

COLONY BANKCORP INC  
Form 10-Q  
November 01, 2016  
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 SEPTEMBER 30, 2016 COMMISSION FILE NUMBER 0-12436

COLONY BANKCORP, INC.  
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

GEORGIA  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

58-1492391  
(I.R.S. EMPLOYER  
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 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 OR A SMALLER REPORTING COMPANY. SEE DEFINITIONS OF "ACCELERATED FILER", "LARGE ACCELERATED FILER" AND "SMALLER REPORTING COMPANY" IN RULE 12b-2 OF THE EXCHANGE ACT.

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

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

YES  NO

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 NOVEMBER 1, 2016</u>
COMMON STOCK, \$1 PAR VALUE	8,439,258



TABLE OF CONTENTS

	<u>Page</u>
<u>PART I – Financial Information</u>	
Forward Looking Statement Disclosure	3
Item 1. Financial Statements	4
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	41
Item 3. Quantitative and Qualitative Disclosures About Market Risk	55
Item 4. Controls and Procedures	55
 <u>PART II – Other Information</u>	
Item 6. Exhibits	56
Signatures	59

## 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 – SEPTEMBER 30, 2016 (UNAUDITED) AND DECEMBER 31, 2015 (AUDITED).

B. CONSOLIDATED STATEMENTS OF INCOME – FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015 AND FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015 (UNAUDITED).

C. CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME – FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015 AND FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015 (UNAUDITED).

D. CONSOLIDATED STATEMENTS OF CASH FLOWS – FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015 (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 NINE MONTH PERIOD ENDED SEPTEMBER 30, 2016 ARE NOT NECESSARILY INDICATIVE OF THE RESULTS TO BE EXPECTED FOR THE FULL YEAR.

**PART 1 (Continued)**

Item 1 (Continued)

**COLONY BANKCORP, INC. AND SUBSIDIARY****CONSOLIDATED BALANCE SHEETS****SEPTEMBER 30, 2016 AND DECEMBER 31, 2015****(DOLLARS IN THOUSANDS)**

<b>ASSETS</b>	<b>September 30, 2016 (Unaudited)</b>	<b>December 31, 2015 (Audited)</b>
<b>Cash and Cash Equivalents</b>		
Cash and Due from Banks	<b>\$ 17,803</b>	\$22,257
<b>Interest-Bearing Deposits</b>	<b>13,872</b>	38,615
<b>Investment Securities</b>		
Available for Sale, at Fair Value	<b>286,089</b>	296,149
<b>Federal Home Loan Bank Stock, at Cost</b>	<b>3,010</b>	2,731
<b>Loans</b>	<b>776,117</b>	758,636
Allowance for Loan Losses	<b>(9,203)</b>	(8,604)
Unearned Interest and Fees	<b>(382)</b>	(357)
	<b>766,532</b>	749,675
<b>Premises and Equipment</b>	<b>27,745</b>	26,454
<b>Other Real Estate (Net of Allowance of \$1,509 and \$1,582 as of September 30, 2016 and December 31, 2015, Respectively)</b>	<b>9,812</b>	8,839
<b>Other Intangible Assets</b>	<b>89</b>	116
<b>Other Assets</b>	<b>27,865</b>	29,313
<b>Total Assets</b>	<b>\$ 1,152,817</b>	\$ 1,174,149
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Deposits</b>		
Noninterest-Bearing	<b>\$ 138,941</b>	\$133,886
Interest-Bearing	<b>839,649</b>	877,668
	<b>978,590</b>	1,011,554
<b>Borrowed Money</b>		
Subordinated Debentures	<b>24,229</b>	24,229
Other Borrowed Money	<b>46,000</b>	40,000
	<b>70,229</b>	64,229
<b>Other Liabilities</b>	<b>3,263</b>	2,909



**Stockholders' Equity**

Preferred Stock, Stated Value \$1,000 a Share; Authorized 10,000,000 Shares, Issued 14,360 Shares and 18,021 as of September 30, 2016 and December 31, 2015, Respectively	<b>14,360</b>	18,021
Common Stock, Par Value \$1 a Share; Authorized 20,000,000 Shares, Issued 8,439,258 Shares as of September 30, 2016 and December 31, 2015	<b>8,439</b>	8,439
Paid-In Capital	<b>29,145</b>	29,145
Retained Earnings	<b>49,582</b>	44,286
Accumulated Other Comprehensive (Loss), Net of Tax Benefits	<b>(791 )</b>	(4,434 )
	<b>100,735</b>	95,457
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 1,152,817</b>	\$1,174,149

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 SEPTEMBER 30, 2016 AND 2015****AND NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015****(UNAUDITED)****(DOLLARS IN THOUSANDS)**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September</b>	September	<b>September</b>	September
	<b>30, 2016</b>	30, 2015	<b>30, 2016</b>	30, 2015
<b>Interest Income</b>				
Loans, Including Fees	<b>\$9,810</b>	\$9,981	<b>\$29,135</b>	\$29,563
Federal Funds Sold	-	-	-	15
Deposits with Other Banks	<b>18</b>	17	<b>79</b>	58
Investment Securities				
U.S. Government Agencies	<b>1,266</b>	1,060	<b>3,978</b>	3,108
State, County and Municipal	<b>30</b>	28	<b>97</b>	78
Dividends on Other Investments	<b>32</b>	31	<b>97</b>	91
	<b>11,156</b>	11,117	<b>33,386</b>	32,913
<b>Interest Expense</b>				
Deposits	<b>1,187</b>	1,210	<b>3,580</b>	3,648
Borrowed Money	<b>413</b>	410	<b>1,269</b>	1,319
	<b>1,600</b>	1,620	<b>4,849</b>	4,967
<b>Net Interest Income</b>	<b>9,556</b>	9,497	<b>28,537</b>	27,946
Provision for Loan Losses	<b>354</b>	250	<b>1,062</b>	741
<b>Net Interest Income After Provision for Loan Losses</b>	<b>9,202</b>	9,247	<b>27,475</b>	27,205
<b>Noninterest Income</b>				
Service Charges on Deposits	<b>1,128</b>	1,133	<b>3,185</b>	3,184
Other Service Charges, Commissions and Fees	<b>686</b>	661	<b>2,104</b>	1,963
Mortgage Fee Income	<b>254</b>	138	<b>507</b>	385
Securities Gains (Losses)	<b>256</b>	9	<b>385</b>	12
Other	<b>313</b>	292	<b>980</b>	1,259
	<b>2,637</b>	2,233	<b>7,161</b>	6,803

**Noninterest Expenses**

Salaries and Employee Benefits	<b>4,726</b>	4,395	<b>13,825</b>	13,270
Occupancy and Equipment	<b>1,025</b>	1,026	<b>2,967</b>	3,036
Other	<b>2,903</b>	2,914	<b>8,451</b>	8,635
	<b>8,654</b>	8,335	<b>25,243</b>	24,941
<b>Income Before Income Taxes</b>	<b>3,185</b>	3,145	<b>9,393</b>	9,067
<b>Income Taxes</b>	<b>927</b>	945	<b>2,907</b>	2,799
<b>Net Income</b>	<b>2,258</b>	2,200	<b>6,486</b>	6,268
<b>Preferred Stock Dividends</b>	<b>378</b>	594	<b>1,189</b>	1,854
<b>Net Income Available to Common Stockholders</b>	<b>\$1,880</b>	\$1,606	<b>\$5,297</b>	\$4,414
<b>Net Income Per Share of Common Stock</b>				
Basic	<b>\$0.22</b>	\$0.19	<b>\$0.63</b>	\$0.52
Diluted	<b>\$0.22</b>	\$0.19	<b>\$0.62</b>	\$0.52
<b>Cash Dividends Declared Per Share of Common Stock</b>	<b>\$-</b>	\$-	<b>\$-</b>	\$-
<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>8,506,268</b>	8,466,285	<b>8,495,752</b>	8,449,057

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 SEPTEMBER 30, 2016 AND 2015****AND NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015**

(UNAUDITED)

(DOLLARS IN THOUSANDS)

	<b>Three Months Ended September 30, 2016</b>		<b>Nine Months Ended September 30, 2016</b>	
	September 30, 2015	September 30, 2015	September 30, 2015	September 30, 2015
<b>Net Income</b>	<b>\$2,258</b>	\$ 2,200	<b>\$6,486</b>	\$ 6,268
<b>Other Comprehensive Income:</b>				
Gains (Losses) on Securities Arising During the Year	(1,182)	2,497	5,905	3,747
Tax Effect	402	(849 )	(2,008 )	(1,274 )
Realized Gains on Sale of AFS Securities	(256 )	(9 )	(385 )	(12 )
Tax Effect	87	3	131	4
Change in Unrealized Gains (Losses) on Securities Available for Sale, Net of Reclassification Adjustment and Tax Effects	(949 )	1,642	3,643	2,465
<b>Comprehensive Income</b>	<b>\$1,309</b>	\$ 3,842	<b>\$10,129</b>	\$ 8,733

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****NINE MONTHS ENDED SEPTEMBER 30, 2016 AND 2015****(UNAUDITED)****(DOLLARS IN THOUSANDS)**

	<b>Nine Months Ended</b>	
	<b>September</b>	<b>September</b>
	<b>30, 2016</b>	<b>30, 2015</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Income	<b>\$6,486</b>	\$ 6,268
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation	<b>1,178</b>	1,237
Provision for Loan Losses	<b>1,062</b>	741
Securities (Gains)	<b>(385 )</b>	(12 )
Amortization and Accretion	<b>1,142</b>	1,391
(Gain) on Sale of Other Real Estate and Repossessions	<b>(17 )</b>	(61 )
Provision for Losses on Other Real Estate	<b>126</b>	431
Increase in Cash Surrender Value of Life Insurance	<b>(416 )</b>	(132 )
Loss on Sale of Premises & Equipment	<b>80</b>	11
Other Prepaids, Deferrals and Accruals, Net	<b>340</b>	928
	<b>9,596</b>	10,802
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of Investment Securities Available for Sale	<b>(49,355)</b>	(63,715 )
Proceeds from Maturities, Calls, and Paydowns of Investment Securities:		
Available for Sale	<b>39,022</b>	40,840
Held for Maturity	<b>-</b>	5
Proceeds from Sale of Investment Securities		
Available for Sale	<b>25,210</b>	28,274
Interest-Bearing Deposits in Other Banks	<b>24,743</b>	5,210
Net Loans to Customers	<b>(21,968)</b>	(25,631 )
Purchase of Premises and Equipment	<b>(2,635 )</b>	(776 )
Proceeds from Sale of Other Real Estate and Repossessions	<b>2,981</b>	5,404
Federal Home Loan Bank Stock	<b>(279 )</b>	100
Proceeds from Sale of Premises and Equipment	<b>86</b>	29

	<b>17,805</b>	(10,260 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Noninterest-Bearing Customer Deposits	<b>5,055</b>	(2,547 )
Interest-Bearing Customer Deposits	<b>(38,019)</b>	(18,722 )
Dividends Paid for Preferred Stock	<b>(1,230 )</b>	(1,908 )
Redemption of Preferred Stock	<b>(3,661 )</b>	(4,833 )
Payments on Federal Home Loan Bank Advances	<b>(4,000 )</b>	(27,000 )
Proceeds from Federal Home Loan Bank Advances	<b>10,000</b>	27,000
	<b>(31,855)</b>	(28,010 )
Net Decrease in Cash and Cash Equivalents	<b>(4,454 )</b>	(27,468 )
Cash and Cash Equivalents at Beginning of Period	<b>22,257</b>	44,605
Cash and Cash Equivalents at End of Period	<b>\$17,803</b>	\$ 17,137

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, 2015 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 nine months ended September 30, 2016, 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, 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 2016. 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, particularly with the current economic downturn in the real estate market. At September 30, 2016, approximately 85 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. Declining collateral real estate values that secure land development, construction and speculative real estate loans in the Company's larger MSA markets have resulted in high loan loss provisions 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 Colony 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 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 \$15,246 and \$14,830 as of September 30, 2016 and December 31, 2015, 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 operations 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 Company is currently evaluating the impact of the pending adoption of ASU 2014-09 on the consolidated financial statements.

ASU 2016-1, "No. 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-1, 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 2016-1 will be effective for the Company on January 1, 2018. The Company is currently evaluating the impact of the pending adoption of ASU 2016-1 on the consolidated financial statements.

ASU 2016-02, "*Leases*." 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 2016-09, "*Improvements to Employee Share-Based Payment Accounting*." This ASU simplifies several aspects of the accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For public business entities, this ASU is effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods therein. The Company is evaluating the impact of this ASU on its financial statements and disclosures.

**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 2016-13, “*Financial Instruments – Credit Losses*.” 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.

**(2) Investment Securities**

Investment securities as of September 30, 2016 and December 31, 2015 are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>September 30, 2016</b>				
<b>Securities Available for Sale:</b>				
U. S. Government Agencies				
Mortgage-Backed	\$ 282,681	\$ 816	\$ (2,116 )	\$281,381
State, County & Municipal	4,607	101	-	4,708
	<b>\$ 287,288</b>	<b>\$ 917</b>	<b>\$ (2,116 )</b>	<b>\$286,089</b>
<b>December 31, 2015</b>				
	Amortized	Gross	Gross	Fair
				Value

	<b>Cost</b>	<b>Unrealized</b>	<b>Unrealized</b>	
		<b>Gains</b>	<b>Losses</b>	
<b>Securities Available for Sale:</b>				
U. S. Government Agencies				
Mortgage-Backed	\$ 297,779	\$ 63	\$ (6,792	) \$291,050
State, County & Municipal	5,089	30	(20	) 5,099
	\$ 302,868	\$ 93	\$ (6,812	) \$296,149

**PART I (Continued)**

## Item 1 (Continued)

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

The amortized cost and fair value of investment securities as of September 30, 2016, 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>\$346</b>	<b>\$348</b>
Due After One Year Through Five Years	<b>1,662</b>	<b>1,685</b>
Due After Five Years Through Ten Years	<b>1,109</b>	<b>1,139</b>
Due After Ten Years	<b>1,490</b>	<b>1,536</b>
	<b>\$4,607</b>	<b>\$4,708</b>
 Mortgage-Backed Securities	 <b>282,681</b>	 <b>281,381</b>
	<b>\$287,288</b>	<b>\$286,089</b>