AMES NATIONAL CORP
Form 10-Q
August 08, 2017
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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 June 30, 2017

[_] 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, 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 Section 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.

COMMON STOCK, $2.00 PAR VALUE	**9,310,913**
(Class)	(Shares Outstanding at July 28, 2017)

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AMES NATIONAL CORPORATION

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(unaudited)

ASSETS	**June 30, 2017**	**December 31, 2016**
Cash and due from banks	$19,573,969	$29,478,068
Interest bearing deposits in financial institutions	28,126,299	31,737,259
Securities available-for-sale	518,914,246	516,079,506
Loans receivable, net	768,208,213	752,181,730
Loans held for sale	543,683	242,618
Bank premises and equipment, net	15,845,997	16,049,379
Accrued income receivable	7,413,393	7,768,689
Other real estate owned	425,359	545,757
Deferred income taxes	1,713,812	3,485,689
Intangible assets, net	1,212,470	1,352,812
Goodwill	6,732,216	6,732,216
Other assets	915,960	799,306
Total assets	$1,369,625,617	$1,366,453,029
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits		
Demand, noninterest bearing	$202,864,782	$212,074,792
NOW accounts	332,846,478	310,427,812
Savings and money market	393,254,840	381,852,433
Time, $250,000 and over	37,291,573	39,031,663
Other time	160,513,103	166,022,165
Total deposits	1,126,770,776	1,109,408,865
Securities sold under agreements to repurchase	38,683,268	58,337,367
Federal Home Loan Bank (FHLB) advances	13,500,000	14,500,000
Other borrowings	13,000,000	13,000,000
Dividends payable	2,048,401	1,955,292
Accrued expenses and other liabilities	3,979,793	4,146,262
Total liabilities	1,197,982,238	1,201,347,786
STOCKHOLDERS' EQUITY		
Common stock, $2 par value, authorized 18,000,000 shares; issued and outstanding 9,310,913 shares as of June 30, 2017 and December 31, 2016	18,621,826	18,621,826

Additional paid-in capital	20,878,728	20,878,728
Retained earnings	129,167,032	126,181,376
Accumulated other comprehensive income (loss) - net unrealized gain (loss) on securities available-for-sale	2,975,793	(576,687)
Total stockholders' equity	171,643,379	165,105,243
Total liabilities and stockholders' equity	$1,369,625,617	$1,366,453,029

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

	Three Months Ended June 30, 2017	2016	Six Months Ended June 30, 2017	2016
Interest income:				
Loans, including fees	$8,499,729	$8,030,602	$16,615,414	$15,888,572
Securities:				
Taxable	1,566,707	1,471,926	3,079,626	2,967,236
Tax-exempt	1,290,808	1,388,791	2,608,870	2,788,822
Interest bearing deposits and federal funds sold	113,353	114,353	250,526	210,056
Total interest income	11,470,597	11,005,672	22,554,436	21,854,686
Interest expense:				
Deposits	1,113,389	755,377	2,034,819	1,505,498
Other borrowed funds	291,343	258,339	570,744	521,709
Total interest expense	1,404,732	1,013,716	2,605,563	2,027,207
Net interest income	10,065,865	9,991,956	19,948,873	19,827,479
Provision for loan losses	766,769	14,070	1,164,343	206,084
Net interest income after provision for loan losses	9,299,096	9,977,886	18,784,530	19,621,395
Noninterest income:				
Wealth management income	734,375	738,213	1,433,307	1,525,321
Service fees	365,753	404,614	724,885	801,705
Securities gains, net	95,644	29,500	460,679	231,193
Gain on sale of loans held for sale	226,530	257,254	364,542	434,011
Merchant and card fees	353,479	356,817	668,515	700,890
Other noninterest income	249,367	139,235	453,838	331,985
Total noninterest income	2,025,148	1,925,633	4,105,766	4,025,105
Noninterest expense:				
Salaries and employee benefits	3,986,327	3,854,417	8,031,971	7,906,201
Data processing	850,133	780,732	1,673,912	1,541,864
Occupancy expenses, net	475,556	407,989	1,019,586	1,011,426
FDIC insurance assessments	111,140	161,531	214,971	325,519
Professional fees	313,528	325,085	611,673	593,001
Business development	222,720	220,956	460,461	456,116

Other real estate owned expense (income), net	(3,330)	23,225	804	3,609
Intangible asset amortization	92,174	91,466	190,976	186,714
Other operating expenses, net	351,166	255,286	671,784	530,961
Total noninterest expense	6,399,414	6,120,687	12,876,138	12,555,411
Income before income taxes	4,924,830	5,782,832	10,014,158	11,091,089
Provision for income taxes	1,452,500	1,683,451	2,931,700	3,184,617
Net income	$3,472,330	$4,099,381	$7,082,458	$7,906,472
Basic and diluted earnings per share	$0.37	$0.44	$0.76	$0.85
Dividends declared per share	$0.22	$0.21	$0.44	$0.42

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	**2016**	**2017**	**2016**
Net income	$3,472,330	$4,099,381	$7,082,458	$7,906,472
Other comprehensive income, before tax:				
Unrealized gains on securities before tax:				
Unrealized holding gains arising during the period	3,417,455	3,952,639	6,099,537	7,916,196
Less: reclassification adjustment for gains realized in net income	95,644	29,500	460,679	231,193
Other comprehensive income, before tax	3,321,811	3,923,139	5,638,858	7,685,003
Tax effect related to other comprehensive income	(1,229,071)	(1,451,561)	(2,086,378)	(2,843,451)
Other comprehensive income, net of tax	2,092,740	2,471,578	3,552,480	4,841,552
Comprehensive income	$5,565,070	$6,570,959	$10,634,938	$12,748,024

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(unaudited)

Six Months Ended June 30, 2017 and 2016

	Common Stock	Additional Paid-in-Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net of Taxes	Total Stockholders' Equity
Balance, December 31, 2015	$18,621,826	$20,878,728	$118,267,767	$ 3,481,736	$161,250,057
Net income	-	-	7,906,472	-	7,906,472
Other comprehensive income	-	-	-	4,841,552	4,841,552
Cash dividends declared, $0.42 per share	-	-	(3,910,584)	-	(3,910,584)
Balance, June 30, 2016	$18,621,826	$20,878,728	$122,263,655	$ 8,323,288	$170,087,497
Balance, December 31, 2016	$18,621,826	$20,878,728	$126,181,376	$ (576,687)	$165,105,243
Net income	-	-	7,082,458	-	7,082,458
Other comprehensive income	-	-	-	3,552,480	3,552,480
Cash dividends declared, $0.44 per share	-	-	(4,096,802)	-	(4,096,802)
Balance, June 30, 2017	$18,621,826	$20,878,728	$129,167,032	$ 2,975,793	$171,643,379

See Notes to Consolidated Financial Statements.

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

Six Months Ended June 30, 2017 and 2016

	2017	**2016**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$7,082,458	$7,906,472
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,164,343	206,084
Provision for off-balance sheet commitments	10,000	32,000
Amortization, net	1,423,539	1,533,920
Amortization of intangible asset	190,976	186,714
Depreciation	567,889	572,632
Deferred income taxes	(314,501)	(68,500)
Securities gains, net	(460,679)	(231,193)
Gain on sales of loans held for sale	(364,542)	(434,011)
Proceeds from loans held for sale	14,927,797	19,147,297
Originations of loans held for sale	(14,864,320)	(19,819,006)
Loss on sale of premises and equipment, net	31,557	-
(Gain) on sale of other real estate owned, net	(11,573)	(4,642)
Change in assets and liabilities:		
Decrease in accrued income receivable	355,296	181,262
(Increase) decrease in other assets	(127,899)	62,076
Increase (decrease) in accrued expenses and other liabilities	(176,469)	594,883
Net cash provided by operating activities	9,433,872	9,865,988
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of securities available-for-sale	(45,014,269)	(36,400,109)
Proceeds from sale of securities available-for-sale	10,823,579	12,886,350
Proceeds from maturities and calls of securities available-for-sale	35,966,958	38,639,280
Net (increase) decrease in interest bearing deposits in financial institutions	3,610,960	(4,242,204)
Net (increase) in loans	(17,142,504)	(11,748,177)
Net proceeds from the sale of other real estate owned	148,639	200,634
Purchase of bank premises and equipment, net	(384,819)	(152,490)
Other	(50,634)	-
Net cash (used in) investing activities	(12,042,090)	(816,716)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase (decrease) in deposits	17,361,911	(8,810,492)
(Decrease) in securities sold under agreements to repurchase	(19,654,099)	(11,385,259)

Payments on FHLB borrowings and other borrowings	(1,000,000)	(1,542,203)
Proceeds from short-term FHLB borrowings, net	-	12,800,000
Dividends paid	(4,003,693)	(3,817,475)
Net cash (used in) by financing activities	(7,295,881)	(12,755,429)
Net (decrease) in cash and due from banks	(9,904,099)	(3,706,157)
CASH AND DUE FROM BANKS		
Beginning	29,478,068	24,005,801
Ending	$19,573,969	$20,299,644

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AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(unaudited)

Six Months Ended June 30, 2017 and 2016

	2017	**2016**
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash payments for:		
Interest	$2,595,215	$2,054,551
Income taxes	3,468,613	2,524,913
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES		
Transfer of loans receivable to other real estate owned	$16,668	$-

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 six months ended June 30, 2017 and 2016 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, 2016 (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 June 30, 2017, 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. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2017, and is to be applied on a modified retrospective basis. The Company is currently assessing the impact that this guidance will have on its consolidated financial statements, but does not expect the guidance to have a material impact on the Company's consolidated financial statements.

In February 2016, the FASB issued 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. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2017. The guidance does not apply to revenues associated with financial instruments, including loans and securities that are accounted for under U.S. GAAP. Based upon management’s revenue recognition analysis, the Company does not expect the guidance to 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.

2. Dividends

On May 10, 2017, the Company declared a cash dividend on its common stock, payable on August 15, 2017 to stockholders of record as of August 1, 2017, equal to $0.22 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 and six months ended June 30, 2017 and 2016 were 9,310,913. The Company had no potentially dilutive securities outstanding during the periods presented.

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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, 2016.

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 June 30, 2017 and December 31, 2016. *(in thousands)*

Description	Total	Level 1	Level 2	Level 3

2017

U.S. government treasuries	$4,448	$4,448	$-	$ -
U.S. government agencies	112,922	-	112,922	-
U.S. government mortgage-backed securities	85,898	-	85,898	-
State and political subdivisions	251,644	-	251,644	-
Corporate bonds	60,945	-	60,945	-
Equity securities, other	3,057	30	3,027	-
	$518,914	$4,478	$514,436	$ -

2016

U.S. government treasuries	$4,368	$4,368	$-	$ -
U.S. government agencies	110,209	-	110,209	-
U.S. government mortgage-backed securities	82,858	-	82,858	-
State and political subdivisions	264,448	-	264,448	-
Corporate bonds	51,184	-	51,184	-
Equity securities, other	3,013	-	3,013	-
	$516,080	$4,368	$511,712	$ -

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Level 1 securities include U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets. U.S government mortgage-backed securities, state and political subdivisions, most corporate bonds and other equity securities 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 June 30, 2017.

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 June 30, 2017 and December 31, 2016. *(in thousands)*

Description	Total	Level 1	Level 2	Level 3
2017				
Loans receivable	$2,645	$ -	$ -	$2,645
Other real estate owned	425	-	-	425
Total	$3,070	$ -	$ -	$3,070
2016				
Loans receivable	$683	$ -	$ -	$683
Other real estate owned	546	-	-	546
Total	$1,229	$ -	$ -	$1,229

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 $321,000 as of June 30, 2017 and $331,000 as of December 31, 2016. 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 June 30, 2017 and December 31, 2016 are as follows: *(in thousands)*

	2017 Estimated Fair Value	Valuation Techniques	Unobservable Inputs	Range (Average)
Impaired Loans	$ 2,645	Evaluation of collateral	Estimation of value	NM*
Other real estate owned	$ 425	Appraisal	Appraisal adjustment	6% - 8% (7%)

	2016 Estimated Fair Value	Valuation Techniques	Unobservable Inputs	Range (Average)
Impaired Loans	$ 683	Evaluation of collateral	Estimation of value	NM*
Other real estate owned	$ 546	Appraisal	Appraisal adjustment	6% - 10% (8%)

* 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 June 30, 2017 and December 31, 2016 are not carried at fair value in their entirety on the consolidated balance sheets.

Cash and due from banks and interest bearing deposits in financial institutions: The recorded amount of these assets approximates fair value.

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

Loans receivable: The fair value of loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates, which reflect the credit and interest rate risk inherent in the loan. The estimate of maturity is based on the historical experience, with repayments for each loan classification modified, as required, by an estimate of the effect of current economic and lending conditions. The effect of nonperforming loans is considered in assessing the credit risk inherent in the fair value estimate.

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

Deposits: Fair values of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings and NOW accounts, and money market accounts, are equal to the amount payable on demand as of the respective balance sheet date. Fair values of certificates of deposit are based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

Securities sold under agreements to repurchase: The carrying amounts of securities sold under agreements to repurchase approximate fair value because of the generally short-term nature of the instruments.

FHLB advances and other borrowings: Fair values of FHLB advances and other borrowings are estimated using discounted cash flow analysis based on interest rates currently being offered with similar terms.

Accrued income receivable and accrued interest payable: The carrying amounts of accrued income receivable and accrued interest payable approximate fair value.

Commitments to extend credit and standby letters of credit: The fair values of commitments to extend credit and standby letters of credit are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreement and credit worthiness of the counterparties. The carrying value and fair value of the commitments to extend credit and standby letters of credit are not considered significant.

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.

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The estimated fair values of the Company's financial instruments as described above as of June 30, 2017 and December 31, 2016 are as follows: *(in thousands)*

		2017		**2016**	
	Fair Value Hierarchy Level	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:					
Cash and due from banks	Level 1	$19,574	$19,574	$29,478	$29,478
Interest bearing deposits	Level 1	28,126	28,126	31,737	31,737
Securities available-for-sale	See previous table	518,914	518,914	516,080	516,080
Loans receivable, net	Level 2	768,208	757,915	752,182	746,580
Loans held for sale	Level 2	544	544	243	243
Accrued income receivable	Level 1	7,413	7,413	7,769	7,769
Financial liabilities:					
Deposits	Level 2	$1,126,771	$1,127,257	$1,109,409	$1,110,211
Securities sold under agreements to repurchase	Level 1	38,683	38,683	58,337	58,337
FHLB advances	Level 2	13,500	13,588	14,500	14,681
Other borrowings	Level 2	13,000	13,222	13,000	13,386
Accrued interest payable	Level 1	418	418	408	408

The methodologies used to determine fair value as of June 30, 2017 did not change from the methodologies described in the December 31, 2016 Annual Financial Statements.

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6. Debt and Equity Securities

The amortized cost of securities available-for-sale and their fair values as of June 30, 2017 and December 31, 2016 are summarized below: *(in thousands)*

2017:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government treasuries	$ 4,407	$ 41	$ -	$ 4,448
U.S. government agencies	112,193	889	(160)	112,922
U.S. government mortgage-backed securities	84,943	1,084	(129)	85,898
State and political subdivisions	249,067	2,984	(407)	251,644
Corporate bonds	60,539	555	(149)	60,945
Equity securities, other	3,042	15	-	3,057
	$ 514,191	$ 5,568	$ (845)	$ 518,914

2016:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government treasuries	$ 4,396	$ 18	$ (46)	$ 4,368
U.S. government agencies	110,372	540	(703)	110,209
U.S. government mortgage-backed securities	82,279	1,018	(439)	82,858
State and political subdivisions	265,204	1,660	(2,416)	264,448
Corporate bonds	51,731	147	(694)	51,184
Equity securities, other	3,013	-	-	3,013
	$ 516,995	$ 3,383	$ (4,298)	$ 516,080

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	**2016**	**2017**	**2016**
Proceeds from sales of securities available-for-sale	$ 183	$ 521	$ 10,824	$ 12,886

Gross realized gains on securities available-for-sale	96	29	463	237
Gross realized losses on securities available-for-sale	-	-	(2)	(6)
Tax provision applicable to net realized gains on securities available-for-sale	33	10	161	81

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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 June 30, 2017 and December 31, 2016 are as follows: *(in thousands)*

2017:	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 agencies	$26,095	$ (105)	$3,949	$ (55)	$30,044	$ (160)
U.S. government mortgage-backed securities	15,178	(129)	-	-	15,178	(129)
State and political subdivisions	42,933	(243)	5,249	(164)	48,182	(407)
Corporate bonds	19,027	(133)	514	(16)	19,541	(149)
	$103,233	$ (610)	$9,712	$ (235)	$112,945	$ (845)

2016:	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	$2,893	$ (46)	$-	$ -	$2,893	$ (46)
U.S. government agencies	48,225	(703)	-	-	48,225	(703)
U.S. government mortgage-backed securities	33,753	(439)	-	-	33,753	(439)
State and political subdivisions	125,558	(2,226)	6,512	(190)	132,070	(2,416)
Corporate bonds	35,703	(694)	-	-	35,703	(694)
	$246,132	$ (4,108)	$6,512	$ (190)	$252,644	$ (4,298)

Gross unrealized losses on debt securities totaled $845,000 as of June 30, 2017. 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 and six months ended June 30, 2017 and 2016 is as follows: *(in thousands)*

Three Months Ended June 30, 2017

	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Balance, March 31, 2017	$932	$ 1,719	$ 4,276	$ 898	$ 1,803	$ 1,142	$ 132	$10,902
Provision (credit) for loan losses	(152)	(9)	161	9	741	12	5	767
Recoveries of loans charged-off	-	3	-	-	27	-	1	31
Loans charged-off	-	-	-	-	(500)	-	(12)	(512)
Balance, June 30, 2017	$780	$ 1,713	$ 4,437	$ 907	$ 2,071	$ 1,154	$ 126	$11,188

Six Months Ended June 30, 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	(128)	(3)	477	46	815	(62)	19	1,164
Recoveries of loans charged-off	-	5	-	-	28	-	4	37
Loans charged-off	-	-	-	-	(500)	-	(20)	(520)
Balance, June 30, 2017	$780	$ 1,713	$ 4,437	$ 907	$ 2,071	$ 1,154	$ 126	$11,188

Three Months Ended June 30, 2016

	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Balance, March 31, 2016	$787	$ 1,757	$ 3,763	$ 817	$ 1,400	$ 1,322	$ 256	$10,102
	(44)	(15)	127	17	34	(103)	(2)	14

Provision (credit) for loan losses								
Recoveries of loans charged-off	15	-	-	-	5	-	4	24
Loans charged-off	-	-	-	-	-	-	(5)	(5)
Balance, June 30, 2016	$758	$ 1,742	$ 3,890	$ 834	$ 1,439	$ 1,219	$ 253	$10,135

Six Months Ended June 30, 2016

	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Balance, December 31, 2015	$999	$ 1,806	$ 3,557	$ 760	$ 1,371	$ 1,256	$ 239	$9,988
Provision (credit) for loan losses	(256)	(66)	333	74	139	(37)	19	206
Recoveries of loans charged-off	15	2	-	-	6	-	5	28
Loans charged-off	-	-	-	-	(77)	-	(10)	(87)
Balance, June 30, 2016	$758	$ 1,742	$ 3,890	$ 834	$ 1,439	$ 1,219	$ 253	$10,135

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Allowance for loan losses disaggregated on the basis of impairment analysis method as of June 30, 2017 and December 31, 2016 is as follows: *(in thousands)*

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	$ -	$ 65	$ -	$ -	$ 866	$ -	$ -	$ 931
Collectively evaluated for impairment	780	1,648	4,437	907	1,205	1,154	126	10,257
Balance June 30, 2017	$ 780	$ 1,713	$ 4,437	$ 907	$ 2,071	$ 1,154	$ 126	$ 11,188

2016	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	$ -	$ 76	$ -	$ -	$ 644	$ -	$ -	$ 720
Collectively evaluated for impairment	908	1,635	3,960	861	1,084	1,216	123	9,787
Balance December 31, 2016	$ 908	$ 1,711	$ 3,960	$ 861	$ 1,728	$ 1,216	$ 123	$ 10,507

Loans receivable disaggregated on the basis of impairment analysis method as of June 30, 2017 and December 31, 2016 is as follows *(in thousands)*:

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	$ -	$ 825	$ 728	$ -	$ 3,554	$ -	$ 63	$ 5,170
Collectively evaluated for impairment	49,810	144,896	346,978	76,228	74,938	70,566	10,883	774,299
	$ 49,810	$						

Balance June 30,
2017