banking in the Lehigh Valley area of Pennsylvania, the Bank’s primary market area.

#### Mission

The Company provides a traditional range of financial products and services to meet the depository and credit needs of individual consumers, small and medium sized businesses and professionals in its market area. As a locally owned and operated community bank, there is a strong focus on service that is highly personalized, efficient and responsive to local needs. It is the intention of the Company to deliver its products and services with the care and professionalism expected of a community bank and with a special dedication to personalized service. To create this environment, the Company employs an experienced, well-trained, highly motivated staff, with interest in building quality client relationships using state-of-the-art delivery systems and client service facilities. The Company’s senior management has extensive banking experience and establishes the Company’s goal to serve the financial needs of its clients and provide a profitable return to its investors, consistent with safe and sound banking practices. The Company focuses on obtaining and retaining customer relationships by offering a broad range of financial services, competitively priced and delivered in a responsive manner, with emphasis on understanding the financial needs of its customers.

Correspondent relationships are utilized where it is cost beneficial. The specific objectives of the Company are: 1) to provide individuals, professionals and local businesses with the highest standard of relationship banking in the local market; 2) to attract deposits and loans by offering state of the art products and services with competitive pricing; 3) to provide a reasonable return to shareholders on capital invested; and 4) to attract, train and retain a happy, motivated and team-oriented group of banking professionals dedicated to meeting the Company’s objectives.

#### Market “Niche”

The Company provides the traditional array of commercial banking products and services emphasizing a one-on-one, sit down approach, for the delivery of products and services to consumers and businesses located in Lehigh and Northampton Counties in Pennsylvania. In the Company’s primary market area, which is dominated by offices of large statewide, regional and interstate banking institutions, banking services that are furnished in a friendly and courteous manner with a timely response to customer needs fill a “niche” that arises due to the continued loss of local institutions through merger and acquisitions.

#### Deposits

The Company offers small business cash management services to help local companies better manage their cash flow, in order for the Company to attract and retain stable deposit relationships. The expertise and experience of the Company’s management coupled with the latest technology accessed through third party providers enables the Company to maximize the growth of business-related deposits.

As for consumers, deposit growth is driven by a variety of factors including, but not limited to, population growth, bank and non-bank competition, local bank mergers and consolidations, increase in household income, interest rates, accessibility of location and the sales efforts of Company personnel. Time deposits can be attracted and increased by paying an interest rate higher than that offered by competitors, but are the most costly type of deposit. The most profitable type of deposits are non-interest bearing demand (checking) accounts which can be attracted by offering free checking. However, both high interest rates and free checking accounts generate certain expenses for a bank and the desire to increase deposits must be balanced with the need to be profitable and the extent of banking relationships with the customers. The deposit services of the Company are generally comprised of demand deposits, savings deposits, money market deposits, time deposits and Individual Retirement Accounts.

## **Loans**

The loan portfolio of the Company consists primarily of secured fixed and variable rate loans, with a significant concentration in commercial real estate transactions and consumer residential real estate mortgage and home equity loans. While most credit facilities are appropriately collateralized, major emphasis is placed upon the financial condition of the borrower and evaluating the borrower's cash flow versus debt service requirements. The Company has an experienced lending and private banking team. The Company believes that the familiarity of its experienced management team and members of the Company's Loan Committee in regard to prospective local borrowers enables the Company to better evaluate the character, integrity and creditworthiness of the prospective borrowers.

Loan growth is driven by customer demand, which in turn is influenced by individual and business indebtedness and consumer demand for goods. The Company's loan and private banking officers call upon accountants, financial planners, attorneys, local realtors and others to generate loans and loan referrals. Again, a balance between growth, credit risk and pricing are required to maintain performing loans for the Company, as lending money will always entail some risk. A performing loan is a loan which is being repaid according to its original terms and is the most desirable type of loan that a bank seeks to make. Without loans a bank cannot generate enough earnings to be profitable. The risk involved in each loan must, therefore, be carefully evaluated before the loan is made. The interest rate at which the loan is made should always reflect the risk factors involved, including the term of the loan, the value of collateral, if any, the reliability of the projected source of repayment and the amount of the loan requested. Credit quality will always be the Company's most important factor.

The Company does not sell its mortgages into the secondary market, has not been involved in any "sub-prime" mortgage lending, and has not purchased or invested in any securities backed by or which include sub-prime loans.

## **Commercial Lending**

The Company generally targets businesses with annual revenues of less than \$10 million, including business owners, legal, and medical professionals. The Company offers responsiveness, flexibility and local decision making for loan applications of small business owners thereby eliminating delays caused by non-local management. The Company participates in local, state and federal loan programs.

## **Consumer Lending**

The Company offers its retail customer base a product line of consumer loan services including mortgage loans, first time home buyer mortgages, secured home equity loans, lines of credit, auto loans, and to a much lesser extent, unsecured personal loans.

## **Residential Mortgage Loans**

The Company offers a range of specialty home equity and mortgage products at competitive rates, which are retained and serviced by the Company. The Company seeks to capitalize on its policy of closing loans in a time frame that will meet the needs of its borrowers.

## **Commercial Mortgage/Construction Loans**

The Company originates various types of loans secured by real estate, including, to a limited extent, construction loans. Construction loans are generally priced at floating rates tied to current market rates. Upon completion of construction, these loans may be converted into permanent commercial and residential loans. Construction lending is expected to constitute a minor portion of the Company's loan portfolio.

In some cases, the Company originates loans larger than its lending limit and enters into participation arrangements for those loans with other banks.

As an independent community bank, the Company serves the special needs of legal, medical, accounting, financial service providers and other professionals. Commercial mortgages, lines of credit, term loans and demand loans are tailored to meet the needs of the Company's customers in the professional community. In addition to the usual criteria for pricing credit-related products, the Company takes into consideration the overall customer relationship to establish credit pricing. Deposit relationships in demand, savings, money market, and certificate accounts are considered in loan pricing along with the credit worthiness of the borrower.

## **Other Services**

To further attract and retain customer relationships, the Company currently provides or expects to provide the standard array of financial services expected of a community bank, which include the following:

ACH Origination	Credit/Debit Card Merchant Processing	Person to Person Payments
Apple Pay and Google Pay	Direct Deposit/ACH Services	Positive Pay
ATM and Debit Cards	Escrow Management Services	Remote Deposit Capture
Automated Teller Machines	Fraud Detection Services	Safe Deposit Boxes
Bank by Mail	Gift Cards	Treasurer Checks
Cash Management Services	Mobile Banking and Deposits	Wire Transfers
Certified Checks	Night Depository Services	
Commercial Credit Cards	On-Line Banking and Bill Pay	

## **Fee Income**

Fee income is non-interest related. The Company earns fee income by charging customers for banking services, credit card and merchant processing, treasurer's checks, overdrafts, wire transfers, check orders, cash management services, as well as other deposit and loan related fees. Unlike many in the industry, the Company does not sell its mortgages on the secondary market, nor does it offer trust or investment/brokerage services to its customers, all of which would generate additional fee income.

## **Service/Market Area**

The Company is headquartered in Hanover Township, Northampton County, Pennsylvania and draws its primary deposits and business from areas immediately surrounding its principal office and its branch offices in South Whitehall Township, Lower Macungie Township, the City of Bethlehem, Salisbury Township, Lower Saucon Township, Lower Nazareth Township, Borough of Nazareth, and Borough of Macungie, Pennsylvania, as well as the remainder of Lehigh and Northampton Counties in Pennsylvania.

According to Federal Deposit Insurance Corporation ("FDIC") data, as of June 30, 2019, the Company ranks 5<sup>th</sup> in market share in Northampton County with four (4) offices, and 6<sup>th</sup> in Lehigh County with five (5) offices, with a combined deposit market share of 7.28% for both counties. The Company believes there is significant room for organic growth in its current market area of Lehigh and Northampton Counties. The Company continually evaluates strategic locations for branch offices within the Lehigh Valley, which are supplemented by convenient access through electronic banking products and services, for both consumer and commercial customers. The Company currently has

nine (9) offices, inclusive of its Preview Center office in Macungie which opened in advance of its new permanent Macungie Office, scheduled to open in 2020.

## **Bank Premises**

The Company currently leases each of its bank operations premises, situated at the following locations:

Northampton County:

- Hanover Township (includes administrative offices)
- Lower Saucon Township
- Lower Nazareth Township
- Borough of Nazareth

Lehigh County:

- South Whitehall Township
- Salisbury Township
- Lower Macungie Township
- City of Bethlehem
- Borough of Macungie

The Company pays certain additional expenses of occupying these spaces including, but not necessarily limited to, real estate taxes, insurance, utilities and repairs. The Company is obligated under the leases to maintain the premises in good order, condition and repair.

## **Employees**

As of December 31, 2019, the Company had a total of 95 full-time equivalent employees.

## **Competition**

The geographic market the Company serves is highly competitive for deposits and loans. The Company competes with local, regional and national traditional banking institutions, as well as non-bank financial service providers such as credit unions, brokerage firms, insurance companies and mortgage companies. In the Company's primary market area, major regional and super-regional banks generally hold larger market share positions. By virtue of their larger capital bases, these institutions have significantly larger lending limits, more robust advertising campaigns, significantly larger branch networks, and can invest in technology on a larger scale. The industry, as a whole, competes primarily in the area of interest rates, products offered, customer service and convenience.

The Company believes it is able to compete within its market by offering competitive interest rates and a superior level of customer service, as reflected in our continued growth in market share. The recent consolidation of banks in the Company's market, due to mergers and acquisitions, has also provided additional opportunities for the Company to build and grow new customer relationships.

Credit unions present a significant competitive challenge to the Company. As credit unions currently enjoy an exemption from income tax, they are able to offer higher deposit rates and lower loan rates than banks can on a comparable basis. Credit unions, because they are not regulated by the FDIC, are also not currently subject to certain regulatory constraints imposed on the banks, such as the Community Reinvestment Act ("CRA"), which require the Company to implement procedures to make and monitor loans throughout the communities served. Adhering to such regulatory requirements raises the Company's compliance costs associated with lending activities and reduces potential operating profits. Accordingly, the Company competes by focusing on building customer relationships and maintaining the commitment to customer service the community has come to expect.

## **Segments**

The Company acts as an independent community financial services provider and offers traditional banking and related financial services to individual, business and government customers. The Company offers a full array of commercial and retail financial services, including the taking of time, savings and demand deposits; the making of commercial, consumer, residential mortgage and home equity loans; and the providing of other financial services.

Management does not separately allocate expenses, including the cost of funding loan demand, between commercial and retail operations of the Company. As such, discrete financial information is not available and segment reporting would not be meaningful.

## **Seasonality**

Management does not feel that the deposits, loans, or the business of the Company are seasonal in nature. Deposit and loan generation may, however, vary with local and national economic and market conditions which should not have a material effect on planning and policy making.

## **Supervision and Regulation**

The Company is subject to extensive regulation under federal and Pennsylvania banking laws, regulations and policies, including prescribed standards relating to capital, earnings, dividends, the repurchase or redemption of shares, loans or extensions of credit to affiliates and insiders, internal controls, information systems, internal audit systems, loan documentation, credit underwriting, asset growth, impaired assets and loan-to-value ratios. The Bank regulatory framework is intended primarily for the protection of depositors, federal deposit insurance funds and the banking systems as a whole, and not for the protection of shareholders.

The following summary sets forth certain of the material elements of the regulatory framework applicable to bank holding companies and their bank subsidiaries and provides certain specific information about the Company and the Bank. It does not describe all of the provisions of the statutes, regulations and policies that are identified. To the extent that the following information describes statutory and regulatory provisions, it is qualified in its entirety by express reference to each of the particular statutory and regulatory provisions. A change in applicable statutes, regulations or regulatory policy may have a material effect on the business of the Company.

### *Dodd-Frank Wall Street Reform and Consumer Protection Act*

As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), which became law on July 21, 2010, there is additional regulatory oversight and supervision of the Company and the Bank. The Dodd-Frank Act significantly changed the regulation of financial institutions and the financial services industry. The Dodd-Frank Act includes provisions affecting large and small financial institutions alike, including several provisions that affect the regulations of community banks and bank holding companies.

The Dodd-Frank Act, among other things, imposed new capital requirements on bank holding companies; changed the base for FDIC insurance assessments to a bank’s average consolidated total assets minus average tangible equity, rather than upon its deposit base; permanently raised the current standard deposit insurance limit to \$250,000; and expanded the FDIC’s authority to raise insurance premiums. The legislation also called for the FDIC to raise its ratio of reserves to deposits from 1.15% to 1.35% for deposit insurance purposes by September 30, 2020 and to “offset the effect” of increased assessments on insured depository institutions with assets of less than \$10 billion. On September 30, 2018 the deposit insurance fund reserve ratio reached 1.36%. Because the reserve ratio exceeded the 1.35%, small banks (total consolidated assets of less than \$10 billion) were awarded assessment credits for their portion of the assessment that contributed to the growth, to be applied when the reserve ratio was at least 1.38%. As of June 30, 2019, the ratio exceeded 1.38% and the Company received credits of \$206 thousand during the year ending December 31, 2019. The Company has a remaining assessment credit balance of \$44 thousand as of December 31, 2019.

The Dodd-Frank Act also includes provisions that affect corporate governance and executive compensation at all publicly traded companies and allows financial institutions to pay interest on business checking accounts. The

legislation also restricts proprietary trading, places restrictions on the owning or sponsoring of hedge and private equity funds, and regulates the derivatives activities of banks and their affiliates. The Dodd-Frank Act also establishes the Financial Stability Oversight Council to identify threats to the financial stability of the U.S., promote market discipline, and respond to emerging threats to the stability of the U.S. financial system.

#### *Consumer Financial Protection Bureau*

Through the Dodd-Frank Act, the Consumer Financial Protection Bureau (the “CFPB”) was established as an independent entity within the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”). The CFPB has broad rulemaking, supervisory and enforcement authority over consumer financial products and services, including deposit products, residential mortgages, home-equity loans and credit cards. The CFPB’s rules contain provisions on mortgage-related matters such as steering incentives, and determinations as to a borrower’s ability to repay, loan servicing, and prepayment penalties.

On January 10, 2013, the CFPB issued a final regulation defining a “qualified mortgage” for purposes of the Dodd-Frank Act, and setting standards for mortgage lenders to determine whether a consumer has the ability to repay the mortgage. This regulation, which became effective on January 10, 2014, also affords safe harbor legal protections for lenders making qualified loans that are not “higher priced.” On January 17, 2013, the CFPB issued a final regulation containing new mortgage servicing rules applicable to our bank subsidiary, which took effect on January 10, 2014. The announced goal of the CFPB is to bring greater consumer protection to the mortgage servicing market. These changes affect notices to be given to consumers in reference to delinquency, foreclosure alternatives, modification applications, interest rate adjustments and options for avoiding “force-placed” insurance. Servicers are also prohibited from processing foreclosures when a loan modification is pending, and must wait until a loan is more than 120 days delinquent before initiating a foreclosure action.

Additionally, the servicer must provide direct and ongoing access to its personnel, and provide prompt review of any loss mitigation application. Servicers must maintain accurate and accessible mortgage records for the life of a loan and until one year after the loan is paid off or transferred.

#### *Capital Standards*

In July 2013, the FDIC and the Federal Reserve Board approved final rules substantially amending the regulatory risk-based capital rules applicable to the Bank and the Company. The final rule implements the “Basel III” regulatory capital reforms and changes required by the Dodd-Frank Act.

The final rule includes a new minimum risk-based capital and leverage ratios, which became effective for the Bank and the Company on January 1, 2015, and refines the definition of what constitutes “capital” for purposes of calculating these ratios. The new minimum capital requirements are: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 to risk-based assets capital ratio of 6%; (iii) a total capital ratio of 8%; and (iv) a Tier 1 leverage ratio of 4%. The final rule also established a “capital conservation buffer” of 2.5%, and results in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0%; (ii) a Tier 1 to risk-based assets capital ratio of 8.5%; and (iii) a total capital ratio of 10.5%. In January 2016, the new capital conservation buffer requirement started being phased in at 0.625% of risk-weighted assets and was fully implemented as of January 2019 for the Company. An institution will be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations will establish a maximum percentage of eligible retained income that can be utilized for such actions.

In addition to the risk-based capital guidelines, the federal banking regulators established minimum leverage ratio (Tier 1 capital to total assets) guidelines for bank holding companies. These guidelines provide for a minimum leverage ratio of 3% for those bank holding companies which have the highest regulatory examination ratings and are not contemplating or experiencing significant growth or expansion. All other bank holding companies are required to maintain a leverage ratio of at least 4%.

The capital ratios to be considered “well capitalized” under current capital rules are: common equity of 6.5%, Tier 1 leverage of 5%, Tier 1 risk-based capital of 8%, and Total Risk-Based capital of 10%.

Effective in the third quarter of 2018, the Federal Reserve raised the consolidated asset limit to be considered a small bank holding company from \$1 billion to \$3 billion. A company that qualifies as a small bank holding company is not subject to the Federal Reserve's consolidated capital rules, although a company that so qualifies may continue to file reports that include such capital amounts and ratios. The Company elected to continue to report those amounts and ratios.

At December 31, 2019, the Company qualified as "well-capitalized" under the foregoing regulatory capital standards and exceeded the capital conservation buffers. See Note 12 of the Notes to Consolidated Financial Statements included in Item 8 of this Report.

#### *Capital Adequacy and Operations*

Enacted in 1991, the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") contains provisions limiting activities and business methods of depository institutions. FDICIA required the primary federal banking regulators to promulgate regulations setting forth standards relating to, among other things, internal controls and audit systems; credit underwriting and loan documentation; interest rate exposure and other off-balance sheet assets and liabilities; and compensation of directors and officers. FDICIA also provided for expanded regulation of depository institutions and their affiliates, including parent holding companies, by such institutions' primary federal banking regulator. Each primary federal banking regulator is required to specify, by regulation, capital standards for measuring the capital adequacy of the depository institutions it supervises and, depending upon the extent to which a depository institution does not meet such capital adequacy measures, the primary federal banking regulator may prohibit such institution from paying dividends or may require such institution to take other steps to become adequately capitalized.

FDICIA established five capital tiers, ranging from "well capitalized" to "critically under-capitalized". A depository institution is well capitalized if it significantly exceeds the minimum level required by regulation for each relevant capital measure. Under FDICIA, an institution that is not well capitalized is generally prohibited from accepting brokered deposits and offering interest rates on deposits higher than the prevailing rate in its market; in addition, "pass through" insurance coverage may not be available for certain employee benefit accounts. FDICIA also requires an undercapitalized depository institution to submit an acceptable capital restoration plan to the appropriate federal bank regulatory agency. One requisite element of such a plan is that the institution's parent holding company must guarantee compliance by the institution with the plan, subject to certain limitations. In the event of the parent holding company's bankruptcy, the guarantee, and any other commitments that the parent holding company has made to federal bank regulators to maintain the capital of its depository institution subsidiaries, would be assumed by the bankruptcy trustee and entitled to priority in payment.

At December 31, 2019, the Bank qualified as "well capitalized" under these regulatory capital standards. See Note 12 of the Notes to Consolidated Financial Statements included at Item 8 of this Report.

#### *Federal Deposit Insurance ("FDI") Act and Part 363 of the FDIC Regulations*

Section 36 of the FDI Act and Part 363 of the FDIC's regulations require insured depository institutions with at least \$500 million in total assets to file a Part 363 Annual Report with the applicable bank regulatory agencies, which, among other things, requires that the Company establish and maintain an effective internal control structure over financial reporting and provide an assessment by management of the institution's compliance with the designated laws and regulations pertaining to insider loans and dividend restrictions.

#### *Bank Holding Company Regulation*

As a bank holding company, the Company is subject to regulation and examination by the Pennsylvania Department of Banking and Securities (the "Pennsylvania Department of Banking") and the Federal Reserve Board. The Company is required to file with the Federal Reserve Board an annual report and such additional information as the Federal Reserve Board may require pursuant to the Bank Holding Company Act of 1956, as amended (the "BHC Act"). The BHC Act requires each bank holding company to obtain the approval of the Federal Reserve Board before

it may acquire substantially all the assets of any bank, or before it may acquire ownership or control of any voting shares of any bank if, after such acquisition, it would own or control, directly or indirectly, more than five percent of the voting shares of such bank. Such a transaction may also require approval of the Pennsylvania Department of Banking. Pennsylvania law permits Pennsylvania bank holding companies to control an unlimited number of banks.

Pursuant to provisions of the BHC Act and regulations promulgated by the Federal Reserve Board thereunder, the Company may only engage in or own companies that engage in activities deemed by the Federal Reserve Board to be so closely related to the business of banking or managing or controlling banks as to be a proper incident thereto, and the holding company must obtain permission from the Federal Reserve Board prior to engaging in most new business activities.

A bank holding company and its subsidiaries are subject to certain restrictions imposed by the BHC Act on any extensions of credit to the bank or any of its subsidiaries, investments in the stock or securities thereof, and on the taking of such stock or securities as collateral for loans to any borrower. A bank holding company and its subsidiaries are also prevented from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property or furnishing of services.

Under the Dodd-Frank Act and Federal Reserve Board regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, in serving as a source of strength to its subsidiary banks, a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve Board to be an unsafe and unsound banking practice or a violation of the Federal Reserve Board regulations or both. This doctrine is commonly known as the "source of strength" doctrine.

#### *Regulation of Embassy Bank for the Lehigh Valley*

Embassy Bank for the Lehigh Valley is a Pennsylvania-chartered banking institution and is subject to regulation, supervision and regular examination by the Pennsylvania Department of Banking and Securities and the FDIC. Federal and state banking laws and regulations govern, among other things, the scope of a bank's business, the investments a bank may make, the reserves against deposits a bank must maintain, the loans a bank makes and collateral it takes, the maximum interest rates a bank may pay on deposits, the activities of a bank with respect to mergers and consolidations, and the establishment of branches, and management practices and other aspects of banking operations.

#### *Dividend Restrictions*

The Company is a legal entity separate and distinct from the Bank. Declaration and payment of cash dividends depends upon cash dividend payments to the Company by the Bank, which is the Company's primary source of revenue and cash flow. Accordingly, the right of the Company, and consequently the right of our creditors and shareholders, to participate in any distribution of the assets or earnings of any subsidiary is necessarily subject to the prior claims of creditors of the subsidiary, except to the extent that claims of the Company in its capacity as a creditor may be recognized.

As a Pennsylvania chartered bank, the Bank is subject to regulatory restrictions on the payment and amounts of dividends under the Pennsylvania Banking Code. Further, the ability of banking subsidiaries to pay dividends is also subject to their profitability, financial condition, capital expenditures and other cash flow requirements. See Note 12 to the consolidated financial statements included at Item 8 of this Report.

The payment of dividends by the Bank and the Company may also be affected by other factors, such as the requirement to maintain adequate capital above regulatory guidelines. The federal banking agencies have indicated that paying dividends that deplete a depository institution's capital base to an inadequate level would be an unsafe and

unsound banking practice. Under the FDICIA of 1991, a depository institution may not pay any dividend if payment would cause it to become undercapitalized or if it already is undercapitalized. Moreover, the federal agencies have issued policy statements that provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings. Federal banking regulators have the authority to prohibit banks and bank holding companies from paying a dividend if the regulators deem such payment to be an unsafe or unsound practice.

#### *Community Reinvestment Act*

The Company had its last CRA examination in 2018 and received a “satisfactory” rating.

The Company’s Directors and Officers are committed to reaching out to the community in which they live and work. The personal, business and community rewards for helping local residents and businesses are numerous. The Board is dedicated to recognizing an ongoing commitment and understanding of the Company’s responsibility under the CRA. The Company is committed to providing access to credit and deposit products for all members of the communities that it serves.

#### *Restrictions on Transactions with Affiliates and Insiders*

The Bank also is subject to the restrictions of Sections 23A, 23B, 22(g) and 22(h) of the Federal Reserve Act and Regulation O adopted by the Federal Reserve Board. Section 23A requires that loans or extensions of credit to an affiliate, purchases of securities issued by an affiliate, purchases of assets from an affiliate (except as may be exempted by order or regulation), the acceptance of securities issued by an affiliate as collateral and the issuance of a guarantee or acceptance of letters of credit on behalf of an affiliate (collectively, “Covered Transactions”) be on terms and conditions consistent with safe and sound banking practices. Section 23A also imposes quantitative restrictions on the amount of and collateralization requirements on such transactions. Section 23B requires that all Covered Transactions and certain other transactions, including the sale of securities or other assets to an affiliate and the payment of money or the furnishing of services to an affiliate, be on terms comparable to those prevailing for similar transactions with non-affiliates.

Section 22(g) and 22(h) of the Federal Reserve Act impose similar limitations on loans and extensions of credit from the bank to its executive officers, directors and principal shareholders and any of their related interests. The limitations restrict the terms and aggregate amount of such transactions. Regulation O implements the provisions of Sections 22(g) and 22(h) and requires maintenance of records of such transactions by the bank and regular reporting of such transactions by insiders. The FDIC also requires the bank, upon request, to disclose publicly loans and extensions of credit to insiders in excess of certain amounts.

#### *Deposit Insurance and Premiums*

The deposits of the Bank are insured up to applicable limits per insured depositor by the FDIC. In October 2008, the FDIC increased FDIC deposit insurance coverage per separately insured depositor for all account types to \$250,000. This increase was extended permanently through the Dodd-Frank Act.

As a FDIC member institution, the Bank’s deposits are insured to the maximum of \$250,000 per depositor through the Deposit Insurance Fund (“DIF”) that is administered by the FDIC and each institution is required to pay quarterly deposit insurance premium assessments to the FDIC.

The Deposit Insurance Funds Act of 1996 recapitalized the Savings Association Insurance Fund (“SAIF”) and provided that DIF deposits would be subject to one-fifth of the assessment to which SAIF deposits are subject for FICO bond payments. Beginning in 2000, DIF deposits and SAIF deposits were subject to the same assessment for FICO bonds. The last of the remaining FICO bonds matured in September 2019 and therefore the last FICO assessment was collected in the first quarter of 2019.

*Other Federal Laws and Regulations*

State usury and credit laws limit the amount of interest and various other charges collected or contracted by a bank on loans. The Bank's loans are also subject to federal laws applicable to credit transactions, such as the following:

- Federal Truth-In-Lending Act, which governs disclosures of credit terms to consumer borrowers;
- Home Mortgage Disclosure Act, requiring financial institutions to provide information to enable public officials to determine whether a financial institution is fulfilling its obligations to meet the housing needs of the community it serves;
- Equal Credit Opportunity Act prohibiting discrimination on the basis of race, creed or other prohibitive factors in extending credit;
- Real Estate Settlement Procedures Act, which requires lenders to disclose certain information regarding the nature and cost of real estate settlements, and prohibits certain lending practices, as well as limits escrow account amounts in real estate transactions;
- Fair Credit Reporting Act governing the manner in which consumer debts may be collected by collection agencies; and
- Various rules and regulations of various federal agencies charged with the implementation of such federal laws.

Additionally, the Company's operations are subject to additional federal laws and regulations applicable to financial institutions, including, without limitation:

- Privacy provisions of the Gramm-Leach-Bliley Act and related regulations, which require the Company to maintain privacy policies intended to safeguard customer financial information, to disclose the policies to the Company's customers and to allow customers to "opt out" of having their financial service providers disclose their confidential financial information to non-affiliated third parties, subject to certain exceptions;
- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- Consumer protection rules for the sale of insurance products by depository institutions, adopted pursuant to the requirements of the Gramm-Leach-Bliley Act; and
- USA Patriot Act, which requires financial institutions to take certain actions to help prevent, detect and prosecute international money laundering and the financing of terrorism.

Effective July 1, 2010, a federal banking rule under the Electronic Fund Transfer Act prohibited financial institutions from charging consumers fees for paying overdrafts on automated teller machines ("ATM") and one-time debit card transactions, unless a consumer consents, or opts in, to the overdraft service for those type of transactions. If a consumer does not opt in, any ATM transaction or debit that overdraws the consumer's account will be denied. Overdrafts on the payment of checks and regular electronic bill payments are not covered by this new rule. Before opting in, the consumer must be provided a notice that explains the financial institution's overdraft services, including the fees associated with the service, and the consumer's choices. Financial institutions must provide consumers who do not opt in with the same account terms, conditions and features (including pricing) that they provide to consumers who do opt in. The Company did not charge customers for these transactions, nor provide these types of services.

*Sarbanes-Oxley Act of 2002*

Enacted in 2002, the Sarbanes-Oxley Act represented a comprehensive revision of laws affecting corporate governance, accounting obligations and corporate reporting. The Sarbanes-Oxley Act is applicable to all companies with equity securities registered or that file reports under the Securities Exchange Act of 1934, including publicly held bank holding companies such as the Company. In particular, the Sarbanes-Oxley Act establishes: (i) requirements for audit committees, including independence, expertise, and responsibilities; (ii) additional responsibilities regarding financial statements for the Chief Executive Officer and Chief Financial Officer of the reporting company; (iii) standards for auditors and regulation of audits; (iv) increased disclosure and reporting obligations for the reporting company and its directors and executive officers; and (v) new and increased civil and criminal penalties for violations of the securities laws.

### *Governmental Policies*

The Company's earnings are significantly affected by the monetary and fiscal policies of governmental authorities, including the Federal Reserve Board. Among the instruments of monetary policy used by the Federal Reserve Board to implement these objectives are open-market operations in U.S. Government securities and federal funds, changes in the discount rate on member bank borrowings and changes in reserve requirements against member bank deposits. These instruments of monetary policy are used in varying combinations to influence the overall level of bank loans, investments and deposits, and the interest rates charged on loans and paid for deposits. The Federal Reserve Board frequently uses these instruments of monetary policy, especially its open-market operations and the discount rate, to influence the level of interest rates and to affect the strength of the economy, the level of inflation or the price of the dollar in foreign exchange markets. The monetary policies of the Federal Reserve Board have had a significant effect on the operating results of banking institutions in the past and are expected to continue to do so in the future. It is not possible to predict the nature of future changes in monetary and fiscal policies, or the effect which they may have on the Company's business and earnings.

### *Other Legislative Initiatives*

Proposals may be introduced in the United States Congress and in the Pennsylvania Legislature and before various bank regulatory authorities which would alter the powers of, and restrictions on, different types of banking organizations and which would restructure part or all of the existing regulatory framework for banks, bank holding companies and other providers of financial services. Moreover, other bills may be introduced in Congress which would further regulate, deregulate or restructure the financial services industry, including proposals to substantially reform the regulatory framework. It is not possible to predict whether these or any other proposals will be enacted into law or, even if enacted, the effect which they may have on the Company's business and earnings.

### **Available Information**

The Company's common stock is registered under Section 12(g) of the Securities Exchange Act of 1934. Trades in Company common stock made by certain brokerage firms are reported on the OTCQX Market Tier of the OTC Markets under the symbol "EMYB". The Company is subject to the informational requirements of the Exchange Act, and, accordingly, electronically files annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy and information statements and other information with the SEC. You may obtain these reports and statements, and any amendments, from the SEC's website at [www.sec.gov](http://www.sec.gov). You may obtain copies of these reports, and any amendments, through our website at [www.embassybank.com](http://www.embassybank.com). These reports are available through our website as soon as reasonably practicable after they are filed electronically with the SEC.

The Company's headquarters are located at 100 Gateway Drive, in Hanover Township, Bethlehem, Pennsylvania 18017, and its telephone number is 1-610-882-8800. The Company has adopted a Code of Conduct/Ethics that applies to all directors and officers of the Company. This document is available in the Investor Relations section on the Company's website. The information included on the website and the Investor Relations page are not considered a part of this document.

### **Caution About Forward-looking Statements**

This report contains forward-looking statements, including statements of goals, intentions, and expectations as to future trends, plans, events or results of Company operations and policies and regarding general economic conditions. These forward-looking statements are intended to be covered by the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995. These statements are based upon current and anticipated economic conditions, nationally and in the Company's market, interest rates and interest rate policy, competitive factors and other conditions that, by their nature, are not susceptible to accurate forecast, and are subject to significant uncertainty.

Such forward-looking statements can be identified by the use of forward-looking terminology such as “believes”, “expects”, “may”, “intends”, “will”, “should”, “anticipates”, or the negative of any of the foregoing or other variations thereon or comparable terminology, or by discussion of strategy.

No assurance can be given that the future results covered by forward-looking statements will be achieved. Such statements are subject to risks, uncertainties, and other factors that could cause actual results to differ materially from future results expressed or implied by such forward-looking statements. Important factors that could impact the Company’s operating results include, but are not limited to, (i) the effects of changing economic conditions in the Company’s market areas and nationally, (ii) credit risks of commercial, real estate, consumer and other lending activities, (iii) significant changes in interest rates, (iv) changes in federal and state banking laws and regulations which could impact the Company’s operations, and (v) other external developments which could materially affect the Company’s business and operations including those described in this Report under section Item 1A – Risk Factors.

## **Item 1A. RISK FACTORS.**

Before investing in Embassy Bancorp, Inc. common stock, an investor should carefully consider the risk factors described below, which are not intended to be all inclusive, and review other information contained in this report and in our other filings with the SEC. The risks and uncertainties described below are not the only ones facing the Company. Additional risks and uncertainties that we are not aware of, or that we currently deem less significant, or that we otherwise are not specifically focused on, may also impact our business, results of operations, and our common stock. If any of these known or unknown risks or uncertainties actually occurs, our business, financial condition and results of operations could be materially and adversely affected. If this were to happen, the market price of our common stock could decline significantly, and an investor could lose all or part of his or her investment in the Company.

Unless the context otherwise requires, references to “we,” “us,” “our,” “Embassy,” or “Embassy Bancorp, Inc.,” collectively refer to Embassy Bancorp, Inc. and its banking subsidiary, and specific references to the “Bank” refer to Embassy Bank for the Lehigh Valley, the wholly-owned banking subsidiary of Embassy Bancorp, Inc.

### **Risks Related to Our Business**

#### ***Changes in interest rates may adversely affect our earnings and financial condition.***

Our ability to make a profit, like that of most financial institutions, substantially depends upon our net interest income, which is the difference between the interest income earned on interest earning assets, such as loans and investment securities, and the interest expense paid on interest-bearing liabilities, such as deposits and borrowings. Changes in interest rates can increase or reduce net interest income and net income.

Different types of assets and liabilities may react differently, and at different times, to changes in market interest rates. When interest-bearing liabilities mature or reprice more quickly than interest-earning assets in a period, an increase in market rates of interest could reduce net interest income. When interest-earning assets mature or reprice more quickly than interest-bearing liabilities, falling interest rates could reduce net interest income. Changes in market interest rates are affected by many factors beyond our control, including inflation, unemployment, money supply, international events, and events in the United States and other financial markets.

We attempt to manage risk from changes in market interest rates, in part, by controlling the mix of interest rate sensitive assets and interest rate sensitive liabilities. However, interest rate risk management techniques are not exact and a substantial, unexpected, prolonged or rapid change in interest rates could adversely affect our financial condition and results of operations.

#### ***We are subject to credit risk.***

As of December 31, 2019, approximately 49 percent of the Company’s loan portfolio consisted of commercial, construction, and commercial real estate loans. These types of loans are generally viewed as having more risk of default than residential real estate or secured consumer loans. These types of loans are also typically larger than residential real estate loans and consumer loans. Because our loan portfolio contains a significant number of commercial, construction and commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in non-performing loans. An increase in non-performing loans could result in a net loss of earnings from these loans, an increase in the provision for possible loan and lease losses and an increase in loan charge-offs, all of which could have a material adverse effect on our financial condition and results of operations.

#### ***Our allowance for loan and lease losses may be insufficient.***

We maintain an allowance for loan and lease losses, which is a reserve established that represents management’s best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan and lease losses and risks inherent in the loan

portfolio. The level of the allowance reflects management's continuing evaluation of industry concentrations; specific credit risks; loan loss experience; current loan portfolio quality; present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for possible loan and lease losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem credits and other factors, both within and outside of our control, may require an increase in the allowance. In addition, bank regulatory agencies periodically review our allowance for possible loan and lease losses and may require an increase in the provision for possible loan and lease losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance, we may need additional provisions to increase the allowance for possible loan and lease losses. Any increases in the allowance resulting from loan loss provisions will result in a decrease in net income and, possibly, capital, and may have a material adverse effect on our financial condition and results of operations.

***Our profitability depends significantly on economic conditions in Pennsylvania.***

Unlike larger or regional financial institutions that are more geographically diversified, our success is dependent to a significant degree on economic conditions in Pennsylvania, especially in Lehigh and Northampton Counties, which are the counties and markets primarily served by us in the years up to and including 2019. The banking industry is affected by general economic conditions, including the effects of inflation, recession, unemployment, real estate values, trends in national and global economics, and other factors beyond our control. An economic recession or a delayed recovery over a prolonged period of time in Pennsylvania, or more specific to the areas served by us, could cause an increase in the level of the Bank's non-performing assets and loan and lease losses, thereby causing operating losses, impairing liquidity, and eroding capital. We can give no assurance that adverse changes in the local economy would not have a material adverse effect on our consolidated financial condition, results of operations, and cash flows.

***Strong competition within our market area may limit our growth and profitability.***

Competition in the banking and financial services industry is intense. The geographic market the Company serves is highly competitive for deposits and loans. The Company competes with local, regional and national traditional banking institutions, as well as, non-bank financial service providers such as credit unions, brokerage firms, insurance companies and mortgage companies. In the Company's primary market area, major regional and super-regional banks generally hold larger market share positions. By virtue of their larger capital bases and greater financial resources, these institutions have significantly larger lending limits, more robust advertising campaigns, larger branch networks, and can invest in technology on a larger scale. The industry, as a whole, competes primarily in the area of interest rates, products offered, customer service and convenience. Our profitability depends upon our ability to successfully compete in our market area.

***The Basel III capital rules require us to maintain higher levels of capital, which could reduce our profitability.***

Basel III targets higher levels of base capital, certain capital buffers, and a migration toward common equity as the key source of regulatory capital. Although the new capital requirements were fully phased in as of January 1, 2019, Basel III signals a growing effort by domestic and international bank regulatory agencies to require financial institutions, including depository institutions, to maintain higher levels of capital. In the future, we may be required to maintain higher levels of capital, thus potentially reducing opportunities to invest capital into interest-earning assets, which could limit the profitable business operations available to us, and adversely impact our financial condition and results of operations.

***If our information systems are interrupted or sustain a breach in security, those events may negatively affect our financial performance and reputation.***

In conducting our business, we rely heavily on our information systems. Maintaining and protecting those systems and data is difficult and expensive, as is dealing with any failure, interruption, or breach in security of these systems,

whether due to acts or omissions by us or by a third party, and whether intentional or not. Any such failure, interruption, or breach could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan, and other systems. A breach of our information security may result from fraudulent activity committed against us or our customers, resulting in financial loss to us or our customers, or privacy breaches against our customers. Such fraudulent activity may consist of check fraud, electronic fraud, wire fraud, “phishing”, social engineering, identity theft, or other deceptive acts. The policies, procedures, and technical safeguards put in place by us to prevent or limit the effect of any failure, interruption, or security breach of our information systems and data may be insufficient to prevent or remedy the effects of any such occurrences. The occurrence of any failures, interruptions, or security breaches of our information systems and data could damage our reputation, cause us to incur additional expenses, result in online services or other businesses becoming inoperable, subject us to regulatory sanctions or additional regulatory scrutiny, or expose us to civil litigation and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

***Our business operations and interaction with customers are increasingly done via electronic means, and this has increased risks related to cyber security.***

We are exposed to the risk of cyber-attacks in the ordinary course of our business. In general, cyber incidents can result from deliberate attacks or unintentional events. An increased level of attention in the industry is focused on cyber-attacks that include, but are not limited to, gaining unauthorized access to digital systems for purposes of misappropriating assets or sensitive information, corrupting data, or causing operational disruption. To combat against these attacks, we have policies and procedures in place to prevent or limit the effect of the possible security breach of our information systems and we have insurance against some cyber-risks and attacks. While we have not incurred any material losses related to cyber-attacks, nor are we aware of any specific or threatened cyber-incidents as of the date of this report, we may incur substantial costs and suffer other negative consequences if we fall victim to successful cyber-attacks. Such negative consequences could include remediation costs, which may include liability for stolen assets or information and repairing system damage; deploying additional personnel and protection technologies, training employees, and engaging third party experts and consultants; lost revenues resulting from unauthorized use of proprietary information or the failure to retain or attract customers following an attack; litigation; and reputational damage adversely affecting customer or investor confidence.

***We operate in a highly regulated environment and may be adversely affected by changes in laws and regulations.***

We are subject to extensive regulation, supervision and examination by federal and state banking authorities. Any change in applicable regulations or federal, state or local legislation could have a substantial impact on us and our operations. Additional legislation and regulations that could significantly affect our powers, authority and operations may be enacted or adopted in the future, which could have a material adverse effect on our financial condition and results of operations. Further, regulators have significant discretion and authority to prevent or remedy unsafe or unsound practices or violations of laws by banks and bank holding companies in the performance of their supervisory and enforcement duties. The exercise of regulatory authority may have a negative impact on our results of operations and financial condition.

***We are required to make a number of judgments in applying generally accepted accounting standards and different estimates and assumptions in the application of these standards could result in a decrease in capital and/or other material changes to our reports of financial condition and results of operations.***

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses and reserve for unfunded lending commitments, the effectiveness of derivatives and other hedging activities, the fair value of certain financial instruments (securities, derivatives, and privately held investments), income tax assets or liabilities (including deferred tax assets and any related valuation allowance), share-based compensation, and accounting for acquisitions, including the fair value determinations and the analysis of goodwill impairment. While we have identified those accounting policies that are considered critical and have procedures in place to facilitate the associated judgments, different assumptions in the application of these standards could result in a decrease to net income and, possibly, capital and may have a material adverse effect on our financial condition and results of operations. From time to time, the Financial Accounting Standards Board and the SEC issues changes to or

updated interpretations of the financial accounting and reporting guidance that governs the preparation of our financial statements. These changes are beyond our control, can be difficult to predict, and could materially impact how we report our financial condition and results of operations. We could be required to apply new or revised guidance retrospectively, which may result in the revision of prior financial statements by material amounts. The implementation of new or revised guidance could also result in material adverse effects to our reported capital.

***Our controls and procedures may fail or could be circumvented.***

Management has implemented a series of internal controls, disclosure controls and procedures, and corporate governance policies and procedures in order to ensure accurate financial control and reporting. However, any system of controls, no matter how well designed and operated, can only provide reasonable, not absolute, assurance that the objectives of the system are met. Any failure or circumvention of our controls and/or procedures could have a material adverse effect on our business and results of operation and financial condition.

***Prior levels of market volatility were unprecedented and future volatility may have materially adverse effects on our liquidity and financial condition.***

In the not too distant past, the capital and credit markets experienced extreme volatility and disruption. In some cases, the markets exerted downward pressure on stock prices, security prices, and credit availability for certain issuers without regard to their underlying financial strength. If such levels of market disruption and volatility return, there can be no assurance that we will not experience adverse effects, which may materially affect our liquidity, financial condition, and profitability.

***Our banking subsidiary may be required to pay higher FDIC insurance premiums or special assessments which may adversely affect our earnings.***

Poor economic conditions and the resulting bank failures from the most recent recession have stressed the Deposit Insurance Fund and increased the costs of our FDIC insurance assessments. Additional bank failures may prompt the FDIC to increase its premiums above the recently increased levels or to issue special assessments. We are generally unable to control the amount of premiums or special assessments that our banking subsidiary is required to pay for FDIC insurance. Any future changes in the calculation or assessment of FDIC insurance premiums may have a material adverse effect on our results of operations, financial condition, and our ability to continue to pay dividends on our common stock at the current rate or at all.

***If we conclude that the decline in the value of any of our investment securities is other than temporary, we are required to write down the value of that security through a charge to earnings.***

We review our investment securities portfolio at each quarter-end reporting period to determine whether the fair value of individual securities or the portfolio as a whole is below the current carrying value. When the fair value of any of our investment securities has declined below its carrying value, we are required to assess whether the decline is other than temporary. If we conclude that the decline is other than temporary, we are required to write down the value of that security through a charge to earnings. Due to the complexity of the calculations and assumptions used in determining whether an asset is impaired, the impairment disclosed, or lack thereof, may not accurately reflect the actual impairment in the future.

***Our financial performance may suffer if our information technology is unable to keep pace with our growth or industry developments.***

Effective and competitive delivery of our products and services is increasingly dependent upon information technology resources and processes, both those provided internally as well as those provided through third party vendors. In addition to better serving customers, the effective use of technology increases efficiency and enables us to reduce costs. Our future success will depend, in part, upon our ability to address the needs of our customers by using technology to provide products and services to enhance customer convenience, as well as to create additional efficiencies in our operations. Many of our competitors have greater resources to invest in technological

improvements. Additionally, as technology in the financial services industry changes and evolves, keeping pace becomes increasingly complex and expensive for us. Our failure to timely and effectively implement technological advances could adversely affect our financial condition and results of operations.

***We are highly reliant on third party vendors and our ability to manage the operational risks associated with outsourcing those services.***

We rely on third parties to provide services that are integral to our operations. These vendors provide services that support our operations, including the storage and processing of sensitive consumer and business customer data, as well as our sales efforts. A cyber security breach of a vendor's system may result in theft of our data or disruption of business processes. In most cases, we will remain primarily liable to our customers for losses arising from a breach of a vendor's data security system. We rely on our outsourced service providers to implement and maintain prudent cyber security controls. We have procedures in place to assess a vendor's cyber security controls prior to establishing a contractual relationship and to periodically review assessments of those control systems; however, these procedures are not infallible, and a vendor's system can be breached despite the procedures we employ. We cannot be sure that we will be able to maintain these relationships on favorable terms. The loss of these vendor relationships could disrupt the services we provide to our customers and cause us to incur expense in connection with replacing these services.

***Loss of our senior executive officers or other key employees could impair our relationship with our customers and adversely affect our business.***

We have assembled a senior management team which has substantial background and experience in banking and financial services in the markets we serve. Loss of these key personnel could negatively impact our earnings because of their skills, customer relationships and/or the potential difficulty of promptly replacing them.

***The soundness of other financial institutions may adversely affect us.***

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and routinely execute transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose us to credit risk in the event of a default by a counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be readily realized or liquidated at prices sufficient to recover the full amount of the credit or derivative exposure due to us. Any such losses could have a material adverse effect on our financial condition and results of operations.

***Acts of terrorism, natural disasters, global climate change, pandemics and global conflicts may have a negative impact on our business and operations.***

Acts of terrorism, natural disasters, global climate change, pandemics, global conflicts or other similar events could have a negative impact on our business and operations. While we have in place business continuity plans, such events could still damage our facilities, disrupt or delay the normal operations of our business (including communications and technology), result in harm to or cause travel limitations on our employees, and have a similar impact on our clients, suppliers, third-party vendors and counterparties. These events also could impact us negatively to the extent that they result in reduced capital markets activity, lower asset price levels, or disruptions in general economic activity in the United States or abroad, or in financial market settlement functions. In addition, these or similar events may impact economic growth negatively, which could have an adverse effect on our business and operations, and may have other adverse effects on us in ways that we are unable to predict.

***Negative public opinion could damage our reputation and adversely affect our earnings.***

Reputational risk, or the risk to our earnings and capital from negative public opinion, is inherent in our business. Negative public opinion can result from the actual or perceived manner in which we conduct our business activities, including banking operations, our management of actual or potential conflicts of interest and ethical issues, and our protection of confidential client information. Negative public opinion can adversely affect our ability to keep and

attract customers and can expose us to litigation and regulatory action. Although we take steps to minimize reputation risk in the way we conduct our business activities and deal with our customers, communities and vendors, these steps may not be effective.

## **Risks Related to Our Common Stock**

***The trading volume in our common stock is less than that of larger public companies, which can contribute to volatility in our stock price and adversely affect the liquidity of an investment in our common stock.***

Our common stock is not traded on a security exchange. Trades in our stock made by certain brokerage firms are reported on the OTCQX Market Tier of the OTC Markets, but trading in our stock is sporadic. The trading history of our common stock has been characterized by relatively low trading volume. This lack of an active public market means that the value of a shareholder's investment in our common stock may be subject to sudden fluctuations, as individual trades have a greater effect on our reported trading price than would be the case in a broad public market with significant daily trading volume.

The market price of our common stock may also be subject to fluctuations in response to numerous other factors, including the factors discussed in this report, regardless of our actual operating performance. The possibility of such fluctuations occurring is increased due to the illiquid nature of the trading market of our common stock. Therefore, a shareholder may be unable to sell our common stock at or above the price at which it was purchased, at or above the current market price, or at the time of his, her or its choosing.

***Our insiders control a substantial percentage of our stock and therefore have the ability to exercise significant control over our affairs.***

As of December 31, 2019, our directors and executive officers beneficially owned in excess of 26% of our issued and outstanding common stock on a fully diluted basis. Such persons, as a group, will have sufficient votes to strongly influence the outcome of all matters submitted to our shareholders, including the election of directors. This concentration of ownership might also have the effect of delaying or preventing a change in control of our company.

***If we need to, or are compelled to, raise additional capital in the future, that capital may not be available when it is needed and on terms favorable to current shareholders.***

Federal banking regulators require us and our bank subsidiary to maintain adequate levels of capital to support our operations. These capital levels are determined and dictated by law, regulation and bank regulatory agencies. In addition, capital levels are also determined by our management and board of directors based on capital levels that they believe are necessary to support our business operations. As of December 31, 2019, all three capital ratios for us and our banking subsidiary were above "well capitalized" levels under current bank regulatory guidelines.

Our ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside of our control, and on our financial performance. Accordingly, we cannot assure you of our ability to raise additional capital on terms and time frames acceptable to us or to raise additional capital at all. If we cannot raise additional capital in sufficient amounts when needed, our ability to comply with regulatory capital requirements could be materially impaired. Additionally, the inability to raise capital in sufficient amounts may adversely affect our operations, financial condition and results of operating. Our ability to borrow could also be impaired by factors that are nonspecific to us, such as severe disruption of the financial markets or negative news and expectations about the prospects for the financial services industry as a whole as evidenced by recent turmoil in the domestic and worldwide credit markets. If we raise capital through the issuance of additional shares of our common stock or other securities, we would likely dilute the ownership interests of current investors and could dilute the per share book value and earnings per share of our common stock. Furthermore, a capital raise through issuance of additional shares of common stock may have an adverse impact on our stock price.

***Our common stock is equity and is subordinate to all of our existing and future indebtedness.***

Shares of our common stock are equity interests in our company and do not constitute indebtedness. As such, shares of our common stock rank junior to all indebtedness and other non-equity claims on us with respect to assets available to satisfy claims on us, including in a liquidation of us. Also, our right to participate in a distribution of assets upon the Bank's liquidation or reorganization is subject to the prior claims of the Bank's creditors, including the preferred claims of the Bank's depositors.

***Our ability to pay dividends on our common stock, and principal and interest on our debt, depends primarily on dividends from our banking subsidiary, which is subject to regulatory limits.***

Embassy Bancorp, Inc. is a bank holding company and its operations are conducted by its direct and indirect subsidiaries, primarily the Bank. Our ability to pay dividends on our common stock and principal and interest on our debt depends on our receipt of dividends from the Bank. Dividend payments from the Bank are subject to legal and regulatory limitations, generally based on net profits and retained earnings, imposed by the various banking regulatory agencies. The ability of the Bank to pay dividends is also subject to profitability, financial condition, liquidity, and capital management limits. There is no assurance that our subsidiary will be able to pay dividends in the future or that we will generate adequate cash flow to pay dividends in the future. Federal Reserve policy, which applies to us as a registered bank holding company, also provides that dividends by bank holding companies should generally be paid out of earnings from both the current period and a designated look-back period. Our failure to pay dividends on our common stock could have a material adverse effect on the market price of our common stock.

***Provisions of our articles of incorporation and bylaws, Pennsylvania law, state and federal banking regulations, and our significant percentage of insider ownership, could act to delay or prevent a takeover by a third party.***

Various Pennsylvania laws affecting business corporations may have the effect of discouraging offers to acquire us, even if the acquisition would be advantageous to our shareholders. By incorporating under Pennsylvania law, our board of directors owes its fiduciary duty solely to the corporation. As such, Pennsylvania law does require a director to act solely because of the effect such action might have on an acquisition or potential acquisition of control of the corporation or the consideration that might be offered or paid to shareholders in such an acquisition. Additionally, Pennsylvania law:

- expands the factors and groups which a corporation's board of directors can consider in determining whether an action is in the best interests of the corporation, including the effect of such action on its shareholders, employees, suppliers, customers, creditors and communities;
- provides that a corporation's board of directors need not consider the interests of any particular group (including the shareholders) as dominant or controlling;
- provides that a corporation's directors, in order to satisfy the presumption that they have acted in the best interests of the corporation, need not satisfy any greater obligation or higher burden of proof with respect to actions relating to an acquisition or potential acquisition of control; and
- provides that actions relating to acquisitions of control that are approved by a majority of "disinterested directors" are presumed to satisfy the directors' standard, unless it is proven by clear and convincing evidence that the directors did not assent to such action in good faith after reasonable investigation.

In addition, we have various anti-takeover measures in place under our articles of incorporation and bylaws, including a supermajority vote requirement for mergers, advance notice requirements for nominations for election of directors and the presentation of shareholder proposals at meetings of shareholders, a staggered Board of Directors, and the absence of cumulative voting.

Further, federal and state banking laws and regulations generally require filings and approvals prior to certain transactions that would result in a party acquiring control of our company.

Any one or more of these laws or measures, particularly when coupled with the fact that our insiders hold approximately 26% of our voting shares, may impede the takeover of us and may prevent our shareholders from taking part in a transaction in which they could realize a premium over the current market price of our common stock.

***Our common stock is not insured by any governmental entity.***

Our common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund or by any other public or private entity. Investment in our common stock is inherently risky for the reasons described in this “Risk Factors” section. As a result, if you acquire our common stock, you may lose some or all of your investment.

**Item 1B. UNRESOLVED STAFF COMMENTS.**

None.

**Item 2. PROPERTIES.**

The Company, through the Bank, occupies nine full-service banking offices in the Lehigh Valley:

Northampton County:

- Hanover Township (includes administrative offices)
- Lower Saucon Township
- Lower Nazareth Township
- Borough of Nazareth

Lehigh County:

- South Whitehall Township
- Salisbury Township
- Lower Macungie Township
- City of Bethlehem
- Borough of Macungie

All properties are currently leased.

**Item 3. LEGAL PROCEEDINGS.**

The Company and the Bank are an occasional party to legal actions arising in the ordinary course of its business. In the opinion of management, the Company has adequate legal defenses and/or insurance coverage respecting any and each of these actions and does not believe that they will materially affect the Company's operations or financial position.

**Item 4. MINE SAFETY DISCLOSURES.**

Not applicable.

## PART II

**Item 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.**

- (a) Shares of Company common stock are traded over-the-counter and in privately negotiated transactions. The Company’s common stock is not listed on any national securities exchange.

Trades in Company common stock made by certain brokerage firms are reported on the OTCQX Market Tier of the OTC Markets under the symbol “EMYB”. The following table reflects high and low bid prices for shares of the Company’s common stock for the periods indicated, based upon information derived from www.otcm Markets.com.

	2019		2018	
	High	Low	High	Low
First Quarter	\$ 15.51	\$ 14.30	\$ 18.00	\$ 15.75
Second Quarter	\$ 16.99	\$ 15.07	\$ 17.33	\$ 16.08
Third Quarter	\$ 16.90	\$ 15.80	\$ 18.35	\$ 17.05
Fourth Quarter	\$ 18.97	\$ 16.00	\$ 17.81	\$ 14.06

The above quotations may not reflect inter-dealer prices and should not be considered over-the-counter market quotations as that term is customarily used.

- (b) As of March 6, 2020, there are approximately 913 owners of record of the common stock of the Company.
- (c) On September 30, 2019, the Company paid \$1,495,385 or \$0.20 per share, in an annual cash dividend on its common stock. On September 30, 2018, the Company paid \$1,270,706, or \$0.17 per share, in an annual cash dividend on its common stock. As a general matter, cash available for dividend distribution to shareholders of the Company may come from dividends paid to the Company by the Bank, depending upon existing cash levels at the Company. See “Supervision and Regulation – Dividend Restrictions” in Item 1 of this report for a description of restrictions that may limit the Company’s ability to pay dividends on its common stock.
- (d) The following table sets forth information about options outstanding under the Company’s shareholder approved Stock Incentive Plan, as of December 31, 2019:

	Number of Shares to be issued upon exercise of outstanding options	Weighted average exercise price of outstanding options	Number of Shares remaining available for future issuance
Equity Compensation Plans and Individual Employment Agreements	116,243	\$ 7.34	500,000

- (e) Sales of Securities.  
None.
- (f) Repurchase of Equity Securities.

There were no shares of common stock repurchased by the Company in 2019. The Company has not publicly announced any purchase plan or program.

**Item 6. SELECTED FINANCIAL DATA.**

Not required.

## **Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

This discussion and analysis provides an overview of the consolidated financial condition and results of operations of the Company for the years ended December 31, 2019 and 2018. This discussion should be read in conjunction with the consolidated financial statements and notes to consolidated financial statements appearing elsewhere in this report.

### **Critical Accounting Policies**

Note 1 to the Company's consolidated financial statements lists significant accounting policies used in the development and presentation of its financial statements. This discussion and analysis, the significant accounting policies, and other financial statement disclosures identify and address key variables and other qualitative and quantitative factors that are necessary for an understanding and evaluation of the Company and its results of operations.

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, which require the Company to make estimates and assumptions. The Company believes that its determination of the allowance for loan losses and the valuation of deferred tax assets involve a higher degree of judgment and complexity than the Company's other significant accounting policies. Further, these estimates can be materially impacted by changes in market conditions or the actual or perceived financial condition of the Company's borrowers, subjecting the Company to significant volatility of earnings.

Securities classified as available for sale are those securities that the Company intends to hold for an indefinite period of time, but not necessarily to maturity. Securities available for sale are carried at fair value. Any decision to sell a security classified as available for sale would be based on various factors, including significant movement in interest rates, changes in maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations and other similar factors. Unrealized gains and losses are reported as increases or decreases in other comprehensive income. Realized gains or losses, determined on the basis of the cost of the specific securities sold, are included in earnings. Premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

Other-than-temporary impairment accounting guidance specifies that (a) if a company does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. When an entity does not intend to sell the security, and it is more likely than not the entity will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. The Company recognized no other-than-temporary impairment charges during the years ended December 31, 2019 and 2018.

The allowance for loan losses is established through the provision for loan losses, which is a charge against earnings. Provision for loan losses is made to reserve for estimated probable losses on loans. The allowance for loan losses is a significant estimate and is regularly evaluated by the Company for adequacy by taking into consideration factors such as changes in the nature and volume of the loan portfolio, trends in actual and forecasted credit quality, including delinquency, charge-off and bankruptcy rates, and current economic conditions that may affect a borrower's ability to pay. The use of different estimates or assumptions could produce different provision for loan losses. For additional discussion concerning the Company's allowance for loan losses and related matters, see "Provision for Loan Losses" and "Allowance for Loan Losses."

Real estate acquired through foreclosure, or deed-in-lieu of foreclosure is recorded at fair value less estimated selling costs at the date of acquisition or transfer, and subsequently at the lower of its new cost or fair value less estimated selling costs. Adjustments to the carrying value at the date of acquisition or transfer are charged to the allowance for loan losses. The carrying value of the individual properties is subsequently adjusted to the extent it exceeds estimated fair value less the estimated selling costs, at which time a provision for loan losses on such real estate is charged to operations. Appraisals are critical in determining the value of properties. Overly optimistic assumptions or negative

changes to assumptions could significantly affect the valuation of a property. The assumptions supporting such appraisals are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable.

Deferred taxes are provided on the asset and liability method whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and net operating loss carryforwards and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion of the deferred tax assets will not be realized. Based upon the level of historical taxable income and projections for future taxable income over periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences.

## **GENERAL**

The Company is a Pennsylvania corporation organized in 2008 and registered as a bank holding company pursuant to the Bank Holding Company Act of 1956, as amended (the “BHC Act”). The Company was formed for purposes of acquiring Embassy Bank For The Lehigh Valley (the “Bank”) in connection with the reorganization of the Bank into a bank holding company structure, which was consummated on November 11, 2008. Accordingly, the Company owns all of the capital stock of the Bank, giving the organization more flexibility in meeting its capital needs as the Company continues to grow.

The Bank, which is the Company’s primary operating subsidiary, was originally incorporated as a Pennsylvania bank on May 11, 2001 and opened its doors on November 6, 2001. It was formed by a group of local business persons and professionals with significant prior experience in community banking in the Lehigh Valley area of Pennsylvania, the Bank’s primary market area.

Since its inception, the Board’s philosophy has been that, by running the Bank with a view toward the long term, only good things will happen for the Bank’s customers, team members, shareholders and the Lehigh Valley community.

## **OVERVIEW**

The Company’s assets grew \$76.7 million from \$1.1 billion at December 31, 2018 to \$1.18 billion at December 31, 2019. The Company’s deposits grew \$100.5 million from \$931.5 million at December 31, 2018 to \$1.03 billion at December 31, 2019. The growth in the Company’s deposits resulted primarily from a relationship building, sales and marketing effort, which served to further increase the Company’s overall presence in the market it serves, along with deposit relationships developed as a result of cross-marketing efforts to its loan and other non-depository banking service customers. The Bank also continued to capitalize on opportunities created by recent merger announcements, name changes, and competitive branch closures in the Company’s market area, attracting customers looking to relocate to a local, reputable community bank. During the same period, loans receivable, net of the allowance for loan losses, increased \$56.2 million to \$1.01 billion at December 31, 2019 from \$949.9 million at December 31, 2018. The market is very competitive and the Company is committed to maintaining a high quality portfolio that returns a reasonable market rate. While the past and current economic and competitive conditions in the marketplace have created more competition for loans to credit-worthy customers, the Company anticipates that its lending activity will continue to be strong in the short-term, as the Company expands its market presence and continues to focus on developing a reputation as being a market leader in both commercial and consumer/mortgage lending. Management believes that this combination of relationship building, cross marketing and responsible underwriting will translate into continued growth of a portfolio of quality loans and core deposit relationships, although there can be no assurance of this. The Company continues to monitor interest rate exposure of its interest bearing assets and liabilities and believes that it is well positioned for any anticipated future market rate adjustments.

The Company’s net income increased \$800 thousand, or 7.9%, to \$10.9 million from \$10.1 million in 2018. Diluted earnings per share increased to \$1.44 in 2019 from \$1.34 in 2018, and basic earnings per share increased to \$1.46 in 2019 from \$1.35 in 2018, respectively. The difference in net income for the year ended December 31, 2019 and

December 31, 2018 resulted, in part, from an increase in interest income due to the Company's growing loan portfolio and increase in yields, the change in the mix of the Company's investment portfolio, an increase in other income, in part due to our growing customer base and increase in bank owned life insurance, offset by an increase in interest expense due to the Company's growth in interest bearing liability balances and rates and increase in non-interest expenses. Non-interest expenses increased, in part, from an increase in salaries and benefits of \$652 thousand, primarily due to an increase in the full-time equivalent employees from ninety-one (91) at December 31, 2018 to ninety-five (95) at December 31, 2019 and annual increases in salaries and benefits.

## **RESULTS OF OPERATIONS**

### **Net Interest Income and Net Interest Margin**

The majority of the Company's earnings is from net interest income, which is the difference between income earned on assets and the cost supporting those assets. The net interest margin is the ratio of net interest income to average earning assets. Earning assets are composed primarily of loans and investments. Interest-bearing deposits and borrowings make up the cost of funds. Non-interest bearing deposits and capital are other components representing funding sources. Changes in the volume and mix of assets and funding sources, along with the changes in yields earned and rates paid, determine changes in net interest income and net interest margin. The timing of deposit and loan growth also impact net interest income.

### **2019 Compared to 2018**

Total interest income for the year ended December 31, 2019 was \$42.9 million, compared to \$38.7 million for the year ended December 31, 2018. Total interest expense for the year ended December 31, 2019 was \$9.3 million, compared to \$6.1 million for the year ended December 31, 2018. The increase in interest income is due to the growth in the balances and increases in yields of taxable loans, the taxable investment portfolio and interest bearing deposits with banks, offset by a decrease in the balances and yields in the non-taxable investment portfolio. The increase in interest expense is, in part, due to an increase in the yields on deposits from changes in competitive pressure on deposit rates which resulted in deposit promotions. Interest expense increased from an increase in yields on interest bearing demand deposits, NOW and money markets, savings, certificates of deposit, securities sold under agreements to repurchase and FHLB borrowings and an increase in the balances of interest bearing demand deposits, NOW and money markets, and certificates of deposit, offset by a decrease in the balances of savings and securities sold under agreements to repurchase and FHLB borrowings. Net interest income increased 3.0% to \$33.5 million for the year ended December 31, 2019 as compared to \$32.6 million for the year ended December 31, 2018.

Generally, changes in net interest income are measured by net interest rate spread and net interest margin. Interest rate spread is the mathematical difference between the average interest earned on earning assets and interest paid on interest bearing liabilities. Interest margin represents the net interest yield on earning assets. The interest margin gives a reader a better indication of asset earning results when compared to peer groups or industry standards.

The Company determines interest rate spread and margin on both a GAAP and tax equivalent basis. The use of tax equivalent basis in determining interest rate spread and margin is considered a non-GAAP measure. The Company believes use of this measure provides meaningful information to the reader of the consolidated financial statements when comparing taxable and non-taxable assets. However, it is supplemental to GAAP which is used to prepare the Company's consolidated financial statements and should not be read in isolation or relied upon as a substitute for GAAP measures. In addition, the non-GAAP measure may not be comparable to non-GAAP measures of other companies. The tax rate used to calculate the tax equivalent adjustments was 21% for 2019 and 2018, and 34% for 2017.

The Company's net interest margin for the year ended December 31, 2019 was 3.06% on a GAAP basis and 3.09% on a non-GAAP basis, compared to 3.19% on a GAAP basis and 3.23% on a non-GAAP basis for the year ended December 31, 2018. The decrease in the margin is due primarily to the increase in the balance and yields of interest bearing demand deposits, NOW and money markets and certificates of deposit, in part due to deposit promotions, offset by the increased yields on the taxable loan and taxable investment portfolio and coupled with the significant

growth in the taxable loan portfolio and decrease in savings, securities sold under agreements to repurchase and FHLB borrowings. During this market environment, the Company continued to grow and attract deposits and loans at competitive rates.

The following table includes the average balances, interest income and expense and the average rates earned and paid for assets and liabilities for the periods presented. All average balances are daily average balances.

**Average Balances, Rates and Interest Income and Expense**

	<u>Year Ended December 31, 2019</u>			<u>Year Ended December 31, 2018</u>			<u>Year Ended December 31, 2017</u>		
	<u>Average Balance</u>	<u>Interest</u>	<u>Tax Equivalent Yield</u>	<u>Average Balance</u>	<u>Interest</u>	<u>Tax Equivalent Yield</u>	<u>Average Balance</u>	<u>Interest</u>	<u>Tax Equivalent Yield</u>
(Dollars in Thousands)									
<b>ASSETS</b>									
Loans - taxable (2)	\$ 970,232	\$ 39,390	4.06%	\$ 904,809	\$ 35,516	3.93%	\$ 816,235	\$ 31,257	3.83%
Loans - non-taxable (1)	7,862	246	3.96%	8,454	261	3.91%	9,051	276	4.62%
Investment securities - taxable	62,157	1,614	2.60%	54,980	1,321	2.40%	53,641	930	1.73%
Investment securities - non-taxable (1)	29,770	990	4.21%	35,785	1,249	4.42%	38,436	1,311	5.17%
Federal funds sold	780	16	2.11%	557	10	1.79%	925	10	1.08%
Interest bearing deposits with banks	24,940	606	2.43%	16,155	334	2.07%	25,511	296	1.16%
<b>TOTAL INTEREST EARNING ASSETS</b>	<b>1,095,741</b>	<b>42,862</b>	<b>3.94%</b>	<b>1,020,740</b>	<b>38,691</b>	<b>3.83%</b>	<b>943,799</b>	<b>34,080</b>	<b>3.70%</b>
Less allowance for loan losses	(7,651)			(7,387)			(6,723)		
Other assets	51,125			37,353			35,267		
<b>TOTAL ASSETS</b>	<b>\$ 1,139,215</b>			<b>\$ 1,050,706</b>			<b>\$ 972,343</b>		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>									
Interest bearing demand deposits, NOW and money market	\$ 158,944	\$ 1,094	0.69%	\$ 118,792	\$ 255	0.21%	\$ 110,149	\$ 100	0.09%
Savings	430,682	2,155	0.50%	477,881	2,323	0.49%	505,186	2,458	0.49%
Certificates of deposit	251,401	5,731	2.28%	169,679	2,877	1.70%	135,737	1,725	1.27%
Securities sold under agreements to repurchase and other borrowings	20,883	349	1.67%	43,568	682	1.57%	11,830	22	0.19%
<b>TOTAL INTEREST BEARING LIABILITIES</b>	<b>861,910</b>	<b>9,329</b>	<b>1.08%</b>	<b>809,920</b>	<b>6,137</b>	<b>0.76%</b>	<b>762,902</b>	<b>4,305</b>	<b>0.56%</b>
Non-interest bearing demand deposits	163,485			150,615			124,828		
Other liabilities	19,533			6,873			6,692		
Stockholders' equity	94,287			83,298			77,921		
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 1,139,215</b>			<b>\$ 1,050,706</b>			<b>\$ 972,343</b>		
Net interest income	\$ 33,533			\$ 32,554			\$ 29,775		
Tax equivalent adjustments:									
Loans	65			69			142		
Investments	263			332			676		
Total tax equivalent adjustments	328			401			818		
Net interest income on a tax equivalent basis	\$ 33,861			\$ 32,955			\$ 30,593		
Net interest spread (GAAP basis)			2.83%			3.03%			3.05%
Net interest margin (GAAP basis)			3.06%			3.19%			3.15%
Net interest spread (non-GAAP basis)			2.86%			3.07%			3.14%
Net interest margin (non-GAAP basis)			3.09%			3.23%			3.24%

(1) Yields on tax exempt assets have been calculated on a fully tax equivalent basis.

(2) The average balance of taxable loans includes loans in which interest is no longer accruing.

The table below demonstrates the relative impact on net interest income of changes in the volume of interest-earning assets and interest-bearing liabilities and changes in rates earned and paid by the Company on such assets and liabilities.

	2019 vs. 2018			2018 vs. 2017		
	Increase (decrease) due to changes in:			Increase (decrease) due to changes in:		
	Volume	Rate	Total	Volume	Rate	Total
(In Thousands)						
<b>Interest-earning assets:</b>						
Loans - taxable	\$ 2,568	\$ 1,306	\$ 3,874	\$ 3,392	\$ 867	\$ 4,259
Loans - non-taxable	(18)	3	(15)	(18)	3	(15)
Investment securities - taxable	172	121	293	23	368	391
Investment securities - non-taxable	(210)	(49)	(259)	(90)	28	(62)
Federal funds sold	4	2	6	(4)	4	-
Interest bearing deposits with banks	182	90	272	(109)	147	38
Total net change in income on interest-earning assets	2,698	1,473	4,171	3,194	1,417	4,611
<b>Interest-bearing liabilities:</b>						
Interest bearing demand deposits, NOW and money market	86	753	839	8	147	155
Savings	(229)	61	(168)	(133)	(2)	(135)
Certificates of deposit	1,386	1,468	2,854	431	721	1,152
Total deposits	1,243	2,282	3,525	306	866	1,172
Securities sold under agreements to repurchase and other borrowings	(355)	22	(333)	59	601	660
Total net change in expense on interest-bearing liabilities	888	2,304	3,192	365	1,467	1,832
Change in net interest income	\$ 1,810	\$ (831)	\$ 979	\$ 2,829	\$ (50)	\$ 2,779

**Provision for Loan Losses**

The provision for loan losses represents the expense recognized to fund the allowance for loan losses. This amount is based on many factors that reflect management’s assessment of the risk in its loan portfolio. Those factors include economic conditions and trends, the value and adequacy of collateral, volume and mix of the portfolio, performance of the portfolio, and internal loan processes of the Company.

For the year ended December 31, 2019, the provision for loan losses was \$605 thousand, compared to \$1.1 million for the year ended December 31, 2018. Loans grew \$56.2 million, or 5.9%, in 2019 over 2018. There were no charge-offs in 2019 compared to total charge-offs of \$728 thousand in 2018. The allowance for loan losses as of December 31, 2019 was \$8.0 million representing 0.79% of outstanding loans, as compared to \$7.4 million as of December 31, 2018, representing 0.77% of outstanding loans. Based principally on current economic conditions, perceived asset quality, and loan-loss experience of the Bank and comparable institutions in the Company’s market area, the allowance is believed to be adequate.

**Non-interest Income**

Non-interest income is derived from the Company’s operations and represents primarily credit card processing fees, debit card interchange fees, service fees on deposit and loan relationships and income from bank owned life

insurance. Non-interest income also may include net gains and losses from the sale of available for sale securities and other real estate owned.

Total non-interest income was \$2.2 million for the year ended December 31, 2019 compared to \$1.7 million for the year ended December 31, 2018. This increase in non-interest income is mainly due to a \$309 thousand, or 80.9%, increase in bank owned life insurance, in part, due to the purchase of an additional \$6.0 million of bank owned life insurance in the third quarter of 2018. Also contributing to the improvement in non-interest income was an increase of \$70 thousand, or 12.9%, in debit card processing fees and an increase of \$43 thousand, or 9.3%, in other service fees due primarily to the growing customer base. A gain of \$45 thousand was recognized on the sale of other real estate owned with no impairment write down taken in 2019, compared to gains of \$94 thousand and write downs of \$84 thousand in 2018. As the deposit customer account base continues to grow and the Company continues to mature and develop additional sources of fee income, non-interest income is expected to become a more significant contributor to the overall profitability of the Company. Currently, and unlike many in the industry, the Company does not derive additional non-interest fee income by selling its mortgages in the secondary market, nor does it offer trust or investment/brokerage services to its customers.

### **Non-interest Expense**

Non-interest expenses represent the normal operating expenses of the Company. These expenses include salaries, employee benefits, occupancy, equipment, data processing, advertising and other expenses related to the overall operation of the Company.

Non-interest expenses for the year ended December 31, 2019 was \$21.7 million, compared to \$20.9 million for the year ended December 31, 2018. The increase in non-interest expenses is primarily due to an increase of \$652 thousand, or 6.6%, over 2018, in salaries and employee benefits primarily due to the number of employees and the annual increase in salaries and benefits. The Company had ninety-five (95) compared to ninety-one (91) full-time equivalent employees at December 31, 2019 and December 31, 2018, respectively. Additional increases in non-interest expenses are attributable to: an increase of \$385 thousand, or 12.8%, over 2018, in occupancy and equipment in part due to an increase in rent expense, leasehold improvements for the Macungie Preview Center and software expense; an increase of \$169 thousand, or 7.8%, in data processing expense due primarily to the expanding customer base; an increase of \$52 thousand, or 3.2%, in other expenses, offset by a decrease of \$246 thousand, or 55.3%, in FDIC insurance premiums due to FDIC assessment credits applied in 2019 and a decrease of \$143 thousand, or 40.4%, in loan and real estate expense primarily from a decrease in legal loan, collection and repossession fees.

A breakdown of other non-interest expenses is included in the Consolidated Statements of Income in the Consolidated Financial Statements included in Item 8 of this Report.

### **Income Taxes**

The provision for income taxes was \$2.5 million and \$2.3 million for December 31, 2019 and December 31, 2018, respectively. The effective rate on income taxes for the years ended December 31, 2019 and 2018 was 18.6% and 18.5%, respectively. The slight increase in the tax rate is primarily the result of the change in the mix of taxable and tax free loans and investments, offset by the increase in income on bank owned life insurance.

## FINANCIAL CONDITION

## Securities

The Company's securities portfolio is classified, in its entirety, as "available for sale." Management believes that a portfolio classification of available for sale allows complete flexibility in the management of the investment portfolio. Using this classification, the Company intends to hold these securities for an indefinite amount of time, but not necessarily to maturity. Such securities are carried at fair value with unrealized gains or losses reported as a separate component of stockholders' equity. The portfolio is structured to provide maximum return on investments while providing a consistent source of liquidity and meeting strict risk standards. The Company holds no high-risk, non-investment grade, securities or derivatives as of December 31, 2019.

The Company's securities portfolio was \$90.8 million at December 31, 2019, a \$81 thousand increase from securities of \$90.7 million at December 31, 2018. The Company's securities have increased primarily due to purchases in the amount of \$20.4 million and an increase in unrealized gains of \$3.3 million, offset by a combination of investment principal pay-downs, maturities and calls totaling \$23.5 million. The carrying value of the securities portfolio as of December 31, 2019 includes a net unrealized gain of \$1.7 million, as compared to a net unrealized loss of \$1.6 million as of December 31, 2018, which is recorded to accumulated other comprehensive income in stockholders' equity. This increase in the unrealized gain is due primarily to changes in market conditions from 2018 to 2019. No securities are deemed to be other than temporarily impaired.

The following table sets forth the composition of the securities portfolio at fair value as of December 31, 2019, 2018 and 2017.

	<u>2019</u>	<u>2018</u>	<u>2017</u>
	(In Thousands)		
U.S. Government agency obligations	\$ -	\$ 2,997	\$ 9,988
Municipal securities	26,444	34,878	38,321
U.S. Government sponsored enterprise (GSE)			
- Mortgage-backed securities - residential	64,385	52,873	41,987
Total Securities Available for Sale	<u>\$ 90,829</u>	<u>\$ 90,748</u>	<u>\$ 90,296</u>

The following table presents the maturities and average weighted yields of the debt securities portfolio as of December 31, 2019. Maturities of mortgage-backed securities are based on estimated life. Yields are based on amortized cost.

## Securities by Maturities

	<u>1 year or Less</u>		<u>1-5 Years</u>		<u>5-10 Years</u>		<u>Over 10 Years</u>		<u>Total</u>	
	<u>Amount</u>	<u>Average Yield</u>	<u>Amount</u>	<u>Average Yield</u>	<u>Amount</u>	<u>Average Yield</u>	<u>Amount</u>	<u>Average Yield</u>	<u>Amount</u>	<u>Average Yield</u>
	(Dollars In Thousands)									
Municipal securities	\$ 786	5.79%	\$ 3,348	4.65%	\$ 5,959	2.91%	\$ 16,351	4.30%	\$ 26,444	4.08%
U.S. GSE - Mortgage-backed securities-residential	8	6.03%	30,246	2.75%	34,131	2.82%	-	-	64,385	2.79%
Total Debt Securities	<u>\$ 794</u>	<u>5.79%</u>	<u>\$ 33,594</u>	<u>2.94%</u>	<u>\$ 40,090</u>	<u>2.83%</u>	<u>\$ 16,351</u>	<u>4.30%</u>	<u>\$ 90,829</u>	<u>3.16%</u>

**Loans**

The following table sets forth information on the composition of the loan portfolio by type at December 31, 2019. All of the Company's loans are to domestic borrowers.

	<u>December 31, 2019</u>		<u>December 31, 2018</u>		<u>December 31, 2017</u>	
	<u>Balance</u>	<u>Percentage of total Loans</u>	<u>Balance</u>	<u>Percentage of total Loans</u>	<u>Balance</u>	<u>Percentage of total Loans</u>
	(Dollars in Thousands)					
Commercial real estate	\$ 427,987	42.24%	\$ 428,487	44.79%	\$ 347,292	40.46%
Commercial construction	12,622	1.25%	10,958	1.15%	30,090	3.51%
Commercial	53,747	5.30%	38,425	4.02%	36,406	4.24%
Residential real estate	518,150	51.13%	477,965	49.96%	443,601	51.68%
Consumer	820	0.08%	850	0.09%	904	0.11%
Gross loans	1,013,326	100.00%	956,685	100.00%	858,293	100.00%
Unearned origination costs	813		671		458	
Allowance for loan losses	(8,022)		(7,412)		(7,040)	
Net Loans	<u>\$ 1,006,117</u>		<u>\$ 949,944</u>		<u>\$ 851,711</u>	
	<u>December 31, 2016</u>		<u>December 31, 2015</u>			
	<u>Balance</u>	<u>Percentage of total Loans</u>	<u>Balance</u>	<u>Percentage of total Loans</u>		
	(Dollars in Thousands)					
Commercial real estate	\$ 321,730	40.27%	\$ 289,304	41.92%		
Commercial construction	28,606	3.58%	17,786	2.58%		
Commercial	39,045	4.89%	34,955	5.06%		
Residential real estate	408,872	51.17%	347,316	50.33%		
Consumer	718	0.09%	745	0.11%		
Gross loans	798,971	100.00%	690,106	100.00%		
Unearned origination costs	144		9			
Allowance for loan losses	(6,517)		(6,068)			
Net Loans	<u>\$ 792,598</u>		<u>\$ 684,047</u>			

The following table shows the maturities of the commercial loan portfolio and the loans subject to interest rate fluctuations at December 31, 2019.

	<u>One year or Less</u>	<u>After One Year Through Five Years</u>	<u>After Five Years</u>	<u>Total</u>
	(In Thousands)			
Commercial real estate	\$ 51,272	\$ 187,131	\$ 189,584	\$ 427,987
Commercial construction	7,948	4,674	-	12,622
Commercial	22,520	19,576	11,651	53,747
	<u>\$ 81,740</u>	<u>\$ 211,381</u>	<u>\$ 201,235</u>	<u>\$ 494,356</u>
Fixed Rates	\$ 42,897	\$ 209,939	\$ 201,197	\$ 454,033
Variable Rates	38,843	1,442	38	40,323
	<u>\$ 81,740</u>	<u>\$ 211,381</u>	<u>\$ 201,235</u>	<u>\$ 494,356</u>

### **Credit Risk and Loan Quality**

The allowance for loan losses increased \$610 thousand to \$8.0 million at December 31, 2019 from \$7.4 million at December 31, 2018. At December 31, 2019 and December 31, 2018, the allowance for loan losses represented 0.79% and 0.77%, respectively, of total loans. Based upon current economic conditions, the composition of the loan portfolio, the perceived credit risk in the portfolio and loan-loss experience of the Bank and comparable institutions in the Bank's market area, management feels the allowance is adequate to absorb reasonably anticipated losses.

At December 31, 2019, aggregate balances on non-performing loans equaled \$2.7 million compared to \$3.2 million at December 31, 2018, representing 0.26% and 0.33% of total loans at December 31, 2019 and December 31, 2018, respectively. In certain circumstances in which the Company has deemed it prudent for reasons related to a borrower's financial condition, the Company has agreed to restructure certain loans (referred to as troubled debt restructurings). Troubled debt restructuring loans, which are considered non-performing loans, outstanding at December 31, 2019 and 2018 totaled \$2.7 million and \$2.9 million, respectively. Generally, a loan is classified as nonaccrual when it is determined that the collection of all or a portion of interest or principal is doubtful or when a default of interest or principal has existed for 90 days or more, unless the loan is well secured and in the process of collection. A non-performing loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. At December 31, 2019, the Company had no recorded investment in consumer mortgage loans collateralized by residential real estate property that is in the process of foreclosure, as compared to \$246 thousand at December 31, 2018.

As of December 31, 2019, the Company had no foreclosed assets. The details for the non-performing loans and assets are included in the following table:

	<b>December 31,</b>				
	<b>2019</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
	(Dollars In Thousands)				
Non-accrual - commercial	\$ -	\$ -	\$ 104	\$ 280	\$ 230
Non-accrual - consumer	18	269	686	874	529
Restructured, accruing interest	2,663	2,918	4,705	4,831	4,723
Loans past due 90 or more days, accruing interest	-	-	-	55	-
<b>Total nonperforming loans</b>	<b>2,681</b>	<b>3,187</b>	<b>5,495</b>	<b>6,040</b>	<b>5,482</b>
Foreclosed assets	-	135	458	480	1,224
<b>Total nonperforming assets</b>	<b>\$ 2,681</b>	<b>\$ 3,322</b>	<b>\$ 5,953</b>	<b>\$ 6,520</b>	<b>\$ 6,706</b>
Nonperforming loans to total loans	<b>0.26%</b>	0.33%	0.64%	0.76%	0.79%
Nonperforming assets to total assets	<b>0.23%</b>	0.30%	0.60%	0.71%	0.83%

**Allowance for Loan Losses**

Based upon current economic conditions, the composition of the loan portfolio and loan loss experience of comparable institutions in the Company's market areas, an allowance for loan losses has been provided at 0.79% of outstanding loans. Based on its knowledge of the portfolio and current economic conditions, management believes that, as of December 31, 2019, the allowance is adequate to absorb reasonably anticipated losses. As of December 31, 2019, the Company had \$3.5 million of impaired loans (defined as a loan that management feels probable the Company will be unable to collect all amounts according to the contractual terms of the loan agreement or loans considered to be troubled debt restructurings) compared to \$3.8 million at December 31, 2018. Most of the Company's impaired loans required no specific reserves due to adequate collateral. As of December 31, 2019, the Company had impaired loans of \$1.1 million requiring a specific reserve of \$202 thousand. As of December 31, 2018, the Company had impaired loans of \$1.1 million requiring a specific reserve of \$219 thousand.

The activity in the allowance for loan losses is shown in the following table, as well as period end loans receivable and the allowance for loan losses as a percent of the total loan portfolio:

	December 31,				
	2019	2018	2017	2016	2015
	(Dollars In Thousands)				
Loans receivable at end of year	<u>\$ 1,014,139</u>	<u>\$ 957,356</u>	<u>\$ 858,751</u>	<u>\$ 799,115</u>	<u>\$ 690,115</u>
Allowance for loan losses:					
Balance, beginning	\$ 7,412	\$ 7,040	\$ 6,517	\$ 6,068	\$ 5,614
Provision for loan losses	<u>605</u>	<u>1,080</u>	<u>1,085</u>	<u>770</u>	<u>532</u>
Loans charged off:					
Commercial real estate	-	-	(217)	(35)	(60)
Commercial construction	-	-	-	-	-
Commercial	-	(705)	(152)	(75)	-
Residential real estate	-	(23)	(206)	(207)	(28)
Consumer	-	-	-	(4)	-
Total charged off	<u>-</u>	<u>(728)</u>	<u>(575)</u>	<u>(321)</u>	<u>(88)</u>
Recoveries of loans previously charged-					
Commercial real estate	-	12	13	-	10
Commercial construction	-	-	-	-	-
Commercial	4	-	-	-	-
Residential real estate	1	8	-	-	-
Consumer	-	-	-	-	-
Total recoveries	<u>5</u>	<u>20</u>	<u>13</u>	<u>-</u>	<u>10</u>
Net charged off	<u>5</u>	<u>(708)</u>	<u>(562)</u>	<u>(321)</u>	<u>(78)</u>
Balance at end of year	<u>\$ 8,022</u>	<u>\$ 7,412</u>	<u>\$ 7,040</u>	<u>\$ 6,517</u>	<u>\$ 6,068</u>
Allowance for loan losses to loans					
receivable at end of year	<u>0.79%</u>	<u>0.77%</u>	<u>0.82%</u>	<u>0.82%</u>	<u>0.88%</u>

**Allocation of the Allowance for Loan Losses**

The following table details the allocation of the allowance for loan losses to various loan categories and the related percent of total loans in each category. While allocations have been established for particular loan categories, management considers the entire allowance to be available to absorb losses in any category.

	December 2019	% of Total Loans	December 2018	% of Total Loans	December 2017	% of Total Loans	December 2016	% of Total Loans	December 2015	% of Total Loans
	(Dollars in Thousands)									
Commercial real estate	\$ 3,221	42.24%	\$ 3,248	44.79%	\$ 2,251	40.46%	\$ 2,349	40.27%	\$ 2,132	41.92%
Commercial construction	121	1.25%	94	1.14%	369	3.51%	516	3.58%	294	2.58%
Commercial	770	5.30%	574	4.02%	472	4.24%	423	4.89%	402	5.06%
Residential real estate	3,488	51.13%	3,179	49.96%	3,510	51.68%	2,937	51.17%	2,529	50.33%
Consumer	19	0.08%	19	0.09%	18	0.11%	15	0.09%	29	0.11%
Unallocated	403		298		420		277		682	
Total Allowance for Loan Losses	<u>\$ 8,022</u>	<u>100.00%</u>	<u>\$ 7,412</u>	<u>100.00%</u>	<u>\$ 7,040</u>	<u>100.00%</u>	<u>\$ 6,517</u>	<u>100.00%</u>	<u>\$ 6,068</u>	<u>100.00%</u>

## Deposits

As growth continues, the Company expects that the principal sources of its funds will be deposits, consisting of demand deposits, NOW accounts, money market accounts, savings accounts, and certificates of deposit from the local market areas surrounding the Company's offices. These accounts provide the Company with a source of fee income and a relatively stable source of funds.

Total deposits at December 31, 2019 were \$1.03 billion, an increase of \$100.5 million, or 10.8%, over total deposits of \$931.5 million as of December 31, 2018. The following table reflects the Company's deposits by category for the periods indicated. All deposits are domestic deposits.

	<u>December 31, 2019</u>	<u>December 31, 2018</u>	<u>December 31, 2017</u>
	(In Thousands)		
Demand, non-interest bearing	\$ 171,815	\$ 148,609	\$ 139,974
Demand, NOW and money market, interest bearing	180,869	135,915	110,122
Savings	425,284	452,809	507,840
Time, \$250 and over	92,517	70,337	61,234
Time, other	161,483	123,845	81,684
<b>Total deposits</b>	<b>\$ 1,031,968</b>	<b>\$ 931,515</b>	<b>\$ 900,854</b>

The following table sets forth the average balance of the Company's deposits and the average rates paid on those deposits:

	<u>December 31, 2019</u>		<u>December 31, 2018</u>		<u>December 31, 2017</u>	
	<u>Average Amount</u>	<u>Average Rate</u>	<u>Average Amount</u>	<u>Average Rate</u>	<u>Average Amount</u>	<u>Average Rate</u>
	(Dollars In Thousands)					
Demand, NOW and money market, interest bearing deposits	\$ 158,944	0.69%	\$ 118,792	0.21%	\$ 110,149	0.09%
Savings	430,682	0.50%	477,881	0.49%	505,186	0.49%
Certificates of deposit	251,401	2.28%	169,679	1.70%	135,737	1.27%
<b>Total interest bearing deposits</b>	<b>841,027</b>	<b>1.07%</b>	<b>766,352</b>	<b>0.71%</b>	<b>751,072</b>	<b>0.57%</b>
Non-interest bearing demand deposits	163,485		150,615		124,828	
<b>Total</b>	<b>\$ 1,004,512</b>		<b>\$ 916,967</b>		<b>\$ 875,900</b>	

The following table displays the maturities and the amounts of the Company's certificates of deposit of \$250,000 or more:

	<b>December 31, 2019</b>
	(In Thousands)
3 months or less	\$ 31,062
Over 3 through 6 months	18,635
Over 6 through 12 months	22,648
Over 12 months	20,172
Total	<u>\$ 92,517</u>

As a FDIC member institution, the Company's deposits are insured to a maximum of \$250,000 per depositor through the DIF that is administered by the FDIC and each institution is required to pay quarterly deposit insurance premium assessments to the FDIC.

### **Liquidity**

Liquidity is a measure of the Company's ability to meet the demands required for the funding of loans and to meet depositors' requirements for use of their funds. The Company's sources of liquidity are cash balances, due from banks, federal funds sold and short-term securities. There are other sources of liquidity that are available to the Company, as well, including those described below.

The Bank has borrowing capacity with the FHLB of approximately \$580.9 million, which includes a line of credit for \$150.0 million. There were short-term borrowings of \$18.1 million outstanding as of December 31, 2019 and \$54.0 million in short-term FHLB advances outstanding as of December 31, 2018. There were no long-term loans outstanding with the FHLB as of December 31, 2019 and December 31, 2018. All FHLB borrowings are secured by qualifying assets of the Bank. The Bank also has a \$10.0 million line of credit with Atlantic Community Bankers Bank, of which none was outstanding at December 31, 2019 and December 31, 2018. Advances from this line are unsecured.

Because of the composition of the Company's balance sheet, its strong capital base, deposit growth, and borrowing capacity, the Company believes that it remains well positioned with respect to liquidity. While it is desirable to be liquid, it has the effect of a lower interest margin. The majority of the Company's funds are invested in loans; however, a portion is invested in investment securities that generally carry a lower yield.

**Contractual Obligations**

The following table represents the Company’s contractual obligations to make future payments as of the year ended December 31, 2019

	<u>2020</u>	<u>2021-2022</u>	<u>2023-2024</u>	<u>Thereafter</u>	<u>Total</u>
	(In Thousands)				
Time deposits	\$ 179,377	\$ 47,756	\$ 26,867	\$ -	\$ 254,000
Short-term borrowings	18,067	-	-	-	18,067
Operating Leases	<u>1,650</u>	<u>3,315</u>	<u>3,217</u>	<u>2,671</u>	<u>10,853</u>
<b>Total</b>	<u>\$ 199,094</u>	<u>\$ 51,071</u>	<u>\$ 30,084</u>	<u>\$ 2,671</u>	<u>\$ 282,920</u>

**Off-Balance Sheet Arrangements**

The Company’s consolidated financial statements do not reflect various off-balance sheet arrangements that are made in the normal course of business, which may involve some liquidity risk. These commitments consist of unfunded loans, lines of credit, and letters of credit made under the same standards as on-balance sheet loan instruments. These off-balance sheet arrangements at December 31, 2019 and December 31, 2018 totaled \$142.4 million and \$120.2 million, respectively. Because these instruments have fixed maturity dates, and because many of them will expire without being drawn upon, they do not generally present any significant liquidity risk to the Company. The Bank also issued standby letters of credit commitments for the benefit of a third party, which secure public deposits in the Bank through the FHLB. These deposit letters of credit are secured by qualifying assets of the Bank. The Company, through the Bank, had \$7.6 million of FHLB deposit letters of credit outstanding as of December 31, 2019 and none as of December 31, 2018. For further information see Note 4.

Management believes that any amounts actually drawn upon can be funded in the normal course of operations.

The Company has no investment in or financial relationship with any unconsolidated entities that are reasonably likely to have a material effect on liquidity or the availability of capital resources.

**Capital Resources and Adequacy**

The Company and the Bank are subject to various regulatory capital requirements administered by banking regulators. Failure to meet minimum capital requirements can initiate certain actions by regulators that could have a material adverse effect on the consolidated financial statements.

The regulations require that banks maintain minimum amounts and ratios of total and Tier 1 capital (as defined in the regulations) to risk weighted assets (as defined), and Tier 1 capital to average assets (as defined). As of December 31, 2019, the Bank met the minimum requirements. In addition, the Bank’s capital ratios exceeded the amounts required to be considered “well capitalized” as defined in the regulations.

The following table provides a comparison of the Bank’s risk-based capital ratios and leverage ratios:

	<u>December 31, 2019</u>	<u>December 31, 2018</u>
	(Dollars In Thousands)	
Tier 1, common stockholders' equity	\$ 98,230	\$ 88,320
Tier 2, allowable portion of allowance for loan losses	8,022	7,412
Total capital	<u>\$ 106,252</u>	<u>\$ 95,732</u>
Common equity tier 1 capital ratio	12.0%	11.3%
Tier 1 risk based capital ratio	12.0%	11.3%
Total risk based capital ratio	13.0%	12.2%
Tier 1 leverage ratio	8.4%	8.1%

Note: Unrealized gains on securities available for sale are excluded from regulatory capital components of risk-based capital and leverage ratios.

In July 2013, the FDIC and the Federal Reserve approved a new rule that substantially amended the regulatory risk based capital rules applicable to the Bank and the Company. The final rule implements the “Basel III” regulatory capital reforms and changes required by the Dodd-Frank Act.

The final rule includes new minimum risk-based capital and leverage ratios, which became effective for the Bank and the Company on January 1, 2015, and refines the definition of what constitutes “capital” for purposes of calculating these ratios. The revised minimum capital requirements are: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 to risk-based assets capital ratio of 6%; (iii) a total capital ratio of 8%; and (iv) a Tier 1 leverage ratio of 4%. The final rule also establishes a “capital conservation buffer” of 2.5%, and will result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0%; (ii) a Tier 1 to risk-based assets capital ratio of 8.5%; and (iii) a total capital ratio of 10.5%. The capital conservation buffer was phased in from 0.0% for 2015 to 2.50% in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations will establish a maximum percentage of eligible retained income that can be utilized for such actions.

In addition to the risk-based capital guidelines, the federal banking regulators established minimum leverage ratio (Tier 1 capital to total assets) guidelines for bank holding companies. These guidelines provide for a minimum leverage ratio of 3% for those bank holding companies which have the highest regulatory examination ratings and are not contemplating or experiencing significant growth or expansion. All other bank holding companies are required to maintain a leverage ratio of at least 4%.

The capital ratios to be considered “well capitalized” under the new capital rules are: common equity of 6.5%, Tier 1 leverage of 5%, Tier 1 risk-based capital of 8%, and Total Risk-Based capital of 10%.

Effective in the third quarter of 2018, the Federal Reserve raised the consolidated asset limit to be considered a small bank holding company from \$1 billion to \$3 billion. A company that qualifies as a small bank holding company is not subject to the Federal Reserve’s consolidated capital rules, although a company that so qualifies may continue to file reports that include such capital amounts and ratios. The Company has elected to continue to report those amounts and ratios.

The following table provides the Company's risk-based capital ratios and leverage ratios:

	<u>December 31, 2019</u>	<u>December 31, 2018</u>
	(Dollars In Thousands)	
Tier 1, common stockholders' equity	\$ 98,275	\$ 88,472
Tier 2, allowable portion of allowance for loan losses	8,022	7,412
Total capital	<u>\$ 106,297</u>	<u>\$ 95,884</u>
Common equity tier 1 capital ratio	12.0%	11.3%
Tier 1 risk based capital ratio	12.0%	11.3%
Total risk based capital ratio	13.0%	12.2%
Tier 1 leverage ratio	8.4%	8.1%

### **Interest Rate Risk Management**

A principal objective of the Company's asset/liability management policy is to minimize the Company's exposure to changes in interest rates by an ongoing review of the maturity and repricing of interest-earning assets and interest-bearing liabilities. The Asset Liability Committee (ALCO), which meets as part of the Board of Directors meeting, oversees this review, which establishes policies to control interest rate sensitivity. Interest rate sensitivity is the volatility of a company's earnings resulting from a movement in market interest rates. The Company monitors rate sensitivity in order to reduce vulnerability to interest rate fluctuations while maintaining adequate capital levels and acceptable levels of liquidity. The Company's asset/liability management policy, monthly and quarterly financial reports, along with simulation modeling, supplies management with guidelines to evaluate and manage rate sensitivity.

GAP, a measure of the difference in volume between interest bearing assets and interest bearing liabilities, is a means of monitoring the sensitivity of a financial institution to changes in interest rates. The chart below provides an indicator of the rate sensitivity of the Company. NOW and savings accounts are categorized by their respective estimated decay rates. The Company is liability sensitive, which means that if interest rates fall, interest income will fall slower than interest expense and net interest income will likely increase. If interest rates rise, interest income will rise slower than interest expense and net interest income will likely decrease. The Company continues to monitor interest rate exposure of its interest bearing assets and liabilities and believes that it is well positioned for any future market rate adjustments.

	0 to 3 Months	Over 3 Months to 12 Months	Over 1 Year to 3 Years	Over 4 Years to 5 Years	Over 5 Years	Total
(In Thousands)						
<b>Interest-earning assets</b>						
Federal funds sold and interest-bearing deposits	\$ 18,590	\$ -	\$ -	\$ -	\$ -	18,590
Investment securities	7,519	6,958	21,315	13,849	42,666	92,307
Loans, gross	89,717	112,743	208,880	186,487	416,312	1,014,139
<b>Total interest-earning assets</b>	<b>115,826</b>	<b>119,701</b>	<b>230,195</b>	<b>200,336</b>	<b>458,978</b>	<b>1,125,036</b>
<b>Interest-bearing liabilities</b>						
NOW and money market accounts	73,592	107,277	-	-	-	180,869
Savings	425,284	-	-	-	-	425,284
Certificates of deposit	70,766	108,611	47,756	26,867	-	254,000
Other borrowed funds	18,067	-	-	-	-	18,067
Repurchase agreements and federal funds purchased	7,208	-	-	-	-	7,208
<b>Total interest-bearing liabilities</b>	<b>594,917</b>	<b>215,888</b>	<b>47,756</b>	<b>26,867</b>	<b>-</b>	<b>885,428</b>
<b>GAP</b>	<b>\$ (479,091)</b>	<b>\$ (96,187)</b>	<b>\$ 182,439</b>	<b>\$ 173,469</b>	<b>\$ 458,978</b>	<b>\$ 239,608</b>
<b>CUMULATIVE GAP</b>	<b>\$ (479,091)</b>	<b>\$ (575,278)</b>	<b>\$ (392,839)</b>	<b>\$ (219,370)</b>	<b>\$ 239,608</b>	
<b>GAP TO INTEREST EARNING ASSETS</b>						
	-42.58%	-8.55%	16.22%	15.42%	40.80%	
<b>CUMULATIVE GAP TO INTEREST EARNING ASSETS</b>						
	-42.58%	-51.13%	-34.92%	-19.50%	21.30%	

Based on a twelve-month forecast of the balance sheet, the following table sets forth our interest rate risk profile at December 31, 2019. For income simulation purposes, personal and business savings accounts reprice every three months, personal and business NOW accounts reprice every four months and personal and business money market accounts reprice every two months. The impact on net interest income, illustrated in the following table, would vary if different assumptions were used or if actual experience differs from that indicated by the assumptions.

Change in Interest Rates	Percentage Change in Net Interest Income
Down 100 basis points	0.3%
Down 200 basis points	-0.7%
Up 100 basis points	-1.6%
Up 200 basis points	-3.4%

### **Return on Assets and Equity**

For the year ended December 31, 2019, the return on average assets was 0.95%, the return on average equity was 11.54%, and the ratio of average shareholders' equity to average total assets was 8.28%.

For the year ended December 31, 2018, the return on average assets was 0.96%, the return on average equity was 12.10%, and the ratio of average shareholders' equity to average total assets was 7.93%.

### **Dividend Payout Ratio**

For the year ended December 31, 2019 and 2018 the dividend payout ratio was 13.74% and 12.61%, respectively.

### **Effects of Inflation**

The majority of assets and liabilities of the Company are monetary in nature, and therefore, differ greatly from most commercial and industrial companies that have significant investments in fixed assets or inventories. The precise impact of inflation upon the Company is difficult to measure. Inflation may affect the borrowing needs of consumers, thereby impacting the growth rate of the Company's assets. Inflation may also affect the general level of interest rates, which can have a direct bearing on the Company.

**Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

Not required.

**Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

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## **Management Report on Internal Controls Over Financial Reporting**

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of its disclosure controls and procedures, as defined in SEC Rules 13a-15(e) and 15d-15(e). Based upon the evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2019, the Company's disclosure controls and procedures are effective. Disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control system is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness of future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2019, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control-Integrated Framework (2013). Based on this assessment, management concluded that, as of December 31, 2019, the Company's internal control over financial reporting is effective based on those criteria.

The effectiveness of the Company's internal control over financial reporting has been audited by Baker Tilly Virchow Krause, LLP, an independent registered public accounting firm, as stated in their report which is included herein.

/s/ David M. Lobach, Jr.

David M. Lobach, Jr.  
Chairman, President and  
Chief Executive Officer  
March 11, 2020

/s/ Judith A. Hunsicker

Judith A. Hunsicker  
First Executive Officer, Chief Operating  
Officer, Secretary and Chief Financial  
Officer  
March 11, 2020

## Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of Embassy Bancorp, Inc. and Subsidiary:

### Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Embassy Bancorp, Inc. and Subsidiary (collectively the "Company") as of December 31, 2019 and 2018, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows, for the years then ended, and the related notes (collectively referred to as the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control – Integrated Framework: (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and 2018, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control – Integrated Framework: (2013)* issued by COSO.

### Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Assessment of Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

### Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of

unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Baker Tilly Virchow Krause, LLP

We have served as the Company's auditor since 2001.

Allentown, Pennsylvania  
March 11, 2020

**Consolidated Balance Sheets**

<b><u>ASSETS</u></b>	<b>December 31, 2019</b>	<b>December 31, 2018</b>
	(In Thousands, Except Share Data)	
Cash and due from banks	\$ 5,825	\$ 14,103
Interest bearing demand deposits with banks	33,161	13,473
Federal funds sold	1,000	-
Cash and Cash Equivalents	39,986	27,576
Securities available for sale	90,829	90,748
Restricted investment in bank stock	1,478	2,794
Loans receivable, net of allowance for loan losses of \$8,022 in 2019; \$7,412 in 2018	1,006,117	949,944
Premises and equipment, net of accumulated depreciation	2,123	2,174
Bank owned life insurance	20,259	19,568
Accrued interest receivable	2,048	2,178
Other real estate owned	-	135
Other assets	13,279	4,270
<b>Total Assets</b>	<b>\$ 1,176,119</b>	<b>\$ 1,099,387</b>
<b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>		
Liabilities:		
Deposits:		
Non-interest bearing	\$ 171,815	\$ 148,609
Interest bearing	860,153	782,906
Total Deposits	1,031,968	931,515
Securities sold under agreements to repurchase	7,208	18,883
Short-term borrowings	18,067	53,995
Accrued interest payable	3,281	1,689
Other liabilities	15,980	6,080
<b>Total Liabilities</b>	<b>1,076,504</b>	<b>1,012,162</b>
Stockholders' Equity:		
Common stock, \$1 par value; authorized 20,000,000 shares; 2019 issued 7,543,524 shares; outstanding 7,478,477 shares; 2018 issued 7,529,567 shares; outstanding 7,464,520 shares	7,544	7,530
Surplus	25,937	25,532
Retained earnings	65,794	56,410
Accumulated other comprehensive income (loss)	1,340	(1,247)
Treasury stock, at cost: 65,047 shares at December 31, 2019 and December 31, 2018, respectively	(1,000)	(1,000)
<b>Total Stockholders' Equity</b>	<b>99,615</b>	<b>87,225</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 1,176,119</b>	<b>\$ 1,099,387</b>

*See notes to consolidated financial statements.*

Consolidated Statements of Income

	Year Ended December 31,	
	2019	2018
(In Thousands, Except Per Share Data)		
<b>INTEREST INCOME</b>		
Loans receivable, including fees	\$ 39,636	\$ 35,777
Securities, taxable	1,614	1,321
Securities, non-taxable	990	1,249
Short-term investments, including federal funds sold	622	344
<b>Total Interest Income</b>	<b>42,862</b>	<b>38,691</b>
<b>INTEREST EXPENSE</b>		
Deposits	8,980	5,455
Securities sold under agreements to repurchase	74	43
Short-term borrowings	275	639
<b>Total Interest Expense</b>	<b>9,329</b>	<b>6,137</b>
<b>Net Interest Income</b>	<b>33,533</b>	<b>32,554</b>
<b>PROVISION FOR LOAN LOSSES</b>	<b>605</b>	<b>1,080</b>
<b>Net Interest Income after Provision for Loan Losses</b>	<b>32,928</b>	<b>31,474</b>
<b>OTHER INCOME</b>		
Credit card processing fees	340	347
Debit card interchange fees	612	542
Other service fees	505	462
Bank owned life insurance	691	382
Gain on sale of other real estate owned	45	94
Impairment on other real estate owned	-	(84)
<b>Total Other Income</b>	<b>2,193</b>	<b>1,743</b>
<b>OTHER EXPENSES</b>		
Salaries and employee benefits	10,464	9,812
Occupancy and equipment	3,400	3,015
Data processing	2,339	2,170
Credit card processing	85	114
Advertising and promotion	1,713	1,686
Professional fees	790	765
FDIC insurance	199	445
Loan & real estate	211	354
Charitable contributions	864	862
Other	1,683	1,631
<b>Total Other Expenses</b>	<b>21,748</b>	<b>20,854</b>
<b>Income before Income Taxes</b>	<b>13,373</b>	<b>12,363</b>
<b>INCOME TAX EXPENSE</b>	<b>2,494</b>	<b>2,284</b>
<b>Net Income</b>	<b>\$ 10,879</b>	<b>\$ 10,079</b>
<b>BASIC EARNINGS PER SHARE</b>	<b>\$ 1.46</b>	<b>\$ 1.35</b>
<b>DILUTED EARNINGS PER SHARE</b>	<b>\$ 1.44</b>	<b>\$ 1.34</b>
<b>DIVIDENDS PER SHARE</b>	<b>\$ 0.20</b>	<b>\$ 0.17</b>

See notes to consolidated financial statements.

**Consolidated Statements of Comprehensive Income**

	<b>Year Ended December 31,</b>	
	<b>2019</b>	<b>2018</b>
	(In Thousands)	
<b>Net Income</b>	<b>\$ 10,879</b>	<b>\$ 10,079</b>
<b>Change in Accumulated Other Comprehensive Income (Loss):</b>		
Unrealized holding gain (loss) on securities available for sale	3,275	(1,602)
Less: reclassification adjustment for realized gains	-	-
	<u>3,275</u>	<u>(1,602)</u>
Income tax effect	<u>(688)</u>	<u>336</u>
Net unrealized gain (loss)	<u>2,587</u>	<u>(1,266)</u>
<b>Other comprehensive income (loss), net of tax</b>	<b>2,587</b>	<b>(1,266)</b>
<b>Comprehensive Income</b>	<b>\$ <u>13,466</u></b>	<b>\$ <u>8,813</u></b>

*See notes to consolidated financial statements.*

**Consolidated Statements of Stockholders' Equity**  
**Years Ended December 31, 2019 and 2018**

	<b>Common Stock</b>	<b>Surplus</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>	<b>Treasury Stock</b>	<b>Total</b>
(In Thousands, Except Share and Per Share Data)						
<b>BALANCE - DECEMBER 31, 2017</b>	\$ 7,492	\$ 24,998	\$ 47,602	\$ 19	\$ (342)	\$ 79,769
Net income	-	-	10,079	-	-	10,079
Other comprehensive loss, net of tax	-	-	-	(1,266)	-	(1,266)
Dividend declared, \$.17 per share	-	-	(1,271)	-	-	(1,271)
Compensation expense recognized on stock options	-	5	-	-	-	5
Common stock grants to directors, 6,731 shares	7	104	-	-	-	111
Common stock grants to officers, 16,116 shares, net of unearned compensation expense of \$659	16	178	-	-	-	194
Shares issued under employee stock purchase plan, 3,429 shares	3	53	-	-	-	56
Purchase treasury stock, 9,700 shares at \$17.60 per share and 30,000 shares at \$16.25 per share	-	-	-	-	(658)	(658)
Shares issued under Dividend Reinvestment and Stock Purchase Plan, 11,599 shares	12	194	-	-	-	206
<b>BALANCE - DECEMBER 31, 2018</b>	<b>\$ 7,530</b>	<b>\$ 25,532</b>	<b>\$ 56,410</b>	<b>\$ (1,247)</b>	<b>\$ (1,000)</b>	<b>\$ 87,225</b>
<b>BALANCE - DECEMBER 31, 2018</b>	<b>\$ 7,530</b>	<b>\$ 25,532</b>	<b>\$ 56,410</b>	<b>\$ (1,247)</b>	<b>\$ (1,000)</b>	<b>\$ 87,225</b>
Net income	-	-	10,879	-	-	10,879
Other comprehensive income, net of tax	-	-	-	2,587	-	2,587
Dividend declared, \$.20 per share	-	-	(1,495)	-	-	(1,495)
Compensation expense recognized on stock options	-	4	-	-	-	4
Common stock grants to directors, 10,799 shares	10	151	-	-	-	161
Compensation expense recognized on stock grants, net of unearned compensation expense of \$457	-	202	-	-	-	202
Shares issued under employee stock purchase plan, 3,158 shares	4	48	-	-	-	52
<b>BALANCE - DECEMBER 31, 2019</b>	<b>\$ 7,544</b>	<b>\$ 25,937</b>	<b>\$ 65,794</b>	<b>\$ 1,340</b>	<b>\$ (1,000)</b>	<b>\$ 99,615</b>

*See notes to consolidated financial statements.*

Consolidated Statements of Cash Flows

	Year Ended December 31,	
	2019	2018
(In Thousands)		
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 10,879	\$ 10,079
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	605	1,080
Amortization of deferred loan costs	262	229
Depreciation	829	774
Net amortization of investment security premiums and discounts	172	174
Stock compensation expense	367	310
Net realized gain on sale of other real estate owned	(45)	(94)
Impairment on other real estate owned	-	84
Income on bank owned life insurance	(691)	(382)
Deferred income taxes	(238)	16
Decrease (increase) in accrued interest receivable	130	(195)
Decrease (increase) in other assets	1,449	(648)
Increase in accrued interest payable	1,592	815
(Decrease) increase in other liabilities	(1,008)	596
<b>Net Cash Provided by Operating Activities</b>	<b>14,303</b>	<b>12,838</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of securities available for sale	(20,429)	(17,284)
Maturities, calls and principal repayments of securities available for sale	23,451	15,056
Net increase in loans	(57,040)	(99,668)
Net redemption (purchase) of restricted investment in bank stock	1,316	(2,211)
Purchase of bank owned life insurance	-	(6,000)
Proceeds from sale of other real estate owned	180	457
Purchases of premises and equipment	(778)	(1,019)
<b>Net Cash Used in Investing Activities</b>	<b>(53,300)</b>	<b>(110,669)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase in deposits	100,453	30,661
Net (decrease) increase in securities sold under agreements to repurchase	(11,675)	8,884
Proceeds from Employee Stock Purchase Plan	52	56
(Decrease) increase in short-term borrowed funds	(35,928)	53,995
Acquisition of treasury stock	-	(658)
Proceeds from Dividend Reinvestment Plan	-	206
Dividends paid	(1,495)	(1,271)
<b>Net Cash Provided by Financing Activities</b>	<b>51,407</b>	<b>91,873</b>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>12,410</b>	<b>(5,958)</b>
<b>CASH AND CASH EQUIVALENTS - BEGINNING</b>	<b>27,576</b>	<b>33,534</b>
<b>CASH AND CASH EQUIVALENTS - ENDING</b>	<b>\$ 39,986</b>	<b>\$ 27,576</b>
<b>SUPPLEMENTARY CASH FLOWS INFORMATION</b>		
Interest paid	\$ 7,737	\$ 5,322
Income taxes paid	\$ 2,666	\$ 2,713
Other real estate sold through bank financing	\$ -	\$ 303
Deferral of gain from sale of other real estate sold through bank financing	\$ -	\$ 2
Other real estate acquired in settlement of loans	\$ -	\$ 429
<b>Non-cash Investing and Financing Activities:</b>		
Recognition of operating lease right of use assets	\$ 10,921	\$ -
Recognition of operating lease liabilities	\$ 11,027	\$ -

See notes to consolidated financial statements.

## **Notes to Consolidated Financial Statements**

### **Note 1 – Summary of Significant Accounting Policies**

#### **Principles of Consolidation and Nature of Operations**

Embassy Bancorp, Inc. (the “Company”) is a Pennsylvania corporation organized in 2008 and registered as a bank holding company pursuant to the Bank Holding Company Act of 1956, as amended (the “BHC Act”). The Company was formed for purposes of acquiring Embassy Bank For The Lehigh Valley (the “Bank”) in connection with the reorganization of the Bank into a bank holding company structure, which was consummated on November 11, 2008. Accordingly, the Company owns all of the capital stock of the Bank, giving the organization more flexibility in meeting its capital needs as the Company continues to grow.

The Bank, which is the Company’s principal operating subsidiary, was originally incorporated as a Pennsylvania bank on May 11, 2001 and opened its doors on November 6, 2001. It was formed by a group of local business persons and professionals with significant prior experience in community banking in the Lehigh Valley area of Pennsylvania, the Bank’s primary market area.

#### **Estimates**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (“GAAP”) 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. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of other real estate owned, and the valuation of deferred tax assets.

#### **Concentrations of Credit Risk**

Most of the Company’s activities are with customers located in the Lehigh Valley area of Pennsylvania. Note 2 discusses the types of securities in which the Company invests. The concentrations of credit by type of loan are set forth in Note 3. The Company does not have any significant concentrations to any one specific industry or customer, with the exception of lending activity to a broad range of lessors of residential and non-residential real estate within the Lehigh Valley. Although the Company has a diversified loan portfolio, its debtors’ ability to honor their contracts is influenced by the region’s economy.

#### **Presentation of Cash Flows**

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing demand deposits with bank, and federal funds sold. Generally, federal funds are purchased or sold for less than one week periods.

#### **Securities**

Securities classified as available for sale are those securities that the Company intends to hold for an indefinite period of time, but not necessarily to maturity. Securities available for sale are carried at fair value. Any decision to sell a security classified as available for sale would be based on various factors, including significant movement in interest rates, changes in maturity mix of the Company’s assets and liabilities, liquidity needs, regulatory capital considerations and other similar factors. Unrealized gains and losses are reported as increases or decreases in other comprehensive income. Realized gains or losses, determined on the basis of the cost of the specific securities sold, are included in earnings. Premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

Other-than-temporary accounting guidance specifies that (a) if a company does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. When an entity does not intend to sell the security, and it is more likely than not the entity will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. The Company recognized no other-than-temporary impairment charges during the years ended December 31, 2019 and 2018.

### **Restricted Investments in Bank Stock**

Restricted investments in bank stock consist of FHLBank Pittsburgh (“FHLB”) stock and Atlantic Community Bankers Bank (“ACBB”) stock. The restricted stocks have no quoted market value and are carried at cost. Federal law requires a member institution of the FHLB to hold stock of its district FHLB according to a predetermined formula.

Management evaluates the FHLB and ACBB restricted stock for impairment. Management’s determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as (1) the significance of the decline in net assets of the issuer as compared to the capital stock amount for the issuer and the length of time this situation has persisted, (2) commitments by the issuer to make payments required by law or regulation and the level of such payments in relation to the operating performance of the issuer, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the issuer.

Management believes no impairment charge is necessary related to the FHLB or ACBB restricted stock as of December 31, 2019. No impairment charge was taken related to the FHLB or ACBB restricted stock as of December 31, 2018.

### **Loans Receivable**

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of any deferred fees or costs. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield using the effective interest method. Premiums and discounts on purchased loans are amortized as adjustments to interest income using the effective interest method. Delinquency fees are recognized in income when chargeable, assuming collectability is reasonably assured.

The loans receivable portfolio is segmented into commercial and consumer loans. Commercial loans consist of the following classes: commercial real estate, commercial construction and commercial. Consumer loans consist of the following classes: residential real estate and other consumer loans.

The Company makes commercial loans for real estate development and other business purposes required by the customer base. The Company’s credit policies determine advance rates against the different forms of collateral that can be pledged against commercial loans. Typically, the majority of loans will be limited to a percentage of their underlying collateral values such as real estate values, equipment, eligible accounts receivable and inventory. Individual loan advance rates may be higher or lower depending upon the financial strength of the borrower and/or term of the loan. The assets financed through commercial loans are used within the business for its ongoing operation. Repayment of these kinds of loans generally comes from the cash flow of the business or the ongoing conversion of assets. Commercial real estate loans include long-term loans financing commercial properties. Repayments of these loans are dependent upon either the ongoing cash flow of the borrowing entity or the resale of or lease of the subject property. Commercial real estate loans typically require a loan to value ratio of not greater than 80% and vary in terms.

Residential mortgages and home equity loans are secured by the borrower’s residential real estate in either a first or second lien position. Residential mortgages and home equity loans have varying interest rates (fixed or variable)

depending on the financial condition of the borrower and the loan to value ratio. Residential mortgages may have amortizations up to 30 years and home equity loans may have maturities up to 25 years. Other consumer loans include installment loans, car loans, and overdraft lines of credit. Some of these loans may be unsecured. For all classes of loans receivable, the accrual of interest may be discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed. Interest received on nonaccrual loans, including impaired loans, generally is applied against principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments.

### **Allowance for Loan Losses**

The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The allowance for loan losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans, or portions of loans, determined to be confirmed losses are charged against the allowance account and subsequent recoveries, if any, are credited to the account. A loss is considered confirmed when information available at the balance sheet date indicates the loan, or a portion thereof, is uncollectible.

Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

Management maintains the allowance for loan losses at a level it believes adequate to absorb probable credit losses related to specifically identified loans, as well as probable incurred losses inherent in the remainder of the loan portfolio as of the balance sheet dates. The allowance for loan losses account consists of specific and general reserves.

For the specific portion of the allowance for loan losses, a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. All amounts due according to the contractual terms means that both the contractual interest and principal payments of a loan will be collected as scheduled in the loan agreement. Factors considered by management in determining impairment include payment status, ability to pay and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Loans considered impaired are measured for impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. If the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral, if the loan is collateral dependent, is less than the recorded investment in the loan, including accrued interest and net deferred loan fees or costs, the Company will recognize the impairment by adjusting the allowance for loan losses account through charges to earnings as a provision for loan losses.

For loans secured by real estate, estimated fair values are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, loan-to-value ratio based on the original appraisal and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For commercial and industrial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable aging or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

The general portion of the allowance for loan losses covers pools of loans by major loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate and other consumer loans. Loss contingencies for each of the major loan pools are determined by applying a total loss factor to the current balance outstanding for each individual pool. The total loss factor is comprised of a historical loss factor using the loss migration method plus a qualitative factor, which adjusts the historical loss factor for changes in trends, conditions and other relevant factors that may affect repayment of the loans in these pools as of the evaluation date. Loss migration involves determining the percentage of each pool that is expected to ultimately result in loss based on historical loss experience. Historical loss factors are based on the ratio of net loans charged-off to loans, net, for each of the major groups of loans. The historical loss factor for each pool, includes but is not limited to, an average of the Company's historical net charge-off ratio for the most recent rolling four years plus current year to date.

In addition to these historical loss factors, management also uses a qualitative factor that represents a number of environmental risks that may cause estimated credit losses associated with the current portfolio to differ from historical loss experience. These environmental risks include: (i) changes in lending policies and procedures including underwriting standards and collection, charge-off and recovery practices; (ii) changes in the composition and volume of the portfolio; (iii) changes in national, local and industry conditions, including the effects of such changes on the value of underlying collateral for collateral-dependent loans; (iv) changes in the volume and severity of classified loans, including past due, nonaccrual, troubled debt restructures and other loan modifications; (v) changes in the levels of, and trends in, charge-offs and recoveries; (vi) the existence and effect of any concentrations of credit and changes in the level of such concentrations; (vii) changes in the experience, ability and depth of lending management and other relevant staff; (viii) changes in the quality of the loan review system and the degree of oversight by the board of directors; and (ix) the effect of external factors such as competition and regulatory requirements on the level of estimated credit losses in the current loan portfolio. Each environmental risk factor is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss calculation.

The unallocated component of the general allowance is used to cover inherent losses that exist as of the evaluation date, but which have not been identified as part of the allocated allowance using the above impairment evaluation methodology due to limitations in the process. One such limitation is the imprecision of accurately estimating the impact current economic conditions will have on historical loss rates. Variations in the magnitude of impact may cause estimated credit losses associated with the current portfolio to differ from historical loss experience, resulting in an allowance that is higher or lower than the anticipated level.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payment, for commercial and consumer loans. Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful and loss. Loans criticized as special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weakness may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness and borrowers are highly leveraged. They include loans that are inadequately protected by the current sound net worth and the paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses. Loans not classified are rated pass.

Federal regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available

to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

### **Other Real Estate Owned**

Other real estate owned is comprised of properties acquired through foreclosure proceedings or acceptance of a deed-in-lieu of foreclosure and loans classified as in-substance foreclosures. A loan is classified as an in-substance foreclosure when the Company has taken possession of the collateral, regardless of whether formal foreclosure proceedings take place. Other real estate owned is recorded at fair value less cost to sell at the time of acquisition. Any excess of the loan balance over the recorded value is charged to the allowance for loan losses at the time of acquisition. After foreclosure, valuations are periodically performed and the assets are carried at the lower of cost or fair value less cost to sell. Changes in the valuation allowance on foreclosed assets are included in other income. Costs to maintain the assets are included in other expenses. Any gain or loss realized upon disposal of other real estate owned is included in other income.

### **Bank Owned Life Insurance**

The Company invests in bank owned life insurance ("BOLI") as a tax deferred investment and a source of funding for employee benefit expenses. BOLI involves the purchasing of life insurance by the Company on certain of its employees and directors. The Company is the owner and primary beneficiary of the policies. This life insurance investment is carried at the cash surrender value of the underlying policies. Income from increases in cash surrender value of the policies is included in non-interest income and is not subject to income taxes unless surrendered. The Company does not intend to surrender these policies, and accordingly, no deferred taxes have been recorded on the earnings from these policies.

### **Premises and Equipment**

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the following estimated useful lives of the related assets: furniture, fixtures and equipment for five to ten years, leasehold improvements for the life of the lease, computer equipment and data processing software for one to five years, and automobiles for five years.

### **Transfers of Financial Assets**

Transfers of financial assets, including sales of loan participations, are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

### **Advertising Costs**

The Company follows the policy of charging the costs of advertising to expense as incurred.

### **Income Taxes**

Income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to taxable income. Deferred income taxes are provided on the asset and liability method whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and net operating loss carry forwards and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

## Earnings Per Share

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period, as adjusted for stock dividends and splits. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustments to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate solely to outstanding stock options and are determined using the treasury stock method.

	Year Ended December 31,	
	2019	2018
	(Dollars In Thousands, Except Per Share Data)	
Net income	\$ 10,879	\$ 10,079
Weighted average shares outstanding	7,475,262	7,472,893
Dilutive effect of potential common shares, stock options	68,839	55,072
Diluted weighted average common shares outstanding	7,544,101	7,527,965
Basic earnings per share	\$ 1.46	\$ 1.35
Diluted earnings per share	\$ 1.44	\$ 1.34

There were no stock options not considered in computing diluted earnings per common share for the year ended December 31, 2019. Anti-dilutive stock options of 4,227 were not considered in computing diluted earnings per common share for the year ended December 31, 2018.

## Employee Benefit Plan

The Company has a 401(k) Plan (the “Plan”) for employees. All employees are eligible to participate after they have attained the age of 21 and have also completed 6 consecutive months of service during which at least 500 hours of service are completed. The employees may contribute up to the maximum percentage allowable by law of their compensation to the Plan, and the Company provides a match of fifty percent of the first 8% percent to eligible participating employees. Full vesting in the Plan is prorated equally over a four-year period. The Company’s contributions to the Plan for the years ended December 31, 2019 and 2018 were \$210 thousand and \$188 thousand, respectively.

## Off Balance Sheet Financial Instruments

In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit and letters of credit. Such financial instruments are recorded in the balance sheet when they are funded.

## Comprehensive Income

GAAP require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

## **Stock-Based Compensation**

The Company measures and records compensation expense for share-based payments based on the instrument's fair value on the date of grant. The fair value of each stock option grant is measured using the Black-Scholes option pricing model. The fair value of stock awards is based on the Company's stock price. Share-based compensation expense is recognized over the service period, generally defined as the vesting period.

In June 2018, the FASB issued ASU 2018-07, Compensation – Stock Compensation, Improvements to Nonemployee Share-based Payment Accounting. ASU 2018-07 was issued to require share-based payment transactions for acquiring goods and services from non-employees be accounted for under the same guidance as those issued to employees. Among other things, the guidance requires non-employee share-based payments be measured at grant-date fair value of the equity instrument received. The Company adopted this guidance effective January 1, 2019. There was no effect on the consolidated financial statements upon adoption. The Company follows this guidance when measuring the share-based payments to non-employee directors as described in Note 10.

## **Non-Interest Income**

The majority of the Company's revenue-generating transactions are not subject to ASU 2014-09 "Revenue from Contracts with Customers (Topic 606)", including revenue generated from financial instruments, such as its loans and investment securities, as these activities are subject to other GAAP discussed elsewhere within the Company's disclosures. Descriptions of the Company's revenue-generating activities that are within the scope of Topic 606, which are presented in the consolidated statement of income as components of non-interest income, are credit card processing fees, debit card interchange fees, other service fees on deposit accounts, and gains and losses on other real estate owned. Credit card processing fees include income from commercial credit cards and merchant processing income. Income for such performance obligations are generally received at the time the performance obligations are satisfied or within the monthly service period. Service fees on deposit accounts represent general service fees for monthly account maintenance and activity or transaction-based fees and consist of transaction-based revenue, time-based revenue (service period), item-based revenue or some other individual attribute-based revenue. Revenue is recognized when the Company's performance obligation is completed, which is generally monthly for account maintenance services or when a transaction has been completed (such as a wire transfer). The Company recognizes debit card interchange fees daily from debit cardholder transactions conducted through the MasterCard payment network. The Company records a gain or loss from the sale of other real estate owned when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of other real estate owned to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Company adjusts the transaction prices and related gain or loss on the sale if a significant financing component is present. The Company does not sell its mortgages on the secondary market, nor does it offer trust or investment brokerage services to its customers to generate fee income.

## **Subsequent Events**

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2019 through the date these consolidated financial statements were available for issuance for items that should potentially be recognized or disclosed in these consolidated financial statements. In January 2020, the Company repurchased 40,000 shares of common stock into treasury at \$18.00 per share in a privately negotiated transaction. In March 2020, the Company had long-term FHLB borrowings of \$10.0 million at a rate of 0.79%, \$2.7 million at a rate of 0.64% and \$2.0 million at a rate of 0.61%, all of which have a maturity of two years.

## **Future Accounting Standards**

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments - Credit Losses". ASU 2016-13 requires entities to report "expected" credit losses on financial instruments and other commitments to extend credit rather than the current "incurred loss" model. These expected credit losses for financial assets held at the reporting date are to be based on historical experience, current conditions, and reasonable and supportable forecasts. This ASU will also

require enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an entity's portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. In November 2019, the FASB issued an update to defer the implementation date for smaller reporting companies from 2020 to 2023. The Company currently qualifies as a smaller reporting company under SEC Regulation S-K and, therefore, the guidance is effective for the Company in 2023. The Company has not yet determined the impact this standard will have on its financial statements or results of operations.

**Reclassification**

Certain amounts in the 2018 consolidated financial statements may have been reclassified to conform to 2019 presentation. These reclassifications had no effect on 2018 net income.

**Note 2 – Securities Available For Sale**

The amortized cost and approximate fair values of securities available-for-sale were as follows at December 31, 2019 and 2018, respectively:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(In Thousands)			
<b>December 31, 2019:</b>				
Municipal bonds	\$ 25,586	\$ 863	\$ (5)	\$ 26,444
U.S. Government Sponsored Enterprise (GSE) - Mortgage-backed securities - residential	63,546	877	(38)	64,385
<b>Total</b>	<b>\$ 89,132</b>	<b>\$ 1,740</b>	<b>\$ (43)</b>	<b>\$ 90,829</b>
<b>December 31, 2018:</b>				
U.S. Government agency obligations	\$ 3,001	\$ -	\$ (4)	\$ 2,997
Municipal bonds	35,171	515	(808)	34,878
U.S. Government Sponsored Enterprise (GSE) - Mortgage-backed securities - residential	54,154	127	(1,408)	52,873
<b>Total</b>	<b>\$ 92,326</b>	<b>\$ 642</b>	<b>\$ (2,220)</b>	<b>\$ 90,748</b>

The amortized cost and fair value of securities as of December 31, 2019, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without any penalties.

	<u>Amortized Cost</u>	<u>Fair Value</u>
	(In Thousands)	
Due in one year or less	\$ 764	\$ 786
Due after one year through five years	3,333	3,348
Due after five years through ten years	5,857	5,959
Due after ten years	15,632	16,351
	<u>25,586</u>	<u>26,444</u>
U.S. Government Sponsored Enterprise (GSE) - Mortgage- backed securities - residential	63,546	64,385
	<u>\$ 89,132</u>	<u>\$ 90,829</u>

There were no sales of securities for the years ended December 31, 2019 and 2018.

The following table shows the Company's investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2019 and 2018, respectively:

	<u>Less Than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
<b>December 31, 2019:</b>	(In Thousands)					
Municipal bonds	\$ 1,295	\$ (5)	\$ -	\$ -	\$ 1,295	\$ (5)
U.S. Government Sponsored Enterprise (GSE) - Mortgage-backed securities - residential	4,701	(1)	8,528	(37)	13,229	(38)
<b>Total Temporarily Impaired Securities</b>	<b>\$ 5,996</b>	<b>\$ (6)</b>	<b>\$ 8,528</b>	<b>\$ (37)</b>	<b>\$ 14,524</b>	<b>\$ (43)</b>
<b>December 31, 2018:</b>						
U.S. Government agency obligations	\$ -	\$ -	\$ 2,997	\$ (4)	\$ 2,997	\$ (4)
Municipal bonds	3,231	(101)	7,711	(707)	10,942	(808)
U.S. Government Sponsored Enterprise (GSE) - Mortgage-backed securities - residential	8,926	(57)	35,940	(1,351)	44,866	(1,408)
<b>Total Temporarily Impaired Securities</b>	<b>\$ 12,157</b>	<b>\$ (158)</b>	<b>\$ 46,648</b>	<b>\$ (2,062)</b>	<b>\$ 58,805</b>	<b>\$ (2,220)</b>

The Company had five (5) securities in an unrealized loss position at December 31, 2019. Unrealized losses are due only to market interest rate fluctuations. As of December 31, 2019, the Company either has the intent and ability to hold the securities until maturity or market price recovery, or believes that it is more likely than not that it will not be required to sell such securities. Management believes that the unrealized loss only represents temporary impairment of the securities. None of the individual losses are significant.

Securities with a carrying value of \$74.0 million and \$85.8 million at December 31, 2019 and December 31, 2018, respectively, were subject to agreements to repurchase, pledged to secure public deposits, or pledged for other purposes required or permitted by law.

**Note 3 – Loans Receivable and Credit Quality**

The following table presents the composition of loans receivable:

	<u>December 31,</u>	
	<u>2019</u>	<u>2018</u>
	(In Thousands)	
Commercial real estate	\$ 427,987	\$ 428,487
Commercial construction	12,622	10,958
Commercial	53,747	38,425
Residential real estate	518,150	477,965
Consumer	820	850
<b>Total Loans</b>	<b>1,013,326</b>	<b>956,685</b>
Unearned net loan origination costs	813	671
Allowance for Loan Losses	(8,022)	(7,412)
<b>Net Loans</b>	<b>\$ 1,006,117</b>	<b>\$ 949,944</b>

The following table summarizes information in regards to the allowance for loan losses as of December 31, 2019 and 2018, respectively:

	<u>Commercial Real Estate</u>	<u>Commercial Construction</u>	<u>Commercial</u>	<u>Residential Real Estate</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
	(In Thousands)						
<b>Allowance for loan losses</b>							
<b>Year Ending December 31, 2019</b>							
<b>Beginning Balance - December 31, 2018</b>	\$ 3,248	\$ 94	\$ 574	\$ 3,179	\$ 19	\$ 298	\$ 7,412
Charge-offs	-	-	-	-	-	-	-
Recoveries	-	-	4	1	-	-	5
Provisions	(27)	27	192	308	-	105	605
<b>Ending Balance - December 31, 2019</b>	<u>\$ 3,221</u>	<u>\$ 121</u>	<u>\$ 770</u>	<u>\$ 3,488</u>	<u>\$ 19</u>	<u>\$ 403</u>	<u>\$ 8,022</u>
<b>Year Ending December 31, 2018</b>							
<b>Beginning Balance - December 31, 2017</b>	\$ 2,251	\$ 369	\$ 472	\$ 3,510	\$ 18	\$ 420	\$ 7,040
Charge-offs	-	-	(705)	(23)	-	-	(728)
Recoveries	12	-	-	8	-	-	20
Provisions	985	(275)	807	(316)	1	(122)	1,080
<b>Ending Balance - December 31, 2018</b>	<u>\$ 3,248</u>	<u>\$ 94</u>	<u>\$ 574</u>	<u>\$ 3,179</u>	<u>\$ 19</u>	<u>\$ 298</u>	<u>\$ 7,412</u>

The following tables represent the allocation of the allowance for loan losses and the related loan portfolio disaggregated based on impairment methodology at December 31, 2019 and December 31, 2018, respectively:

	<u>Commercial Real Estate</u>	<u>Commercial Construction</u>	<u>Commercial</u>	<u>Residential Real Estate</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
	(In Thousands)						
<b>December 31, 2019</b>							
<b>Allowance for Loan Losses</b>							
Ending Balance	\$ 3,221	\$ 121	\$ 770	\$ 3,488	\$ 19	\$ 403	\$ 8,022
Ending balance: individually evaluated for impairment	\$ -	\$ -	\$ 27	\$ 175	\$ -	\$ -	\$ 202
Ending balance: collectively evaluated for impairment	\$ 3,221	\$ 121	\$ 743	\$ 3,313	\$ 19	\$ 403	\$ 7,820
<b>Loans receivables:</b>							
Ending balance	\$ 427,987	\$ 12,622	\$ 53,747	\$ 518,150	\$ 820		\$ 1,013,326
Ending balance: individually evaluated for impairment	\$ 1,626	\$ 315	\$ 234	\$ 1,346	\$ -		\$ 3,521
Ending balance: collectively evaluated for impairment	\$ 426,361	\$ 12,307	\$ 53,513	\$ 516,804	\$ 820		\$ 1,009,805
<b>December 31, 2018</b>							
<b>Allowance for Loan Losses</b>							
Ending Balance	\$ 3,248	\$ 94	\$ 574	\$ 3,179	\$ 19	\$ 298	\$ 7,412
Ending balance: individually evaluated for impairment	\$ -	\$ -	\$ 33	\$ 186	\$ -	\$ -	\$ 219
Ending balance: collectively evaluated for impairment	\$ 3,248	\$ 94	\$ 541	\$ 2,993	\$ 19	\$ 298	\$ 7,193
<b>Loans receivables:</b>							
Ending balance	\$ 428,487	\$ 10,958	\$ 38,425	\$ 477,965	\$ 850		\$ 956,685
Ending balance: individually evaluated for impairment	\$ 1,732	\$ 315	\$ 239	\$ 1,557	\$ -		\$ 3,843
Ending balance: collectively evaluated for impairment	\$ 426,755	\$ 10,643	\$ 38,186	\$ 476,408	\$ 850		\$ 952,842

The following table summarizes information in regards to impaired loans by loan portfolio class as of December 31, 2019 and 2018, respectively:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Year to Date	
				Average Recorded Investment	Interest Income Recognized
<b>December 31, 2019</b>					
With no related allowance recorded:					
Commercial real estate	\$ 1,626	\$ 1,890		\$ 1,686	\$ 86
Commercial construction	315	315		315	11
Commercial	-	-		-	-
Residential real estate	530	786		640	14
Consumer	-	-		-	-
With an allowance recorded:					
Commercial real estate	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial construction	-	-	-	-	-
Commercial	234	234	27	236	10
Residential real estate	816	816	175	828	30
Consumer	-	-	-	-	-
Total:					
Commercial real estate	\$ 1,626	\$ 1,890	\$ -	\$ 1,686	\$ 86
Commercial construction	315	315	-	315	11
Commercial	234	234	27	236	10
Residential real estate	1,346	1,602	175	1,468	44
Consumer	-	-	-	-	-
	<u>\$ 3,521</u>	<u>\$ 4,041</u>	<u>\$ 202</u>	<u>\$ 3,705</u>	<u>\$ 151</u>
<b>December 31, 2018</b>					
With no related allowance recorded:					
Commercial real estate	\$ 1,732	\$ 1,996		\$ 4,733	\$ 199
Commercial construction	315	315		315	11
Commercial	-	-		18	2
Residential real estate	709	965		832	10
Consumer	-	-		-	-
With an allowance recorded:					
Commercial real estate	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial construction	-	-	-	-	-
Commercial	239	239	33	242	10
Residential real estate	848	848	186	911	31
Consumer	-	-	-	-	-
Total:					
Commercial real estate	\$ 1,732	\$ 1,996	\$ -	\$ 4,733	\$ 199
Commercial construction	315	315	-	315	11
Commercial	239	239	33	260	12
Residential real estate	1,557	1,813	186	1,743	41
Consumer	-	-	-	-	-
	<u>\$ 3,843</u>	<u>\$ 4,363</u>	<u>\$ 219</u>	<u>\$ 7,051</u>	<u>\$ 263</u>

The following table presents the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention (potential weaknesses), substandard (well defined weaknesses) and doubtful (full collection unlikely) within the Company's internal risk rating system as of December 31, 2019 and 2018, respectively:

	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
<b>December 31, 2019</b>					
	(In Thousands)				
Commercial real estate	\$ 426,526	\$ -	\$ 1,461	\$ -	\$ 427,987
Commercial construction	12,307	-	315	-	12,622
Commercial	53,656	91	-	-	53,747
Residential real estate	517,281	719	150	-	518,150
Consumer	820	-	-	-	820
Total	<u>\$ 1,010,590</u>	<u>\$ 810</u>	<u>\$ 1,926</u>	<u>\$ -</u>	<u>\$ 1,013,326</u>
<b>December 31, 2018</b>					
Commercial real estate	\$ 426,988	\$ -	\$ 1,499	\$ -	\$ 428,487
Commercial construction	10,643	-	315	-	10,958
Commercial	38,309	116	-	-	38,425
Residential real estate	476,811	747	407	-	477,965
Consumer	850	-	-	-	850
Total	<u>\$ 953,601</u>	<u>\$ 863</u>	<u>\$ 2,221</u>	<u>\$ -</u>	<u>\$ 956,685</u>

The following table presents nonaccrual loans by classes of the loan portfolio:

	<u>December 31,</u>	
	<u>2019</u>	<u>2018</u>
	(In Thousands)	
Commercial real estate	\$ -	\$ -
Commercial construction	-	-
Commercial	-	-
Residential real estate	18	269
Consumer	-	-
Total	<u>\$ 18</u>	<u>\$ 269</u>

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the past due status as of December 31, 2019 and 2018, respectively:

	<u>30-59 Days Past Due</u>	<u>60-89 Days Past Due</u>	<u>Greater than 90 Days Past Due</u>	<u>Total Past Due</u>	<u>Current</u>	<u>Total Loan Receivables</u>	<u>Loan Receivables &gt; 90 Days and Accruing</u>
(In Thousands)							
<b>December 31, 2019</b>							
Commercial real estate	\$ -	\$ -	\$ -	\$ -	\$ 427,987	\$ 427,987	\$ -
Commercial construction	-	-	-	-	12,622	12,622	-
Commercial	-	-	-	-	53,747	53,747	-
Residential real estate	951	-	-	951	517,199	518,150	-
Consumer	-	-	-	-	820	820	-
Total	<u>\$ 951</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 951</u>	<u>\$ 1,012,375</u>	<u>\$ 1,013,326</u>	<u>\$ -</u>
<b>December 31, 2018</b>							
Commercial real estate	\$ 323	\$ -	\$ -	\$ 323	\$ 428,164	\$ 428,487	\$ -
Commercial construction	-	-	-	-	10,958	10,958	-
Commercial	138	-	-	138	38,287	38,425	-
Residential real estate	696	-	-	696	477,269	477,965	-
Consumer	-	-	-	-	850	850	-
Total	<u>\$ 1,157</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,157</u>	<u>\$ 955,528</u>	<u>\$ 956,685</u>	<u>\$ -</u>

### **Troubled Debt Restructurings**

The Company may grant a concession or modification for economic or legal reasons related to a borrower's financial condition than it would not otherwise consider, resulting in a modified loan which is then identified as troubled debt restructuring ("TDR"). The Company may modify loans through rate reductions, extensions to maturity, interest only payments, or payment modifications to better coincide the timing of payments due under the modified terms with the expected timing of cash flows from the borrowers' operations. Loan modifications are intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. TDRs are considered impaired loans for purposes of calculating the Company's allowance for loan losses.

The Company identifies loans for potential restructure primarily through direct communication with the borrower and the evaluation of the borrower's financial statements, revenue projections, tax returns, and credit reports. Even if the borrower is not presently in default, management will consider the likelihood that cash flow shortages, adverse economic conditions, and negative trends may result in a payment default in the near future.

The following table presents TDRs outstanding at December 31, 2019 and 2018, respectively:

	<u>Accrual Loans</u>	<u>Non-Accrual Loans</u>	<u>Total Modifications</u>
	(In Thousands)		
<b>December 31, 2019</b>			
Commercial real estate	\$ 1,188	\$ -	\$ 1,188
Commercial construction	260	-	260
Commercial	233	-	233
Residential real estate	982	18	1,000
Consumer	-	-	-
	<u>\$ 2,663</u>	<u>\$ 18</u>	<u>\$ 2,681</u>
<b>December 31, 2018</b>			
Commercial real estate	\$ 1,269	\$ -	\$ 1,269
Commercial construction	260	-	260
Commercial	239	-	239
Residential real estate	1,150	23	1,173
Consumer	-	-	-
	<u>\$ 2,918</u>	<u>\$ 23</u>	<u>\$ 2,941</u>

There were no new TDRs during the year ended December 31, 2019 and December 31, 2018.

As December 31, 2019 and 2018, no available commitments were outstanding on TDRs.

There were no loans that were modified and classified as a TDR within the prior twelve months that experienced a payment default (loans ninety or more days past due) during the years ended December 31, 2019 and December 31, 2018.

**Note 4 - Financial Instruments with Off-Balance Sheet Risk**

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

The following financial instruments were outstanding whose contract amounts represent credit risk:

	<b>December 31,</b>	
	<b>2019</b>	<b>2018</b>
	(In Thousands)	
Commitments to grant loans, fixed	\$ 14,574	\$ 1,560
Commitments to grant loans, variable	1,450	2,076
Unfunded commitments under lines of credit, fixed	16,967	15,680
Unfunded commitments under lines of credit, variable	106,491	95,372
Standby letters of credit	2,889	5,551
	<b>\$ 142,371</b>	<b>\$ 120,239</b>

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation.

Collateral held varies but may include personal or commercial real estate, accounts receivable, inventory and equipment.

Outstanding letters of credit written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The majority of these standby letters of credit expire within the next twelve months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Company requires collateral supporting these letters of credit as deemed necessary. The maximum undiscounted exposure related to these commitments at December 31, 2019 and 2018 was \$2.9 million and \$5.6 million, respectively, and the approximate value of underlying collateral upon liquidation that would be expected to cover this maximum potential exposure was \$1.8 million and \$4.3 million, respectively. The current amount of the liability as of December 31, 2019 and 2018 for guarantees under standby letters of credit issued is not considered material.

FHLB deposit letters of credit are standby letters of credit commitments issued by the Bank for the benefit of a third party, which secure public deposits in the Bank. FHLB deposit letters of credit are secured by qualifying assets of the Bank. The Company, through the Bank, had \$7.6 million of FHLB deposit letters of credit outstanding as of December 31, 2019 and none as of December 31, 2018.

**Note 5 - Bank Premises and Equipment**

The components of premises and equipment are as follows:

	<b>December 31,</b>	
	<b>2019</b>	<b>2018</b>
	(In Thousands)	
Furniture, fixtures and equipment	\$ 3,396	\$ 3,284
Leasehold improvements	3,268	3,209
Computer equipment and data processing software	3,771	3,320
Automobiles	272	228
Construction in progress	127	15
	<b>10,834</b>	10,056
Accumulated depreciation	<b>(8,711)</b>	(7,882)
	<b>\$ 2,123</b>	<b>\$ 2,174</b>

**Note 6 – Deposits**

The components of deposits:

	<b>December 31,</b>	
	<b>2019</b>	<b>2018</b>
	(In Thousands)	
Demand, non-interest bearing	\$ 171,815	\$ 148,609
Demand, NOW and money market, interest bearing	180,869	135,915
Savings	425,284	452,809
Time, \$250 and over	92,517	70,337
Time, other	161,483	123,845
Total deposits	<b>\$ 1,031,968</b>	<b>\$ 931,515</b>

At December 31, 2019, the scheduled maturities of time deposits are as follows (in thousands):

2020	\$ 179,377
2021	40,541
2022	7,215
2023	22,974
2024	3,893
	<b>\$ 254,000</b>

**Note 7 - Securities Sold under Agreements to Repurchase and Offsetting Assets and Liabilities**

Securities sold under agreements to repurchase generally mature within a few days from the transaction date and are reflected at the amount of cash received in connection with the transaction. The securities are retained under the Company's control at its safekeeping agent. The Company adjusts collateral based on the fair value of the underlying securities, on a monthly basis. Information concerning securities sold under agreements to repurchase is summarized as follows:

	<u>2019</u>	<u>2018</u>
	(Dollars In Thousands)	
Balance outstanding at December 31	\$ 7,208	\$ 18,883
Weighted average interest rate at the end of the year	0.588%	0.220%
Average daily balance during the year	\$ 10,870	\$ 16,901
Weighted average interest rate during the year	0.676%	0.260%
Maximum month-end balance during the year	\$ 17,570	\$ 20,050

The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, these repurchase agreements are accounted for as collateralized financing arrangements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Company's consolidated balance sheets, while the securities underlying the repurchase agreements remain in the respective investment securities asset accounts. In other words, there is no offsetting or netting of the investment securities assets with the repurchase agreement liabilities. In addition, as the Company does not enter into reverse repurchase agreements, there is no such offsetting to be done with the repurchase agreements.

The right of setoff for a repurchase agreement resembles a secured borrowing, whereby the collateral would be used to settle the fair value of the repurchase agreement should the Company be in default (e.g., fails to make an interest payment to the counterparty). For private institution repurchase agreements, if the private institution counterparty were to default (e.g., declare bankruptcy), the Company could cancel the repurchase agreement (i.e., cease payment of principal and interest), and attempt collection on the amount of collateral value in excess of the repurchase agreement fair value. The collateral is held by a third-party financial institution in the counterparty's custodial account. The counterparty has the right to sell or repledge the investment securities. For government entity repurchase agreements, the collateral is held by the Company in a segregated custodial account under a tri-party agreement.



Internal Revenue Code of 1986, non-qualified stock options, stock appreciation rights, restricted stock and deferred stock awards. The term of the option, the amount of time for the option to vest after grant, if any, and other terms and limitations will be determined at the time of grant. Options granted under the SIP may not have an exercise period that is more than ten years from the time the option is granted. The maximum number of shares of common stock authorized for issuance under the Plan increased from 500,000 to 756,356 (in order to replenish the shares that were previously issued). The SIP provides for appropriate adjustments in the number and kind of shares available for grant or subject to outstanding awards under the SIP to avoid dilution in the event of merger, stock splits, stock dividends or other changes in the capitalization of the Company. The SIP expires on June 20, 2029. At December 31, 2019, there were 500,000 shares available for issuance under the SIP.

The Company grants shares of restricted stock, under the SIP, to certain members of its Board of Directors as compensation for their services, in accordance with the Company's Non-employee Directors Compensation program adopted in October 2010. The Company also granted restricted stock to certain officers under individual agreements with these officers. Some of these restricted stock awards vest immediately, while the remainder vest over three to nine service years. Management recognizes compensation expense for the fair value of the restricted stock awards on a straight-line basis over the requisite service period. Since inception of the plan and through the Company's restricted stock grants activity for the year ended December 31, 2019, there have been 140,113 awards granted. During the years ended December 31, 2019 and 2018 there were 10,799 and 22,847 awards granted, respectively. During the years ended December 31, 2019 and 2018 the Company recognized \$363 thousand and \$305 thousand in compensation expense for the restricted stock awards.

Information regarding the Company's restricted stock grants activity for the years ended December 31, 2019 and 2018 are as follows:

	<u>Restricted Stock Awards</u>	<u>Weighted Average Grant Date Fair Value</u>
<b>Non-Vested at December 31, 2017</b>	46,524	\$ 13.16
Granted	22,847	15.51
Vested	<u>(19,911)</u>	<u>14.31</u>
<b>Non-Vested at December 31, 2018</b>	49,460	\$ 13.78
Granted	<b>10,799</b>	<b>14.92</b>
Vested	<u>(25,005)</u>	<u>14.49</u>
<b>Non-Vested at December 31, 2019</b>	<u><b>35,254</b></u>	<u><b>\$ 13.63</b></u>

The Company has granted stock options to purchase shares of stock to certain executive officers under individual agreements and/or in accordance with their respective employment agreements. Stock compensation expense related to these options was \$4 thousand and \$5 thousand for the years ended December 31, 2019 and 2018, respectively. At December 31, 2019, there was no unrecognized cost to the stock options.

Activities under the SIP, related to stock options, is summarized as follows:

	<u>Number of Options</u>	<u>Weighted Average Exercise Price</u>
<b>Outstanding, December 31, 2017</b>	116,243	\$ 7.34
Granted	-	-
Exercised	-	-
Forfeited	-	-
<b>Outstanding, December 31, 2018</b>	116,243	\$ 7.34
Granted	-	-
Exercised	-	-
Forfeited	-	-
<b>Outstanding, December 31, 2019</b>	<b>116,243</b>	<b>\$ 7.34</b>
<b>Exercisable, December 31, 2019</b>	<b>116,243</b>	<b>\$ 7.34</b>

Stock options outstanding at December 31, 2019 are exercisable at prices ranging from \$6.60 to \$13.21 per share. The weighted-average remaining contractual life of options outstanding and exercisable at December 31, 2019 is 2.06 years. The weighted-average remaining contractual life of options outstanding and exercisable at December 31, 2018 was 3.06 years and 3.01 years, respectively. At December 31, 2019, the aggregate intrinsic value of options outstanding and exercisable was \$1.3 million. The intrinsic value was determined by using the latest known sales price of the Company's common stock.

The following table summarizes information about the range of exercise prices for stock options outstanding at December 31, 2019:

<u>Range of Exercise Price</u>	<u>Weighted Average Exercise Price</u>	<u>Number Outstanding</u>	<u>Weighted Average Remaining Contractual Life (Years)</u>	<u>Number Exercisable</u>
\$6.60 to \$8.26	\$ 7.14	112,016	1.91	112,016
\$11.56 to \$13.21	\$ 12.64	4,227	5.98	4,227
		<b>116,243</b>	<b>2.06</b>	<b>116,243</b>

#### Employee Stock Purchase Plan:

On January 1, 2017, the Company implemented the Embassy Bancorp, Inc. Employee Stock Purchase Plan, which was approved by the Company's shareholders at the annual meeting held on June 16, 2016. Under the plan, each employee of the Company and its subsidiaries who is employed on an offering date and customarily is scheduled to work at least twenty (20) hours per week and more than five (5) months in a calendar year is eligible to participate. The purchase price for shares purchased under the plan shall initially equal 95% of the fair market value of such shares on the date of purchase. The purchase price may be adjusted from time to time by the Board of Directors; provided, however, that the discount to fair market value shall not exceed 15%. The Company has authorized 350,000 shares of its common stock for the plan, of which 10,222 shares have been issued as of December 31, 2019. The Company recognized discount expense in relation to the employee stock purchase plan of \$3 thousand during the years ending December 31, 2019 and 2018.

**Note 11 – Other Comprehensive Income (Loss)**

The components of other comprehensive income (loss), both before tax and net of tax, are as follows:

	Year Ended December 31,					
	2019			2018		
	Before Tax	Tax Effect	Net of Tax	Before Tax	Tax Effect	Net of Tax
Change in accumulated other comprehensive income (loss):			(In Thousands)			
Unrealized holding gains (losses) on securities available for sale	\$ 3,275	\$ (688)	\$ 2,587	\$ (1,602)	\$ 336	\$ (1,266)
Reclassification adjustments for gains on securities transactions included in net income (A),(B)	-	-	-	-	-	-
Total other comprehensive income (loss)	<u>\$ 3,275</u>	<u>\$ (688)</u>	<u>\$ 2,587</u>	<u>\$ (1,602)</u>	<u>\$ 336</u>	<u>\$ (1,266)</u>

(A) Realized gains on securities transactions included in gain on sales of securities, net, in the accompanying Consolidated Statements of Income.

(B) Tax effect included in income tax expense in the accompanying Consolidated Statements of Income.

There were no gains on securities available for sale for the twelve months ended December 31, 2019 and 2018.

A summary of the accumulated other comprehensive income (loss), net of tax, is as follows:

Year Ended December 31, 2019 and 2018	Securities Available for Sale
	(In Thousands)
<b>Balance January 1, 2019</b>	\$ (1,247)
Other comprehensive income before reclassifications	2,587
Amounts reclassified from accumulated other comprehensive income	-
Net other comprehensive income during the period	2,587
<b>Balance December 31, 2019</b>	<u>\$ 1,340</u>
<b>Balance January 1, 2018</b>	\$ 19
Other comprehensive loss before reclassifications	(1,266)
Amounts reclassified from accumulated other comprehensive income	-
Net other comprehensive loss during the period	(1,266)
<b>Balance December 31, 2018</b>	<u>\$ (1,247)</u>

**Note 12 - Regulatory Matters**

The Company is required to maintain cash reserve balances in vault cash and with the Federal Reserve Bank. As of December 31, 2019, the Company had a \$15.6 million minimum reserve balance.

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. The final rules implementing the BASEL Committee on Banking Supervisor’s Capital Guidance for U.S. banks (BASEL III rules) became effective for the Company on January 1, 2015, with full compliance with all of the requirements being phased in over a multi-year schedule and were fully phased in on January 1, 2019. Under the BASEL III rules the Company and the Bank must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer has been phased in from 0.0% for 2015 to 2.50% at January 1, 2019. The net unrealized gain or losses on available-for-sale securities are not included in computing regulatory

capital amounts. Failure to meet the 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 Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, both the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk-weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth below) of total, Tier 1 common capital, and Tier 1 capital (as defined in the regulations) to risk-weighted assets and of Tier 1 capital to average assets. Management believes, as of December 31, 2019, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

Effective in the third quarter of 2018, the Federal Reserve raised the consolidated asset limit to be considered a small bank holding company from \$1 billion to \$3 billion. A company that qualifies as a small bank holding company is not subject to the Federal Reserve's consolidated capital rules, although a company that so qualifies may continue to file reports that include such capital amounts and ratios. The Company has elected to continue to report those amounts and ratios.

As of December 31, 2019, the most recent notification from the regulatory agencies 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 total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Bank's actual capital amounts and ratios at December 31, 2019 and 2018 are presented below:

	Actual		For Capital Adequacy Purposes		To be Well Capitalized under Prompt Corrective	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollar Amounts in Thousands)						
<b>December 31, 2019:</b>						
Total capital (to risk-weighted assets)	\$ 106,252	13.0 %	\$ ≥ 65,584	≥ 8.0 %	\$ ≥ 81,980	≥ 10.0 %
Tier 1 common capital (to risk-weighted assets)	98,230	12.0	≥ 36,891	≥ 4.5	≥ 53,287	≥ 6.5
Tier 1 capital (to risk-weighted assets)	98,230	12.0	≥ 49,188	≥ 6.0	≥ 65,584	≥ 8.0
Tier 1 capital (to average assets)	98,230	8.4	≥ 46,674	≥ 4.0	≥ 58,343	≥ 5.0
<b>December 31, 2018:</b>						
Total capital (to risk-weighted assets)	\$ 95,732	12.2 %	\$ ≥ 62,761	≥ 8.0 %	\$ ≥ 78,451	≥ 10.0 %
Tier 1 common capital (to risk-weighted assets)	88,320	11.3	≥ 35,303	≥ 4.5	≥ 50,993	≥ 6.5
Tier 1 capital (to risk-weighted assets)	88,320	11.3	≥ 47,071	≥ 6.0	≥ 62,761	≥ 8.0
Tier 1 capital (to average assets)	88,320	8.1	≥ 43,462	≥ 4.0	≥ 54,327	≥ 5.0

The Company's actual capital amounts and ratios at December 31, 2019 and 2018 are presented below:

	Actual		For Capital Adequacy Purposes	
	Amount	Ratio	Amount	Ratio
(Dollar Amounts in Thousands)				
<b>December 31, 2019:</b>				
Total capital (to risk-weighted assets)	\$ 106,297	13.0 %	\$ ≥ 65,568	≥ 8.0 %
Tier 1 common capital (to risk-weighted assets)	98,275	12.0	≥ 36,882	≥ 4.5
Tier 1 capital (to risk-weighted assets)	98,275	12.0	≥ 49,176	≥ 6.0
Tier 1 capital (to average assets)	98,275	8.4	≥ 46,675	≥ 4.0
<b>December 31, 2018:</b>				
Total capital (to risk-weighted assets)	\$ 95,884	12.2 %	\$ ≥ 62,717	≥ 8.0 %
Tier 1 common capital (to risk-weighted assets)	88,472	11.3	≥ 35,278	≥ 4.5
Tier 1 capital (to risk-weighted assets)	88,472	11.3	≥ 47,038	≥ 6.0
Tier 1 capital (to average assets)	88,472	8.1	≥ 43,463	≥ 4.0

The Bank is subject to certain restrictions on the amount of dividends that it may declare due to regulatory considerations. The Pennsylvania Banking Code provides that cash dividends may be declared and paid only out of accumulated net earnings.

**Note 13 - Fair Value of Financial Instruments**

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

Fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

GAAP establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

*Level 1:* Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

*Level 2:* Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

*Level 3:* Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy utilized at December 31, 2019 and 2018 are as follows:

Description	(Level 1)	(Level 2)	(Level 3)	Total
	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs	
(In Thousands)				
Municipal bonds	\$ -	\$ 26,444	\$ -	\$ 26,444
U.S. Government Sponsored Enterprise (GSE) - Mortgage-backed securities - residential	-	64,385	-	64,385
<b>December 31, 2019 Securities available for sale</b>	<b>\$ -</b>	<b>\$ 90,829</b>	<b>\$ -</b>	<b>\$ 90,829</b>
U.S. Government agency obligations	\$ -	\$ 2,997	\$ -	\$ 2,997
Municipal bonds	-	34,878	-	34,878
U.S. Government Sponsored Enterprise (GSE) - Mortgage-backed securities - residential	-	52,873	-	52,873
<b>December 31, 2018 Securities available for sale</b>	<b>\$ -</b>	<b>\$ 90,748</b>	<b>\$ -</b>	<b>\$ 90,748</b>

The fair value of securities available for sale are determined by matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted prices. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the security's terms and conditions, among other things.

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2019 and 2018 are as follows:

Description	(Level 1)	(Level 2)	(Level 3)	Total
	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs	
(In Thousands)				
December 31, 2019 Impaired loans	\$ -	\$ -	\$ 848	\$ 848
December 31, 2019 Other real estate owned	\$ -	\$ -	\$ -	\$ -
December 31, 2018 Impaired loans	\$ -	\$ -	\$ 868	\$ 868
December 31, 2018 Other real estate owned	\$ -	\$ -	\$ 135	\$ 135

Fair value is generally determined through independent appraisals of the underlying collateral, which generally include Level 3 input which are not identifiable. Fair values may also include qualitative adjustments by management based on economic conditions and liquidation expenses.

Impaired loans are generally measured based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

Real estate properties acquired through, or in lieu of, foreclosure are to be sold and are carried at fair value less estimated cost to sell. Fair value is based upon independent market prices or appraised value of the property. These assets are included in Level 3 fair value based upon the lowest level of input that is significant to the fair value measurement.

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Company has utilized Level 3 inputs to determine fair value:

Description	Quantitative Information about Level 3 Fair Value Measurements			
	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)
(Dollars In Thousands)				
<b>December 31, 2019:</b>				
Impaired loans	\$ 848	Appraisal of collateral	Appraisal adjustments (1)	0% to -25% (-25.0%)
			Liquidation expenses (2)	0% to -7.5% (-7.5%)
Other real estate owned	\$ -			
<b>December 31, 2018:</b>				
Impaired loans	\$ 868	Appraisal of collateral	Appraisal adjustments (1)	0% to -25% (-19.7%)
			Liquidation expenses (2)	0% to -8.5% (-8.0%)
Other real estate owned	\$ 135	Listings, Letters of Intent & Third Party Evaluations	Liquidation expenses (2)	-5% (-5%)

- (1) Appraisals may be adjusted by management for qualitative factors including economic conditions and the age of the appraisal. The range and weighted average of appraisal adjustments are presented as a percent of the appraisal.
- (2) Appraisals and pending agreements of sale are adjusted by management for liquidation expenses. The range and weighted of liquidation expense adjustments are presented as a percent of the appraisal or pending agreement of sale.

The estimated fair values of the Company's financial instruments were as follows at December 31, 2019 and 2018:

	<u>Carrying Amount</u>	<u>Fair Value Estimate</u>	<u>(Level 1) Quoted Prices in Active Markets for Identical Assets</u>	<u>(Level 2) Significant Other Observable Inputs</u>	<u>(Level 3) Significant Unobservable Inputs</u>
	(In Thousands)				
<b>December 31, 2019:</b>					
Financial assets:					
Cash and cash equivalents	\$ 39,986	\$ 39,986	\$ 39,986	\$ -	\$ -
Securities available-for-sale	90,829	90,829	-	90,829	-
Loans receivable, net of allowance	1,006,117	1,013,093	-	-	1,013,093
Restricted investments in bank stock	1,478	1,478	-	1,478	-
Accrued interest receivable	2,048	2,048	-	2,048	-
Financial liabilities:					
Deposits	1,031,968	1,033,786	-	1,033,786	-
Securities sold under agreements to repurchase and federal funds purchased	7,208	7,208	-	7,208	-
Short-term borrowings	18,067	18,067	-	18,067	-
Accrued interest payable	3,281	3,281	-	3,281	-
Off-balance sheet financial instruments:					
Commitments to grant loans	-	-	-	-	-
Unfunded commitments under lines of credit	-	-	-	-	-
Standby letters of credit	-	-	-	-	-
<b>December 31, 2018:</b>					
Financial assets:					
Cash and cash equivalents	\$ 27,576	\$ 27,576	\$ 27,576	\$ -	\$ -
Securities available-for-sale	90,748	90,748	-	90,748	-
Loans receivable, net of allowance	949,944	935,500	-	-	935,500
Restricted investments in bank stock	2,794	2,794	-	2,794	-
Accrued interest receivable	2,178	2,178	-	2,178	-
Financial liabilities:					
Deposits	931,515	930,306	-	930,306	-
Securities sold under agreements to repurchase and federal funds purchased	18,883	18,883	-	18,883	-
Short-term borrowings	53,995	53,995	-	53,995	-
Accrued interest payable	1,689	1,689	-	1,689	-
Off-balance sheet financial instruments:					
Commitments to grant loans	-	-	-	-	-
Unfunded commitments under lines of credit	-	-	-	-	-
Standby letters of credit	-	-	-	-	-

**Note 14 - Transactions with Executive Officers, Directors and Principal Stockholders**

The Company has had, and may be expected to have in the future, banking transactions in the ordinary course of business with its executive officers, directors, principal stockholders, their immediate families and affiliated companies (commonly referred to as related parties).

Related parties were indebted to the Company for loans totaling \$10.2 million and \$10.7 million at December 31, 2019 and 2018, respectively. During 2019, loans totaling \$1.3 million were disbursed and loan repayments totaled \$1.8 million.

Deposits with related parties were \$15.7 million and \$20.7 million at December 31, 2019 and 2018, respectively.

Fees paid to related parties for legal services for the years ended December 31, 2019 and 2018 were approximately \$43 thousand and \$88 thousand, respectively. The Company leases its main banking office from an investment group comprised of related parties and its West Broad Street office also from a related party, as described in Note 15.

### **Note 15 - Lease Commitments**

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)", which superseded the lease requirements in Topic 840. The ASU required lessees to recognize a right of use asset and related lease liability for all leases, with a limited exception for short term leases. Leases are classified as either finance or operating, with the classification affecting the pattern of expense recognition in the consolidated statement of income. Previously, leases were classified as either capital or operating, with only capital leases recognized on the consolidated balance sheets. The reporting of lease related expenses in the statements of income and cash flows are generally consistent with the current guidance. The new guidance became effective for the Company on January 1, 2019. The standard was applied using the optional transition method in accordance with the July 2018 issued ASU No. 2018-11. The Company has made an accounting policy election to not apply the recognition requirements in ASU 2016-02 to short-term leases. The Company has also elected to use the practical expedients allowed by the new standard as follows: 1) forego an assessment of whether any existing contracts are or contain leases, 2) forego an assessment of the classification of existing leases as to whether they are operating leases or capital leases, and 3) forego an assessment of direct costs for any existing leases. At adoption the Company had an increase on its consolidated balance sheet in January 2019 for the right of use asset of \$10.9 million and the lease liability of \$11.0 million.

The Company's leases are all classified as operating leases, with one lease being short term. Currently, many of these leases contain renewal options. The Company has reviewed and based the right of use assets and lease liabilities, primarily, on the present value of unpaid future minimum lease payments. Additionally, the amounts for the branch leases were impacted by assumptions around renewals and/or extensions and the interest rate used to discount those future lease obligations. The Company used the FHLB advance rates to calculate the discount rate in their review because none of the Company's leases provided an implicit rate. The Company uses its incremental borrowing rate based on the information available at the lease commencement date in determining the present value of the lease payments at December 31, 2019. The weighted average discount rate for all operating leases was 3.17%, with branch leases having a weighted average discount rate of 3.18% and equipment leases having a weighted average discount rate of 2.81%. These leases expire at various dates through August 2030. All operating equipment leases do not have renewal language in their contracts and therefore use the current term. As of December 31, 2019, the operating leases overall had a weighted average lease term of 6.72 years, with the branch leases having a weighted average life of 6.78 years and equipment leases having a weighted average life of 2.49 years.

At December 31, 2019, the Company had right of use assets of \$9.6 million (included in other assets) and lease liabilities of \$9.7 million (included in other liabilities). The cost for operating leases was \$1.7 million, including short-term lease cost of \$3 thousand, for the year ended December 31, 2019. Operating cash flow paid for lease liabilities was \$1.6 million for the year ended December 31, 2019.

In addition to fixed rentals, the leases require the Company to pay certain additional expenses of occupying these spaces, including real estate taxes, insurance, utilities and repairs. A portion of these leases are with related parties as noted in the following table.

The Company has excluded from the table the ground lease, entered into November 2017, for a branch location on West Main Street in the Borough of Macungie, Lehigh County. The estimated opening of the branch in 2020 is contingent on the prior receipt of proper construction, regulatory approvals, and government permits. The Company's preview center office in Macungie, which is also excluded from the table, opened in advance of its new permanent Macungie Office and is a short term lease.

A reconciliation of operating lease liabilities by minimum lease payments by year and in aggregate and discount amounts in aggregate, as of December 31, 2019, are as follows:

	<b>Branch Leases</b>		<b>Equipment</b>		<b>Total</b>
	<b>Third Parties</b>	<b>Related Parties</b>	<b>Leases</b>		
	(In Thousands)				
2020	\$ 936	\$ 635	\$ 79	\$	1,650
2021	953	647	39		1,639
2022	983	660	33		1,676
2023	1,000	673	4		1,677
2024	854	685	1		1,540
Thereafter	1,247	1,424	-		2,671
<b>Total Payments</b>	<b>5,973</b>	<b>4,724</b>	<b>156</b>		<b>10,853</b>
Less: Discount Amount	605	523	6		1,134
<b>Total Lease Liability</b>	<b>\$ 5,368</b>	<b>\$ 4,201</b>	<b>\$ 150</b>	<b>\$</b>	<b>9,719</b>

Rent expense to related parties was \$661 thousand and \$531 thousand for the years ended December 31, 2019 and 2018, respectively, as described in Note 14.

**Note 16 - Federal Income Taxes**

The components of income tax expense are as follows:

	<b>Year Ended December 31,</b>	
	<b>2019</b>	<b>2018</b>
	(In Thousands)	
Current	\$ 2,732	\$ 2,268
Deferred	(238)	16
<b>Income Tax Expense</b>	<b>\$ 2,494</b>	<b>\$ 2,284</b>

A reconciliation of the statutory federal income tax at a rate of 21% as of December 31, 2019 and December 31, 2018 to the income tax expense included in the consolidated statements of income is as follows:

	<b>Years Ended December 31,</b>			
	<b>2019</b>		<b>2018</b>	
	(In Thousands)			
	<b>Dollar</b>	<b>%</b>	<b>Dollar</b>	<b>%</b>
Federal income tax at statutory rate	\$ 2,808	21.0 %	\$ 2,596	21.0 %
Tax-exempt interest	(249)	(1.9)%	(308)	(2.5)%
Bank owned life insurance	(120)	(0.9)%	(55)	(0.4)%
Other	55	0.4 %	51	0.4 %
<b>Income Tax Expense</b>	<b>\$ 2,494</b>	<b>18.6 %</b>	<b>\$ 2,284</b>	<b>18.5 %</b>

The Company evaluates its tax positions and a tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that has a likelihood of being realized on examination of more than 50 percent. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. Under the “more likely than not” threshold guidelines, the Company believes no significant uncertain tax positions exist, either individually or in the aggregate, that would give rise to the non-recognition of an existing tax benefit. As of December 31, 2019 and 2018, the Company had no material unrecognized tax benefits or accrued interest and

penalties. The Company's policy is to account for interest as a component of interest expense and penalties as a component of other expense.

The components of the net deferred tax asset (included in other assets) are as follows:

	<b>December 31,</b>	
	<b>2019</b>	<b>2018</b>
(In Thousands)		
Deferred tax assets:		
Allowance for loan losses	\$ 1,685	\$ 1,556
Deferred compensation	1,112	1,015
Lease liability	2,041	
Premises and equipment	3	-
Unrealized loss on securities available for sale	-	331
Other	4	49
<b>Total Deferred Tax Assets</b>	<b>4,845</b>	<b>2,951</b>
Deferred tax liabilities:		
Premises and equipment	-	16
Prepaid assets	276	295
Non-qualified stock awards	-	22
Deferred loan costs	497	459
Right of use asset	2,006	
Unrealized gain on securities available for sale	357	-
<b>Total Deferred Tax Liabilities</b>	<b>\$ 3,136</b>	<b>\$ 792</b>
<b>Net Deferred Tax Asset</b>	<b>\$ 1,709</b>	<b>\$ 2,159</b>

Based upon the level of historical taxable income and projections for future taxable income over periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences.

**Note 17 – Parent Company Only Financial**

Condensed financial information pertaining only to the parent company, Embassy Bancorp, Inc., is as follows:

**BALANCE SHEETS**

	<b>December 31,</b>	
	<b>2019</b>	<b>2018</b>
	<b>(In Thousands)</b>	
<b><u>ASSETS</u></b>		
Cash	\$ 256	\$ 331
Other assets	26	30
Investment in subsidiary	99,569	87,072
Total Assets	<u>\$ 99,851</u>	<u>\$ 87,433</u>
<b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>		
Other liabilities	\$ 236	\$ 208
Stockholders' equity	99,615	87,225
Total Liabilities and Stockholders' Equity	<u>\$ 99,851</u>	<u>\$ 87,433</u>

**STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**

	<b>Years Ending December 31,</b>	
	<b>2019</b>	<b>2018</b>
	<b>(In Thousands)</b>	
Other expenses	\$ (438)	\$ (361)
Equity in net income of banking subsidiary	11,233	10,370
Income before income taxes	10,795	10,009
Income tax benefit	84	70
Net income	<u>\$ 10,879</u>	<u>\$ 10,079</u>
Equity in other comprehensive gain (loss) of banking subsidiary	2,587	(1,266)
Comprehensive income	<u>\$ 13,466</u>	<u>\$ 8,813</u>

STATEMENT OF CASH FLOWS

	Years Ending December 31,	
	2019	2018
	(In Thousands)	
<b>Cash Flows from Operating Activities:</b>		
Net income	\$ 10,879	\$ 10,079
Adjustments to reconcile net income to net cash used in operating activities:		
Stock compensation expense	4	5
Net change in other assets and liabilities	32	25
Equity in net income of banking subsidiary	(11,233)	(10,370)
<b>Net Cash Used in Operating Activities</b>	<b>(318)</b>	<b>(261)</b>
<b>Cash Flows Provided By Investing Activities:</b>		
Dividend from banking subsidiary	1,323	1,720
<b>Cash Flows from Financing Activities:</b>		
Exercise of stock options, net of payment stock tendered, and proceeds from ESPP and DRIP	415	567
Purchase of treasury stock	-	(658)
Dividends paid	(1,495)	(1,271)
<b>Net Cash Used in Financing Activities</b>	<b>(1,080)</b>	<b>(1,362)</b>
<b>Net (Decrease) Increase in Cash</b>	<b>(75)</b>	<b>97</b>
<b>Cash – Beginning</b>	<b>331</b>	<b>234</b>
<b>Cash - Ending</b>	<b>\$ 256</b>	<b>\$ 331</b>

**Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None.

**Item 9A. CONTROLS AND PROCEDURES.**

**Evaluation of Disclosure Controls and Procedures**

The Company carried out an evaluation, under the supervision and with the participation of its management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15 as of December 31, 2019. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded, as of December 31, 2019, that the Company's disclosure controls and procedures were effective in recording, processing, summarizing, and reporting information required to be disclosed by the Company within the time periods specified in the SEC's rules and forms, and such information is accumulated and communicated to management to allow timely decisions regarding required disclosures.

A Report of Management's Assessment of Internal Control Over Financial Reporting is located on page 45 of this report, and incorporated herein by reference.

**Changes in Internal Controls over Financial Reporting**

There have been no changes in the Company's internal control over financial reporting during the fourth quarter of 2019 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 9B. OTHER INFORMATION.**

None.

### **PART III**

#### **Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.**

The information required by Part III, Item 10, is incorporated herein by reference to the information under the captions “Board of Directors,” “Information as to Nominees and Directors,” “Executive Officers,” “Nominating Process,” “Code of Conduct (Ethics),” “Committees of the Board of Directors” and “Section 16(a) Beneficial Ownership Reporting Compliance” in the Company’s definitive proxy statement to be filed with the SEC in connection with the Company’s 2020 annual meeting of shareholders.

#### **Item 11. EXECUTIVE COMPENSATION.**

The information required by Part III, Item 11, is incorporated herein by reference to the information under the captions “Director Compensation,” “Executive Compensation” and “Agreements with Executive Officers” in the Company’s definitive proxy statement to be filed with the SEC in connection with the Company’s 2020 annual meeting of shareholders.

#### **Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.**

The information required by Part III, Item 12, is incorporated herein by reference to the information under Item 5 of this report and the information under the caption “Information Concerning Share Ownership” in the Company’s definitive proxy statement to be filed with the SEC in connection with the Company’s 2020 annual meeting of shareholders.

#### **Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.**

The information required by Part III, Item 13, is incorporated herein by reference to the information under the captions “Certain Relationships and Related Transactions” and “Director Independence” in the Company’s definitive proxy statement to be filed with the SEC in connection with the Company’s 2020 annual meeting of shareholders.

#### **Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.**

The information required by Part III, Item 14, is incorporated herein by reference to the information under the captions “Independent Registered Public Accounting Firm”, “Fees of Independent Accountants” and “Report of Audit Committee” in the Company’s definitive proxy statement to be filed with the SEC in connection with the Company’s 2020 annual meeting of shareholders.

**PART IV**

**Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.**

- (a) Financial Statement Schedules can be found under Item 8 of this report.
- (b) Exhibits required by Item 601 of Regulation S-K:

Exhibit

<u>Number</u>	<u>Description</u>
<a href="#">3.1</a>	Articles of Incorporation, as amended (conformed) (Incorporated by reference to Exhibit 3.1 of Registrant's Form 10-Q filed on August 12, 2016).
<a href="#">3.2</a>	By-Laws (Incorporated by reference to Exhibit 3.2 of Registrant's Form 10-Q filed on August 12, 2016).
<a href="#">10.1</a>	Embassy Bancorp, Inc. Dividend Reinvestment and Stock Purchase Plan (Incorporated by reference to Exhibit 10.1 of Registrant's Form 10-K filed on March 15, 2018).
<a href="#">10.2</a>	Embassy Bancorp, Inc. 2010 Stock Incentive Plan (Incorporated by reference to Exhibit 10.2 of Registrant's Form 10-K filed on March 30, 2016).
<a href="#">10.3</a>	Amended and Restated Embassy Bancorp, Inc. 2010 Stock Incentive Plan (Incorporated by reference to Annex A of Registrant's definitive proxy statement filed on May 1, 2019).
<a href="#">10.4</a>	Form of Stock Option Grant Agreement – Directors (Incorporated by reference to Exhibit 10.3 of Registrant's Form 10-K filed on March 30, 2016).
<a href="#">10.5</a>	Form of Stock Option Grant Agreement – Executive Officers (Incorporated by reference to Exhibit 10.4 of Registrant's Form 10-K filed on March 30, 2016).
<a href="#">10.6</a>	Lease Agreement dated June 11, 2001 for the Rte. 512 Bethlehem office, Bethlehem, PA (Incorporated by reference to Exhibit 10.5 of Registrant's Form 10-K filed on March 30, 2015).
<a href="#">10.7</a>	Lease Agreement dated October 21, 2005 for Hamilton Blvd. and Mill Creek Rd., Lower Macungie Township, PA (Incorporated by reference to Exhibit 10.6 of Registrant's Form 10-K filed on March 30, 2015).
<a href="#">10.8</a>	Lease Addendum dated January 1, 2005 for additional space in the Rte. 512, Bethlehem office, Bethlehem, PA (Incorporated by reference to Exhibit 10.7 of Registrant's Form 10-K filed on March 30, 2015).
<a href="#">10.9</a>	Lease Agreement dated March 11, 2009 for Cedar Crest Blvd., Allentown, PA (Incorporated by reference to Exhibit 10.8 of Registrant's Form 10-K filed on March 30, 2015).
<a href="#">10.10</a>	Lease Agreement dated March 21, 2003 for Tilghman Street, Allentown, PA (Incorporated by reference to Exhibit 10.9 of Registrant's Form 10-K filed on March 30, 2015).
<a href="#">10.11</a>	Lease Agreement dated March 17, 2006 for 925 West Broad St, Bethlehem PA (Incorporated by reference to Exhibit 10.10 of Registrant's Form 10-K filed on March 30, 2015).
<a href="#">10.12</a>	Lease Agreement dated June 17, 2008 for 5828 Old Bethlehem Pike, Center Valley, PA (Incorporated by reference to Exhibit 10.11 of Registrant's Form 10-K filed on March 30, 2015).
<a href="#">10.13</a>	Lease Agreement dated March 13, 2009 for Corriere Road and Route 248 in Lower Nazareth Township, PA (Incorporated by reference to Exhibit 10.12 of Registrant's Form 10-K filed on March 30, 2015).
<a href="#">10.14</a>	Second Lease Expansion Addendum dated October 21, 2011 by and between Embassy Bank for the Lehigh Valley and Red Bird Associates, LLC (Incorporated by reference to Exhibit 10.13 of Registrant's Form 10-K filed on March 30, 2017).
<a href="#">10.15</a>	Lease Renewal and Modification Agreement dated May 4, 2012 by and between Embassy Bank for the Lehigh Valley and Red Bird Associates LLC (Incorporated by reference to Exhibit 10.14 of Registrant's Form 10-K filed on March 15, 2018).
<a href="#">10.16</a>	Lease Renewal dated February 17, 2017 by and between Embassy Bank for the Lehigh Valley and Red Bird Associates, LLC (Incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed on February 21, 2017).
<a href="#">10.17</a>	Lease Agreement dated September 1, 2015 by and between Embassy Bank for the Lehigh Valley and Orwig Property Management Center Square, LLC (Incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed on September 3, 2015).
<a href="#">10.18</a>	Lease Agreement dated November 10, 2017 by and between Embassy Bank for the Lehigh Valley and Pope Valley Properties, LLC (Incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed on November 14, 2017).

**Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES. (Continued)**

<u>Exhibit Number</u>	<u>Description</u>
<a href="#">10.19</a>	Lease Expansion Agreement dated June 15, 2018 by and between Embassy Bank for the Lehigh Valley and Red Bird Associates, LLC (Incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed on June 19, 2018).
<a href="#">10.20</a>	Lease Amendment dated December 28, 2018 for a reduced rent escalator for 5828 Old Bethlehem Pike, Center Valley, PA (Incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed on December 31, 2018).
<a href="#">10.21</a>	Amended and Restated Employment Agreement between Embassy Bank for the Lehigh Valley and David M. Lobach, Jr., dated May 24, 2018 (Incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed on May 29, 2018).
<a href="#">10.22</a>	Amended and Restated Employment Agreement between Embassy Bank for the Lehigh Valley and Judith A. Hunsicker, dated May 24, 2018 (Incorporated by reference to Exhibit 10.2 of Registrant's Form 8-K filed on May 29, 2018).
<a href="#">10.23</a>	Employment Agreement – J. Bartholomew, dated February 20, 2009 (Incorporated by reference to Exhibit 10.19 of Registrant's Form 10-K filed on March 30, 2015).
<a href="#">10.24</a>	Amendment to Employment Agreement between Embassy Bank for the Lehigh Valley and James R. Bartholomew, dated November 19, 2010 (Incorporated by reference to Exhibit 10.21 of Registrant's Form 10-K filed on March 30, 2016).
<a href="#">10.25</a>	Amended and Restated Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and David M. Lobach, Jr., dated November 19, 2010 (Incorporated by reference to Exhibit 10.22 of Registrant's Form 10-K filed on March 30, 2016).
<a href="#">10.26</a>	Amendment No. 1 to Amended and Restated Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and David M. Lobach, Jr., dated November 21, 2011 (Incorporated by reference to Exhibit 10.23 of Registrant's Form 10-K filed on March 30, 2017).
<a href="#">10.27</a>	Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and David M. Lobach, Jr., dated November 19, 2010 (Incorporated by reference to Exhibit 10.24 of Registrant's Form 10-K filed on March 30, 2016).
<a href="#">10.28</a>	Amendment No. 2 to Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and David M. Lobach, Jr., dated January 1, 2013 (Incorporated by reference to Exhibit 10.27 of Registrant's Form 10-K filed on March 13, 2019).
<a href="#">10.29</a>	Amendment No. 3 to Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and David M. Lobach, Jr., dated January 23, 2014.
<a href="#">10.30</a>	Amended and Restated Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and Judith A. Hunsicker, dated November 19, 2010 (Incorporated by reference to Exhibit 10.27 of Registrant's Form 10-K filed on March 30, 2016).
<a href="#">10.31</a>	Amendment No. 2 to Amended and Restated Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and Judith A. Hunsicker, dated January 1, 2013 (Incorporated by reference to Exhibit 10.30 of Registrant's Form 10-K filed on March 13, 2019).
<a href="#">10.32</a>	Amendment No. 3 to Amended and Restated Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and Judith A. Hunsicker, dated January 23, 2014.
<a href="#">10.33</a>	Amended and Restated Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and James R. Bartholomew, dated November 19, 2010 (Incorporated by reference to Exhibit 10.30 of Registrant's Form 10-K filed on March 30, 2016).
<a href="#">10.34</a>	Amendment No. 2 to Amended and Restated Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and James R. Bartholomew, dated January 1, 2013 (Incorporated by reference to Exhibit 10.33 of Registrant's Form 10-K filed on March 13, 2019).
<a href="#">10.35</a>	Amendment No. 3 to Amended and Restated Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and James R. Bartholomew, dated January 23, 2014.
<a href="#">10.36</a>	Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and Judith A. Hunsicker, dated December 23, 2015 (Incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed on December 29, 2015).

**Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES. (Continued)**

<u>Exhibit</u>	<u>Description</u>
<a href="#">10.37</a>	Amendment No. 1 to Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and Judith A. Hunsicker, dated December 21, 2016 (Incorporated by reference to Exhibit 10.1 of Registrant’s Form 8-K filed on December 27, 2016).
<a href="#">10.38</a>	Amendment No. 2 to Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and Judith A. Hunsicker, dated December 20, 2017 (Incorporated by reference to Exhibit 10.1 of Registrant’s Form 8-K filed on December 20, 2017).
<a href="#">10.39</a>	Amendment No. 3 to Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and Judith A. Hunsicker, dated December 21, 2018 (Incorporated by reference to Exhibit 10.1 of Registrant’s Form 8-K filed on December 21, 2018).
<a href="#">10.40</a>	Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and James R. Bartholomew, dated December 23, 2015 (Incorporated by reference to Exhibit 10.2 of Registrant’s Form 8-K filed on December 29, 2015).
<a href="#">10.41</a>	Amendment No. 1 to Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and James R. Bartholomew, dated December 21, 2016 (Incorporated by reference to Exhibit 10.2 of Registrant’s Form 8-K filed on December 27, 2016).
<a href="#">10.42</a>	Amendment No. 2 to Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and James R. Bartholomew, dated December 20, 2017 (Incorporated by reference to Exhibit 10.2 of Registrant’s Form 8-K filed on December 20, 2017).
<a href="#">10.43</a>	Amendment No. 3 to Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and James R. Bartholomew, dated December 21, 2018 (Incorporated by reference to Exhibit 10.2 of Registrant’s Form 8-K filed on December 21, 2018).
<a href="#">10.44</a>	Embassy Bancorp, Inc. Employee Stock Purchase Plan (Incorporated by reference to Appendix A of Registrant’s definitive proxy statement filed on April 21, 2016).
<a href="#">21.1</a>	Subsidiaries of the Registrant.
<a href="#">23.1</a>	Consent of Baker Tilly Virchow Krause LLP.
<a href="#">31.1</a>	Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a).
<a href="#">31.2</a>	Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a).
<a href="#">32.1</a>	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 1350 of the Sarbanes-Oxley Act of 2002.
101.1	XBRL - Related Documents
	No.      Description
101. INS	XBRL Instance Document.
101. SCH	XBRL Taxonomy Extension Schema Document.
101. CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101. LAB	XBRL Taxonomy Extension Label Linkbase Document.
101. PRE	XBRL Taxonomy Extension Presentation Linkbase Document.
101. DEF	XBRL Taxonomy Extension Definitions Linkbase Document.

**Item 16. FORM 10-K SUMMARY.**

None.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed in its behalf by the undersigned, thereunto duly authorized.

EMBASSY BANCORP, INC.

Dated: March 11, 2020

By: /s/ David M. Lobach, Jr.  
David M. Lobach, Jr.  
Chairman, President and Chief Executive Officer

Dated: March 11, 2020

By: /s/ Judith A. Hunsicker  
Judith A. Hunsicker  
First Executive Officer, Chief Operating  
Officer, Secretary and Chief Financial Officer



**Exhibit 21.1**

**SUBSIDIARIES OF THE REGISTRANT**

1. Embassy Bank for the Lehigh Valley, Bethlehem, Pennsylvania; a state-chartered bank organized under Pennsylvania Banking Code of 1965.

**Exhibit 23.1**

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-169018, 333-212583, and 333-233401) of Embassy Bancorp, Inc. and Subsidiary of our report dated March 11, 2020 relating to the consolidated financial statements and the effectiveness of Embassy Bancorp, Inc. and Subsidiary's internal control over financial reporting, which appears in this annual report on Form 10-K for the year ended December 31, 2019.

/s/ Baker Tilly Virchow Krause, LLP

Allentown, Pennsylvania  
March 11, 2020





**EXHIBIT 32.1**

**Certification Pursuant to 18 U.S.C. 1350 and  
Section 906 of Sarbanes-Oxley Act of 2002**

We hereby certify that the foregoing Form 10-K of Embassy Bancorp, Inc. for the year ended December 31, 2019 complies in all respects with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained therein fairly presents, in all material respects, the financial condition and results of operations of Embassy Bancorp, Inc.

/s/ David M. Lobach, Jr.

David M. Lobach, Jr.

Chairman, President and Chief Executive Officer

/s/ Judith A. Hunsicker

Judith A. Hunsicker

First Executive Officer, Chief Operating  
Officer, Secretary and Chief Financial Officer

DATED: March 11, 2020

## Embassy Bancorp, Inc.

Embassy Bancorp, Inc. (the “Company”) is a Pennsylvania corporation and registered bank holding company. It is the parent company of Embassy Bank For The Lehigh Valley (the “Bank”), a full service bank providing personal and business lending and deposit service through nine branch offices in the Lehigh Valley area of Pennsylvania.

### Transfer Agent

Computershare  
P.O. Box 43078  
Providence, RI 02940-3078  
Phone: 1-800-368-5948

### Corporate Headquarters

100 Gateway Drive, Suite 100  
P.O. Box 20405  
Lehigh Valley, PA 18002-0405  
610-882-8800 Fax: 610-691-5600  
www.embassybank.com

### Annual Meeting

The Annual Meeting of Embassy Bancorp, Inc. will be held on June 18, 2020 at 4:30 P.M. EDT, virtually via the internet at [www.meetingcenter.io/231931679](http://www.meetingcenter.io/231931679). To access the meeting, you must have the control number and password from the 2020 Annual Meeting Proxy Card.

### Form 10-K Request

The Company’s Annual Report on Form 10-K, as filed with the Securities and Exchange Commission, is available without charge at the Company’s website at [www.embassybank.com](http://www.embassybank.com) or by contacting:

Judith Hunsicker, Chief Operating Officer  
Embassy Bancorp, Inc.  
P.O. Box 20405  
Lehigh Valley, PA 18002-0405

## Market & Dividend Information

Embassy Bancorp, Inc. common stock is quoted on the OTCQX under the symbol EMBY and is traded over-the-counter and in privately negotiated transactions. The common stock is not listed on any national securities exchange. OTC Markets ([www.otcm Markets.com](http://www.otcm Markets.com)) maintains a list of market makers of Company common stock. You may also obtain this list by contacting Lynne Neel at 610-882-8805.

On June 20, 2019, the Company declared an annual cash dividend of \$0.20 per share.

## Direct Stock Purchase and Dividend Reinvestment Plan

The Company’s Transfer Agent, Computershare Trust Company, N.A., sponsors and administers a plan that offers a convenient way for current and prospective investors to purchase shares of Company common stock through direct purchases or reinvestment of cash dividends.

For more information about the plan, please contact Computershare at:

Computershare  
P.O. Box 43021  
Providence, RI 02940-3021  
Phone: 1-800-368-5948  
[www.computershare.com](http://www.computershare.com)

**ALLENTOWN**

1142 S. Cedar Crest Blvd.  
(484) 223-0018

**ALLENTOWN**

4148 W. Tilghman St.  
(484) 223-1782

**BETHLEHEM**

100 Gateway Dr.  
(610) 882-8800

**BETHLEHEM**

925 W. Broad St.  
(484) 821-1210

**EASTON**

3751 Easton-Nazareth Hwy.  
(484) 536-1870

**MACUNGIE**

207 E. Main St.  
(484) 519-9150

**NAZARETH**

10 N. Main St.  
(610) 614-3251

**SAUCON VALLEY**

3495 Rt. 378  
(610) 332-2981

**TREXLERTOWN**

6379 Hamilton Blvd.  
(610) 336-8034