

COLONY BANKCORP INC  
Form 10-Q  
August 03, 2018  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2018 COMMISSION FILE NUMBER 0-12436

COLONY BANKCORP, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

GEORGIA

58-1492391

(STATE OR OTHER JURISDICTION OF (I.R.S. EMPLOYER

INCORPORATION OR ORGANIZATION) IDENTIFICATION NUMBER)

115 SOUTH GRANT STREET, FITZGERALD, GEORGIA 31750

ADDRESS OF PRINCIPAL EXECUTIVE OFFICES

229/426-6000

REGISTRANT'S TELEPHONE NUMBER INCLUDING AREA CODE

INDICATE BY CHECK MARK WHETHER THE REGISTRANT (1) HAS FILED ALL REPORTS REQUIRED TO BE FILED BY SECTIONS 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 SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS.

YES  NO

INDICATE BY CHECK MARK WHETHER THE REGISTRANT HAS SUBMITTED ELECTRONICALLY AND POSTED ON ITS CORPORATE WEB SITE, IF ANY, EVERY INTERACTIVE DATA FILE REQUIRED TO BE SUBMITTED AND POSTED 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 AND POST SUCH FILES).

YES  NO

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A LARGE ACCELERATED FILER, AN ACCELERATED FILER, A NON-ACCELERATED FILER, 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

ACCELERATED FILER

NON-ACCELERATED FILER (DO NOT CHECK IF A SMALLER REPORTING COMPANY)

SMALLER REPORTING COMPANY

EMERGING GROWTH 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 SECITON 13(A) OF THE EXCHANGE ACT.



INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A SHELL COMPANY (AS DEFINED IN RULE 12B-2 OF THE EXCHANGE ACT).

YES            NO   X

INDICATE THE NUMBER OF SHARES OUTSTANDING OF EACH OF THE ISSUER'S CLASSES OF COMMON STOCK, AS OF THE LATEST PRACTICABLE DATE.

<u>CLASS</u>	<u>OUTSTANDING AT AUGUST 3, 2018</u>
COMMON STOCK, \$1 PAR VALUE	8,439,258

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## Forward Looking Statement Disclosure

Certain statements contained in this Quarterly Report that are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the Act), notwithstanding that such statements are not specifically identified. In addition, certain statements may be contained in the Company's future filings with the SEC, in press releases, and in oral and written statements made by or with the approval of the Company that are not statements of historical fact and constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other financial items; (ii) statements of plans and objectives of Colony Bankcorp, Inc. or its management or Board of Directors, including those relating to products or services; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as "believes," "anticipates," "expects," "intends," "targeted" and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:

Local and regional economic conditions and the impact they may have on the Company and its customers and the Company's assessment of that impact.

Changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements.

The effects of and changes in trade, monetary and fiscal policies and laws, including interest rate policies of the Federal Reserve Board.

Inflation, interest rate, market and monetary fluctuations.

Political instability.

Acts of war, terrorism or cyberterrorism.

The timely development and acceptance of new products and services and perceived overall value of these products and services by users.

Changes in consumer spending, borrowings and savings habits.

Technological changes.

Acquisitions and integration of acquired businesses.

The ability to increase market share and control expenses.

The effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which the Company and its subsidiary must comply.

The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Financial Accounting Standards Board and other accounting standard setters.

Changes in the Company's organization, compensation and benefit plans.

The costs and effects of litigation and of unexpected or adverse outcomes in such litigation.

Greater than expected costs or difficulties related to the integration of new lines of business.

The Company's success at managing the risks involved in the foregoing items.

Forward-looking statements speak only as of the date on which such statements are made. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made, or to reflect the occurrence of unanticipated events.

Readers should carefully review all disclosures we file from time to time with the Securities and Exchange Commission (SEC).

**PART 1. FINANCIAL INFORMATION**

ITEM 1

**FINANCIAL STATEMENTS**

THE FOLLOWING FINANCIAL STATEMENTS ARE PROVIDED FOR COLONY BANKCORP, INC. AND ITS WHOLLY-OWNED SUBSIDIARY BANK, COLONY BANK

- A. CONSOLIDATED BALANCE SHEETS – JUNE 30, 2018 (UNAUDITED) AND DECEMBER 31, 2017 (AUDITED).
- B. CONSOLIDATED STATEMENTS OF INCOME – FOR THE THREE MONTHS ENDED JUNE 30, 2018 AND 2017 AND FOR THE SIX MONTHS ENDED JUNE 30, 2018 AND 2017 (UNAUDITED).
- C. CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME – FOR THE THREE MONTHS ENDED JUNE 30, 2018 AND 2017 AND THE SIX MONTHS ENDED JUNE 30, 2018 AND 2017 (UNAUDITED).
- D. CONSOLIDATED STATEMENTS OF CASH FLOWS – FOR THE SIX MONTHS ENDED JUNE 30, 2018 AND 2017 (UNAUDITED).

THE CONSOLIDATED FINANCIAL STATEMENTS FURNISHED HAVE NOT BEEN AUDITED BY INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS, BUT REFLECT, IN THE OPINION OF MANAGEMENT, ALL ADJUSTMENTS (CONSISTING SOLELY OF NORMAL RECURRING ADJUSTMENTS) NECESSARY FOR A FAIR PRESENTATION OF THE RESULTS OF OPERATIONS FOR THE PERIODS PRESENTED.

THE RESULTS OF OPERATIONS FOR THE SIX MONTH PERIOD ENDED JUNE 30, 2018 ARE NOT NECESSARILY INDICATIVE OF THE RESULTS TO BE EXPECTED FOR THE FULL YEAR.

**PART I (Continued)**

## Item 1 (Continued)

**COLONY  
BANKCORP,  
INC. AND  
SUBSIDIARY  
CONSOLIDATED  
BALANCE  
SHEETS  
JUNE 30, 2018  
AND  
DECEMBER 31,  
2017  
(DOLLARS IN  
THOUSANDS)**

	<b>June 30, 2018 (Unaudited)</b>	<b>December 31, 2017 (Audited)</b>
<b>ASSETS</b>		
<b>Cash and Cash Equivalents</b>		
Cash and Due from Banks	<b>\$ 9,900</b>	\$23,145
<b>Interest-Bearing Deposits</b>	<b>38,573</b>	34,668
<b>Investment Securities</b>		
Available for Sale, at Fair Value	<b>331,938</b>	354,247
<b>Federal Home Loan Bank Stock, at Cost</b>	<b>3,382</b>	3,043
<b>Loans</b>	<b>766,796</b>	765,284
Allowance for Loan Losses	<b>(7,159)</b>	(7,508)
Unearned Interest and Fees	<b>(541)</b>	(495)
	<b>759,096</b>	757,281
<b>Premises and Equipment</b>	<b>28,638</b>	27,639
<b>Other Real Estate (Net of Allowance of \$862 and \$1,451 as of June 30, 2018 and December 31, 2017, Respectively)</b>	<b>3,595</b>	4,256
<b>Other Intangible Assets</b>	<b>27</b>	45
<b>Other Assets</b>	<b>29,323</b>	28,431
<b>Total Assets</b>	<b>\$ 1,204,472</b>	\$ 1,232,755
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Deposits</b>		
Noninterest-Bearing	<b>\$ 177,336</b>	\$ 190,928
Interest-Bearing	<b>858,550</b>	877,057

	<b>1,035,886</b>	1,067,985
<b>Borrowed Money</b>		
Subordinated Debentures	<b>24,229</b>	24,229
Other Borrowed Money	<b>53,508</b>	47,500
	<b>77,737</b>	71,729
<b>Other Liabilities</b>	<b>2,603</b>	2,718
<b>Stockholders' Equity</b>		
Common Stock, Par Value \$1 a Share; Authorized 20,000,000 Shares, Issued 8,439,258 Shares as of June 30, 2018 and December 31, 2017	<b>8,439</b>	8,439
Paid-In Capital	<b>25,970</b>	29,145
Retained Earnings	<b>64,643</b>	59,230
Accumulated Other Comprehensive (Loss), Net of Tax Benefits	<b>(10,806 )</b>	(6,491 )
	<b>88,246</b>	90,323
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 1,204,472</b>	\$ 1,232,755

The accompanying notes are an integral part of these statements.

**PART I (Continued)**

## Item 1 (Continued)

**COLONY  
BANKCORP,  
INC. AND  
SUBSIDIARY  
CONSOLIDATED  
STATEMENTS  
OF INCOME  
THREE  
MONTHS  
ENDED JUNE 30,  
2018 AND 2017  
AND SIX  
MONTHS  
ENDED JUNE 30,  
2018 AND 2017  
(UNAUDITED)  
(DOLLARS IN  
THOUSANDS)**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30, 2018</b>	<b>June 30, 2017</b>	<b>June 30, 2018</b>	<b>June 30, 2017</b>
<b>Interest Income</b>				
Loans, Including Fees	<b>\$10,065</b>	\$9,733	<b>\$19,793</b>	\$19,130
Deposits with Other Banks	<b>69</b>	34	<b>144</b>	114
Investment Securities				
U.S. Government Agencies	<b>1,877</b>	1,685	<b>3,788</b>	3,248
State, County and Municipal	<b>25</b>	30	<b>52</b>	60
Corporate Debt	<b>29</b>	21	<b>57</b>	36
Dividends on Other Investments	<b>44</b>	35	<b>85</b>	71
	<b>12,109</b>	11,538	<b>23,919</b>	22,659
<b>Interest Expense</b>				
Deposits	<b>1,401</b>	1,177	<b>2,601</b>	2,368
Federal Funds Purchased	<b>1</b>	3	<b>1</b>	3
Borrowed Money	<b>542</b>	542	<b>1,023</b>	1,010
	<b>1,944</b>	1,722	<b>3,625</b>	3,381
<b>Net Interest Income</b>	<b>10,165</b>	9,816	<b>20,294</b>	19,278
Provision for Loan Losses	<b>44</b>	-	<b>70</b>	335
<b>Net Interest Income After Provision for Loan Losses</b>	<b>10,121</b>	9,816	<b>20,224</b>	18,943
<b>Noninterest Income</b>				

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Service Charges on Deposits	<b>1,031</b>	1,091	<b>2,132</b>	2,146
Other Service Charges, Commissions and Fees	<b>822</b>	772	<b>1,611</b>	1,559
Mortgage Fee Income	<b>182</b>	202	<b>331</b>	388
Securities Gains (Losses)	<b>116</b>	-	<b>116</b>	-
Other	<b>173</b>	329	<b>568</b>	701
	<b>2,324</b>	2,394	<b>4,758</b>	4,794
<b>Noninterest Expenses</b>				
Salaries and Employee Benefits	<b>5,002</b>	4,880	<b>9,922</b>	9,665
Occupancy and Equipment	<b>979</b>	991	<b>2,025</b>	1,951
Other	<b>2,620</b>	2,749	<b>5,190</b>	5,412
	<b>8,601</b>	8,620	<b>17,137</b>	17,028
<b>Income Before Income Taxes</b>	<b>3,844</b>	3,590	<b>7,845</b>	6,709
<b>Income Taxes</b>	<b>775</b>	1,157	<b>1,588</b>	2,159
<b>Net Income</b>	<b>3,069</b>	2,433	<b>6,257</b>	4,550
<b>Preferred Stock Dividends</b>	-	-	-	211
<b>Net Income Available to Common Stockholders</b>	<b>\$3,069</b>	\$2,433	<b>\$6,257</b>	\$4,339
<b>Net Income Per Share of Common Stock</b>				
Basic	<b>\$0.36</b>	\$0.29	<b>\$0.74</b>	\$0.51
Diluted	<b>\$0.36</b>	\$0.28	<b>\$0.72</b>	\$0.50
<b>Cash Dividends Paid Per Share of Common Stock</b>	<b>\$0.05</b>	\$0.025	<b>\$0.10</b>	\$0.050
<b>Weighted Average Basic Shares Outstanding</b>	<b>8,439,258</b>	8,439,258	<b>8,439,258</b>	8,439,258
<b>Weighted Average Diluted Shares Outstanding</b>	<b>8,612,352</b>	8,630,207	<b>8,634,865</b>	8,632,465

The accompanying notes are an integral part of these statements.

**PART I (Continued)**

## Item 1 (Continued)

**COLONY  
BANKCORP, INC.  
AND SUBSIDIARY  
CONSOLIDATED  
STATEMENTS OF  
COMPREHENSIVE  
INCOME  
THREE MONTHS  
ENDED JUNE 30,  
2018 AND 2017  
AND SIX MONTHS  
ENDED JUNE 30,  
2018 AND 2017  
(UNAUDITED)  
(DOLLARS IN  
THOUSANDS)**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30, 2018</b>	<b>June 30, 2017</b>	<b>June 30, 2018</b>	<b>June 30, 2017</b>
<b>Net Income</b>	<b>\$3,069</b>	\$2,433	<b>\$6,257</b>	\$4,550
<b>Other Comprehensive Income:</b>				
Gains (Losses) on Securities Arising During the Year	<b>(1,624)</b>	1,377	<b>(5,578)</b>	1,586
Tax Effect	<b>341</b>	(468 )	<b>1,171</b>	(539 )
Realized Gains on Sale of AFS Securities	<b>116</b>	-	<b>116</b>	-
Tax Effect	<b>(24 )</b>	-	<b>(24 )</b>	-
Change in Unrealized Gains (Losses) on Securities Available for Sale, Net of Reclassification Adjustment and Tax Effects	<b>(1,191)</b>	909	<b>(4,315)</b>	1,047
<b>Comprehensive Income</b>	<b>\$1,878</b>	\$3,342	<b>\$1,942</b>	\$5,597

The accompanying notes are an integral part of these statements.



**PART I (Continued)**

## Item 1 (Continued)

**COLONY  
BANKCORP,  
INC. AND  
SUBSIDIARY  
CONSOLIDATED  
STATEMENTS  
OF CASH  
FLOWS  
SIX MONTHS  
ENDED JUNE 30,  
2018 AND 2017  
(UNAUDITED)  
(DOLLARS IN  
THOUSANDS)**

	<b>Six Months Ended</b>	
	<b>June 30, 2018</b>	<b>June 30, 2017</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Income	<b>\$6,257</b>	\$4,550
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation	<b>867</b>	823
Provision for Loan Losses	<b>70</b>	335
Securities (Gains)	<b>(116 )</b>	-
Amortization and Accretion	<b>591</b>	750
(Gain) on Sale of Other Real Estate and Repossessions	<b>(120 )</b>	(93 )
Provision for Losses on Other Real Estate	<b>157</b>	206
Increase in Cash Surrender Value of Life Insurance	<b>(261 )</b>	(305 )
Loss on Sale of Premises & Equipment	<b>3</b>	(15 )
Other Prepaids, Deferrals and Accruals, Net	<b>465</b>	1,080
	<b>7,913</b>	7,331
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of Investment Securities Available for Sale	<b>(19,257)</b>	(41,269)
Proceeds from Maturities, Calls, and Paydowns of Investment Securities:		
Available for Sale	<b>24,379</b>	28,074
Proceeds from Sale of Investment Securities Available for Sale	<b>11,268</b>	-
Interest-Bearing Deposits in Other Banks	<b>(3,905 )</b>	35,357
Net Loans to Customers	<b>(2,560 )</b>	(22,848)
Purchase of Premises and Equipment	<b>(1,869 )</b>	(531 )
Proceeds from Sale of Other Real Estate and Repossessions	<b>1,236</b>	2,259
Federal Home Loan Bank Stock	<b>(339 )</b>	(245 )

Proceeds from Sale of Premises and Equipment	-	38
	<b>8,953</b>	835
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Noninterest-Bearing Customer Deposits	<b>(13,592)</b>	3,869
Interest-Bearing Customer Deposits	<b>(18,507)</b>	(21,688)
Dividends Paid for Preferred Stock	-	(316 )
Dividends Paid for Common Stock	<b>(844 )</b>	(422 )
Redemption of Preferred Stock	-	(9,360 )
Repurchase of Warrants	<b>(3,175 )</b>	-
Payments on Federal Home Loan Bank Advances	<b>(2,500 )</b>	-
Proceeds from Federal Home Loan Bank Advances	<b>10,000</b>	5,000
Payments on Other Borrowed Money	<b>(1,500 )</b>	(16 )
Proceeds from Other Borrowed Money	<b>7</b>	5,016
	<b>(30,111)</b>	(17,917)
Net Decrease in Cash and Cash Equivalents	<b>(13,245)</b>	(9,751 )
Cash and Cash Equivalents at Beginning of Period	<b>23,145</b>	28,822
Cash and Cash Equivalents at End of Period	<b>\$9,900</b>	\$19,071

The accompanying notes are an integral part of these statements.

**PART I (Continued)**

Item 1 (Continued)

**COLONY BANKCORP, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(1) Summary of Significant Accounting Policies**

**Presentation**

Colony Bankcorp, Inc. (the “Company”) is a bank holding company located in Fitzgerald, Georgia. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Colony Bank, Fitzgerald, Georgia (the “Bank”). All significant intercompany accounts have been eliminated in consolidation. The accounting and reporting policies of the Company conform to generally accepted accounting principles and practices utilized in the commercial banking industry.

All dollars in notes to consolidated financial statements are rounded to the nearest thousand, except for per share amounts.

The consolidated financial statements in this report are unaudited, except for the December 31, 2017 consolidated balance sheet. All adjustments consisting of normal recurring accruals which are, in the opinion of management, necessary for fair presentation of the interim consolidated financial statements, have been included and fairly and accurately present the financial position, results of operations and cash flows of the Company. The results of operations for the six months ended June 30, 2018 are not necessarily indicative of the results which may be expected for the entire year.

**Nature of Operations**

The Bank provides a full range of retail and commercial banking services for consumers and small- to medium-size businesses located primarily in central, south and coastal Georgia. The Bank is headquartered in Fitzgerald, Georgia with banking offices in Albany, Ashburn, Broxton, Centerville, Columbus, Cordele, Douglas, Eastman, Fitzgerald,

Leesburg, Moultrie, Quitman, Rochelle, Savannah, Soperton, Sylvester, Statesboro, Thomaston, Tifton, Valdosta and Warner Robins. Lending and investing activities are funded primarily by deposits gathered through its retail banking office network.

### **Use of Estimates**

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the balance sheet date and revenues and expenses for the period. Actual results could differ significantly 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 and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans.

### **Reclassifications**

In certain instances, amounts reported in prior years' consolidated financial statements have been reclassified to conform to statement presentations selected for 2018. Such reclassifications have not affected previously reported stockholders' equity or net income.

### **Concentrations of Credit Risk**

Concentrations of credit risk can exist in relation to individual borrowers or groups of borrowers, certain types of collateral, certain types of industries, or certain geographic regions. The Company has a concentration in real estate loans as well as a geographic concentration that could pose an adverse credit risk. At June 30, 2018, approximately 87 percent of the Company's loan portfolio was concentrated in loans secured by real estate. A substantial portion of borrowers' ability to honor their contractual obligations is dependent upon the viability of the real estate economic sector. Collateral real estate values that secure land development, construction and speculative real estate loans in the Company's larger Metropolitan Statistical Area (MSA) markets have started showing signs of stabilization in values in recent years. In addition, a large portion of the Company's foreclosed assets are also located in these same geographic markets, making the recovery of the carrying amount of foreclosed assets susceptible to changes in market conditions. Management continues to monitor these concentrations and has considered these concentrations in its allowance for loan loss analysis.

**PART I (Continued)**

Item 1 (Continued)

**(1) Summary of Significant Accounting Policies (Continued)**

**Concentrations of Credit Risk (Continued)**

The success of the Company is dependent, to a certain extent, upon the economic conditions in the geographic markets it serves. Adverse changes in the economic conditions in these geographic markets would likely have a material adverse effect on the Company's results of operations and financial condition. The operating results of the Company depend primarily on its net interest income. Accordingly, operations are subject to risks and uncertainties surrounding the exposure to changes in the interest rate environment.

At times, the Company may have cash and cash equivalents at financial institutions in excess of federal deposit insurance limits. The Company places its cash and cash equivalents with high credit quality financial institutions whose credit ratings are monitored by management to minimize credit risk.

**Investment Securities**

The Company classifies its investment securities as trading, available for sale or held to maturity. Securities that are held principally for resale in the near term are classified as trading. Trading securities are carried at fair value, with realized and unrealized gains and losses included in noninterest income. Currently, no securities are classified as trading. Securities acquired with both the intent and ability to be held to maturity are classified as held to maturity and reported at amortized cost. All securities not classified as trading or held to maturity are considered available for sale. Securities available for sale are reported at estimated fair value. Unrealized gains and losses on securities available for sale are excluded from earnings and are reported, net of deferred taxes, in accumulated other comprehensive income (loss), a component of stockholders' equity. Gains and losses from sales of securities available for sale are computed using the specific identification method. Securities available for sale includes securities which may be sold to meet liquidity needs arising from unanticipated deposit and loan fluctuations, changes in regulatory capital requirements, or unforeseen changes in market conditions.

The Company evaluates each investment security held to maturity and available for sale security in a loss position for other-than-temporary impairment (OTTI). In estimating other-than-temporary impairment losses, management considers such factors as the length of time and the extent to which the market value has been below cost, the financial condition of the issuer and the Company's intent to sell and whether it is more likely than not that the Company will be

required to sell the security before anticipated recovery of the amortized cost basis. If the Company intends to sell or if it is more likely than not that the Company will be required to sell the security before recovery, the OTTI write-down is recognized in earnings. If the Company does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the OTTI write-down is separated into an amount representing credit loss, which is recognized in earnings and an amount related to all other factors, which is recognized in other comprehensive income (loss).

### **Federal Home Loan Bank Stock**

Investment in stock of a Federal Home Loan Bank (FHLB) is required for every federally insured institution that utilizes its services. FHLB stock is considered restricted, as defined in the accounting standards. The FHLB stock is reported in the consolidated financial statements at cost. Dividend income is recognized when earned.

### **Loans**

Loans that the Company has the ability and intent to hold for the foreseeable future or until maturity are recorded at their principal amount outstanding, net of unearned interest and fees. Loan origination fees, net of certain direct origination costs, are deferred and amortized over the estimated terms of the loans using the straight-line method. Interest income on loans is recognized using the effective interest method.

A loan is considered to be delinquent when payments have not been made according to contractual terms, typically evidenced by nonpayment of a monthly installment by the due date.

When management believes there is sufficient doubt as to the collectability of principal or interest on any loan or generally when loans are 90 days or more past due, the accrual of applicable interest is discontinued and the loan is designated as nonaccrual, unless the loan is well secured and in the process of collection. Interest payments received on nonaccrual loans are either applied against principal or reported as income, according to management's judgment as to the collectability of principal. Loans are returned to an accrual status when factors indicating doubtful collectability on a timely basis no longer exist.

**PART I (Continued)**

Item 1 (Continued)

**(1) Summary of Significant Accounting Policies (Continued)**

**Loans Modified in a Troubled Debt Restructuring (“TDR”)**

Loans are considered to have been modified in a TDR when, due to a borrower’s financial difficulty, the Company makes certain concessions to the borrower that it would not otherwise consider for new debt with similar risk characteristics. Modifications may include interest rate reductions, principal or interest forgiveness, forbearance, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of the collateral. Generally, a non-accrual loan that has been modified in a TDR remains on non-accrual status for a period of 6 months to demonstrate that the borrower is able to meet the terms of the modified loan. However, performance prior to the modification, or significant events that coincide with the modification, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of loan modification or after a shorter performance period. If the borrower’s ability to meet the revised payment schedule is uncertain, the loan remains on non-accrual status. Once a loan is modified in a troubled debt restructuring it is accounted for as an impaired loan, regardless of its accrual status, until the loan is paid in full, sold or charged off. A TDR may cease being classified as impaired if the loan is subsequently modified at market terms and, has performed according to the modified terms for at least six months, and there has not been any prior principal forgiveness on a cumulative basis.

**Allowance for Loan Losses**

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the inability to collect a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management’s periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revisions as more information becomes available.

The allowance consists of specific, historical and general components. The specific component relates to loans that are classified as either doubtful, substandard or special mention. For such loans that are also classified as impaired, an

allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan are lower than the carrying value of that loan. The historical component covers nonclassified loans and is based on historical loss experience adjusted for qualitative factors. A general component is maintained to cover uncertainties that could affect management's estimate of probable losses. The general component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and historical losses in the portfolio. General valuation allowances are based on internal and external qualitative risk factors such as (1) changes in lending policies and procedures, including changes in underwriting standards and collections, charge offs, and recovery practices, (2) changes in international, national, regional, and local conditions, (3) changes in the nature and volume of the portfolio and terms of loans, (4) changes in the experience, depth, and ability of lending management, (5) changes in the volume and severity of past due loans and other similar conditions, (6) changes in the quality of the organization's loan review system, (7) changes in the value of underlying collateral for collateral dependent loans, (8) the existence and effect of any concentrations of credit and changes in the levels of such concentrations, and (9) the effect of other external factors (i.e. competition, legal and regulatory requirements) on the level of estimated credit losses.

Loans identified as losses by management, internal loan review and/or regulatory agencies are charged off.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value 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. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent.

**PART I (Continued)**

Item 1 (Continued)

**(1) Summary of Significant Accounting Policies (Continued)**

**Allowance for Loan Losses (Continued)**

A significant portion of the Company's impaired loans are deemed to be collateral dependent. Management therefore measures impairment on these loans based on the fair value of the collateral. Collateral values are determined based on appraisals performed by qualified licensed appraisers hired by the Company or by senior members of the Company's credit administration staff. The decision whether or not to obtain an external third-party appraisal usually depends on the type of property being evaluated. External appraisals are usually obtained on more complex, income producing properties such as hotels, shopping centers and businesses. Less complex properties such as residential lots, farm land and single family houses may be evaluated internally by senior credit administration staff. When the Company does obtain appraisals from external third-parties, the values utilized in the impairment calculation are "as is" or current market values. The appraisals, whether prepared internally or externally, may utilize a single valuation approach or a combination of approaches including the comparable sales, income and cost approach. Appraised amounts used in the impairment calculation are typically discounted 10 percent to account for selling and marketing costs, if the repayment of the loan is to come from the sale of the collateral. Although appraisals are not obtained each year on all impaired loans, the collateral values used in the impairment calculations are evaluated quarterly by management. Based on management's knowledge of the collateral and the current real estate market conditions, appraised values may be further discounted to reflect facts and circumstances known to management since the most recent appraisal was performed.

Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a level 3 classification of the inputs for determining fair value. Because of the high degree of judgment required in estimating the fair value of collateral underlying impaired loans and because of the relationship between fair value and general economic conditions, we consider the fair value of impaired loans to be highly sensitive to changes in market conditions.

**Premises and Equipment**

Premises and equipment are recorded at acquisition cost net of accumulated depreciation.

Depreciation is charged to operations over the estimated useful lives of the assets. The estimated useful lives and methods of depreciation are as follows:

Description	Life in Years	Method
Banking Premises	15-40	Straight-Line and Accelerated
Furniture and Equipment	5 - 10	Straight-Line and Accelerated

Expenditures for major renewals and betterments are capitalized. Maintenance and repairs are charged to operations as incurred. When property and equipment are retired or sold, the cost and accumulated depreciation are removed from the respective accounts and any gain or loss is reflected in other income or expense.

### **Intangible Assets**

Intangible assets consist of core deposit intangibles acquired in connection with a business combination. The core deposit intangible is initially recognized based on a valuation performed as of the consummation date. The core deposit intangible is amortized by the straight-line method over the average remaining life of the acquired customer deposits.

### **Transfers of Financial Assets**

Transfers of financial assets 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.

**PART I (Continued)**

Item 1 (Continued)

**(1) Summary of Significant Accounting Policies (Continued)**

**Statement of Cash Flows**

For reporting cash flows, cash and cash equivalents include cash on hand, noninterest-bearing amounts due from banks and federal funds sold. Cash flows from demand deposits, interest-bearing checking accounts, savings accounts, loans and certificates of deposit are reported net.

**Advertising Costs**

The Company expenses the cost of advertising in the periods in which those costs are incurred.

**Income Taxes**

The provision for income taxes is based upon income for financial statement purposes, adjusted for nontaxable income and nondeductible expenses. Deferred income taxes have been provided when different accounting methods have been used in determining income for income tax purposes and for financial reporting purposes.

Deferred tax assets and liabilities are recognized based on future tax consequences attributable to differences arising from the financial statement carrying values of assets and liabilities and their tax bases. The differences relate primarily to depreciable assets (use of different depreciation methods for financial statement and income tax purposes) and allowance for loan losses (use of the allowance method for financial statement purposes and the direct write-off method for tax purposes). In the event of changes in the tax laws, deferred tax assets and liabilities are adjusted in the period of the enactment of those changes, with effects included in the income tax provision. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Company and its subsidiary file a consolidated federal income tax return. The subsidiary pays its proportional share of federal income taxes to the Company based on its taxable income.

Positions taken in the Company's tax returns may be subject to challenge by the taxing authorities upon examination. Uncertain tax positions are initially recognized in the consolidated financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions are both initially and subsequently measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon settlement with the tax authority, assuming full knowledge of the position and all relevant facts. The Company provides for interest and, in some cases, penalties on tax positions that may be challenged by the taxing authorities. Interest expense is recognized beginning in the first period that such interest would begin accruing. Penalties are recognized in the period that the Company claims the position in the tax return. Interest and penalties on income tax uncertainties are classified within income tax expense in the consolidated statement of income.

### **Other Real Estate**

Other real estate generally represents real estate acquired through foreclosure and is initially recorded at estimated fair value at the date of acquisition less the cost of disposal. Losses from the acquisition of property in full or partial satisfaction of debt are recorded as loan losses. Properties are evaluated regularly to ensure the recorded amounts are supported by current fair values, and valuation allowances are recorded as necessary to reduce the carrying amount to fair value less estimated cost of disposal. Routine holding costs and gains or losses upon disposition are included in other noninterest expense.

### **Bank-Owned Life Insurance**

The Company has purchased life insurance on the lives of certain key members of management and directors. The life insurance policies are recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or amounts due that are probable at settlement, if applicable. Increases in the cash surrender value are recorded as other income in the consolidated statements of income. The cash surrender value of the insurance contracts is recorded in other assets on the consolidated balance sheets in the amount of \$17,349 and \$17,089 as of June 30, 2018 and December 31, 2017, respectively.

## **PART I (Continued)**

### Item 1 (Continued)

#### **(1) Summary of Significant Accounting Policies (Continued)**

##### **Comprehensive Income**

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on securities available for sale, represent equity changes from economic events of the period other than transactions with owners and are not reported in the consolidated statements of income but as a separate component of the equity section of the consolidated balance sheets. Such items are considered components of other comprehensive income (loss). Accounting standards codification requires the presentation in the consolidated financial statements of net income and all items of other comprehensive income (loss) as total comprehensive income (loss).

##### **Off-Balance Sheet Credit Related Financial Instruments**

In the ordinary course of business, the Company has entered into commitments to extend credit, commercial letters of credit and standby letters of credit. Such financial instruments are recorded when they are funded.

##### **Changes in Accounting Principles and Effects of New Accounting Pronouncements**

ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity is expected to be entitled for those goods or services. ASU 2014-09 defines a five-step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each performance obligation. ASU 2014-09, as deferred one year by ASU 2015-14, is effective for the Company in the first quarter of fiscal year 2018. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. ASU 2016-01 is effective for the Company on January 1, 2018. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

ASU 2016-02, *Leases (Topic 842)*. This ASU requires lessees to put most leases on their balance sheets but recognize expenses in the income statement in a manner similar to current accounting treatment. This ASU changes the guidance on sale-leaseback transactions, initial direct costs and lease execution costs, and, for lessors, modifies the classification criteria and the accounting for sales-type and direct financing leases. For public business entities, this ASU is effective for annual periods beginning after December 15, 2018, and interim periods therein. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. The Company is evaluating the impact of this ASU on its financial statements and disclosures.

ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326)*. This ASU sets forth a “current expected credit loss” (CECL) model which requires the Company to measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions and reasonable supported forecasts. This replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost and applies to some off-balance sheet credit exposures. This ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is currently assessing the impact of the adoption of this ASU on its consolidated financial statements.

**PART I (Continued)**

Item 1 (Continued)

**(1) Summary of Significant Accounting Policies (Continued)**

**Changes in Accounting Principles and Effects of New Accounting Pronouncements (Continued)**

ASU 2016-15, *Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments*. ASU 2016-15 provides guidance related to certain cash flow issues in order to reduce the current and potential future diversity in practice. ASU 2016-15 is effective for us on January 1, 2018 and did not have a significant impact on our financial statements.

ASU 2017-08, *Premium Amortization on Purchased Callable Debt Securities*. This ASU shortens the amortization period for the premium on certain purchased callable debt securities to the earliest call date. Today, entities generally amortize the premium over the contractual life of the security. The new guidance does not change the accounting for purchased callable debt securities held at a discount; the discount continues to be amortized to maturity. ASU No. 2017-08 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. The guidance calls for a modified retrospective transition approach under which a cumulative-effect adjustment will be made to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Company is currently evaluating the provisions of ASU No. 2017-08 to determine the potential impact the new standard will have on the Company's Consolidated Financial Statements.

ASU 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220). Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. This ASU allows an entity to elect a reclassification from accumulated other comprehensive income (AOCI) to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act (TCJ Act). ASU 2018-02 is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted. The Company elected to early adopt the provisions of ASU 2018-02 in the fourth quarter of 2017 and, as a result, reclassified \$1.1 million from AOCI to retained earnings as of December 31, 2017.

**(2) Investment Securities**

Investment securities as of June 30, 2018 and December 31, 2017 are summarized as follows:

<b>June 30, 2018</b>	<b>Amortized Cost</b>	<b>Gross</b>	<b>Gross</b>	<b>Fair Value</b>
		<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	
<b>Securities Available for Sale:</b>				
U. S. Government Agencies				
Mortgage-Backed	\$ 338,593	\$ 212	\$ (13,809 )	\$ 324,996
State, County & Municipal	4,040	4	(55 )	3,989
Corporate Bonds	2,984	5	(36 )	2,953
	\$ 345,617	\$ 221	\$ (13,900 )	\$ 331,938

<b>December 31, 2017</b>	<b>Amortized Cost</b>	<b>Gross</b>	<b>Gross</b>	<b>Fair Value</b>
		<b>Unrealized Gains</b>	<b>Unrealized Losses</b>	
<b>Securities Available for Sale:</b>				
U. S. Government Agencies				
Mortgage-Backed	\$ 354,931	\$ 258	\$ (8,466 )	\$ 346,723
State, County & Municipal	4,493	23	(23 )	4,493
Corporate Bonds	2,048	12	-	2,060
Asset-Backed	993	-	(22 )	971
	\$ 362,465	\$ 293	\$ (8,511 )	\$ 354,247

**PART I (Continued)**

## Item 1 (Continued)

**(2) Investment Securities (Continued)**

The amortized cost and fair value of investment securities as of June 30, 2018, by contractual maturity, are shown hereafter. Expected maturities may differ from contractual maturities for certain investments because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. This is often the case with mortgage-backed securities, which are disclosed separately in the table below.

	<b>Securities</b>	
	<b>Available for Sale</b>	
	<b>Amortized</b>	<b>Fair</b>
	<b>Cost</b>	<b>Value</b>
Due In One Year or Less	<b>\$361</b>	<b>\$360</b>
Due After One Year Through Five Years	<b>4,148</b>	<b>4,110</b>
Due After Five Years Through Ten Years	<b>1,314</b>	<b>1,310</b>
Due After Ten Years	<b>1,201</b>	<b>1,162</b>
	<b>\$7,024</b>	<b>\$6,942</b>
 Mortgage-Backed Securities	 <b>338,593</b>	 <b>324,996</b>
	<b>\$345,617</b>	<b>\$331,938</b>

Proceeds from the sale of investments available for sale totaled \$11,268 for the first six months of 2018. The sale of investments available for sale during the first six months of 2018 resulted in gross realized gains of \$116 and losses of \$0. The Bank did not sell any investments during the first six months of 2017. Therefore the Bank did not have any proceeds, gains or losses during the first six months of 2017.

Investment securities having a carrying value approximating \$132,812 and \$175,484 as of June 30, 2018 and December 31, 2017, respectively, were pledged to secure public deposits and for other purposes.

Information pertaining to securities with gross unrealized losses at June 30, 2018 and December 31, 2017 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

**Less Than 12 Months    12 Months or Greater    Total**

	<b>Fair</b>	<b>Gross</b>	<b>Fair</b>	<b>Gross</b>	<b>Fair</b>	<b>Gross</b>
	<b>Value</b>	<b>Unrealized</b>	<b>Value</b>	<b>Unrealized</b>	<b>Value</b>	<b>Unrealized</b>
		<b>Losses</b>		<b>Losses</b>		<b>Losses</b>
<b>June 30, 2018</b>						
U. S. Government Agencies						
Mortgage-Backed	<b>\$121,705</b>	<b>\$ (3,542 )</b>	<b>\$193,486</b>	<b>\$ (10,267 )</b>	<b>\$315,191</b>	<b>\$ (13,809 )</b>
State, County and Municipal	<b>2,931</b>	<b>(22 )</b>	<b>843</b>	<b>(33 )</b>	<b>3,774</b>	<b>(55 )</b>
Corporate Bonds	<b>909</b>	<b>(36 )</b>	<b>-</b>	<b>-</b>	<b>909</b>	<b>(36 )</b>
	<b>\$125,545</b>	<b>\$ (3,600 )</b>	<b>\$194,329</b>	<b>\$ (10,300 )</b>	<b>\$319,874</b>	<b>\$ (13,900 )</b>
<b>December 31, 2017</b>						
U.S. Government Agencies						
Mortgage-Backed	\$120,139	\$ (1,655 )	\$190,196	\$ (6,811 )	\$310,335	\$ (8,466 )
State, County and Municipal	2,598	(23 )	-	-	2,598	(23 )
Asset-Backed	971	(22 )	-	-	971	(22 )
	\$123,708	\$ (1,700 )	\$190,196	\$ (6,811 )	\$313,904	\$ (8,511 )

**PART I (Continued)**

## Item 1 (Continued)

**(2) Investment Securities (Continued)**

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At June 30, 2018, 146 securities have unrealized losses which have depreciated 4.16 percent from the Company's amortized cost basis. These securities are guaranteed by either the U.S. Government, other governments or U.S. corporations. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred and the results of reviews of the issuer's financial condition. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other than temporary.

**(3) Loans**

The following table presents the composition of loans segregated by class of loans, as of June 30, 2018 and December 31, 2017.

	<b>June 30, 2018</b>	December 31, 2017
<b>Commercial and Agricultural</b>		
Commercial	<b>\$45,029</b>	\$48,122
Agricultural	<b>20,037</b>	16,443
<b>Real Estate</b>		
Commercial Construction	<b>48,909</b>	45,214
Residential Construction	<b>11,541</b>	8,583
Commercial	<b>352,063</b>	351,172
Residential	<b>187,591</b>	194,049

Farmland	<b>67,867</b>	67,768
<b>Consumer and Other</b>		
Consumer	<b>18,746</b>	18,956
Other	<b>15,013</b>	14,977
<b>Total Loans</b>	<b>\$766,796</b>	\$765,284

Commercial and industrial loans are extended to a diverse group of businesses within the Company's market area. These loans are often underwritten based on the borrower's ability to service the debt from income from the business. Real estate construction loans often require loan funds to be advanced prior to completion of the project. Due to uncertainties inherent in estimating construction costs, changes in interest rates and other economic conditions, these loans often pose a higher risk than other types of loans. Consumer loans are originated at the Bank level. These loans are generally smaller loan amounts spread across many individual borrowers to help minimize risk.

*Credit Quality Indicators.* As part of the ongoing monitoring of the credit quality of the loan portfolio, management tracks certain credit quality indicators including trends related to (i) the risk grade assigned to commercial and consumer loans, (ii) the level of classified commercial loans, (iii) net charge-offs, (iv) nonperforming loans, and (v) the general economic conditions in the Company's geographic markets.

The Company uses a risk grading matrix to assign a risk grade to each of its loans. Loans are graded on a scale of 1 to 8. A description of the general characteristics of the grades is as follows:

**PART I (Continued)**

Item 1 (Continued)

**(3) Loans (Continued)**

Grades 1 and 2 – Borrowers with these assigned grades range in risk from virtual absence of risk to minimal risk. Such loans may be secured by Company-issued and controlled certificates of deposit or properly-margined equity securities or bonds. Other loans comprising these grades are made to companies that have been in existence for a long period of time with many years of consecutive profits and strong equity, good liquidity, excellent debt service ability and unblemished past performance, or to exceptionally strong individuals with collateral of unquestioned value that fully secures the loans. Loans in this category fall into the “pass” classification.

Grades 3 and 4 – Loans assigned these “pass” risk grades are made to borrowers with acceptable credit quality and risk. The risk ranges from loans with no significant weaknesses in repayment capacity and collateral protection to acceptable loans with one or more risk factors considered to be more than average.

Grade 5 – This grade includes “special mention” loans on management’s watch list and is intended to be used on a temporary basis for pass grade loans where risk-modifying action is intended in the short-term.

Grade 6 – This grade includes “substandard” loans in accordance with regulatory guidelines. This category includes borrowers with well-defined weaknesses that jeopardize the payment of the debt in accordance with the agreed terms. Loans considered to be impaired are assigned this grade, and these loans often have assigned loss allocations as part of the allowance for loan and lease losses. Generally, loans on which interest accrual has been stopped would be included in this grade.

Grades 7 and 8 – These grades correspond to regulatory classification definitions of “doubtful” and “loss,” respectively. In practice, any loan with these grades would be for a very short period of time, and generally the Company has no loans with these assigned grades. Management manages the Company’s problem loans in such a way that uncollectible loans or uncollectible portions of loans are charged off immediately with any residual, collectible amounts assigned a risk grade of 6.

The following table presents the loan portfolio by credit quality indicator (risk grade) as of June 30, 2018 and December 31, 2017. Those loans with a risk grade of 1, 2, 3 or 4 have been combined in the pass column for presentation purposes. For the period ending June 30, 2018, the Company did not have any loans classified as “doubtful” or a “loss”.

**June 30, 2018**

**Pass**

**Substandard**

		<b>Special Mention</b>		<b>Total Loans</b>
<b>Commercial and Agricultural</b>				
Commercial	\$43,619	\$ 755	\$ 655	\$45,029
Agricultural	19,255	438	344	20,037
<b>Real Estate</b>				
Commercial Construction	47,606	618	685	48,909
Residential Construction	11,541	-	-	11,541
Commercial	338,114	7,591	6,358	352,063
Residential	172,844	4,318	10,429	187,591
Farmland	63,869	2,039	1,959	67,867
<b>Consumer and Other</b>				
Consumer	18,350	41	355	18,746
Other	15,006	7	-	15,013
<b>Total Loans</b>	<b>\$730,204</b>	<b>\$ 15,807</b>	<b>\$ 20,785</b>	<b>\$766,796</b>

**PART I (Continued)**

## Item 1 (Continued)

**(3) Loans (Continued)****December 31, 2017**

	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>Total Loans</b>
<b>Commercial and Agricultural</b>				
Commercial	\$46,469	\$ 825	\$ 828	\$48,122
Agricultural	15,868	175	400	16,443
<b>Real Estate</b>				
Commercial Construction	41,282	578	3,354	45,214
Residential Construction	8,583	-	-	8,583
Commercial	338,776	7,663	4,733	351,172
Residential	177,963	4,865	11,221	194,049
Farmland	66,335	444	989	67,768
<b>Consumer and Other</b>				
Consumer	18,496	53	407	18,956
Other	14,969	8	-	14,977
<b>Total Loans</b>	<b>\$728,741</b>	<b>\$ 14,611</b>	<b>\$ 21,932</b>	<b>\$765,284</b>

A loan's risk grade is assigned at the inception of the loan and is based on the financial strength of the borrower and the type of collateral. Loan risk grades are subject to reassessment at various times throughout the year as part of the Company's ongoing loan review process. Loans with an assigned risk grade of 6 or below and an outstanding balance of \$250,000 or more are reassessed on a quarterly basis. During this reassessment process individual reserves may be identified and placed against certain loans which are not considered impaired.

In assessing the overall economic condition of the markets in which it operates, the Company monitors the unemployment rates for its major service areas. The unemployment rates are reviewed on a quarterly basis as part of the allowance for loan loss determination.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Generally, loans are placed on nonaccrual status if principal or interest payments become 90 days past due or when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provision. Loans may be placed on nonaccrual status regardless of whether or not such loans are considered past due.



**PART I (Continued)**

## Item 1 (Continued)

**(3) Loans (Continued)**

The following table represents an age analysis of past due loans and nonaccrual loans, segregated by class of loans, as of June 30, 2018 and December 31, 2017:

**June 30, 2018**

	Accruing Loans			Nonaccrual Loans	Current Loans	Total Loans
	30-89 Days Past Due	90 Days or More Past Due	Total Accruing Loans Past Due			
<b>Commercial and Agricultural</b>						
Commercial	\$280	\$ -	\$ 280	\$ 367	\$44,382	\$45,029
Agricultural	177	-	177	290	19,570	20,037
<b>Real Estate</b>						
Commercial Construction	354	-	354	428	48,127	48,909
Residential Construction	-	-	-	-	11,541	11,541
Commercial	1,382	-	1,382	1,228	349,453	352,063
Residential	2,286	-	2,286	2,140	183,165	187,591
Farmland	79	-	79	979	66,809	67,867
<b>Consumer and Other</b>						
Consumer	112	-	112	200	18,434	18,746
Other	-	-	-	-	15,013	15,013
<b>Total Loans</b>	<b>\$4,670</b>	<b>\$ -</b>	<b>\$ 4,670</b>	<b>\$ 5,632</b>	<b>\$756,494</b>	<b>\$766,796</b>

**December 31, 2017**

	Accruing Loans			Nonaccrual Loans	Current Loans	Total Loans
	30-89 Days Past Due	90 Days or More Past Due	Total Accruing Loans Past Due			
<b>Commercial and Agricultural</b>						

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Commercial	\$329	\$ -	\$ 329	\$ 598	\$47,195	\$48,122
Agricultural	111	-	111	399	15,933	16,443
<b>Real Estate</b>						
Commercial Construction	27	-	27	477	44,710	45,214
Residential Construction	119	-	119	-	8,464	8,583
Commercial	919	-	919	2,172	348,081	351,172
Residential	2,482	-	2,482	2,830	188,737	194,049
Farmland	318	-	318	839	66,611	67,768
<b>Consumer and Other</b>						
Consumer	246	-	246	188	18,522	18,956
Other	7	-	7	-	14,970	14,977
<b>Total Loans</b>	<b>\$4,558</b>	<b>\$ -</b>	<b>\$ 4,558</b>	<b>\$ 7,503</b>	<b>\$753,223</b>	<b>\$765,284</b>

**PART I (Continued)**

## Item 1 (Continued)

**(3) Loans (Continued)**

The following table details impaired loan data as of June 30, 2018:

**June 30, 2018**

	<b>Unpaid Contractual Principal Balance</b>	<b>Impaired Balance</b>	<b>Related Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>	<b>Interest Income Collected</b>
<b>With No Related Allowance Recorded</b>						
Commercial	\$ 367	\$ 367	\$ -	\$ 520	\$ 5	\$ 5
Agricultural	311	290	-	360	9	12
Commercial Construction	16	16	-	38	1	1
Residential Construction	-	-	-	-	-	-
Commercial Real Estate	10,201	10,201	-	11,092	235	236
Residential Real Estate	3,892	3,805	-	4,113	87	89
Farmland	980	978	-	896	5	7
Consumer	200	200	-	199	6	6
Other	-	-	-	-	-	-
	<b>15,967</b>	<b>15,857</b>	<b>-</b>	<b>17,218</b>	<b>348</b>	<b>356</b>
<b>With An Allowance Recorded</b>						
Commercial	-	-	-	-	-	-
Agricultural	-	-	-	-	-	-
Commercial Construction	482	482	54	487	2	2
Residential Construction	-	-	-	-	-	-
Commercial Real Estate	5,047	5,047	1,371	5,371	106	99
Residential Real Estate	36	36	21	60	1	1
Farmland	367	367	28	369	12	12
Consumer	-	-	-	-	-	-
Other	-	-	-	-	-	-
	<b>5,932</b>	<b>5,932</b>	<b>1,474</b>	<b>6,287</b>	<b>121</b>	<b>114</b>
<b>Total</b>						
Commercial	367	367	-	520	5	5
Agricultural	311	290	-	360	9	12

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Commercial Construction	<b>498</b>	<b>498</b>	<b>54</b>	<b>525</b>	<b>3</b>	<b>3</b>
Residential Construction	-	-	-	-	-	-
Commercial Real Estate	<b>15,248</b>	<b>15,248</b>	<b>1,371</b>	<b>16,463</b>	<b>341</b>	<b>335</b>
Residential Real Estate	<b>3,928</b>	<b>3,841</b>	<b>21</b>	<b>4,173</b>	<b>88</b>	<b>90</b>
Farmland	<b>1,347</b>	<b>1,345</b>	<b>28</b>	<b>1,265</b>	<b>17</b>	<b>19</b>
Consumer	<b>200</b>	<b>200</b>	-	<b>199</b>	<b>6</b>	<b>6</b>
Other	-	-	-	-	-	-
	<b>\$ 21,899</b>	<b>\$ 21,789</b>	<b>\$ 1,474</b>	<b>\$ 23,505</b>	<b>\$ 469</b>	<b>\$ 470</b>

**PART I (Continued)**

## Item 1 (Continued)

**(3) Loans (Continued)**

The following table details impaired loan data as of December 31, 2017:

**December 31, 2017**

	<b>Unpaid Contractual Principal Balance</b>	<b>Impaired Balance</b>	<b>Related Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>	<b>Interest Income Collected</b>
<b>With No Related Allowance Recorded</b>						
Commercial	\$ 599	\$ 599	\$ -	\$ 634	\$ 33	\$ 34
Agricultural	485	398	-	297	11	19
Commercial Construction	54	54	-	141	3	4
Residential Construction	-	-	-	79	-	-
Commercial Real Estate	12,637	12,637	-	12,808	560	550
Residential Real Estate	4,978	4,580	-	4,566	212	227
Farmland	840	839	-	791	54	58
Consumer	188	188	-	186	9	9
	19,781	19,295	-	19,502	882	901
<b>With An Allowance Recorded</b>						
Commercial	-	-	-	-	-	-
Agricultural	-	-	-	-	-	-
Commercial Construction	493	493	66	241	23	33
Residential Construction	-	-	-	-	-	-
Commercial Real Estate	5,729	5,729	1,713	6,599	229	237
Residential Real Estate	109	109	27	482	4	7
Farmland	371	371	21	376	22	22
Consumer	-	-	-	-	-	-
	6,702	6,702	1,827	7,698	278	299
<b>Total</b>						
Commercial	599	599	-	634	33	34
Agricultural	485	398	-	297	11	19
Commercial Construction	547	547	66	382	26	37
Residential Construction	-	-	-	79	-	-

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Commercial Real Estate	18,366	18,366	1,713	19,407	789	787
Residential Real Estate	5,087	4,689	27	5,048	216	234
Farmland	1,211	1,210	21	1,167	76	80
Consumer	188	188	-	186	9	9
	\$ 26,483	\$ 25,997	\$ 1,827	\$ 27,200	\$ 1,160	\$ 1,200

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**PART I (Continued)**

## Item 1 (Continued)

**(3) Loans (Continued)**

The following table details impaired loan data as of June 30, 2017:

**June 30, 2017**

	<b>Unpaid Contractual Principal Balance</b>	<b>Impaired Balance</b>	<b>Related Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>	<b>Interest Income Collected</b>
<b>With No Related Allowance Recorded</b>						
Commercial	\$ 608	\$ 608	\$ -	\$ 639	\$ 11	\$ 15
Agricultural	370	349	-	254	11	13
Commercial Construction	102	102	-	159	1	1
Residential Construction	199	199	-	66	5	5
Commercial Real Estate	10,454	10,454	-	13,543	226	222
Residential Real Estate	5,667	4,871	-	4,511	98	115
Farmland	679	678	-	759	56	56
Consumer	149	149	-	188	3	3
	18,228	17,410	-	20,119	411	430
<b>With An Allowance Recorded</b>						
Commercial	-	-	-	-	-	-
Agricultural	-	-	-	-	-	-
Commercial Construction	71	71	4	72	2	2
Residential Construction	-	-	-	-	-	-
Commercial Real Estate	7,169	7,169	1,517	6,714	135	134
Residential Real Estate	49	41	20	755	(2)	2
Farmland	376	376	26	378	11	11
Consumer	-	-	-	-	-	-
	7,665	7,657	1,567	7,919	146	149
<b>Total</b>						
Commercial	608	608	-	639	11	15
Agricultural	370	349	-	254	11	13
Commercial Construction	173	173	4	231	3	3
Residential Construction	199	199	-	66	5	5

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Commercial Real Estate	17,623	17,623	1,517	20,257	361	356
Residential Real Estate	5,716	4,912	20	5,266	96	117
Farmland	1,055	1,054				