AMES NATIONAL CORP
Form 10-Q
May 08, 2018

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[Mark One]

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

For the quarterly period ended March 31, 2018

[_] 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 0-32637

AMES NATIONAL CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

IOWA	**42-1039071**
(State or Other Jurisdiction of Incorporation or Organization)	(I. R. S. Employer Identification Number)

405 FIFTH STREET

AMES, IOWA 50010

(Address of Principal Executive Offices)

Registrant's Telephone Number, Including Area Code: **(515) 232-6251**

Not Applicable

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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 such filing requirements for the past 90 days. Yes _X 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 (Section 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 __X_ No ____

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

Large accelerated filer____ Accelerated filer__X__ (Do not check if a smaller reporting company) Non-accelerated filer____ 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 Section 13(1) 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.

COMMON STOCK, $2.00 PAR VALUE	**9,310,913**
(Class)	(Shares Outstanding at April 30, 2018)

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AMES NATIONAL CORPORATION

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(unaudited)

	March 31, 2018	**December 31, 2017**
ASSETS		
Cash and due from banks	$22,484,501	$26,397,550
Interest bearing deposits in financial institutions	68,832,839	43,021,953
Securities available-for-sale	489,091,103	495,321,664
Federal Home Loan Bank (FHLB) and Federal Reserve Bank (FRB) stock, at cost	2,557,400	3,021,200
Loans receivable, net	772,494,978	771,549,655
Loans held for sale	148,906	-
Bank premises and equipment, net	15,348,582	15,399,146
Accrued income receivable	7,730,256	8,382,391
Other real estate owned	385,509	385,509
Deferred income taxes, net	3,849,437	2,542,533
Intangible assets, net	1,018,887	1,091,462
Goodwill	6,732,216	6,732,216
Other assets	1,104,703	1,214,371
Total assets	$1,391,779,317	$1,375,059,650
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits		
Demand, noninterest bearing	$217,191,985	$227,332,347
NOW accounts	357,058,832	322,392,945
Savings and money market	401,030,635	389,630,180
Time, $250,000 and over	38,904,107	38,838,782
Other time	156,237,985	156,196,433
Total deposits	1,170,423,544	1,134,390,687
Securities sold under agreements to repurchase	36,534,018	37,424,619
Federal Home Loan Bank (FHLB) advances	2,000,000	13,500,000
Other borrowings	7,000,000	13,000,000
Dividends payable	4,469,238	2,048,401
Accrued expenses and other liabilities	4,806,299	3,942,801
Total liabilities	1,225,233,099	1,204,306,508
STOCKHOLDERS' EQUITY		
Common stock, $2 par value, authorized 18,000,000 shares; issued and outstanding 9,310,913 shares as of March 31, 2018 and December 31, 2017	18,621,826	18,621,826
Additional paid-in capital	20,878,728	20,878,728
Retained earnings	131,335,175	131,684,961
	(4,289,511)	(432,373)

Accumulated other comprehensive (loss) - net unrealized (loss) on securities available-for-sale		
Total stockholders' equity	166,546,218	170,753,142
Total liabilities and stockholders' equity	$1,391,779,317	$1,375,059,650

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
(unaudited)

	Three Months Ended March 31, 2018	**2017**
Interest income:		
Loans, including fees	$8,888,855	$8,115,685
Securities:		
Taxable	1,556,838	1,512,919
Tax-exempt	1,186,346	1,318,062
Interest bearing deposits and federal funds sold	165,319	137,173
Total interest income	11,797,358	11,083,839
Interest expense:		
Deposits	1,362,481	921,430
Other borrowed funds	248,390	279,401
Total interest expense	1,610,871	1,200,831
Net interest income	10,186,487	9,883,008
Provision for loan losses	29,000	397,574
Net interest income after provision for loan losses	10,157,487	9,485,434
Noninterest income:		
Wealth management income	751,000	698,932
Service fees	338,242	359,132
Securities gains, net	-	365,035
Gain on sale of loans held for sale	177,200	138,012
Merchant and card fees	309,659	315,036
Other noninterest income	187,901	187,504
Total noninterest income	1,764,002	2,063,651
Noninterest expense:		
Salaries and employee benefits	4,568,045	4,045,644
Data processing	781,032	823,779
Occupancy expenses, net	494,946	544,030
FDIC insurance assessments	105,995	103,831
Professional fees	345,407	298,145
Business development	254,548	237,741
Intangible asset amortization	87,535	98,802
Other operating expenses, net	227,629	307,785
Total noninterest expense	6,865,137	6,459,757

Income before income taxes	5,056,352	5,089,328
Provision for income taxes	1,019,600	1,479,200
Net income	$4,036,752	$3,610,128
Basic and diluted earnings per share	$0.43	$0.39
Dividends declared per share	$0.48	$0.22

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	Three Months Ended March 31,	
	2018	**2017**
Net income	$4,036,752	$3,610,128
Other comprehensive income (loss), before tax:		
Unrealized gains (losses) on securities before tax:		
Unrealized holding gains (losses) arising during the period	(5,033,043)	2,682,082
Less: reclassification adjustment for gains realized in net income	-	365,035
Other comprehensive income (loss), before tax	(5,033,043)	2,317,047
Tax effect related to other comprehensive income (loss)	1,258,605	(857,307)
Other comprehensive income (loss), net of tax	(3,774,438)	1,459,740
Comprehensive income	$262,314	$5,069,868

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(unaudited)
Three Months Ended March 31, 2018 and 2017

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net of Taxes	Total Stockholders' Equity
Balance, December 31, 2016	$18,621,826	$20,878,728	$126,181,376	$(576,687)	$165,105,243
Net income	-	-	3,610,128	-	3,610,128
Other comprehensive income	-	-	-	1,459,740	1,459,740
Cash dividends declared, $0.22 per share	-	-	(2,048,401)	-	(2,048,401)
Balance, March 31, 2017	$18,621,826	$20,878,728	$127,743,103	$883,053	$168,126,710
Balance, December 31, 2017	$18,621,826	$20,878,728	$131,684,961	$(432,373)	$170,753,142
Net income	-	-	4,036,752	-	4,036,752
Other comprehensive (loss)	-	-	-	(3,774,438)	(3,774,438)
The cumulative effect from change in accounting policy (1)	-	-	82,700	(82,700)	-
Cash dividends declared, $0.48 per share	-	-	(4,469,238)	-	(4,469,238)
Balance, March 31, 2018	$18,621,826	$20,878,728	$131,335,175	$(4,289,511)	$166,546,218

(1) The cumulative effect for the quarter ended March 31, 2018, reflects adoption in first quarter 2018 of ASU 2018-02.

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
Three Months Ended March 31, 2018 and 2017

	2018	**2017**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$4,036,752	$3,610,128
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	29,000	397,574
Provision for off-balance sheet commitments	(4,000)	10,000
Amortization, net	515,844	728,139
Amortization of intangible asset	87,535	98,802
Depreciation	260,358	274,347
Deferred income taxes	(48,299)	(221,700)
Securities gains, net	-	(365,035)
(Gain) on sales of loans held for sale	(177,200)	(138,012)
Proceeds from loans held for sale	7,516,348	4,617,145
Originations of loans held for sale	(7,488,054)	(4,432,660)
Loss on sale of premises and equipment, net	115	29,276
(Gain) on sale of other real estate owned, net	-	(7,024)
Change in assets and liabilities:		
Decrease in accrued income receivable	652,135	497,732
(Increase) decrease in other assets	104,485	(285,212)
Increase in accrued expenses and other liabilities	867,498	1,428,546
Net cash provided by operating activities	6,352,517	6,242,046
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of securities available-for-sale	(7,854,442)	(18,797,565)
Proceeds from sale of securities available-for-sale	-	1,491,070
Proceeds from maturities and calls of securities available-for-sale	8,364,369	9,869,153
Purchase of FHLB stock	(227,700)	(71,900)
Proceeds from the redemption of FHLB stock	691,500	7,200
Net (increase) in interest bearing deposits in financial institutions	(25,810,886)	(17,624,685)
Net (increase) in loans	(802,576)	(7,985,518)
Net proceeds from the sale of other real estate owned	-	26,637
Purchase of bank premises and equipment, net	(204,726)	(150,578)
Other	(14,960)	15,720
Net cash (used in) investing activities	(25,859,421)	(33,220,466)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in deposits	36,032,857	32,263,439
(Decrease) in securities sold under agreements to repurchase	(890,601)	(7,963,862)
Payments on FHLB borrowings and other borrowings	(17,500,000)	-
Dividends paid	(2,048,401)	(1,955,292)
Net cash provided by financing activities	15,593,855	22,344,285

Net (decrease) in cash and due from banks	(3,913,049)	(4,634,135)
CASH AND DUE FROM BANKS		
Beginning	26,397,550	29,478,068
Ending	$22,484,501	$24,843,933

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(unaudited)
Three Months Ended March 31, 2018 and 2017

	2018	**2017**
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash payments for:		
Interest	$1,538,837	$1,205,110
Income taxes	-	75,459
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES		
Transfer of loans receivable to other real estate owned	$-	$16,668
Proceeds from the sale of securities available-for-sale, recorded in other assets pending settlement	$-	$9,149,603

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements *(unaudited)*

1. Significant Accounting Policies

The consolidated financial statements for the three months ended March 31, 2018 and 2017 are unaudited. In the opinion of the management of Ames National Corporation (the "Company"), these financial statements reflect all adjustments, consisting only of normal recurring accruals, necessary to present fairly these consolidated financial statements. The results of operations for the interim periods are not necessarily indicative of results which may be expected for an entire year. Certain information and footnote disclosures normally included in complete financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted in accordance with the requirements for interim financial statements. The interim financial statements and notes thereto should be read in conjunction with the year-end audited financial statements contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 (the "Annual Report"). The consolidated financial statements include the accounts of the Company and its wholly-owned banking subsidiaries (the "Banks"). All significant intercompany balances and transactions have been eliminated in consolidation.

Goodwill: Goodwill represents the excess of cost over the fair value of net assets acquired. Goodwill resulting from acquisitions is not amortized, but is tested for impairment annually or whenever events change and circumstances indicate that it is more likely than not that an impairment loss has occurred. Goodwill is tested for impairment using a two-step process that begins with an estimation of the fair value of a reporting unit. The second step, if necessary, measures the amount of impairment, if any.

Significant judgment is applied when goodwill is assessed for impairment. This judgment includes developing cash flow projections, selecting appropriate discount rates, identifying relevant market comparables, incorporating general economic and market conditions and selecting an appropriate control premium. At March 31, 2018, Company management has performed a goodwill impairment assessment and determined goodwill was not impaired.

New and Pending Accounting Pronouncements: In January 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") No. 2016-01, Financial Instruments—Overall (Subtopic 825-10): *Recognition and Measurement of Financial Assets and Financial Liabilities.* The update enhances the reporting model for financial instruments to provide users of financial statements with more decision-useful information by updating certain aspects of recognition, measurement, presentation and disclosure of financial instruments. Among other changes, the update includes requiring changes in fair value of equity securities with readily determinable fair value to be recognized in net income and clarifies that entities should evaluate the need for a valuation allowance on a deferred tax asset related to available for sale securities in combination with the entities' other deferred tax assets. Among other items the ASC requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. The Company adopted this guidance effective January 1, 2018 and is to be applied on a modified retrospective basis. The fair value of the Company's loan portfolio is presented using an exit price method. Also, the Company is no longer required to disclose the methodologies used for estimating fair value of financial instruments measured at amortized cost on a recurring or nonrecurring basis. The remaining requirements of this update did not have a material impact on the Company's consolidated financial statements.

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) No. 2016-02, Leases (Topic 842). The ASU requires a lessee to recognize on the balance sheet assets and liabilities for leases with lease terms of more than 12 months. Consistent with current GAAP, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. Unlike current GAAP, which requires that only capital leases be recognized on the balance sheet, the ASC requires that both types of leases by recognized on the balance sheet. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2018. Early application is permitted. The adoption of this guidance is not expected to have a material impact on the Company’s consolidated financial statements.

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In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The ASU requires an organization to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2019. The Company is currently planning for the implementation of this accounting standard. It is too early to assess the impact that the guidance will have on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606): *Summary and Amendments that Create Revenue from Contracts with Customers (Topic 606) and Other Assets and Deferred Costs—Contracts with Customers (Subtopic 340-40)* . The guidance in this update supersedes the revenue recognition requirements in ASC Topic 605, Revenue Recognition, and most industry-specific guidance throughout the industry topics of the Codification. The Company adopted this guidance effective January 1, 2018. The guidance does not apply to revenues associated with financial instruments, including loans and securities that are accounted for under U.S. GAAP. The requirements of this update did not have a material impact on the Company's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles-Goodwill and Other (Topic 350): *Simplifying the Test for Goodwill Impairment*. The guidance in this update eliminates the Step 2 from the goodwill impairment test. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2019, with early adoption permitted for interim and annual goodwill impairment test with a measurement date after January 1, 2017. The Company does not expect the guidance to have a material impact on the Company's consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, Income Statement-Reporting Comprehensive Income (Topic 220): *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.* The amendments in this ASU would require a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the newly enacted federal corporate income tax rate. The amount of the reclassification would be the difference between the historical corporate income tax rate and the newly enacted 21 percent corporate income tax rate. The amendments in this update will be effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption of the amendments in this update is permitted. The Company adopted this ASU in the first quarter of 2018. The Company made an election to reclassify the income tax effects of the Tax Cuts and Jobs Act from accumulated comprehensive income to retained earnings. This update did not have a material impact on the Company's financial statements.

Reclassifications: Certain amounts in prior year financial statements have been reclassified, with no effect on net income, comprehensive income or stockholder's equity, to conform with current period presentation.

2. Dividends

On February 14, 2018, the Company declared a cash dividend on its common stock, payable on May 15, 2018 to stockholders of record as of May 1, 2018, equal to $0.23 per share. Also on February 14, 2018, the Company declared a one-time cash dividend on its common stock, payable on May 15, 2018 to stockholders of record as of May 1, 2018, equal to $0.25 per share.

3. Earnings Per Share

Earnings per share amounts were calculated using the weighted average shares outstanding during the periods presented. The weighted average outstanding shares for the three months ended March 31, 2018 and 2017 were 9,310,913. The Company had no potentially dilutive securities outstanding during the periods presented.

4. Off-Balance Sheet Arrangements

The Company is party to financial instruments with off-balance sheet risk in the normal course of business. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. No material changes in the Company’s off-balance sheet arrangements have occurred since December 31, 2017.

5. Fair Value Measurements

Assets and liabilities carried at fair value are required to be classified and disclosed according to the process for determining fair value. There are three levels of determining fair value.

Level 1: Inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

Level 2: Inputs to the valuation methodology include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatility, prepayment speeds, credit risk); or inputs derived principally from or can be corroborated by observable market data by correlation or other means.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement. Level 3 assets and liabilities include financial instruments whose value is determined using discounted cash flow methodologies, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The following table presents the balances of assets measured at fair value on a recurring basis by level as of March 31, 2018 and December 31, 2017. *(in thousands)*

Description	Total	Level 1	Level 2	Level 3
2018				
U.S. government treasuries	$6,788	$6,788	$-	$ -
U.S. government agencies	112,641	-	112,641	-
U.S. government mortgage-backed securities	76,913	-	76,913	-
State and political subdivisions	235,545	-	235,545	-
Corporate bonds	57,204	-	57,204	-
	$489,091	$6,788	$482,303	$ -
2017				
U.S. government treasuries	$6,367	$6,367	$-	$-
U.S. government agencies	111,263	-	111,263	-
U.S. government mortgage-backed securities	81,780	-	81,780	-
State and political subdivisions	237,413	-	237,413	-
Corporate bonds	58,464	-	58,464	-
Equity securities, other	35	35	-	-
	$495,322	$6,402	$488,920	$-

Level 1 securities include U.S. Treasury securities and other equity securities that are traded by dealers or brokers in active over-the-counter markets. U.S government agencies, mortgage-backed securities, state and political subdivisions, and most corporate bonds are reported at fair value utilizing Level 2 inputs. 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.

The Company's policy is to recognize transfers between levels at the end of each reporting period, if applicable. There were no transfers between levels of the fair value hierarchy during the three months ended March 31, 2018.

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Certain assets are measured at fair value on a nonrecurring basis; that is, they are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets carried on the balance sheet (after specific reserves) by caption and by level within the valuation hierarchy as of March 31, 2018 and December 31, 2017. *(in thousands)*

Description	Total	Level 1	Level 2	Level 3
2018				
Loans receivable	$2,707	$ -	$ -	$2,707
Other real estate owned	386	-	-	386
Total	$3,093	$ -	$ -	$3,093
2017				
Loans receivable	$2,606	$ -	$ -	$2,606
Other real estate owned	386	-	-	386
Total	$2,992	$ -	$ -	$2,992

Loans Receivable: Loans in the tables above consist of impaired credits held for investment. In accordance with the loan impairment guidance, impairment was measured based on the fair value of collateral less estimated selling costs for collateral dependent loans. Fair value for impaired loans is based upon appraised values of collateral adjusted for trends observed in the market. A valuation allowance was recorded for the excess of the loan's recorded investment over the amounts determined by the collateral value method. This valuation allowance is a component of the allowance for loan losses. The Company considers these fair value measurements as level 3.

Other Real Estate Owned: Other real estate owned in the table above consists of real estate obtained through foreclosure. Other real estate owned is recorded at fair value less estimated selling costs, at the date of transfer, with any impairment amount charged to the allowance for loan losses. Subsequent to the transfer, other real estate owned is carried at the lower of cost or fair value, less estimated selling costs, with any impairment amount recorded as a noninterest expense. The carrying value of other real estate owned is not re-measured to fair value on a recurring basis but is subject to fair value adjustments when the carrying value exceeds the fair value less estimated selling costs. Management uses appraised values and adjusts for trends observed in the market and for disposition costs in determining the value of other real estate owned. A valuation allowance was recorded for the excess of the asset's recorded investment over the amount determined by the fair value, less estimated selling costs. This valuation allowance is a component of the allowance for other real estate owned. The valuation allowance was $287,000 as of March 31, 2018 and December 31, 2017. The Company considers these fair value measurements as level 3.

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The significant inputs used in the fair value measurements for Level 3 assets measured at fair value on a nonrecurring basis as of March 31, 2018 and December 31, 2017 are as follows: *(in thousands)*

	2018 Estimated Fair Value	Valuation Techniques	Unobservable Inputs	Range (Average)	
Impaired Loans	$2,707	Evaluation of collateral	Estimation of value	NM*	
Other real estate owned	$386	Appraisal	Appraisal adjustment	6%-8%	(7%)

	2017 Estimated Fair Value	Valuation Techniques	Unobservable Inputs	Range (Average)	
Impaired Loans	$2,606	Evaluation of collateral	Estimation of value	NM*	
Other real estate owned	$386	Appraisal	Appraisal adjustment	6%-8%	(7%)

* Not Meaningful. Evaluations of the underlying assets are completed for each impaired loan with a specific reserve. The types of collateral vary widely and could include accounts receivables, inventory, a variety of equipment and real estate. Collateral evaluations are reviewed and discounted as appropriate based on knowledge of the specific type of collateral. In the case of real estate, an independent appraisal may be obtained. Types of discounts considered included aging of receivables, condition of the collateral, potential market for the collateral and estimated disposal costs. These discounts will vary from loan to loan, thus providing a range would not be meaningful.

GAAP requires disclosure of the fair value of financial assets and financial liabilities, including those that are not measured and reported at fair value on a recurring basis or nonrecurring basis. The methodologies for estimating the fair value of financial assets and financial liabilities that are measured at fair value on a recurring or nonrecurring basis are discussed above. The methodologies for other financial assets and financial liabilities are discussed below.

Fair value of financial instruments:

Disclosure of fair value information about financial instruments, for which it is practicable to estimate that value, is required whether or not recognized in the consolidated balance sheets. In cases in which 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 estimate of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases could not be realized in immediate settlement of the instruments. Certain financial instruments with a fair value that is not practicable to estimate and all non-financial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value amounts presented do not necessarily represent the underlying value of the Company.

The following disclosures represent financial instruments in which the ending balances at March 31, 2018 and December 31, 2017 are not carried at fair value in their entirety on the consolidated balance sheets.

Securities available-for-sale: Fair value measurement for Level 1 securities is based upon quoted prices. Fair value measurement for Level 2 securities are based upon quoted prices, if available. If quoted prices are not available, 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. Level 1 securities include U.S. Treasury and other equity securities that are traded by dealers or brokers in active over-the-counter markets. U.S government mortgage-backed securities, state and political subdivisions, and some corporate bonds are reported at fair value utilizing Level 2 inputs.

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Loans held for sale: The fair value of loans held for sale is based on prevailing market prices.

Limitations: Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The estimated fair values of the Company's financial instruments as described above as of March 31, 2018 and December 31, 2017 are as follows: *(in thousands)*

		2018		**2017**	
	Fair Value Hierarchy Level	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:					
Cash and due from banks	Level 1	$22,485	$22,485	$26,398	$26,398
Interest bearing deposits	Level 1	68,833	68,833	43,022	43,022
Securities available-for-sale	See previous table	489,091	489,091	495,322	495,322
FHLB and FRB stock	Level 2	2,557	2,557	3,021	3,021
Loans receivable, net	Level 2	772,495	749,858	771,550	768,444
Loans held for sale	Level 2	149	149	-	-
Accrued income receivable	Level 1	7,730	7,730	8,382	8,382
Financial liabilities:					
Deposits	Level 2	$1,170,424	$1,169,925	$1,134,391	$1,134,468
Securities sold under agreements to repurchase	Level 1	36,534	36,534	37,425	37,425
FHLB advances	Level 2	2,000	1,948	13,500	13,482
Other borrowings	Level 2	7,000	7,025	13,000	13,079
Accrued interest payable	Level 1	480	480	477	477

The methodologies used to determine fair value as of March 31, 2018 did not change from the methodologies described in the December 31, 2017 Annual Financial Statements, except for loans receivables which are now presented using an exit price method.

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6. Debt and Equity Securities

The amortized cost of securities available-for-sale and their fair values as of March 31, 2018 and December 31, 2017 are summarized below: *(in thousands)*

2018:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government treasuries	$ 6,917	$ -	$ (129)	$ 6,788
U.S. government agencies	114,359	25	(1,743)	112,641
U.S. government mortgage-backed securities	77,873	173	(1,133)	76,913
State and political subdivisions	237,150	708	(2,313)	235,545
Corporate bonds	58,511	11	(1,318)	57,204
	$ 494,810	$ 917	$ (6,636)	$ 489,091

2017:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government treasuries	$ 6,413	$ 2	$ (48)	$ 6,367
U.S. government agencies	111,900	136	(773)	111,263
U.S. government mortgage-backed securities	81,685	422	(327)	81,780
State and political subdivisions	237,349	1,233	(1,169)	237,413
Corporate bonds	58,647	206	(389)	58,464
Equity securities, other	15	20	-	35
	$ 496,009	$ 2,019	$ (2,706)	$ 495,322

The proceeds, gains and losses from securities available-for-sale are summarized as follows: *(in thousands)*

	Three Months Ended March 31, **2018**	**2017**
Proceeds from sales of securities available-for-sale	$ -	$ 10,641
Gross realized gains on securities available-for-sale	-	367

Gross realized losses on securities available-for-sale	-	(2)
Tax provision applicable to net realized gains on securities available-for-sale	-	128

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Unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position are summarized as of March 31, 2018 and December 31, 2017 are as follows: *(in thousands)*

2018:	Less than 12 Months Estimated Fair Value	Less than 12 Months Unrealized Losses	12 Months or More Estimated Fair Value	12 Months or More Unrealized Losses	Total Estimated Fair Value	Total Unrealized Losses
Securities available-for-sale:						
U.S. government treasuries	$6,788	$ (129)	$-	$ -	$6,788	$ (129)
U.S. government agencies	97,368	(1,408)	9,678	(335)	107,046	(1,743)
U.S. government mortgage-backed securities	60,207	(999)	5,121	(134)	65,328	(1,133)
State and political subdivisions	120,587	(1,588)	16,348	(725)	136,935	(2,313)
Corporate bonds	47,860	(937)	6,505	(381)	54,365	(1,318)
	$332,810	$ (5,061)	$37,652	$ (1,575)	$370,462	$ (6,636)

2017:	Less than 12 Months Fair Value	Less than 12 Months Unrealized Losses	12 Months or More Fair Value	12 Months or More Unrealized Losses	Total Fair Value	Total Unrealized Losses
Securities available-for-sale:						
U.S. government treasuries	$4,894	$ (48)	$-	$ -	$4,894	$ (48)
U.S. government agencies	73,953	(549)	10,168	(224)	84,121	(773)
U.S. government mortgage-backed securities	39,565	(245)	5,344	(82)	44,909	(327)
State and political subdivisions	89,904	(703)	16,631	(466)	106,535	(1,169)
Corporate bonds	29,808	(198)	6,709	(191)	36,517	(389)
	$238,124	$ (1,743)	$38,852	$ (963)	$276,976	$ (2,706)

Gross unrealized losses on debt securities totaled $6,636,000 as of March 31, 2018. These unrealized losses are generally due to changes in interest rates or general market conditions. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, state or political subdivision, or corporations. Management then determines whether downgrades by bond rating agencies have occurred, and reviews industry analysts' reports. The Company's procedures for evaluating investments in states, municipalities and political subdivisions include but are not limited to reviewing the offering statement and the most current available financial information, comparing yields to yields of bonds of similar credit quality, confirming capacity to repay, assessing operating and financial performance, evaluating the stability of tax revenues, considering debt profiles and local demographics, and for revenue bonds, assessing the source and strength of revenue structures for municipal authorities. These procedures, as applicable, are utilized for all municipal purchases and are utilized in whole or in part for monitoring the portfolio of municipal holdings. The Company does not utilize third party credit rating agencies as a primary component of determining if the municipal issuer has an adequate capacity to meet the financial commitments under the security for the projected life of the investment, and, therefore, does not compare internal assessments to those of the credit rating agencies. Credit rating downgrades are utilized as an additional indicator of credit weakness and as a reference point for historical default rates. Management concluded that the gross unrealized losses on debt securities were temporary. Due to potential changes in conditions, it is at least reasonably possible that changes in fair values and management’s assessments will occur in the near term and that such changes could materially affect the amounts reported in the Company’s financial statements.

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7. Loans Receivable and Credit Disclosures

Activity in the allowance for loan losses, on a disaggregated basis, for the three months ended March 31, 2018 and 2017 is as follows: *(in thousands)*

	Three Months Ended March 31, 2018							
	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Balance, December 31, 2017	$796	$ 1,716	$ 4,734	$ 997	$ 1,739	$ 1,171	$ 168	$11,321
Provision (credit) for loan losses	8	26	29	(20)	(6)	(3)	(5)	29
Recoveries of loans charged-off	-	2	-	-	18	-	8	28
Loans charged-off	-	-	-	-	(1)	-	(54)	(55)
Balance, March 31, 2018	$804	$ 1,744	$ 4,763	$ 977	$ 1,750	$ 1,168	$ 117	$11,323

	Three Months Ended March 31, 2017							
	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Balance, December 31, 2016	$908	$ 1,711	$ 3,960	$ 861	$ 1,728	$ 1,216	$ 123	$10,507
Provision (credit) for loan losses	24	6	316	37	74	(74)	15	398
Recoveries of loans charged-off	-	2	-	-	1	-	3	6
Loans charged-off	-	-	-	-	-	-	(9)	(9)
Balance, March 31, 2017	$932	$ 1,719	$ 4,276	$ 898	$ 1,803	$ 1,142	$ 132	$10,902

Allowance for loan losses disaggregated on the basis of impairment analysis method as of March 31, 2018 and December 31, 2017 is as follows: *(in thousands)*

2018	1-4 Family

	Construction Real Estate	Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Individually evaluated for impairment	$ -	$ 69	$ 115	$ -	$ 582	$ -	$ 28	$ 794
Collectively evaluated for impairment	804	1,675	4,648	977	1,168	1,168	89	10,529
Balance March 31, 2018	$ 804	$ 1,744	$ 4,763	$ 977	$ 1,750	$ 1,168	$ 117	$ 11,323

2017	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Individually evaluated for impairment	$ -	$ 42	$ 115	$ -	$ 607	$ -	$ 47	$ 811
Collectively evaluated for impairment	796	1,674	4,619	997	1,132	1,171	121	10,510
Balance December 31, 2017	$ 796	$ 1,716	$ 4,734	$ 997	$ 1,739	$ 1,171	$ 168	$ 11,321

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Loans receivable disaggregated on the basis of impairment analysis method as of March 31, 2018 and December 31, 2017 is as follows *(in thousands)*:

2018	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Individually evaluated for impairment	$ -	$ 902	$ 366	$ -	$ 2,978	$ -	$ 33	$ 4,279
Collectively evaluated for impairment	50,904	146,645	351,546	81,030	70,721	70,773	8,013	779,632
Balance March 31, 2018	$ 50,904	$ 147,547	$ 351,912	$ 81,030	$ 73,699	$ 70,773	$ 8,046	$ 783,911

2017	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Individually evaluated for impairment	$ -	$ 689	$ 901	$ -	$ 3,140	$ -	$ 80	$ 4,810
Collectively evaluated for impairment	50,309	145,569	349,725	81,790	70,676	69,806	10,265	778,140
Balance December 31, 2017	$ 50,309	$ 146,258	$ 350,626	$ 81,790	$ 73,816	$ 69,806	$ 10,345	$ 782,950

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 payment of principal and 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. The Company will apply its normal loan review procedures to identify loans that should be evaluated for impairment.

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The following is a recap of impaired loans, on a disaggregated basis, as of March 31, 2018 and December 31, 2017:
(in thousands)

	2018			2017		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no specific reserve recorded:						
Real estate - construction	$ -	$ -	$ -	$ -	$ -	$ -
Real estate - 1 to 4 family residential	567	690	-	572	677	-
Real estate - commercial	147	609	-	671	1,353	-
Real estate - agricultural	-	-	-	-	-	-
Commercial	64	68	-	125	148	-
Agricultural	-	-	-	-	-	-
Consumer and other	-	-	-	25	44	-
Total loans with no specific reserve:	778	1,367	-	1,393	2,222	-
With an allowance recorded:						
Real estate - construction	-	-	-	-	-	-
Real estate - 1 to 4 family residential	335	362	69	117	180	42
Real estate - commercial	219	219	115	230	230	115
Real estate - agricultural	-	-	-	-	-	-
Commercial	2,914	3,238	582	3,015	3,336	607
Agricultural	-	-	-	-	-	-
Consumer and other	33	37	28	55	43	47
Total loans with specific reserve:	3,501	3,856	794	3,417	3,789	811
Total						
Real estate - construction	-	-	-	-	-	-
Real estate - 1 to 4 family residential	902	1,052	69	689	857	42
Real estate - commercial	366	828	115	901	1,583	115
Real estate - agricultural	-	-	-	-	-	-
Commercial	2,978	3,306	582	3,140	3,484	607
Agricultural	-	-	-	-	-	-
Consumer and other	33	37	28	80	87	47
	$4,279	$ 5,223	$ 794	$4,810	$ 6,011	$ 811

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The following is a recap of the average recorded investment and interest income recognized on impaired loans for the three months ended March 31, 2018 and 2017: *(in thousands)*

	Three Months Ended March 31,			
	2018		**2017**	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no specific reserve recorded:				
Real estate - construction	$ -	$ -	$ -	$ -
Real estate - 1 to 4 family residential	570	23	438	3
Real estate - commercial	409	258	580	-
Real estate - agricultural	-	-	-	-
Commercial	95	-	2,774	-
Agricultural	-	-	-	-
Consumer and other	13	-	75	-
Total loans with no specific reserve:	1,087	281	3,867	3
With an allowance recorded:				
Real estate - construction	-	-	32	-
Real estate - 1 to 4 family residential	226	-	196	-
Real estate - commercial	225	-	-	-
Real estate - agricultural	-	-	-	-
Commercial	2,965	-	1,123	-
Agricultural	-	-	-	-
Consumer and other	44	1	2	-
Total loans with specific reserve:	3,460	1	1,353	-
Total				
Real estate - construction	-	-	32	-
Real estate - 1 to 4 family residential	796	23	634	3
Real estate - commercial	634	258	580	-
Real es				