

COLONY BANKCORP INC  
Form 10-Q  
November 02, 2018

**UNITED STATES**

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

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

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

COLONY BANKCORP, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

GEORGIA 58-1492391  
(STATE OR OTHER JURISDICTION OF (I.R.S. EMPLOYER  
INCORPORATION OR ORGANIZATION) IDENTIFICATION NUMBER)

115 SOUTH GRANT STREET, FITZGERALD, GEORGIA 31750

ADDRESS OF PRINCIPAL EXECUTIVE OFFICES

229/426-6000

REGISTRANT'S TELEPHONE NUMBER INCLUDING AREA CODE

INDICATE BY CHECK MARK WHETHER THE REGISTRANT (1) HAS FILED ALL REPORTS REQUIRED TO BE FILED BY SECTIONS 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 DURING THE PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO FILE SUCH REPORTS), AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS.

YES  NO

INDICATE BY CHECK MARK WHETHER THE REGISTRANT HAS SUBMITTED ELECTRONICALLY EVERY INTERACTIVE DATA FILE REQUIRED TO BE SUBMITTED PURSUANT TO RULE 405 OF REGULATION S-T (§232.405 OF THIS CHAPTER) DURING THE PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO SUBMIT AND POST SUCH FILES).

YES  NO

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A LARGE ACCELERATED FILER, AN ACCELERATED FILER, A NON-ACCELERATED FILER, SMALLER REPORTING COMPANY, OR AN EMERGING GROWTH COMPANY. SEE THE DEFINITIONS OF "LARGE ACCELERATED FILER," "ACCELERATED FILER," "SMALLER REPORTING COMPANY," AND "EMERGING GROWTH COMPANY" IN RULE 12b-2 OF THE EXCHANGE ACT.

LARGE ACCELERATED FILER

ACCELERATED FILER

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

SMALLER REPORTING COMPANY

EMERGING GROWTH COMPANY

IF AN EMERGING GROWTH COMPANY, INDICATE BY CHECK MARK IF THE REGISTRANT HAS ELECTED NOT TO USE THE EXTENDED TRANSITION PERIOD FOR COMPLYING WITH ANY NEW OR REVISED FINANCIAL ACCOUNTING STANDARDS PROVIDED PURSUANT TO 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.

<u>CLASS</u>	<u>OUTSTANDING AT NOVEMBER 2, 2018</u>
COMMON STOCK, \$1 PAR VALUE	8,444,908

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## Forward Looking Statement Disclosure

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

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

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

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

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

Inflation, interest rate, market and monetary fluctuations.

Political instability.

Acts of war, terrorism or cyberterrorism.

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

Changes in consumer spending, borrowings and savings habits.

Technological changes.

Acquisitions and integration of acquired businesses.

The ability to increase market share and control expenses.

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

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

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

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

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

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

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

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

**PART 1. FINANCIAL INFORMATION**

ITEM 1

**FINANCIAL STATEMENTS**

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

A. CONSOLIDATED BALANCE SHEETS – SEPTEMBER 30, 2018 (UNAUDITED) AND DECEMBER 31, 2017 (AUDITED).

B. CONSOLIDATED STATEMENTS OF INCOME – FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017 AND FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017 (UNAUDITED).

C. CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME – FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017 AND THE NINE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017 (UNAUDITED).

D. CONSOLIDATED STATEMENTS OF CASH FLOWS – FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017 (UNAUDITED).

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

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



**PART I (Continued)**

## Item 1 (Continued)

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

	<b>September 30, 2018 (Unaudited)</b>	<b>December 31, 2017 (Audited)</b>
<b>ASSETS</b>		
<b>Cash and Cash Equivalents</b>		
Cash and Due from Banks	<b>\$ 10,149</b>	\$23,145
<b>Interest-Bearing Deposits</b>	<b>21,764</b>	34,668
<b>Investment Securities</b>		
Available for Sale, at Fair Value	<b>318,032</b>	354,247
<b>Federal Home Loan Bank Stock, at Cost</b>	<b>3,594</b>	3,043
<b>Loans</b>	<b>779,443</b>	765,284
Allowance for Loan Losses	<b>(7,155)</b>	(7,508)
Unearned Interest and Fees	<b>(515)</b>	(495)
	<b>771,773</b>	757,281
<b>Premises and Equipment</b>	<b>27,744</b>	27,639
<b>Other Real Estate (Net of Allowance of \$815 and \$1,451 as of September 30, 2018 and December 31, 2017, Respectively)</b>	<b>2,173</b>	4,256
<b>Other Intangible Assets</b>	<b>18</b>	45
<b>Other Assets</b>	<b>30,949</b>	28,431
<b>Total Assets</b>	<b>\$ 1,186,196</b>	\$ 1,232,755

**LIABILITIES AND STOCKHOLDERS' EQUITY****Deposits**

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Noninterest-Bearing	\$ 177,261	\$ 190,928
Interest-Bearing	833,798	877,057
	<b>1,011,059</b>	1,067,985
<b>Borrowed Money</b>		
Subordinated Debentures	24,229	24,229
Other Borrowed Money	58,500	47,500
	<b>82,729</b>	71,729
<b>Other Liabilities</b>	<b>3,420</b>	2,718
<b>Stockholders' Equity</b>		
Common Stock, Par Value \$1 a Share; Authorized 20,000,000 Shares, Issued 8,444,908 and 8,439,258 Shares as of September 30, 2018 and December 31, 2017 respectively	8,445	8,439
Paid-In Capital	25,970	29,145
Retained Earnings	66,916	59,230
Accumulated Other Comprehensive (Loss), Net of Tax Benefits	(12,343 )	(6,491 )
	<b>88,988</b>	90,323
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 1,186,196</b>	\$ 1,232,755

The accompanying notes are an integral part of these statements.

**PART I (Continued)**

## Item 1 (Continued)

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September</b>	<b>September</b>	<b>September</b>	<b>September</b>
	<b>30, 2018</b>	<b>30, 2017</b>	<b>30, 2018</b>	<b>30, 2017</b>
<b>Interest Income</b>				
Loans, Including Fees	<b>\$10,255</b>	\$9,754	<b>\$30,048</b>	\$28,884
Deposits with Other Banks	<b>48</b>	52	<b>192</b>	166
Investment Securities				
U.S. Government Agencies	<b>1,847</b>	1,684	<b>5,635</b>	4,932
State, County and Municipal	<b>25</b>	27	<b>77</b>	87
Corporate Debt	<b>27</b>	23	<b>84</b>	59
Dividends on Other Investments	<b>49</b>	38	<b>134</b>	109
	<b>12,251</b>	11,578	<b>36,170</b>	34,237
<b>Interest Expense</b>				
Deposits	<b>1,564</b>	1,191	<b>4,165</b>	3,559
Federal Funds Purchased	<b>3</b>	-	<b>4</b>	3
Borrowed Money	<b>579</b>	544	<b>1,602</b>	1,554
	<b>2,146</b>	1,735	<b>5,771</b>	5,116
<b>Net Interest Income</b>	<b>10,105</b>	9,843	<b>30,399</b>	29,121

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Provision for Loan Losses	<b>61</b>	-	<b>131</b>	335
<b>Net Interest Income After Provision for Loan Losses</b>	<b>10,044</b>	9,843	<b>30,268</b>	28,786
<b>Noninterest Income</b>				
Service Charges on Deposits	<b>1,134</b>	1,169	<b>3,266</b>	3,315
Other Service Charges, Commissions and Fees	<b>803</b>	741	<b>2,414</b>	2,300
Mortgage Fee Income	<b>176</b>	241	<b>507</b>	629
Securities Gains (Losses)	-	-	<b>116</b>	-
Other	<b>292</b>	273	<b>860</b>	974
	<b>2,405</b>	2,424	<b>7,163</b>	7,218
<b>Noninterest Expenses</b>				
Salaries and Employee Benefits	<b>5,110</b>	4,802	<b>15,032</b>	14,467
Occupancy and Equipment	<b>1,052</b>	1,014	<b>3,077</b>	2,965
Other	<b>2,916</b>	2,564	<b>8,106</b>	7,976
	<b>9,078</b>	8,380	<b>26,215</b>	25,408
<b>Income Before Income Taxes</b>	<b>3,371</b>	3,887	<b>11,216</b>	10,596
<b>Income Taxes</b>	<b>676</b>	1,265	<b>2,264</b>	3,424
<b>Net Income</b>	<b>2,695</b>	2,622	<b>8,952</b>	7,172
<b>Preferred Stock Dividends</b>	-	-	-	211
<b>Net Income Available to Common Stockholders</b>	<b>\$2,695</b>	\$2,622	<b>\$8,952</b>	\$6,961
<b>Net Income Per Share of Common Stock</b>				
Basic	<b>\$0.32</b>	\$0.31	<b>\$1.06</b>	\$0.82
Diluted	<b>\$0.32</b>	\$0.30	<b>\$1.04</b>	\$0.81
<b>Cash Dividends Paid Per Share of Common Stock</b>	<b>\$0.05</b>	\$0.025	<b>\$0.15</b>	\$0.075
<b>Weighted Average Basic Shares Outstanding</b>	<b>8,439,415</b>	8,439,258	<b>8,439,310</b>	8,439,258
<b>Weighted Average Diluted Shares Outstanding</b>	<b>8,444,816</b>	8,629,523	<b>8,571,516</b>	8,631,566

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,  
2018 AND 2017  
AND NINE  
MONTHS ENDED  
SEPTEMBER 30,  
2018 AND 2017  
(UNAUDITED)  
(DOLLARS IN  
THOUSANDS)**

	<b>Three Months Ended September 30, 2018</b>		<b>Nine Months Ended September 30, 2018</b>	
	September 30, 2017		September 30, 2017	
<b>Net Income</b>	<b>\$2,695</b>	\$ 2,622	<b>\$8,952</b>	\$ 7,172
<b>Other Comprehensive Income:</b>				
Gains (Losses) on Securities Arising During the Year	(1,945)	300	(7,291)	1,888
Tax Effect	408	(102 )	1,531	(642 )
Realized Gains on Sale of AFS Securities	-	-	(116 )	-
Tax Effect	-	-	24	-
Change in Unrealized Gains (Losses) on Securities Available for Sale, Net of Reclassification Adjustment and Tax Effects	(1,537)	198	(5,852)	1,246
<b>Comprehensive Income</b>	<b>\$1,158</b>	\$ 2,820	<b>\$3,100</b>	\$ 8,418

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,  
2018 AND 2017  
(UNAUDITED)  
(DOLLARS IN  
THOUSANDS)**

	<b>Nine Months Ended</b>	
	<b>September</b>	<b>September</b>
	<b>30, 2018</b>	<b>30, 2017</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Income	<b>\$8,952</b>	\$ 7,172
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation	<b>1,310</b>	1,240
Provision for Loan Losses	<b>131</b>	335
Securities (Gains)	<b>(116 )</b>	-
Amortization and Accretion	<b>909</b>	1,077
(Gain) on Sale of Other Real Estate and Repossessions	<b>(168 )</b>	(111 )
Provision for Losses on Other Real Estate	<b>201</b>	256
Increase in Cash Surrender Value of Life Insurance	<b>(368 )</b>	(404 )
Loss on Sale of Premises & Equipment	<b>1</b>	(11 )
Provision for Losses on Premises & Equipment	<b>170</b>	-
Other Prepaids, Deferrals and Accruals, Net	<b>813</b>	1,344
	<b>11,835</b>	10,898
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of Investment Securities Available for Sale	<b>(20,893)</b>	(54,448 )
Proceeds from Maturities, Calls, and Paydowns of Investment Securities:		
Available for Sale	<b>37,667</b>	40,698
Proceeds from Sale of Investment Securities Available for Sale	<b>11,268</b>	-

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Interest-Bearing Deposits in Other Banks	<b>12,904</b>	33,593
Net Loans to Customers	<b>(15,380)</b>	(18,360 )
Purchase of Premises and Equipment	<b>(2,256 )</b>	(913 )
Proceeds from Sale of Other Real Estate and Repossessions	<b>2,769</b>	3,168
Federal Home Loan Bank Stock	<b>(551 )</b>	(245 )
Proceeds from Sale of Premises and Equipment	<b>8</b>	38
	<b>25,536</b>	3,531
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Noninterest-Bearing Customer Deposits	<b>(13,667)</b>	3,647
Interest-Bearing Customer Deposits	<b>(43,259)</b>	(27,741 )
Dividends Paid for Preferred Stock	-	(316 )
Dividends Paid for Common Stock	<b>(1,266 )</b>	(633 )
Redemption of Preferred Stock	-	(9,360 )
Repurchase of Warrants	<b>(3,175 )</b>	-
Payments on Federal Home Loan Bank Advances	<b>(26,500)</b>	-
Proceeds from Federal Home Loan Bank Advances	<b>39,000</b>	5,000
Payments on Other Borrowed Money	<b>(1,507 )</b>	(16 )
Proceeds from Other Borrowed Money	<b>7</b>	5,016
	<b>(50,367)</b>	(24,403 )
Net Decrease in Cash and Cash Equivalents	<b>(12,996)</b>	(9,974 )
Cash and Cash Equivalents at Beginning of Period	<b>23,145</b>	28,822
Cash and Cash Equivalents at End of Period	<b>\$10,149</b>	\$ 18,848

The accompanying notes are an integral part of these statements.



**PART I (Continued)**

Item 1 (Continued)

**COLONY BANKCORP, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**Presentation**

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

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

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

**Nature of Operations**

The Bank provides a full range of retail and commercial banking services for consumers and small- to medium-size businesses located primarily in central, south and coastal Georgia. The Bank is headquartered in Fitzgerald, Georgia with banking offices in Albany, Ashburn, Broxton, Centerville, Columbus, Cordele, Douglas, Eastman, Fitzgerald, Leesburg, Moultrie, Quitman, Rochelle, Savannah, Soperton, Sylvester, Statesboro, Thomaston, Tifton, Valdosta and Warner Robins. Lending and investing activities are funded primarily by deposits gathered through its retail banking office network.

### **Use of Estimates**

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the balance sheet date and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans.

### **Reclassifications**

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

### **Concentrations of Credit Risk**

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

**PART I (Continued)**

Item 1 (Continued)

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

**Concentrations of Credit Risk (Continued)**

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

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

**Investment Securities**

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

The Company evaluates each investment security held to maturity and available for sale security in a loss position for other-than-temporary impairment (OTTI). In estimating other-than-temporary impairment losses, management

considers such factors as the length of time and the extent to which the market value has been below cost, the financial condition of the issuer and the Company's intent to sell and whether it is more likely than not that the Company will be required to sell the security before anticipated recovery of the amortized cost basis. If the Company intends to sell or if it is more likely than not that the Company will be required to sell the security before recovery, the OTTI write-down is recognized in earnings. If the Company does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the OTTI write-down is separated into an amount representing credit loss, which is recognized in earnings and an amount related to all other factors, which is recognized in other comprehensive income (loss).

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

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

### **Loans**

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

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

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

**PART I (Continued)**

Item 1 (Continued)

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

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

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

**Allowance for Loan Losses**

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

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

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

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

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent.

**PART I (Continued)**

Item 1 (Continued)

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

**Allowance for Loan Losses (Continued)**

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

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

**Premises and Equipment**

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

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

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

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

### **Intangible Assets**

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

### **Transfers of Financial Assets**

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



**PART I (Continued)**

Item 1 (Continued)

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

**Statement of Cash Flows**

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

**Advertising Costs**

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

**Income Taxes**

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

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

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

### **Other Real Estate**

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

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

The Company has purchased life insurance on the lives of certain key members of management and directors. The life insurance policies are recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or amounts due that are probable at settlement, if applicable. Increases in the cash surrender value are recorded as other income in the consolidated statements of income. The cash surrender value of the insurance contracts is recorded in other assets on the consolidated balance sheets in the amount of \$17,457 and \$17,089 as of September 30, 2018 and December 31, 2017, respectively.

## **PART I (Continued)**

### Item 1 (Continued)

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

##### **Comprehensive Income**

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

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

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

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

ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. On January 1, 2018, the Company adopted ASU 2014-09 and all subsequent amendments to the ASU and ASC 606 which (1) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (2) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as other real estate owned. The majority of the Company's revenues came from interest income and other sources, including loans and investment securities, that are outside the scope of ASC 606. With the exception of gain/losses on the sale of other real estate owned, the Company's services that fall within the scope of ASC 606 are presented within noninterest income and are recognized as revenue as the Company satisfies its obligations to the customer. Services within the scope of ASC 606 reported in noninterest income include service charges on deposit accounts, debit card interchange fees, and ATM fees. The net of gains and losses on the sale of other real estate owned are recorded in other noninterest expenses in the Company's consolidated statements of income. The adoption of ASC 606 did not change the timing or amount of revenue recognized for the

Company. Accordingly, no cumulative effect adjustment was recorded under the modified retrospective transition method. See Note 15 for further discussion on the Company's accounting policies for revenue source within the scope of ASC 606.

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

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

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

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

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

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

adopt the provisions of ASU 2018-02 in the fourth quarter of 2017 and, as a result, reclassified \$1.1 million from AOCI to retained earnings as of December 31, 2017.

ASU 2018-13, *Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement (Topic 820)*. This ASU modifies the disclosure requirements on fair value measurements. ASU 2018-13 is effective for interim and annual reporting periods after December 15, 2019; early adoption is permitted. The Company is currently evaluating the provisions of ASU 2018-13 to determine the potential impact the new standard will have on the Company's Consolidated Financial Statements.

**PART I (Continued)**

## Item 1 (Continued)

**(2) Investment Securities**

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

<b>September 30, 2018</b>	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
<b>Securities Available for Sale:</b>				
U. S. Government Agencies Mortgage-Backed	\$ 326,676	\$ 52	\$ (15,550 )	\$ 311,178
State, County & Municipal	4,024	4	(56 )	3,972
Corporate Bonds	2,956	-	(74 )	2,882
	<b>\$ 333,656</b>	<b>\$ 56</b>	<b>\$ (15,680 )</b>	<b>\$ 318,032</b>

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

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

**Securities**

	<b>Available for Sale</b>	
	<b>Amortized Fair</b>	
	<b>Cost</b>	<b>Value</b>
Due In One Year or Less	<b>\$358</b>	<b>\$356</b>
Due After One Year Through Five Years	<b>4,311</b>	<b>4,232</b>
Due After Five Years Through Ten Years	<b>1,134</b>	<b>1,136</b>
Due After Ten Years	<b>1,177</b>	<b>1,130</b>
	<b>\$6,980</b>	<b>\$6,854</b>
 Mortgage-Backed Securities	 <b>326,676</b>	 <b>311,178</b>
	<b>\$333,656</b>	<b>\$318,032</b>

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

Investment securities having a carrying value approximating \$126,869 and \$175,484 as of September 30, 2018 and December 31, 2017, respectively, were pledged to secure public deposits and for other purposes.



**PART I (Continued)**

## Item 1 (Continued)

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

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

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
<b>September 30, 2018</b>						
U. S. Government Agencies	\$96,095	\$ (3,370 )	\$209,451	\$ (12,180 )	\$305,546	\$ (15,550 )
Mortgage-Backed						
State, County and Municipal	2,498	(21 )	1,258	(35 )	3,756	(56 )
Corporate Bonds	2,000	(35 )	882	(39 )	2,882	(74 )
	<b>\$100,593</b>	<b>\$ (3,426 )</b>	<b>\$211,591</b>	<b>\$ (12,254 )</b>	<b>\$312,184</b>	<b>\$ (15,680 )</b>
<b>December 31, 2017</b>						
U.S. Government Agencies	\$120,139	\$ (1,655 )	\$190,196	\$ (6,811 )	\$310,335	\$ (8,466 )
Mortgage-Backed						
State, County and Municipal	2,598	(23 )	-	-	2,598	(23 )
Asset-Backed	971	(22 )	-	-	971	(22 )
	<b>\$123,708</b>	<b>\$ (1,700 )</b>	<b>\$190,196</b>	<b>\$ (6,811 )</b>	<b>\$313,904</b>	<b>\$ (8,511 )</b>

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

At September 30, 2018, 151 securities have unrealized losses which have depreciated 4.78 percent from the Company's amortized cost basis. These securities are guaranteed by either the U.S. Government, other governments or

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

**PART I (Continued)**

## Item 1 (Continued)

**(3) Loans**

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

	<b>September 30, 2018</b>	December 31, 2017
<b>Commercial and Agricultural</b>		
Commercial	<b>\$ 47,292</b>	\$48,122
Agricultural	<b>21,415</b>	16,443
<b>Real Estate</b>		
Commercial Construction	<b>53,570</b>	45,214
Residential Construction	<b>12,897</b>	8,583
Commercial	<b>349,408</b>	351,172
Residential	<b>189,153</b>	194,049
Farmland	<b>70,069</b>	67,768
<b>Consumer and Other</b>		
Consumer	<b>18,623</b>	18,956
Other	<b>17,016</b>	14,977
<b>Total Loans</b>	<b>\$ 779,443</b>	\$765,284

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

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

the general economic conditions in the Company's geographic markets.

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**PART I (Continued)**

Item 1 (Continued)

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

**(3) Loans (Continued)**

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

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

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

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

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

The following table presents the loan portfolio by credit quality indicator (risk grade) as of September 30, 2018 and December 31, 2017. Those loans with a risk grade of 1, 2, 3 or 4 have been combined in the pass column for

presentation purposes. For the period ending September 30, 2018, the Company did not have any loans classified as “doubtful” or a “loss”.

**September 30, 2018**

	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>Total Loans</b>
<b>Commercial and Agricultural</b>				
Commercial	\$45,612	\$ 847	\$ 833	\$47,292
Agricultural	20,026	919	470	21,415
<b>Real Estate</b>				
Commercial Construction	52,181	631	758	53,570
Residential Construction	12,897	-	-	12,897
Commercial	335,844	7,000	6,564	349,408
Residential	173,987	4,543	10,623	189,153
Farmland	66,002	2,002	2,065	70,069
<b>Consumer and Other</b>				
Consumer	18,239	38	346	18,623
Other	17,010	6	-	17,016
<b>Total Loans</b>	<b>\$741,798</b>	<b>\$ 15,986</b>	<b>\$ 21,659</b>	<b>\$779,443</b>

**PART I (Continued)**

## Item 1 (Continued)

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

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

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

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

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

become due, as well as when required by regulatory provision. Loans may be placed on nonaccrual status regardless of whether or not such loans are considered past due.



**PART I (Continued)**

## Item 1 (Continued)

**(3) Loans (Continued)**

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

**September 30, 2018**

	Accruing Loans 90 Days			Nonaccrual Loans	Current Loans	Total Loans
	30-89 Days Past Due	or More Past Due	Total Accruing Loans Past Due			
<b>Commercial and Agricultural</b>						
Commercial	\$376	\$ -	\$ 376	\$ 471	\$46,445	\$47,292
Agricultural	65	-	65	423	20,927	21,415
<b>Real Estate</b>						
Commercial Construction	141	-	141	505	52,924	53,570
Residential Construction	-	-	-	-	12,897	12,897
Commercial	895	-	895	2,277	346,236	349,408
Residential	2,485	-	2,485	2,219	184,449	189,153
Farmland	58	-	58	2,066	67,945	70,069
<b>Consumer and Other</b>						
Consumer	141	1	142	175	18,306	18,623
Other	9	-	9	-	17,007	17,016
<b>Total Loans</b>	<b>\$4,170</b>	<b>\$ 1</b>	<b>\$ 4,171</b>	<b>\$ 8,136</b>	<b>\$767,136</b>	<b>\$779,443</b>

**December 31, 2017**

	Accruing Loans 90 Days			Nonaccrual Loans
	30-89 Days	or More	Total Accruing	

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

**PART I (Continued)**

## Item 1 (Continued)

**(3) Loans (Continued)**

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

**September 30, 2018**

	<b>Unpaid Contractual Principal Balance</b>	<b>Impaired Balance</b>	<b>Related Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>	<b>Interest Income Collected</b>
<b>With No Related Allowance Recorded</b>						
Commercial	\$ 472	\$ 472	\$ -	\$ 508	\$ 13	\$ 15
Agricultural	444	423	-	375	14	21
Commercial Construction	102	102	-	54	3	3
Residential Construction	-	-	-	-	-	-
Commercial Real Estate	9,758	9,758	-	10,759	345	352
Residential Real Estate	3,954	3,868	-	4,052	141	145
Farmland	2,067	2,065	-	1,189	46	75
Consumer	175	175	-	193	9	10
Other	-	-	-	-	-	-
	<b>16,972</b>	<b>16,863</b>	<b>-</b>	<b>17,130</b>	<b>571</b>	<b>621</b>
<b>With An Allowance Recorded</b>						
Commercial	-	-	-	-	-	-
Agricultural	-	-	-	-	-	-
Commercial Construction	471	471	44	483	3	3
Residential Construction	-	-	-	-	-	-
Commercial Real Estate	5,800	5,800	1,394	5,478	185	187
Residential Real Estate	35	35	20	54	2	2
Farmland	366	366	29	368	18	18
Consumer	-	-	-	-	-	-
Other	-	-	-	-	-	-
	<b>6,672</b>	<b>6,672</b>	<b>1,487</b>	<b>6,383</b>	<b>208</b>	<b>210</b>
<b>Total</b>						

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Commercial	472	472	-	508	13	15
Agricultural	444	423	-	375	14	21
Commercial Construction	573	573	44	537	6	6
Residential Construction	-	-	-	-	-	-
Commercial Real Estate	15,558	15,558	1,394	16,237	530	539
Residential Real Estate	3,989	3,903	20	4,106	143	147
Farmland	2,433	2,431	29	1,557	64	93
Consumer	175	175	-	193	9	10
Other	-	-	-	-	-	-
	<b>\$ 23,644</b>	<b>\$ 23,535</b>	<b>\$ 1,487</b>	<b>\$ 23,513</b>	<b>\$ 779</b>	<b>\$ 831</b>

**PART I (Continued)**

## Item 1 (Continued)

**(3) Loans (Continued)**

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

**December 31, 2017**

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

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Commercial Construction	547	547	66	382	26	37
Residential Contruction	-	-	-	79	-	-
Commercial Real Estate	18,366	18,366	1,713	19,407	789	787
Residential Real Estate	5,087	4,689	27	5,048	216	234
Farmland	1,211	1,210	21	1,167	76	80
Consumer	188	188	-	186	9	9
	\$ 26,483	\$ 25,997	\$ 1,827	\$ 27,200	\$ 1,160	\$ 1,200

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**PART I (Continued)**

## Item 1 (Continued)

**(3) Loans (Continued)**

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

**September 30, 2017**

	<b>Unpaid Contractual Principal Balance</b>	<b>Impaired Balance</b>	<b>Related Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>	<b>Interest Income Collected</b>
<b>With No Related Allowance Recorded</b>						
Commercial	\$ 653	\$ 653	\$ -	\$ 642	\$ 28	\$ 28
Agricultural	342	322	-	271	5	12
Commercial Construction	176	176	-	163	4	5
Residential Construction	198	198	-	99	5	5
Commercial Real Estate	10,775	10,775	-	12,851	368	356
Residential Real Estate	5,506	4,718	-	4,563	156	176
Farmland	841	839	-	779	54	58
Consumer	180	179	-	186	5	5
	18,671	17,860	-	19,554	625	645
<b>With An Allowance Recorded</b>						
Commercial	-	-	-	-	-	-
Agricultural	-	-	-	-	-	-
Commercial Construction	497	497	69	178	22	32
Residential Construction	-	-	-	-	-	-
Commercial Real Estate	7,124	7,124	1,471	6,817	201	202
Residential Real Estate	37	37	21	575	(1)	2
Farmland	373	373	24	377	17	16
Consumer	-	-	-	-	-	-
	8,031	8,031	1,585	7,947	239	252
<b>Total</b>						
Commercial	653	653	-	642	28	28
Agricultural	342	322	-	271	5	12

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Commercial Construction	673	673	69	341	26	37
Residential Construction	198	198	-	99	5	5
Commercial Real Estate	17,899	17,899	1,471	19,668	569	558
Residential Real Estate	5,543	4,755	21	5,138	155	178
Farmland	1,214	1,212	24	1,156	71	74
Consumer	180	179	-	186	5	5
	\$ 26,702	\$ 25,891	\$ 1,585	\$ 27,501	\$ 864	\$ 897



**PART I (Continued)**

Item 1 (Continued)

**(3) Loans (Continued)**

TDRs are troubled loans on which the original terms of the loan have been modified in favor of the borrower due to deterioration in the borrower's financial condition. Each potential loan modification is reviewed individually and the terms of the loan are modified to meet the borrower's specific circumstances at a point in time. Not all loan modifications are TDRs. Loan modifications are reviewed and approved by the Company's senior lending staff, who then determine whether the loan meets the criteria for a TDR. Generally, the types of concessions granted to borrowers that are evaluated in determining whether a loan is classified as a TDR include:

Interest rate reductions – Occur when the stated interest rate is reduced to a nonmarket rate or a rate the borrower would not be able to obtain elsewhere under similar circumstances.

Amortization or maturity date changes – Result when the amortization period of the loan is extended beyond what is considered a normal amortization period for loans of similar type with similar collateral.

Principal reductions – These are often the result of commercial real estate loan workouts where two new notes are created. The primary note is underwritten based upon our normal underwriting standards and is structured so that the projected cash flows are sufficient to repay the contractual principal and interest of the newly restructured note. The terms of the secondary note vary by situation and often involve that note being charged-off, or the principal and interest payments being deferred until after the primary note has been repaid. In situations where a portion of the note is charged-off during modification there is often no specific reserve allocated to those loans. This is due to the fact that the amount of the charge-off usually represents the excess of the original loan balance over the collateral value and the Company has determined there is no additional exposure on those loans.

As discussed in Note 1, Summary of Significant Accounting Policies, once a loan is identified as a TDR, it is accounted for as an impaired loan. The Company had no unfunded commitments to lend to a customer that has a troubled debt restructured loan as of September 30, 2018. The Company had one commercial construction real estate loan totaling \$402 thousand that was restructured during the three month period ended September 30, 2018 and for the nine month period ended September 30, 2018. There were no loan contracts restructured during the three month period ended and the nine month period ended September 30, 2017. Loans modified in a troubled debt restructuring are considered to be in default once the loan becomes 90 days past due. 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.

The Company did not have any TDRs that subsequently defaulted for the three months ended September 30, 2018 and had one loan that subsequently defaulted during the nine months ended September 30, 2018. The loan totaling \$131 thousand failed to continue to perform as agreed and was moved to non-accrual status.

**PART I (Continued)**

## Item 1 (Continued)

**(4) Allowance for Loan Losses**

The following tables detail activity in the allowance for loan losses, segregated by class of loan, for the nine month period ended September 30, 2018 and September 30, 2017. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other loan categories and periodically may result in reallocation within the provision categories.

**September 30, 2018**

	<b>Beginning Balance</b>	<b>Charge-Offs</b>	<b>Recoveries</b>	<b>Provision</b>	<b>Ending Balance</b>
<b>Commercial and Agricultural</b>					
Commercial	\$ 447	\$ (118 )	\$ 114	\$ (59 )	\$ 384
Agricultural	186	(123 )	7	245	315
<b>Real Estate</b>					
Commercial Construction	1,216	-	39	(1,130 )	125
Residential Construction	-	-	-	17	17
Commercial	3,874	(258 )	39	626	4,281
Residential	968	(124 )	83	255	1,182
Farmland	780	-	11	(61 )	730
<b>Consumer and Other</b>					
Consumer	34	(214 )	59	214	93
Other	3	-	1	24	28
	<b>\$ 7,508</b>	<b>\$ (837 )</b>	<b>\$ 353</b>	<b>\$ 131</b>	<b>\$ 7,155</b>

**September 30, 2017**

	<b>Beginning Balance</b>	<b>Charge-Offs</b>	<b>Recoveries</b>	<b>Provision</b>	<b>Ending Balance</b>
<b>Commercial and Agricultural</b>					
Commercial	\$ 456	\$ (215 )	\$ 124	\$ 71	\$ 436

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Agricultural	168	(160	)	3	238	249
<b>Real Estate</b>						
Commercial Construction	323	(49	)	241	473	988
Residential Construction	13	-		-	(7	) 6
Commercial	5,751	(966	)	523	(1,085	) 4,223
Residential	1,396	(648	)	47	334	1,129
Farmland	722	(61	)	2	209	872
<b>Consumer and Other</b>						
Consumer	80	(184	)	60	100	56
Other	14	-		2	2	18
	\$ 8,923	\$ (2,283	)	\$ 1,002	\$ 335	\$ 7,977

Management continually evaluates the allowance for loan losses methodology seeking to refine and enhance this process as appropriate, and it is likely that the methodology will continue to evolve over time.

**PART I (Continued)**

Item 1 (Continued)

**(4) Allowance for Loan Losses (Continued)**

The Company determines its individual reserves during its quarterly review of substandard loans. This process involves reviewing all loans with a risk grade of 6 or greater and an outstanding balance of \$250,000 or more, regardless of the loans impairment classification. At September 30, 2018, there were 139 impaired loans totaling \$4.0 million below the \$250,000 review threshold which were not individually reviewed for impairment. Those loans were subject to the bank's general loan loss reserve methodology and are included in the "Collectively Evaluated for Impairment" column of the following tables. Likewise, at September 30, 2017, there were 155 impaired loans totaling \$4.5 million which were below the \$250,000 review threshold and were subject to the bank's general loan loss reserve methodology and are included in the "Collectively Evaluated for Impairment" column of the following tables.

Since not all loans in the substandard category are considered impaired, this quarterly review process may result in the identification of specific reserves on unimpaired loans. Management considers those loans graded substandard, but not classified as impaired, to be higher risk loans and, therefore, makes specific allocations to the allowance for those loans if warranted. The total of such loans is \$8.73 million and \$12.68 million as of September 30, 2018 and 2017, respectively. Specific allowance allocations were made for these loans totaling \$1.25 million and \$1.49 million as of September 30, 2018 and 2017, respectively. Since these loans are not considered impaired, both the loan balance and related specific allocation are included in the "Collectively Evaluated for Impairment" column of the following tables.

**PART I (Continued)**

## Item 1 (Continued)

**(4) Allowance for Loan Losses (Continued)**

The following tables present breakdowns of the allowance for loan losses, segregated by impairment methodology for September 30, 2018 and 2017:

**September 30, 2018**

	Ending Allowance Balance			Ending Loan Balance		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
<b>Commercial and Agricultural</b>						
Commercial	\$-	\$ 384	\$384	\$39	\$ 47,253	\$47,292
Agricultural	-	315	315	27	21,388	21,415
<b>Real Estate</b>						
Commercial Construction	44	81	125	471	53,099	53,570
Residential Construction	-	17	17	-	12,897	12,897
Commercial	1,394	2,887	4,281	15,164	334,244	349,408
Residential	20	1,162	1,182	1,753	187,400	189,153
Farmland	29	701	730	2,103	67,966	70,069
<b>Consumer and Other</b>						
Consumer	-	93	93	-	18,623	18,623
Other	-	28	28	-	17,016	17,016
<b>Total End of Period Balance</b>	<b>\$1,487</b>	<b>\$ 5,668</b>	<b>\$7,155</b>	<b>\$19,557</b>	<b>\$ 759,886</b>	<b>\$779,443</b>

**September 30, 2017**

	Ending Allowance Balance			Ending Loan Balance		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
<b>Commercial and Agricultural</b>						

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Commercial	\$-	\$ 436	\$436	\$77	\$ 45,286	\$45,363
Agricultural	-	249	249	5	25,241	25,246
<b>Real Estate</b>						
Commercial Construction	69	919	988	497	36,036	36,533
Residential Construction	-	6	6	-	8,905	8,905
Commercial	1,471	2,752	4,223	17,605	328,646	346,251
Residential	21	1,108	1,129	2,204	194,128	196,332
Farmland	24	848	872	1,038	70,865	71,903
<b>Consumer and Other</b>						
Consumer	-	56	56	-	18,677	18,677
Other	-	18	18	-	20,836	20,836
<b>Total End of Period Balance</b>	<b>\$1,585</b>	<b>\$ 6,392</b>	<b>\$7,977</b>	<b>\$21,426</b>	<b>\$ 748,620</b>	<b>\$770,046</b>

**PART I (Continued)**

## Item 1 (Continued)

**(5) Other Real Estate Owned**

The aggregate carrying amount of Other Real Estate Owned (OREO) at September 30, 2018 and December 31, 2017 was \$2,173 and \$4,256, respectively. All of the Company's other real estate owned represents properties acquired through foreclosure or deed in lieu of foreclosure. The following table details the change in OREO for the nine months ended September 30, 2018 and the year ended December 31, 2017.

	<b>Nine Months Ended September 30, 2018</b>	Twelve Months Ended December 31, 2017
<b>Balance, Beginning</b>	<b>\$ 4,256</b>	\$ 6,439
Additions	<b>674</b>	1,725
Sales of OREO	<b>(2,718 )</b>	(3,787 )
Gains (Losses) on Sale	<b>162</b>	213
Provision for Losses	<b>(201 )</b>	(334 )
<b>Balance, Ending</b>	<b>\$ 2,173</b>	\$ 4,256

At September 30, 2018, the Company held \$485 thousand of residential real estate property as foreclosed property compared to \$479 thousand as of December 31, 2017. Also at September 30, 2018, \$71 thousand of consumer mortgage loans collateralized by residential real estate property were in the process of foreclosure according to local requirements of the applicable jurisdictions. At December 31, 2017, only \$184 thousand of consumer mortgage loans collateralized by residential real estate property were in the process of foreclosure according to local requirements of the applicable jurisdictions.

**(6) Deposits**



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The aggregate amount of overdrawn deposit accounts reclassified as loan balances totaled \$459 and \$475 as of September 30, 2018 and December 31, 2017.

Components of interest-bearing deposits as of September 30, 2018 and December 31, 2017 are as follows:

	<b>Nine Months Ended September 30, 2018</b>	Twelve Months Ended December 31, 2017
Interest-Bearing Demand	<b>\$ 438,241</b>	\$458,717
Savings	<b>78,532</b>	78,172
Time, \$250,000 and Over	<b>39,487</b>	38,920
Other Time	<b>277,538</b>	301,248
	<b>\$ 833,798</b>	\$ 877,057

At September 30, 2018 and December 31, 2017, the Company had brokered deposits of \$77,670 and \$46,329, respectively. All of these brokered deposits represent Certificate of Deposits Account Registry Service (CDARS) reciprocal deposits. The CDARS deposits are ones in which customers placed core deposits into the CDARS program for FDIC insurance coverage and the Company receives reciprocal brokered deposits in a like amount. The aggregate amount of short-term jumbo certificates of deposit, each with a minimum denomination of \$250,000 was approximately \$24,031 and \$32,152 as of September 30, 2018 and December 31, 2017, respectively. The aggregate amount of certificates of deposit, each with a minimum deposit of \$250,000 was \$39,487 and \$38,920 as of September 30, 2018 and December 31, 2017.

**PART I (Continued)**

## Item 1 (Continued)

**(6) Deposits (Continued)**

As of September 30, 2018 and December 31, 2017, the scheduled maturities of certificates of deposits are as follows:

<u>Maturity</u>	<b>September 30, 2018</b>	December 31, 2017
One Year and Under	<b>\$ 207,262</b>	\$255,575
One to Three Years	<b>89,495</b>	63,327
Three Years and Over	<b>20,268</b>	21,266
	<b>\$ 317,025</b>	\$340,168

**(7) Other Borrowed Money**

Other borrowed money at September 30, 2018 and December 31, 2017 is summarized as follows:

	<b>September 30, 2018</b>	December 31, 2017
Federal Home Loan Bank Advances	<b>\$ 58,500</b>	\$ 46,000
Other Borrowings	-	1,500
	<b>\$ 58,500</b>	<b>\$ 47,500</b>

Advances from the Federal Home Loan Bank (FHLB) have maturities ranging from 2019 to 2028 and interest rates ranging from 0.98 percent to 3.51 percent. As collateral on the outstanding FHLB advances, the Company has provided a blanket lien on its portfolio of qualifying residential first mortgage loans and commercial loans. At September 30, 2018 the book value of those loans pledged is \$112,120. At September 30, 2018 the Company had remaining credit availability from the FHLB of \$242,147. The Company may be required to pledge additional qualifying collateral in order to utilize the full amount of the remaining credit line.

In 2017, the Company borrowed \$5,000 as a short term loan to be paid off within one year with an interest rate of 4.75 percent. The loan was paid off in January 2018.

The aggregate stated maturities of other borrowed money at September 30, 2018 are as follows:

<u>Year</u>	Amount
2018	\$ 14,500
2019	5,000
2020	2,500
2021	-
2022	18,000
After 2022	18,500
	\$58,500

The Company also has available federal funds lines of credit with various financial institutions totaling \$43,500, none of which were outstanding at September 30, 2018.

The Company has the ability to borrow funds from the Federal Reserve Bank (FRB) of Atlanta utilizing the discount window. The discount window is an instrument of monetary policy that allows eligible institutions to borrow money from the FRB on a short-term basis to meet temporary liquidity shortages caused by internal or external disruptions. At September 30, 2018, the Company had borrowing capacity available under this arrangement, with no outstanding balances. The Company would be required to pledge certain available-for-sale investment securities as collateral under this agreement.

## **(8) Preferred Stock and Warrants**

The Company redeemed 9,360 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the Preferred Stock) outstanding with private investors as of March 31, 2017. The Company redeemed 8,661 shares of Preferred Stock at \$1,000 per share in 2016. The Company redeemed 9,979 shares of Preferred Stock at \$1,000 per share during 2015. The Company currently has no outstanding shares of Preferred Stock. The Company also had a warrant (the Warrant) to purchase up to 500,000 shares of the Company's common stock outstanding with private investors. The Warrant was repurchased by the Company on June 5, 2018, for \$3.2 million. Both the Preferred Stock and the Warrant originated in 2009 through transactions with the United States Department of the Treasury and were subsequently sold to the public through an auction process during 2013. The Company currently has no outstanding warrants as of September 30, 2018.

**PART I (Continued)**

## Item 1 (Continued)

**(9) Subordinated Debentures (Trust Preferred Securities)**

<b>Description</b>	<b>Date</b>	<b>Amount</b>	<b>3 Month Libor Rate</b>	<b>Added Points</b>	<b>Total Rate</b>	<b>Maturity</b>	<b>5 Year Call Option</b>
Colony Bankcorp Statutory Trust III	6/17/2004	\$ 4,640	2.33413	2.68	5.01415	6/14/2034	6/17/2009
Colony Bankcorp Capital Trust I	4/13/2006	5,155	2.39600	1.50	3.89600	4/13/2036	4/13/2011
Colony Bankcorp Capital Trust II	3/12/2007	9,279	2.39600	1.65	4.04600	3/12/2037	3/12/2012
Colony Bankcorp Capital Trust III	9/14/2007	5,155	2.33888	1.40	3.73888	9/14/2037	9/14/2012

The Trust Preferred Securities are recorded as subordinated debentures on the consolidated balance sheets, but subject to certain limitations, qualify as Tier 1 Capital for regulatory capital purposes. The proceeds from the offerings were used to fund certain acquisitions, pay off holding company debt and inject capital into the bank subsidiary.

The Trust Preferred Securities pay interest quarterly.

**(10) Commitments and Contingencies**

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

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance sheet instruments. We evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include cash or cash equivalents, negotiable instruments, real estate, accounts receivable, inventory, oil, gas and

mineral interests, property, plant, and equipment.

At September 30, 2018 and December 31, 2017 the following financial instruments were outstanding whose contract amounts represent credit risk:

	<b>Contract Amount</b>	
	<b>September</b>	<b>December</b>
	<b>30, 2018</b>	<b>31, 2017</b>
Loan Commitments	<b>\$100,518</b>	\$ 96,374
Letters of Credit	<b>1,435</b>	1,536

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

Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are uncollateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Company is committed.

Standby and performance letters of credit are conditional lending commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements.

Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

*Legal Contingencies.* In the ordinary course of business, there are various legal proceedings pending against the Company and the Bank. The aggregate liabilities, if any, arising from such proceedings would not, in the opinion of management, have a material adverse effect on the Company's consolidated financial position.



**PART I (Continued)**

Item 1 (Continued)

**(11) Fair Value of Financial Instruments and Fair Value Measurements**

Generally accepted accounting principles in the U.S. require disclosure of fair value information about financial instruments, whether or not recognized on the face of the balance sheet, for which it is practicable to estimate that value. The assumptions used in the estimation of the fair value of the Company and the Bank's financial instruments are detailed hereafter. Where quoted prices are not available, fair values are based on estimates using discounted cash flows and other valuation techniques. The use of discounted cash flows can be significantly affected by the assumptions used, including the discount rate and estimates of future cash flows.

Generally accepted accounting principles related to Fair Value Measurements define fair value, establish a framework for measuring fair value, establish a three-level valuation hierarchy for disclosure of fair value measurement and enhance disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 inputs to the valuation methodology are unobservable and represent the Company's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

The following disclosures should not be considered a surrogate of the liquidation value of the Company, but rather a good-faith estimate of the increase or decrease in value of financial instruments held by the Company since purchase, origination or issuance.

**Cash and Short-Term Investments** – For cash, due from banks, bank-owned deposits and federal funds sold, the carrying amount is a reasonable estimate of fair value and is classified as Level 1.

**Investment Securities** – Fair values for investment securities are based on quoted market prices where available and classified as Level 1. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable instruments and classified as Level 2. If a comparable is not available, the investment securities are classified as Level 3.

**Federal Home Loan Bank Stock** – The fair value of Federal Home Loan Bank stock approximates carrying value and is classified as Level 1.

**Loans** – The fair value of fixed rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings. For variable rate loans, the carrying amount is a reasonable estimate of fair value. Most loans are classified as Level 2, but impaired loans with a related allowance are classified as Level 3.

**Bank-Owned Life Insurance** – The carrying value of bank-owned life insurance policies approximates fair value and is classified as Level 1.

**Deposit Liabilities** – The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date and is classified as Level 1. The fair value of fixed maturity certificates of deposit is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities and is classified as Level 2.

**Subordinated Debentures** – The fair value of subordinated debentures is estimated by discounting the future cash flows using the current rates at which similar advances would be obtained. Subordinate Debentures are classified as Level 2.

**Other Borrowed Money** – The fair value of other borrowed money is calculated by discounting contractual cash flows using an estimated interest rate based on current rates available to the Company for debt of similar remaining maturities and collateral terms. Other borrowed money is classified as Level 2 due to their expected maturities.



**PART I (Continued)**

## Item 1 (Continued)

**(11) Fair Value of Financial Instruments and Fair Value Measurements (Continued)**

Disclosures of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis, are required in the financial statements.

The carrying amount, estimated fair values, and placement in the fair value hierarchy of the Company's financial instruments as of September 30, 2018 and December 31, 2017 are as follows:

	<b>Fair Value Measurements at September 30, 2018</b>				
	<b>Carrying Value</b>	<b>Estimated Fair Value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets</b>					
Cash and Short-Term Investments	\$31,913	\$31,913	\$31,913	\$-	\$-
Investment Securities Available for Sale	318,032	318,032	-	311,402	6,630
Federal Home Loan Bank Stock	3,594	3,594	3,594	-	-
Loans, Net	771,773	769,207	-	764,022	5,185
Bank-Owned Life Insurance	17,457	17,457	17,457	-	-
<b>Liabilities</b>					
Deposits	1,011,059	1,012,953	694,034	318,919	-
Subordinated Debentures	24,229	24,229	-	24,229	-
Other Borrowed Money	58,500	58,472	-	58,472	-

	<b>Fair Value Measurements at December 31, 2017</b>				
	<b>Carrying Value</b>	<b>Estimated Fair Value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets</b>					
Cash and Short-Term Investments	\$57,813	\$57,813	\$57,813	\$-	\$-
Investment Securities Available for Sale	354,247	354,247	-	346,950	7,297
Federal Home Loan Bank Stock	3,043	3,043	3,043	-	-

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Loans, Net	757,281	757,163	-	752,287	4,876
Bank-Owned Life Insurance	17,089	17,089	17,089	-	-

**Liabilities**

Deposits	1,067,985	1,068,392	727,818	340,574	-
Subordinated Debentures	24,229	24,229	-	24,229	-
Other Borrowed Money	47,500	47,626	-	47,626	-

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on many judgments. 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.

Fair value estimates are based on existing on and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets and liabilities that are not considered financial instruments include deferred income taxes and premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

**PART I (Continued)**

Item 1 (Continued)

**(11) Fair Value of Financial Instruments and Fair Value Measurements (Continued)**

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring and nonrecurring basis, as well as the general classification of such instruments pursuant to the valuation hierarchy:

**Assets**

*Securities* – Where quoted prices are available in an active market, securities are classified within level 1 of the valuation hierarchy. Level 1 inputs include securities that have quoted prices in active markets for identical assets. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flow. Examples of such instruments, which would generally be classified within level 2 of the valuation hierarchy, include certain collateralized mortgage and debt obligations and certain high-yield debt securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within level 3 of the valuation hierarchy. When measuring fair value, the valuation techniques available under the market approach, income approach and/or cost approach are used. The Company's evaluations are based on market data and the Company employs combinations of these approaches for its valuation methods depending on the asset class.

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

*Other Real Estate* – Other real estate owned assets are adjusted to fair value less estimated selling costs upon transfer of the loans to other real estate owned. Typically, an external, third-party appraisal is performed on the collateral upon transfer into the other real estate owned account to determine the asset's fair value. Subsequent adjustments to the collateral's value may be based upon either updated third-party appraisals or management's knowledge of the collateral and the current real estate market conditions. Appraised amounts used in determining the asset's fair value, whether internally or externally prepared, are discounted 10 percent to account for selling and marketing costs. 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 other real

estate owned assets and because of the relationship between fair value and general economic conditions, we consider the fair value of other real estate owned assets to be highly sensitive to changes in market conditions.

*Assets and Liabilities Measured at Fair Value on a Recurring and Nonrecurring Basis* – The following table presents the recorded amount of the Company’s assets measured at fair value on a recurring and nonrecurring basis as of September 30, 2018 and December 31, 2017, aggregated by the level in the fair value hierarchy within which those measurements fall. The table below includes only impaired loans with a specific reserve and only other real estate properties with a valuation allowance at September 30, 2018 and at December 31, 2017. Those impaired loans and other real estate properties are shown net of the related specific reserves and valuation allowances.

**PART I (Continued)**

Item 1 (Continued)

**(11) Fair Value of Financial Instruments and Fair Value Measurements (Continued)**

		Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>September 30, 2018</b>	<b>Total Fair Value</b>			
<b>Recurring Securities Available for Sale</b>				
U.S. Government Agencies				
Mortgage-Backed State, County and Municipal Corporate Bonds	\$311,178	\$-	\$ 306,763	\$ 4,415
	3,972	-	3,757	215
	2,882		882	2,000
	\$318,032	\$-	\$ 311,402	\$ 6,630
<b>Nonrecurring</b>				
Impaired Loans	\$5,185	\$-	\$ -	\$ 5,185
Other Real Estate	\$1,468	\$-	\$ -	\$ 1,468

		Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>December 31, 2017</b>	<b>Total Fair Value</b>			

**Recurring Securities Available for Sale**

U.S. Government Agencies				
Mortgage-Backed	\$346,723	\$-	\$ 341,701	\$ 5,022
State, County and Municipal	4,493	-	4,277	216
Corporate	2,060	-	-	2,060
Asset-Backed	971		971	-
	\$354,247	\$-	\$ 346,949	\$ 7,298

**Nonrecurring**

Impaired Loans	\$4,876	\$-	\$ -	\$ 4,876
Other Real Estate	\$2,015	\$-	\$ -	\$ 2,015

**Liabilities**

The Company did not identify any liabilities that are required to be presented at fair value.

**PART I (Continued)**

## Item 1 (Continued)

**(11) Fair Value of Financial Instruments and Fair Value Measurements (Continued)***Fair Value Measurements Using Significant Unobservable Inputs (Level 3)*

The following table presents quantitative information about the significant unobservable inputs used in the fair value measurements for assets in level 3 of the fair value hierarchy measured on a nonrecurring basis at September 30, 2018 and December 31, 2017. This table is comprised primarily of collateral dependent impaired loans and other real estate owned:

	<b>September 30, 2018</b>	<b>Valuation Techniques</b>	<b>Unobservable Inputs</b>	<b>Range Weighted Avg</b>
Real Estate Commercial Construction	<b>\$ 427</b>	<b>Sales Comparison</b>	<b>Adjustment for Differences Between the Comparable Sales</b>	<b>(16.00)% - 1975.00%</b>
			<b>Management Adjustments for Age of Appraisals and/or Current Market Conditions</b>	<b>0.00% - 10.00%</b> <b>5.00%</b>
Residential Real Estate	<b>15</b>	<b>Sales Comparison</b>	<b>Adjustment for Differences Between the Comparable Sales</b>	<b>(43.30)% - 66.70%</b>
			<b>Management Adjustments for Age of Appraisals and/or Current Market Conditions</b>	<b>10.00% - 25.00%</b> <b>17.50%</b>

Commercial Real Estate	4,406	<b>Income Approach</b>	<b>Capitalization Rate</b>		<b>10.75%</b>
		<b>Sales Contract</b>	<b>Adjustment for Estimated Costs to Sell</b>	<b>0.00%</b>	- <b>0.00%</b>
			<b>Management Adjustments for Age of Appraisals and/or Current Market Conditions</b>	<b>0.00%</b>	- <b>10.00%</b>
					<b>4.74%</b>
Farmland	337	<b>Sales Comparison</b>	<b>Adjustment for Differences Between the Comparable Sales</b>	<b>(71.00)%</b>	- <b>88.70%</b>
			<b>Management Adjustments for Age of Appraisals and/or Current Market Conditions</b>	<b>10.00%</b>	- <b>80.00%</b>
					<b>45.00%</b>
Other Real Estate Owned	1,468	<b>Sales Comparison</b>	<b>Adjustment for Differences Between the Comparable Sales</b>	<b>(47.60)%</b>	- <b>25.02%</b>
			<b>Management Adjustments for Age of Appraisals and/or Current Market Conditions</b>	<b>9.82%</b>	- <b>81.21%</b>
					<b>34.48%</b>
		<b>Income Approach</b>	<b>Discount Rate</b>		<b>10.00%</b>



**PART I (Continued)**

## Item 1 (Continued)

**(11) Fair Value of Financial Instruments and Fair Value Measurements (Continued)**

	<b>December 31, 2017</b>	<b>Valuation Techniques</b>	<b>Unobservable Inputs</b>	<b>Range Weighted Avg</b>	
Real Estate Commercial Construction	\$ 427	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(16.00)% - 979.50%	1,975.00%
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	0.00% - 5.00%	10.00%
Residential Real Estate	82	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(43.30)% - 20.00%	83.30%
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	0.00% - 12.50%	25.00%
Commercial Real Estate	4,017	Income Approach	Management Adjustments for Age of Appraisals and/or Current Market Conditions	0.00% - 5.00%	10.00%
			Capitalization Rate	10.75%	
Farmland	350	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(71.00)% - 8.85%	88.70%
			Management Adjustments for Age of Appraisals and/or Current	10.00% - 42.50%	75.00%

Market Conditions

Other Real Estate Owned	2,015	Sales Comparison	Adjustment for Differences	(22.74)% -	15.00%
			Between the Comparable Sales	(3.87)%	
			Management Adjustment for Age of Appraisals and/or Current Market Conditions	5.44% -	87.24%
				24.44%	
		Income Approach	Capitalization Rate		10.00%

**PART I (Continued)**

## Item 1 (Continued)

**(11) Fair Value of Financial Instruments and Fair Value Measurements (Continued)**

The table below presents a reconciliation and statement of income classification of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (level 3) for the nine months ended September 30, 2018 and the twelve months ended December 31, 2017.

	<b>Available for Sale Securities</b>	
	<b>September 30, 2018</b>	December 31, 2017
<b>Balance, Beginning</b>	<b>\$7,298</b>	\$ 576
Transfers out of Level 3	-	-
Maturities	-	(360 )
Loss on OTTI Impairment Included in Noninterest Income	-	-
Purchases	-	7,070
Paydowns	<b>(501 )</b>	-
Unrealized Gains included in Other Comprehensive Income (Loss)	<b>(167 )</b>	12
<b>Balance, Ending</b>	<b>\$6,630</b>	\$ 7,298

The Company's policy is to recognize transfers in and transfers out of levels 1, 2 and 3 as of the end of a reporting period. There were no transfers of securities between levels for the nine months ended September 30, 2018 and the twelve months ended December 31, 2017.

The following table presents quantitative information about recurring level 3 fair value measurements as of September 30, 2018.

<b>September 30, 2018</b>	<b>Valuation Techniques</b>	<b>Unobservable Inputs</b>	<b>Range</b>
---------------------------	---------------------------------	--------------------------------	--------------

	<b>Fair Value</b>			<b>(Weighted Avg)</b>
State, County and Municipal	<b>\$215</b>	Discounted Cash Flow	Discount Rate or Yield	N/A*
U. S. Government Agencies Mortgage -Backed	<b>4,415</b>	Fundamental Analysis	Discount Rate or Yield	N/A*
Corporate	<b>2,000</b>	Option Pricing	Discount Rate or Yield	N/A*

\* The Company relies on a third-party pricing service to value its securities. The details of the unobservable inputs and other adjustments used by the third-party pricing service were not readily available to the Company.

## (12) Regulatory Capital Matters

The amount of dividends payable to the parent company from the subsidiary bank is limited by various banking regulatory agencies. Upon approval by regulatory authorities, the Bank may pay cash dividends to the parent company in excess of regulatory limitations.

The Company is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and, possibly, additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

**PART I (Continued)**

## Item 1 (Continued)

**(12) Regulatory Capital Matters (Continued)**

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. As of September 30, 2018, the interim final Basel III rules (Basel III) require the Company to also maintain minimum amounts and ratios of common equity Tier 1 capital to risk-weighted assets. These amounts and ratios as defined in regulations are presented hereafter. Management believes, as of September 30, 2018, the Company meets all capital adequacy requirements to which it is subject under the regulatory framework for prompt corrective action. In the opinion of management, there are no events or conditions since prior notification of capital adequacy from the regulators that have changed the institution's category.

The Basel III rules also require the implementation of a new capital conservation buffer comprised of common equity Tier 1 capital. The capital conservation buffer will be phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and increase each subsequent year by 0.625% until reaching its final level of 2.5% on January 1, 2019.

The following table summarizes regulatory capital information as of September 30, 2018 and December 31, 2017 on a consolidated basis and for the subsidiary, as defined. Regulatory capital ratios for September 30, 2018 and December 31, 2017 were calculated in accordance with the Basel III rules.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of September 30, 2018</b>						
Total Capital to Risk-Weighted Assets						
Consolidated	\$131,968	15.88 %	\$66,466	8.00 %	N/A	N/A
Colony Bank	128,955	15.54	66,371	8.00	\$82,964	10.00 %

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Tier I Capital to Risk-Weighted Assets						
Consolidated	<b>124,813</b>	<b>15.02</b>	<b>49,849</b>	<b>6.00</b>	<b>N/A</b>	<b>N/A</b>
Colony Bank	<b>121,800</b>	<b>14.68</b>	<b>49,778</b>	<b>6.00</b>	<b>66,371</b>	<b>8.00</b>
Common Equity Tier I Capital to Risk-Weighted Assets						
Consolidated	<b>101,313</b>	<b>12.19</b>	<b>37,387</b>	<b>4.50</b>	<b>N/A</b>	<b>N/A</b>
Colony Bank	<b>121,800</b>	<b>14.68</b>	<b>37,334</b>	<b>4.50</b>	<b>53,926</b>	<b>6.50</b>
Tier I Capital to Average Assets						
Consolidated	<b>124,813</b>	<b>10.45</b>	<b>47,794</b>	<b>4.00</b>	<b>N/A</b>	<b>N/A</b>
Colony Bank	<b>121,800</b>	<b>10.21</b>	<b>47,720</b>	<b>4.00</b>	<b>59,650</b>	<b>5.00</b>

**PART I (Continued)**

## Item 1 (Continued)

**(12) Regulatory Capital Matters (Continued)**

	<b>Actual</b>		<b>For Capital Adequacy Purposes</b>		<b>To Be Well Capitalized Under Prompt Corrective Provisions</b>	
	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>
<b>As of December 31, 2017</b>						
Total Capital to Risk-Weighted Assets						
Consolidated	\$127,786	15.56%	\$65,718	8.00 %	N/A	N/A
Colony Bank	127,470	15.54	65,628	8.00	\$82,036	10.00%
Tier I Capital to Risk-Weighted Assets						
Consolidated	120,279	14.64	49,289	6.00	N/A	N/A
Colony Bank	119,963	14.62	49,221	6.00	65,628	8.00
Common Equity Tier I Capital to Risk-Weighted Assets						
Consolidated	96,779	11.78	36,967	4.50	N/A	N/A
Colony Bank	119,963	14.62	36,916	4.50	53,323	6.50
Tier I Capital to Average Assets						
Consolidated	120,279	9.89	48,635	4.00	N/A	N/A
Colony Bank	119,963	9.88	48,566	4.00	60,708	5.00

**PART I (Continued)**

## Item 1 (Continued)

**(13) Earnings Per Share**

Basic earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during each period. Diluted earnings per share reflects the potential dilution of restricted stock and common stock warrants. Net income available to common stockholders represents net income after preferred stock dividends. The following table presents earnings per share for the three month and nine month period ended September 30, 2018 and 2017.

	<b>Three Months Ended September 30 2018</b>		<b>Nine Months Ended September 30 2017</b>	
<b>Numerator</b>				
Net Income Available to Common Stockholders	<b>\$2,695</b>	\$2,622	<b>\$8,952</b>	\$6,961
<b>Denominator</b>				
Weighted Average Number of Common Shares Outstanding for Basic Earnings Per Common Share	<b>8,439</b>	8,439	<b>8,439</b>	8,439
Dilutive Effect of Potential Common Stock				
Restricted Stock	<b>6</b>	-	<b>6</b>	-
Stock Warrants	-	191	<b>127</b>	193
Weighted-Average Number of Shares Outstanding for Diluted Earnings Per Common Share	<b>8,445</b>	8,630	<b>8,572</b>	8,632
Earnings Per Share - Basic	<b>\$0.32</b>	\$0.31	<b>\$1.06</b>	\$0.82
Earnings Per Share - Diluted	<b>\$0.32</b>	\$0.30	<b>\$1.04</b>	\$0.81

**(14) Accumulated Other Comprehensive Income (Loss)**



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Changes in accumulated other comprehensive income (loss) for unrealized gains and losses securities available for sale for the period ended September 30, 2018 and the year ended December 31, 2017 are as follows:

	<b>September 30, 2018</b>	December 31, 2017
<b>Beginning Balance</b>	<b>\$ (6,491 )</b>	\$ (5,022 )
Other Comprehensive Income Before Reclassification	<b>(5,760 )</b>	(401 )
Amounts Reclassified from Accumulated Other Comprehensive Income TCJ Act	<b>(92 )</b> -	- (1,068 )
Net Current Period Other Comprehensive Income	<b>(5,852 )</b>	(1,469 )
<b>Ending Balance</b>	<b>\$ (12,343 )</b>	\$ (6,491 )

**PART I (Continued)**

Item 1 (Continued)

**(15) Revenue From Contracts with Customers**

With the exception of gains/losses on the sale of other real estate owned discussed below, revenue from contracts with customers is recorded in the service charges on deposits category and the other service charges, commissions and fees category in the Company's consolidated statements of income as part of noninterest income. The following provides information on these noninterest income categories that contain ASC 606 Revenue for the periods indicated.

**Service Charges on Deposits**

This includes both account maintenance fees and overdraft fees. The overdraft fees are recognized at the point in time that the overdraft occurs. For the three and nine month periods ended September 30, 2018, there was \$1.13 million and \$3.27 million, respectively, in service charges on deposits.

**Other Service Charges, Commissions and Fees**

This includes debit card interchange fees and ATM fees. Debit card interchange fees are earned from debit card holder transactions conducted through various payment networks. Interchange fees from debit card holders transactions represent a percentage of the underlying transaction amount and are recognized daily, concurrently with the transaction processing services provided to the debit cardholder. For the three and nine month periods ended September 30, 2018, there was \$689 thousand and \$2.05 million, respectively, for debit card interchange fees. ATM fees are transaction-based fees recognized at the time the transaction is executed as that is the point at which the Company satisfies the performance obligation. For the three and nine month periods ended September 30, 2018, there was \$84 thousand and \$264 thousand, respectively, for ATM fees.

**Gains/Losses on the Sale of Other Real Estate**

The net gains and losses on sales of other real estate owned are recorded in other noninterest expenses in the Company's consolidated statements of income. The Company records a gain or loss from the sale of other real estate owned when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of other real estate owned to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the other real estate owned asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. The Company does not provide financing for the sale of other real estate owned property unless these criteria are met and the property can be derecognized. For the three and nine month periods ended September 30, 2018, there was \$48 thousand and \$162 thousand, respectively, for the gains/losses on the sale of other real estate.

#### **(16) Subsequent Events**

On October 22, 2018, the Bank completed its purchase of the Albany, Georgia branch of Planters First Bank. The purchase included approximately \$12.0 million in deposits and \$20.7 million in loans. In addition, the Company purchased a vacant lot owned by Planters First Bank in Albany for \$725 thousand, on which it plans to build a new branch office. The Company is currently evaluating all fair value adjustments related to loans, premises, and interest-bearing deposits.

On October 10, 2018, several of the Bank's geographic markets were impacted by Hurricane Michael. Several branches within these markets had minimal damage from the hurricane. Currently, the Bank is assessing this impact with its customers and especially the collectability of any loans impacted by the hurricane.

**Part I (Continued)**

Item 2

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Future Outlook**

During the recent financial crisis, the financial industry experienced tremendous adversities as a result of the collapse of the real estate markets across the country. The Company, like most banking companies, has been affected by these economic challenges that started with a rapid stall of real estate sales and developments throughout the country. We have accomplished a considerable amount of work in bringing our problem assets to an acceptable level. With these challenges behind us, we are now focusing on increasing our deposits along with solid loan growth. We continue to explore opportunities to improve core non-interest income. Revenue enhancement initiatives to accomplish this include new product lines and services.

In 2018 we are committed to improving earnings. Given the improved condition of the company, we are also considering product and market expansion. In January 2017, the Company opened its third office in Savannah, Georgia. In February 2018, the Company purchased a property in Statesboro, Georgia for a new office in the future. In May 2018, the Company closed one branch office in Albany, Georgia to improve operating efficiencies.

In July 2018, the Bank entered into a definitive agreement with Planters First Bank to purchase a branch in Albany, Georgia along with a vacant lot of real estate in Albany, Georgia on which the Bank intends to eventually build a new branch office. The transaction closed in October 2018 resulting in additional \$20.7 million of loans and \$12.0 million of deposits for the Bank.

In addition to improving earnings, reducing problem assets and maintaining strong capital levels, we have reinstated dividend payments beginning first quarter 2017 and throughout 2017 on a quarterly basis at \$0.025 per common stock. For the three quarters of 2018, we paid a dividend payment of \$0.05 per common stock.

In June 2018, the Company repurchased the warrants originated in 2009 through transactions with the United States Department of the Treasury for \$3.2 million. The warrants were auctioned to private investors in 2013. The warrants

were cancelled upon the completion of the transaction.

In July 2018, the Company announced the retirement of its President and Chief Executive Officer, Edward P. Loomis, Jr. and named Mr. T. Heath Fountain as his replacement. Mr. Fountain previously served as President and Chief Executive Officer of Planters First Bank for three years and Chief Financial Officer of Heritage Financial Group and Heritage Bank of the South for eight years.

In addition, we continue to make efforts to attract and retain top talent to improve business operations. To that end, the Company entered into Retention Agreements with members of management in the first quarter of 2015 and has extended those agreements during the first quarter of 2018. The Company expects that these agreements will facilitate the retention of key individuals responsible for maintaining current operations and spearheading future product and market expansion.

### **Major Trends/Significant Considerations**

The following discussion sets forth management's discussion and analysis of our consolidated financial condition as of September 30, 2018, and the consolidated results of operations for the nine months ended September 30, 2018. This discussion should be read in conjunction with the Company's annual report on Form 10-K filed with the Securities and Exchange Commission on March 15, 2018. Readers should also carefully review all other disclosures we file from time to time with the SEC.

### **Non-GAAP Financial Measures**

Our accounting and reporting policies conform to generally accepted accounting principles (GAAP) in the United States and prevailing practices in the banking industry. However, certain non-GAAP measures are used by management to supplement the evaluation of our performance. These include the fully-taxable equivalent measures: tax-equivalent net interest income, tax-equivalent net interest margin, and tax-equivalent net interest spread, which include the effects of taxable-equivalent adjustments using a federal income tax rate of 21% in 2018 and 34% in 2017 to increase tax-exempt interest income to a tax-equivalent basis. Tax-equivalent adjustments are reported in Notes 1 and 2 to the Average Balances with Average Yields and Rates table under Rate/Volume Analysis. Tangible book value per common share is also a non-GAAP measure used in the selected Financial Data Section.

**Part I (Continued)**

## Item 2 (Continued)

*Tax-equivalent net interest income, net interest margin and net interest spread.* Net interest income on a tax-equivalent basis is a non-GAAP measure that adjusts for the tax-favored status of net interest income from loans and investments. We believe this measure to be the preferred industry measurement of net interest income and it enhances comparability of net interest income arising from taxable and tax-exempt sources. The most directly comparable financial measure calculated in accordance with GAAP is our net interest income. Net interest margin on a tax-equivalent basis is net interest income on a tax-equivalent basis divided by average interest-earning assets on a tax-equivalent basis. The most directly comparable financial measure calculated in accordance with GAAP is our net interest margin. Net interest spread on a tax-equivalent basis is the difference in the average yield on average interest-earning assets on a tax equivalent basis and the average rate paid on average interest-bearing liabilities. The most directly comparable financial measure calculated in accordance with GAAP is our net interest spread.

These non-GAAP financial measures should not be considered alternatives to GAAP-basis financial statements, and other bank holding companies may define or calculate these non-GAAP measures or similar measures differently.

A reconciliation of these performance measures to GAAP performance measures is included in the tables below.

**Non-GAAP Performance Measures Reconciliation**

	<b>Three months ended September 30, 2018</b>		<b>Nine months ended September 30, 2018</b>	
	2017		2017	
<b>Interest Income Reconciliation</b>				
Interest Income – Taxable Equivalent	\$11,622	<b>\$12,274</b>	\$34,355	<b>\$36,227</b>
Tax Equivalent Adjustment	44	<b>23</b>	118	<b>57</b>
Interest Income (GAAP)	\$11,578	<b>\$12,251</b>	\$34,237	<b>\$36,170</b>
<b>Net Interest Income Reconciliation</b>				
Net Interest Income – Taxable Equivalent	\$9,887	<b>\$10,128</b>	\$29,239	<b>\$30,456</b>
Tax Equivalent Adjustment	44	<b>23</b>	118	<b>57</b>
Net Interest Income (GAAP)	\$9,843	<b>\$10,105</b>	\$29,121	<b>\$30,399</b>
		<b>Three Months</b>		<b>Nine Months Ended</b>

	<b>Ended September 30, 2018</b>	2017	<b>September 30, 2018</b>	2017
<b>Net Interest Margin Reconciliation</b>				
Net Interest Margin – Taxable Equivalent	<b>3.57 %</b>	3.50 %	<b>3.56 %</b>	3.45 %
Tax Equivalent Adjustment	<b>0.00</b>	0.01	<b>0.00</b>	0.02
Net Interest Margin (GAAP)	<b>3.57 %</b>	3.49 %	<b>3.56 %</b>	3.43 %
<b>Interest Rate Spread Reconciliation</b>				
Interest Rate Spread – Taxable Equivalent	<b>3.40 %</b>	3.38 %	<b>3.41 %</b>	3.33 %
Tax Equivalent Adjustment	<b>0.01</b>	0.01	<b>0.01</b>	0.01
Interest Rate Spread (GAAP)	<b>3.39 %</b>	3.37 %	<b>3.40 %</b>	3.32 %

### The Company

Colony Bankcorp, Inc. is a bank holding company headquartered in Fitzgerald, Georgia that provides, through Colony Bank, its wholly owned subsidiary (collectively referred to as the Company), a broad array of products and services throughout 19 Georgia markets. The Company offers commercial, consumer and mortgage banking services.

**Part I (Continued)**

Item 2 (Continued)

**Application of Critical Accounting Policies and Accounting Estimates**

The accounting and reporting policies of the Company are in accordance with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. The Company's financial position and results of operations are affected by management's application of accounting policies, including judgments made to arrive at the carrying value of assets and liabilities and amounts reported for revenues, expenses and related disclosures. Different assumptions in the application of these policies could result in material changes in the Company's financial position and/or results of operations. Critical accounting policies are those policies that management believes are the most important to the portrayal of the Company's financial condition and results of operations, and they require management to make estimates that are difficult and subjective.

**Overview**

The following discussion and analysis presents the more significant factors affecting the Company's financial condition as of September 30, 2018 and December 31, 2017, and results of operations for each of the three months and nine months in the periods ended September 30, 2018 and 2017. This discussion and analysis should be read in conjunction with the Company's consolidated financial statements, notes thereto and other financial information appearing elsewhere in this report.

Taxable-equivalent adjustments are the result of increasing income from tax-free loans and investments by an amount equal to the taxes that would be paid if the income were fully taxable based on a 21 percent in 2018 and 34 percent in 2017 federal tax rate, thus making tax-exempt yields comparable to taxable asset yields.

Dollar amounts in tables are stated in thousands, except for per share amounts.

**Results of Operations**



The Company's results of operations are determined by its ability to effectively manage interest income and expense, to minimize loan and investment losses, to generate noninterest income and to control noninterest expense. Since market forces and economic conditions beyond the control of the Company determine interest rates, the ability to generate net interest income is dependent upon the Company's ability to obtain an adequate spread between the rate earned on interest-earning assets and the rate paid on interest-bearing liabilities. Thus, the key performance for net interest income is the interest margin or net yield, which is taxable-equivalent net interest income divided by average interest-earning assets. Net income available to common shareholders totaled \$2.70 million, or \$0.32 diluted per common share, in the three months ended September 30, 2018 compared to net income available to common shareholders of \$2.62 million, or \$0.30 diluted per common share, in the three months ended September 30, 2017. Net income available to common shareholders totaled \$8.95 million, or \$1.04 diluted per common share, in nine months ended September 30, 2018 compared to net income available to common shareholders of \$6.96 million, or \$0.81 diluted per common share, in nine months ended September 30, 2017. The Company did not have any material changes in the third quarter of 2018.

**Part I (Continued)**

## Item 2 (Continued)

Selected income statement data, returns on average assets and average common equity and dividends per share for the comparable periods were as follows:

	Three Months Ended September 30				Nine Months Ended September 30			
	2018	2017	\$ Variance	% Variance	2018	2017	\$ Variance	% Variance
Taxable-equivalent net interest income	<b>\$10,128</b>	\$9,887	<b>\$ 241</b>	<b>2.44</b> %	<b>\$30,456</b>	\$29,239	<b>\$ 1,217</b>	<b>4.16</b> %
Taxable-equivalent adjustment	<b>23</b>	44	<b>(21 )</b>	<b>(47.73 )</b>	<b>57</b>	118	<b>(61 )</b>	<b>(51.69 )</b>
Net interest income	<b>10,105</b>	9,843	<b>262</b>	<b>2.66</b>	<b>30,399</b>	29,121	<b>1,278</b>	<b>4.39</b>
Provision for loan losses	<b>61</b>	-	<b>61</b>	<b>100.00</b>	<b>131</b>	335	<b>(204 )</b>	<b>(60.90 )</b>
Noninterest income	<b>2,405</b>	2,424	<b>(19 )</b>	<b>(0.78 )</b>	<b>7,163</b>	7,218	<b>(55 )</b>	<b>(0.76 )</b>
Noninterest expense	<b>9,078</b>	8,380	<b>698</b>	<b>8.33</b>	<b>26,215</b>	25,408	<b>807</b>	<b>3.18</b>
Income before income taxes	<b>3,371</b>	3,887	<b>(516 )</b>	<b>(13.28 )</b>	<b>11,216</b>	10,596	<b>620</b>	<b>5.85</b>
Income taxes	<b>676</b>	1,265	<b>(589 )</b>	<b>(46.56 )</b>	<b>2,264</b>	3,424	<b>(1,160 )</b>	<b>(33.88 )</b>
Net income	<b>2,695</b>	2,622	<b>73</b>	<b>2.78</b>	<b>8,952</b>	7,172	<b>1,780</b>	<b>24.82</b>
Preferred stock dividends	-	-	-	-	-	211	<b>(211 )</b>	<b>(100.00 )</b>
Net income available to common shareholders	<b>\$2,695</b>	\$2,622	<b>\$ 73</b>	<b>2.78</b> %	<b>\$8,952</b>	\$6,961	<b>\$ 1,991</b>	<b>28.60</b> %
Net income available to common shareholders:								
Basic	<b>\$0.32</b>	\$0.31	<b>\$ 0.01</b>	<b>3.23</b> %	<b>\$1.06</b>	\$0.82	<b>\$ 0.24</b>	<b>29.27</b> %
Diluted	<b>\$0.32</b>	\$0.30	<b>\$ 0.02</b>	<b>6.67</b> %	<b>\$1.04</b>	\$0.81	<b>\$ 0.23</b>	<b>28.40</b> %
Return on average assets	<b>0.90</b> %	0.88 %	<b>0.02</b> %	<b>2.27</b> %	<b>1.00</b> %	0.78 %	<b>0.22</b> %	<b>28.21</b> %
Return on average total equity	<b>12.10</b> %	11.57 %	<b>0.53</b> %	<b>4.58</b> %	<b>13.37</b> %	10.23 %	<b>3.14</b> %	<b>30.69</b> %

Details of the changes in the various components of net income are further discussed below.

### **Net Interest Income**

Net interest income is the difference between interest income on earning assets, such as loans and securities, and interest expense on liabilities, such as deposits and borrowings, which are used to fund those assets. Net interest income is the Company's largest source of revenue, representing 80.93 percent of total revenue for nine months ended September 30, 2018 and 80.14 percent for the same period a year ago.

Net interest margin is the taxable-equivalent net interest income as a percentage of average interest-earning assets for the period. The level of interest rates and the volume and mix of interest-earning assets and interest-bearing liabilities impact net interest income and net interest margin.

The Federal Reserve Board influences the general market rates of interest, including the deposit and loan rates offered by many financial institutions. The Company's loan portfolio is significantly affected by changes in the prime interest rate. The prime interest rate, which is the rate offered on loans to borrowers with strong credit, is currently 5.25 percent. The rate increased 25 basis points in each of the three quarters of 2018 and three times in 2017. The federal funds rate moved similarly to the prime rate with interest rates currently at 2.25 percent. We expect an additional rate increase in 2018.

The following table presents the changes in taxable-equivalent net interest income and identifies the changes due to differences in the average volume of interest-earning assets and interest-bearing liabilities and the changes due to changes in the average interest rate on those assets and liabilities. The changes in net interest income due to changes in both average volume and average interest rate have been allocated to the average volume change or the average interest rate change in proportion to the absolute amounts of the change in each. The Company's consolidated average balance sheets along with an analysis of taxable-equivalent net interest earnings are presented in the Quantitative and Qualitative Disclosures About Market Risk included elsewhere in this report.

**Part I (Continued)**

## Item 2 (Continued)

**Rate/Volume Analysis**

The rate/volume analysis presented hereafter illustrates the change from September 30, 2017 to September 30, 2018 for the nine months period ended for each component of the taxable equivalent net interest income separated into the amount generated through volume changes and the amount generated by changes in the yields/rates.

(\$ in thousands)	Changes from September 30, 2017 to September 30, 2018		
	Volume	Rate	Total
Interest Income			
Loans, Net-taxable	\$247	\$866	\$1,113
Investment Securities			
Taxable	64	662	726
Tax-exempt	(6 )	(12 )	(18 )
Total Investment Securities	58	650	708
Interest-Bearing Deposits in other Banks	(13 )	39	26
Federal Funds Sold	-	-	-
Other Interest - Earning Assets	4	21	25
Total Interest Income	296	1,576	1,872
Interest Expense			
Interest-Bearing Demand and Savings Deposits	47	519	566
Time Deposits	(200)	240	40
Subordinated Debentures	-	42	42
Other Borrowed Money	36	(30 )	6
Federal Funds Purchased	-	1	1
Total Interest Expense	(117)	772	655
Net Interest Income	\$413	\$804	\$1,217

(1) Changes in net interest income for the periods, based on either changes in average balances or changes in average rates for interest-earning assets and interest-bearing liabilities, are shown on this table. During each year, there are numerous and simultaneous balance and rate changes; therefore, it is not possible to precisely allocate the changes between balances and rates. For the purpose of this table, changes that are not exclusively due to balance changes or rate changes have been attributed to rates.

The Company maintains about 23.1 percent of its loan portfolio in adjustable rate loans that reprice with prime rate changes, while the bulk of its other loans mature within 3 years. The liabilities to fund assets are primarily in short term certificate of deposits that mature within one year. The net interest margin increased to 3.56 percent for the nine months ended September 30, 2018 compared to 3.45 percent for the same period a year ago. We anticipate the net interest margin remaining relatively flat for 2018.

Taxable-equivalent net interest income for the nine months ended September 30, 2018 increased by \$1.22 million, or 4.16 percent compared to the same period a year ago. The average volume of earning assets during nine months ended September 30, 2018 increased \$9.04 million compared to the same period a year ago. Growth in average earning assets during 2018 was primarily in investments and loans.

The average volume of loans increased \$6.48 million for the nine months ended September 30, 2018 compared to the same period a year ago. The average yield on loans increased 15 basis points for the nine months ended September 30, 2018 compared to the same period a year ago. The average volume of investment securities increased \$4.12 million for the nine months ended September 30, 2018 compared to the same year ago period, while the average yield on investment securities increased 24 basis points for the same period comparison. The average volume of deposits decreased \$30 thousand for the nine months ended September 30, 2018 compared to the same period a year ago, with interest-bearing deposits decreasing \$15.74 million for the nine months ended September 30, 2018.

**Part I (Continued)**

Item 2 (Continued)

Accordingly, the ratio of average interest-bearing deposits to total average deposits was 83.41 percent for the nine months ended September 30, 2018 compared to 84.94 percent in the same period a year ago. This deposit mix, combined with a general increase in market rates, had the effect of increasing the average cost of total deposits by 8 basis points in nine months ended September 30, 2018 compared to the same period a year ago.

The Company's net interest spread, which represents the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities, was 3.41 percent in nine months ended September 30, 2018 compared to 3.33 percent in the same period a year ago. The net interest spread, as well as the net interest margin, will be impacted by future changes in short-term and long-term interest rate levels, as well as the impact from the competitive environment.

**Part I (Continued)**

## Item 2 (Continued)

AVERAGE BALANCE SHEETS (\$ in thousands)	Nine Months Ended September 30, 2018			Nine Months Ended September 30, 2017		
	Average Balances	Income/ Expense	Yields/ Rates	Average Balances	Income/ Expense	Yields/ Rates
Assets						
Interest-Earning Assets						
Loans, Net of Unearned Interest and fees						
Taxable (1)	<b>\$767,017</b>	<b>\$30,094</b>	<b>5.23 %</b>	\$760,540	\$28,981	5.08 %
Investment Securities						
Taxable	<b>347,548</b>	<b>5,763</b>	<b>2.21 %</b>	343,183	5,037	1.96 %
Tax-Exempt (2)	<b>2,066</b>	<b>44</b>	<b>2.84 %</b>	2,307	62	3.58 %
Total Investment Securities	<b>349,614</b>	<b>5,807</b>	<b>2.21 %</b>	345,490	5,099	1.97 %
Interest-Bearing Deposits	<b>19,942</b>	<b>192</b>	<b>1.28 %</b>	21,611	166	1.02 %
Federal Funds Sold	-	-	- %	-	-	- %
Interest-Bearing Other Assets	<b>3,220</b>	<b>134</b>	<b>5.55 %</b>	3,114	109	4.67 %
Total Interest-Earning Assets	<b>\$1,139,793</b>	<b>\$36,227</b>	<b>4.24 %</b>	\$1,130,755	\$34,355	4.05 %
Non-interest-Earning Assets						
Cash and Cash Equivalents	<b>13,415</b>			19,942		
Allowance for Loan Losses	<b>(7,357)</b>			(8,691)		
Other Assets	<b>48,125</b>			54,991		
Total Noninterest-Earning Assets	<b>54,183</b>			66,242		
Total Assets	<b>\$1,193,976</b>			\$1,196,997		
Liabilities and Stockholders' Equity						
Interest-Bearing Liabilities						
Interest-Bearing Deposits						
Interest-Bearing Demand and Savings	<b>\$532,748</b>	<b>\$1,971</b>	<b>0.49 %</b>	\$515,412	\$1,405	0.36 %
Other Time	<b>323,995</b>	<b>2,194</b>	<b>0.90 %</b>	357,075	2,154	0.80 %
Total Interest-Bearing Deposits	<b>856,743</b>	<b>4,165</b>	<b>0.65 %</b>	872,487	3,559	0.54 %
Other Interest-Bearing Liabilities						
Other Borrowed Money	<b>49,865</b>	<b>893</b>	<b>2.39 %</b>	47,923	887	2.47 %
Subordinated Debentures	<b>24,229</b>	<b>709</b>	<b>3.90 %</b>	24,229	667	3.67 %
Federal Funds Purchased	<b>240</b>	<b>4</b>	<b>2.22 %</b>	233	3	1.72 %
Total Other Interest-Bearing Liabilities	<b>74,334</b>	<b>1,606</b>	<b>2.88 %</b>	72,385	1,557	2.87 %
Total Interest-Bearing Liabilities	<b>\$931,077</b>	<b>\$5,771</b>	<b>0.83 %</b>	\$944,872	\$5,116	0.72 %
Noninterest-Bearing Liabilities and Stockholders' Equity						
Demand Deposits	<b>170,437</b>			154,723		
Other Liabilities	<b>3,164</b>			6,640		
Stockholders' Equity	<b>89,298</b>			90,762		
Total Noninterest-Bearing Liabilities and Stockholders' Equity	<b>262,899</b>			252,125		
Total Liabilities and Stockholders' Equity	<b>\$1,193,976</b>			\$1,196,997		

Interest Rate Spread		<b>3.41 %</b>		3.33 %
Net Interest Income	<b>\$30,456</b>		\$29,239	
Net Interest Margin		<b>3.56 %</b>		3.45 %

The average balance of loans includes the average balance of nonaccrual loans. Income on such loans is recognized (1) and recorded on the cash basis. Taxable equivalent adjustments totaling \$46 and \$97 for nine month periods ended September 30, 2018 and 2017, respectively, are included in tax-exempt interest on loans.

Taxable-equivalent adjustments totaling \$11 and \$21 for nine month periods ended September 30, 2018 and 2017, respectively, are included in tax-exempt interest on investment securities. The adjustments are based on a federal (2) tax rate of 21 percent in 2018 and 34 percent in 2017 with appropriate reductions for the effect of disallowed interest expense incurred in carrying tax-exempt obligations.



**Part I (Continued)**

## Item 2 (Continued)

**Provision for Loan Losses**

The provision for loan losses is determined by management as the amount to be added to the allowance for loan losses after net charge-offs have been deducted to bring the allowance to a level which, in management's best estimate, is necessary to absorb probable losses within the existing loan portfolio. The provision for loan losses totaled \$131 thousand in the nine months ended September 30, 2018 compared to \$335 thousand in the same period a year ago. See the section captioned "Allowance for Loan Losses" elsewhere in this discussion for further analysis of the provision for loan losses.

**Noninterest Income**

The components of noninterest income were as follows:

	Three Months Ended September 30				Nine Months Ended September 30			
	2018	2017	\$ Variance	% Variance	2018	2017	\$ Variance	% Variance
Service Charges on Deposit Accounts	<b>\$1,134</b>	\$1,169	\$ (35 )	(2.99 )%	<b>\$3,266</b>	\$3,315	\$ (49 )	(1.48 )%
Other Charges, Commissions and Fees	<b>803</b>	741	62	8.37 %	<b>2,414</b>	2,300	114	4.96 %
Mortgage Fee Income	<b>176</b>	241	(65 )	(26.97 )%	<b>507</b>	629	(122 )	(19.40 )%
Securities Gains (Losses)	-	-	-	- %	<b>116</b>	-	116	100.00 %
Other	<b>292</b>	273	19	6.96 %	<b>860</b>	974	(114 )	(11.70 )%
Total	<b>\$2,405</b>	\$2,424	\$ (19 )	(0.78 )%	<b>\$7,163</b>	\$7,218	\$ (55 )	(0.76 )%

*Other Charges, Commissions and Fees.* Debit card interchange fees and foreign fees increased \$123 thousand in 2018 compared to the same period in 2017.

*Mortgage Fee Income.* The volume of mortgage loans has shown a decrease in 2018 compared to the same period in 2017 which contributed to the decrease in mortgage fee income.

*Other.* The decrease in 2018 compared to prior year is primarily attributable to rental income for other real estate owned which decreased by \$57 thousand from \$129 thousand in 2017 to \$72 thousand in 2018. Income for deferred compensation decreased by \$35 thousand.

## Noninterest Expense

The components of noninterest expense were as follows:

	Three Months Ended September 30				Nine Months Ended September 30			
	2018	2017	\$ Variance	% Variance	2018	2017	\$ Variance	% Variance
Salaries and Employee Benefits	\$5,110	\$4,802	\$ 308	6.41 %	\$15,032	\$14,467	\$ 565	3.91 %
Occupancy and Equipment	1,052	1,014	38	3.75 %	3,077	2,965	112	3.78 %
Other	2,916	2,564	352	13.73 %	8,106	7,976	130	1.63 %
Total	\$9,078	\$8,380	\$ 698	8.33 %	\$26,215	\$25,408	\$ 807	3.18 %

*Salaries and Employee Benefits.* The increase in 2018 is primarily attributable to merit pay increases and increase in headcount.

*Occupancy and Equipment.* The increase in the three months ended September 30, 2018 as compared to comparable periods is primarily attributable to an increase in depreciation expense in 2018 and an increase in maintenance on equipment and building in 2018.

**Part I (Continued)**

## Item 2 (Continued)

*Other.* The increase in the nine months ended September 30, 2018 as compared to comparable periods is primarily attributable to data processing expenses which increased by \$429 thousand from \$207 thousand in 2017 compared to \$636 thousand in 2018. The Company changed its information technology processes from an in-house approach to outsourcing with our core processing provider during the first quarter of 2018. With this change, the Company has shown a decrease of \$286 thousand in software expense in 2018 compared to 2017. Other increases occurred with ATM expense of \$39 thousand, telephone expense of \$13 thousand, and legal and professional expense of \$97 thousand. Other decreases that offset the overall increase in other noninterest income were foreclosed property expenses decreasing by \$163 thousand and \$19 thousand in FDIC assessments.

**Investment Portfolio**

The following table presents carrying values of investment securities held by the Company for the periods indicated.

	<b>September 30, 2018</b>	December 31, 2017
State, County & Municipal	<b>\$ 3,972</b>	\$4,493
US Government Agencies		
Mortgage-Backed	<b>311,178</b>	346,723
Corporate	<b>2,882</b>	2,060
Asset-Backed	-	971
<b>Total Investment Securities</b>	<b>\$ 318,032</b>	\$354,247

The following table represents expected maturities and weighted-average yields of investment securities held by the Company as of September 30, 2018. (Mortgage-backed securities are based on the average life at the projected speed, while State and Political Subdivisions reflect anticipated calls being exercised.)

	Within 1 Year		After 1 Year But		After 5 Years		After 10 Years	
			Within 5 Years		But			
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield

US Government Agencies								
Mortgage-Backed	<b>\$22,479</b>	<b>2.53 %</b>	<b>\$161,252</b>	<b>1.90 %</b>	<b>\$111,079</b>	<b>2.55 %</b>	<b>\$16,368</b>	<b>3.55 %</b>
State, County & Municipal	<b>1,007</b>	<b>2.44</b>	<b>2,717</b>	<b>2.39</b>	<b>-</b>	<b>-</b>	<b>248</b>	<b>4.03</b>
Corporate	<b>-</b>	<b>-</b>	<b>2,882</b>	<b>3.75</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total Investment Portfolio</b>	<b>\$23,486</b>	<b>2.53 %</b>	<b>\$166,851</b>	<b>1.94 %</b>	<b>\$111,079</b>	<b>2.55 %</b>	<b>\$16,616</b>	<b>3.56 %</b>

Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income. The Company has 100 percent of its portfolio classified as available for sale.

At September 30, 2018, there were no holdings of any one issuer, other than the U.S. government and its agencies, in an amount greater than 10 percent of the Company's stockholders' equity.

The average yield of the securities portfolio was 2.21 percent for the nine months ended September 30, 2018 compared to 1.97 percent for the same period in 2017. The increase in the average yield from 2017 to 2018 was primarily attributed to the purchase of new securities which have a higher yield.

**Part I (Continued)**

## Item 2 (Continued)

**Loans**

The following table presents the composition of the Company's loan portfolio as of September 30, 2018 and December 31, 2017:

	<b>September 30, 2018</b>	December 31, 2017	\$ Variance	% Variance	
<b>Commercial and Agricultural</b>					
Commercial	<b>\$ 47,292</b>	\$48,122	\$ (830 )	(1.72 )	)%
Agricultural	<b>21,415</b>	16,443	4,972	30.24	
<b>Real Estate</b>					
Commercial Construction	<b>53,570</b>	45,214	8,356	18.48	
Residential Construction	<b>12,897</b>	8,583	4,314	50.26	
Commercial	<b>349,408</b>	351,172	(1,764 )	(0.50 )	
Residential	<b>189,153</b>	194,049	(4,896 )	(2.52 )	
Farmland	<b>70,069</b>	67,768	2,301	3.40	
<b>Consumer and Other</b>					
Consumer	<b>18,623</b>	18,956	(333 )	(1.76 )	
Other	<b>17,016</b>	14,977	2,039	13.61	
<b>Gross Loans</b>	<b>779,443</b>	765,284	14,159	1.85	
Unearned Interest and Fees	<b>(515 )</b>	(495 )	(20 )	4.04	
Allowance for Loan Losses	<b>(7,155 )</b>	(7,508 )	353	(4.70 )	
<b>Net Loans</b>	<b>\$ 771,773</b>	\$ 757,281	\$ 14,492	1.91	%

*Loan Origination/Risk Management.* In accordance with the Company's decentralized banking model, loan decisions are made at the Bank level. The Company utilizes both an Executive Loan Committee and a Director Loan Committee to assist lenders with the decision making and underwriting process of larger loan requests. Due to the diverse economic markets served by the Company, evaluation and underwriting criteria may vary slightly by market. Overall, loans are extended after a review of the borrower's repayment ability, collateral adequacy, and overall credit worthiness.

Commercial purpose, commercial real estate, and agricultural loans are underwritten similarly to how other loans are underwritten throughout the Company. The properties securing the Company's commercial real estate portfolio are diverse in terms of type and geographic location. In addition, the Company restricts total loans to \$10 million per

borrower, subject to exception and approval by the Director Loan Committee. This diversity helps reduce the company's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans monthly based on collateral, geography, and risk grade criteria. The Company also utilizes information provided by third-party agencies to provide additional insight and guidance about economic conditions and trends affecting the markets it serves.

The Company extends loans to builders and developers that are secured by non-owner occupied properties. In such cases, the Company reviews the overall economic conditions and trends for each market to determine the desirability of loans to be extended for residential construction and development. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim mini-perm loan commitment from the Company until permanent financing is obtained. In some cases, loans are extended for residential loan construction for speculative purposes and are based on the perceived present and future demand for housing in a particular market served by the Company. These loans are monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, general economic conditions and trends, the demand for the properties, and the availability of long-term financing.

The Company originates consumer loans at the Bank level. Due to the diverse economic markets served by the Company, underwriting criteria may vary slightly by market. The Company is committed to serving the borrowing needs of all markets served and, in some cases, adjusts certain evaluation methods to meet the overall credit demographics of each market. Consumer loans represent relatively small loan amounts that are spread across many individual borrowers to help minimize risk. Additionally, consumer trends and outlook reports are reviewed by management on a regular basis.

The Company utilizes an independent third party company for loan review and validation of the credit risk program on an ongoing quarterly basis. Results of these reviews are presented to management and the audit committee. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

**Part I (Continued)**

Item 2 (Continued)

*Commercial and Agricultural.* Commercial and agricultural loans at September 30, 2018 increased 6.42 percent to \$68.71 million from December 31, 2017 at \$64.57 million. The Company's commercial and agricultural loans are a diverse group of loans to small, medium and large businesses. The purpose of these loans varies from supporting seasonal working capital needs to term financing of equipment. While some short-term loans may be made on an unsecured basis, most are secured by the assets being financed with collateral margins that are consistent with the Company's loan policy guidelines.

*Real Estate.* Commercial and residential construction loans increased by \$12.67 million, or 23.55 percent, at September 30, 2018 to \$66.47 million from \$53.80 million at December 31, 2017. This increase is partially due to new commercial construction loans being financed during the year that have not been completed by the end of the quarter. Commercial real estate decreased \$1.76 million, or 0.50 percent, at September 30, 2018 to \$349.41 million from \$351.17 million at December 31, 2017.

*Other.* Other loans at September 30, 2018 increased 13.61 percent to \$17.02 million from \$14.98 million at December 31, 2017.

*Collateral Concentrations.* 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, 2018, approximately 87 percent of the Company's loan portfolio was concentrated in loans secured by real estate. A substantial portion of borrowers' ability to honor their contractual obligations is dependent upon the viability of the real estate economic sector. 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. In the recent year, we have seen real estate values stabilizing in our markets. The stabilization of rates has resulted in a decrease in the number of loans being classified as impaired over the past several years.

*Maturities and Sensitivities of Loans to Changes in Interest Rates.* The following table presents the maturity distribution of the Company's loans at September 30, 2018. The table also presents the portion of loans that have fixed interest rates or variable interest rates that fluctuate over the life of the loans in accordance with changes in an interest rate index such as the prime rate.

	<b>Due in One Year or Less</b>	<b>After One, but Within Three Years</b>	<b>After Three, but Within Five Years</b>	<b>After Five Years</b>	<b>Total</b>
Loans with fixed interest rates	<b>\$219,784</b>	<b>\$227,303</b>	<b>\$117,284</b>	<b>\$35,138</b>	<b>\$599,509</b>
Loans with floating interest rates	<b>92,135</b>	<b>47,432</b>	<b>38,349</b>	<b>2,018</b>	<b>179,934</b>
Total	<b>\$311,919</b>	<b>\$274,735</b>	<b>\$155,633</b>	<b>\$37,156</b>	<b>\$779,443</b>

The Company may renew loans at maturity when requested by a customer whose financial strength appears to support such renewal or when such renewal appears to be in the Company's best interest. In such instances, the Company generally requires payment of accrued interest and may adjust the rate of interest, require a principal reduction or modify other terms of the loan at the time of renewal.



**Part I (Continued)**

## Item 2 (Continued)

**Nonperforming Assets and Potential Problem Loans**

Nonperforming assets and accruing past due loans as of September 30, 2018, December 31, 2017 and September 30, 2017 were as follows:

	<b>September 30, 2018</b>	December 31, 2017	September 30, 2017		
Loans Accounted for on Nonaccrual	<b>\$ 8,136</b>	\$ 7,503	\$ 8,807		
Loans Accruing Past Due 90 Days or More	<b>1</b>	-	-		
Other Real Estate Foreclosed	<b>2,173</b>	4,256	4,520		
Total Nonperforming Assets	<b>\$ 10,310</b>	\$ 11,759	\$ 13,327		
Nonperforming Assets by Segment					
Construction and Land Development	<b>\$ 925</b>	\$ 2,630	\$ 2,907		
1-4 Family Residential	<b>2,704</b>	3,309	3,542		
Nonfarm Residential	<b>3,544</b>	3,796	4,885		
Farmland	<b>2,066</b>	839	839		
Commercial and Consumer	<b>1,071</b>	1,185	1,154		
Total Nonperforming Assets	<b>\$ 10,310</b>	\$ 11,759	\$ 13,327		
Nonperforming Assets as a Percentage of:					
Total Loans and Foreclosed Assets	<b>1.32</b>	%	1.53	%	1.72
Total Assets	<b>0.87</b>	%	0.95	%	1.11
Nonperforming Loans as a Percentage of:					
Total Loans	<b>1.04</b>	%	0.98	%	1.14
Supplemental Data:					
Trouble Debt Restructured Loans In Compliance with Modified Terms	<b>\$ 15,400</b>	\$ 18,363	\$ 16,952		
Trouble Debt Restructured Loans Past Due 30-89 Days	<b>-</b>	131	132		
Accruing Past Due Loans:					
30-89 Days Past Due	<b>\$ 4,170</b>	\$ 4,558	\$ 5,250		
90 or More Days Past Due	<b>1</b>	-	-		
Total Accruing Past Due Loans	<b>\$ 4,171</b>	\$ 4,558	\$ 5,250		
Allowance for Loan Losses	<b>\$ 7,155</b>	\$ 7,508	\$ 7,977		
ALLL as a Percentage of:					
Total Loans	<b>0.92</b>	%	0.98	%	1.04

Nonperforming Loans	<b>87.93</b>	%	100.06	%	90.58	%
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Nonperforming assets include nonaccrual loans, loans past due 90 days or more and foreclosed real estate. Nonperforming assets at September 30, 2018 decreased 12.32 percent from December 31, 2017.

Generally, loans are placed on non-accrual status if principal or interest payments become 90 days past due and/or management deems the collectability of the principal and/or interest to be in question, as well as when required by regulatory requirements. Loans to a customer whose financial condition has deteriorated are considered for non-accrual status whether or not the loan is 90 days or more past due. For consumer loans, collectability and loss are generally determined before the loan reaches 90 days past due. Accordingly, losses on consumer loans are recorded at the time they are determined. Consumer loans that are 90 days or more past due are generally either in liquidation/payment status or bankruptcy awaiting confirmation of a plan. Once interest accruals are discontinued, accrued but uncollected interest is charged to current year operations. Subsequent receipts on nonaccrual loans are recorded as a reduction of principal, and interest income is recorded only after principal recovery is reasonably assured. Classification of a loan as nonaccrual does not preclude the ultimate collection of loan principal or interest.

Troubled debt restructured loans are loans on which, due to deterioration in the borrower's financial condition, the original terms have been modified in favor of the borrower or either principal or interest has been forgiven.

**Part I (Continued)**

Item 2 (Continued)

Foreclosed assets represent property acquired as the result of borrower defaults on loans. Foreclosed assets are recorded at estimated fair value less estimated selling costs, at the time of foreclosure. Write-downs occurring at foreclosure are charged against the allowance for loan losses. On an ongoing basis, properties are appraised as required by market indications and applicable regulations. Write-downs are provided for subsequent declines in value and are included in other non-interest expense along with other expenses related to maintaining the properties.

**Allowance for Loan Losses**

The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The allowance for loan losses includes allowance allocations calculated in accordance with current U.S. accounting standards. The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Company's allowance for loan losses consists of specific valuation allowances established for probable losses on specific loans and historical valuation allowances for other loans with similar risk characteristics. The allowances established for probable losses on specific loans are the result of management's quarterly review of substandard loans with an outstanding balance of \$250,000 or more. This review process usually involves regional credit officers along with local lending officers reviewing the loans for impairment. Specific valuation allowances are determined after considering the borrower's financial condition, collateral deficiencies, and economic conditions affecting the borrower's industry, among other things. In the case of collateral dependent loans, collateral shortfall is most often based upon local market real estate value estimates. This review process is performed at the subsidiary bank level and is reviewed at the parent Company level.

Once the loan becomes impaired, it is removed from the pool of loans covered by the general reserve and reviewed individually for exposure as described above. In cases where the individual review reveals no exposure, no reserve is recorded for that loan, either through an individual reserve or through a general reserve. If, however, the individual

review of the loan does indicate some exposure, management often charges off this exposure, rather than recording a specific reserve. In these instances, a loan which becomes nonperforming could actually reduce the allowance for loan losses. Those loans deemed uncollectible are transferred to our problem loan department for workout, foreclosure and/or liquidation. The problem loan department obtains a current appraisal on the property in order to record the fair market value (less selling expenses) when the property is foreclosed on and moved into other real estate.

The allowances established for the remainder of the loan portfolio are based on historical loss factors, adjusted for certain qualitative factors, which are applied to groups of loans with similar risk characteristics. Loans are segregated into fifteen separate groups based on call codes. Most of the Company's charge-offs during the past two years have been real estate dependent loans. The historical loss ratios applied to these groups of loans are updated quarterly based on actual charge-off experience. The historical loss ratios are further adjusted by qualitative factors.

Management evaluates the adequacy of the allowance for each of these components on a quarterly basis. Peer comparisons, industry comparisons, and regulatory guidelines are also used in the determination of the general valuation allowance. Loans identified as losses by management, internal loan review, and/or bank examiners are charged off. Additional information about the Company's allowance for loan losses is provided in the Notes to the Consolidated Financial Statements for Allowance for Loan Losses.

**Part I (Continued)**

## Item 2 (Continued)

The following table sets forth the breakdown of the allowance for loan losses by loan category for the periods indicated. The allocation of the allowance to each category is subjective and is not necessarily indicative of future losses and does not restrict the use of the allowance to absorb losses in any other category.

	<b>September</b>			December		
	<b>30,</b>			31,		
	<b>2018</b>			2017		
	<b>Reserve %*</b>			Reserve %*		
<b>Commercial and Agricultural</b>						
Commercial	<b>\$384</b>	<b>6</b>	<b>%</b>	\$447	6	%
Agricultural	<b>315</b>	<b>3</b>	<b>%</b>	186	2	%
<b>Real Estate</b>						
Commercial Construction	<b>125</b>	<b>7</b>	<b>%</b>	1,216	6	%
Residential Construction	<b>17</b>	<b>2</b>	<b>%</b>	-	1	%
Commercial	<b>4,281</b>	<b>45</b>	<b>%</b>	3,874	46	%
Residential	<b>1,182</b>	<b>24</b>	<b>%</b>	968	25	%
Farmland	<b>730</b>	<b>9</b>	<b>%</b>	780	9	%
<b>Consumer and Other</b>						
Consumer	<b>93</b>	<b>2</b>	<b>%</b>	34	3	%
Other	<b>28</b>	<b>2</b>	<b>%</b>	3	2	%
	<b>\$7,155</b>	<b>100</b>	<b>%</b>	\$7,508	100	%

\*Percentage represents the loan balance in each category expressed as a percentage of total end of period loans.

**Part I (Continued)**

## Item 2 (Continued)

The following table presents an analysis of the Company's loan loss experience for the periods indicated.

	<b>Nine Months Ended September 30, 2018      2017</b>	
Allowance for Loan Losses at Beginning of Year	<b>\$7,508</b>	\$8,923
Charge-Offs		
Commercial	<b>118</b>	215
Agricultural	<b>123</b>	160
Commercial Construction	-	49
Residential Construction	-	-
Commercial	<b>258</b>	966
Residential	<b>124</b>	648
Farmland	-	61
Consumer	<b>214</b>	184
Other	-	-
	<b>\$837</b>	\$2,283
Recoveries		
Commercial	<b>114</b>	124
Agricultural	<b>7</b>	3
Commercial Construction	<b>39</b>	241
Residential Construction	-	-
Commercial	<b>39</b>	523
Residential	<b>83</b>	47
Farmland	<b>11</b>	2
Consumer	<b>59</b>	60
Other	<b>1</b>	2
	<b>353</b>	1,002
Net Charge-Offs	<b>484</b>	1,281
Provision for Loans Losses	<b>131</b>	335

Allowance for Loan Losses at End of Year	<b>\$7,155</b>	\$7,977
Ratio of Annualized Net Charge-Offs to Average Loans	<b>0.08 %</b>	0.22 %

**Part I (Continued)**

## Item 2 (Continued)

**Deposits**

The following table presents the average amount outstanding and the average rate paid on deposits by the Company for the three month periods ended September 30, 2018 and September 30, 2017.

	<b>September 30, 2018</b>		September 30, 2017	
	<b>Average Amount</b>	<b>Average Rate (1)</b>	Average Amount	Average Rate (1)
Noninterest-Bearing Demand Deposits	<b>\$170,437</b>		\$154,723	
Interest-Bearing Demand and Savings Deposits	<b>532,748</b>	<b>0.49</b> %	515,412	0.36 %
Time Deposits	<b>323,995</b>	<b>0.90</b> %	357,075	0.80 %
<b>Total Deposits</b>	<b>\$1,027,180</b>	<b>0.54</b> %	\$1,027,210	0.46 %

(1) Average rate is an annualized rate.

Average deposits decreased \$30 thousand to \$1.03 billion at September 30, 2018 from \$1.03 billion at September 30, 2017. The decrease was attributed to a decrease in time deposits of \$33.08 million, or 9.26 percent, while being offsetted by increases of noninterest-bearing demand deposits of \$15.71 million, or 10.16 percent, and interest-bearing demand and savings deposits of \$17.34 million, or 3.36 percent. Accordingly the ratio of average noninterest-bearing deposits to total average deposits was 16.59 percent for nine months ended September 30, 2018 compared to 15.06 percent for nine months ended September 30, 2017. The general increase in market rates, had the effect of increasing the average cost of total deposits by 8 basis points in nine months ended September 30, 2018 compared to the same period a year ago.



**Part I (Continued)**

## Item 2 (Continued)

**Off-Balance-Sheet Arrangements, Commitments, Guarantees, and Contractual Obligations**

The following table summarizes the Company's contractual obligations and other commitments to make future payments as of September 30, 2018. Payments for borrowings do not include interest. Payments related to leases are based on actual payments specified in the underlying contracts. Loan commitments and standby letters of credit are presented at contractual amounts; however, since many of these commitments are expected to expire unused or only partially used, the total amounts of these commitments do not necessarily reflect future cash requirements. The off-balance-sheet arrangements for loan commitments consist of approximately \$12 million in 1-4 residential home equity and construction loans, \$23 million in commercial real estate construction loans, \$19 million in commercial/industrial loans and \$47 million in the overdraft privilege program.

	<b>Payments Due by Period</b>				
	<b>Total</b>	<b>Less Than 1 Year</b>	<b>1 – 3 Years</b>	<b>3 – 5 Years</b>	<b>More Than 5 Years</b>
<b>Contractual Obligations:</b>					
Subordinated Debentures	\$24,229	\$-	\$-	\$-	\$24,229
Federal Home Loan Bank Advances	58,500	14,500	7,500	24,000	12,500
Operating Leases	175	43	42	90	-
Deposits with Stated Maturity Dates	317,025	207,262	89,495	20,132	136
	<b>399,929</b>	<b>221,805</b>	<b>97,037</b>	<b>44,222</b>	<b>36,865</b>
<b>Other Commitments:</b>					
Loan Commitments (1)	100,518	100,518	-	-	-
Standby Letters of Credit (1)	1,435	1,435	-	-	-
	<b>101,953</b>	<b>101,953</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total Contractual Obligations and Other Commitments</b>	<b>\$501,882</b>	<b>\$323,758</b>	<b>\$97,037</b>	<b>\$44,222</b>	<b>\$36,865</b>

(1) Additional information is included in Footnote 10 of the notes to consolidated financial statements.

In the ordinary course of business, the Company has entered into off-balance sheet financial instruments which are not reflected in the consolidated financial statements. These instruments include commitments to extend credit, standby letters of credit, performance letters of credit, guarantees and liability for assets held in trust.

Such financial instruments are recorded in the financial statements when funds are disbursed or the instruments become payable. The Company uses the same credit policies for these off-balance sheet financial instruments as they do for instruments that are recorded in the consolidated financial statements.

*Loan Commitments.* The Company enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the Company's commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. The Company minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for loan losses. Loan commitments outstanding at September 30, 2018 are included in the preceding table.

*Standby Letters of Credit.* Letters of credit are written conditional commitments issued by the Company to guarantee the performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, the Company would be entitled to seek recovery from the customer. The Company's policies generally require that standby letters of credit arrangements contain security and debt covenants similar to those contained in loan agreements. Standby letters of credit outstanding at September 30, 2018 are included in the preceding table.

**Part I (Continued)**

Item 2 (Continued)

**Capital and Liquidity**

At September 30, 2018, stockholders' equity totaled \$88.99 million compared to \$90.32 million at December 31, 2017. In addition to net income of \$8.95 million, other significant changes in stockholders' equity during nine months ended September 30, 2018 included \$1.27 million of dividends declared on common stock, \$3.17 million repurchase of warrants and the issuance of approximately \$6 thousand in shares of restricted stock. The accumulated other comprehensive income (loss) component of stockholders' equity totaled \$(12.34) million at September 30, 2018 compared to \$(6.49) million at December 31, 2017. This fluctuation was mostly related to the after-tax effect of changes in the fair value of securities available for sale.

On August 23, 2018, the Company granted 5,650 restricted shares of common stock to T. Heath Fountain, President and Chief Executive Officer, as part of his employment agreement. The restricted shares will vest over a three year period.

Regulatory agencies for banks and bank holding companies utilize capital guidelines designed to measure Tier 1 and total capital and take into consideration the risk inherent in both on-balance sheet and off-balance sheet items.

Tier 1 capital consists of common stock and qualifying preferred stockholders' equity and trust preferred securities less goodwill. Tier 2 capital consists of tier 1 capital and the allowance for loan losses up to 1.25 percent of risk-weighted assets. The Company has no Tier 2 capital other than the allowance for loan losses.

Using the capital requirements presently in effect, the Tier 1 ratio as of September 30, 2018 was 15.02 percent and total Tier 1 and 2 risk-based capital was 15.88 percent. Both of these measures compare favorably with the regulatory minimum to be adequately capitalized of 6 percent for Tier 1 and 8 percent for total risk-based capital. The Company's common equity Tier 1 ratio as of September 30, 2018 was 12.19, which exceeds the regulatory minimum of 4.50 percent. The Company's Tier 1 leverage ratio as of September 30, 2018 was 10.45 percent, which exceeds the required ratio standard of 4 percent.

As of September 30, 2018, average capital was \$89.30 million, representing 7.48 percent of average assets for the year. This compares to 7.58 percent for September 2017.

After suspending common stock dividend payments beginning in the third quarter of 2009 for capital retention purposes, the Company reinstated common stock dividends in the first quarter of 2017. The Company paid \$0.025 per share of common stock in each of the quarters of 2017. The Company paid \$0.05 per share of common stock in each of the first three quarters of 2018.

The Company declared dividends of \$211 thousand preferred stock on March 31, 2017. The Company redeemed the remaining \$9.36 million of preferred stock in the first quarter of 2017. The Company repurchased the Warrants in the second quarter of 2018 for \$3.17 million. Additional information is provided in the Notes to the Consolidated Financial Statements for Preferred Stock and Warrants.

The Company, primarily through the actions of the Bank, engages in liquidity management to ensure adequate cash flow for deposit withdrawals, credit commitments and repayments of borrowed funds. Needs are met through loan repayments, net interest and fee income and the sale or maturity of existing assets. In addition, liquidity is continuously provided through the acquisition of new deposits, the renewal of maturing deposits and external borrowings.

Management monitors deposit flow and evaluates alternate pricing structures to retain and grow deposits. To the extent needed to fund loan demand, traditional local deposit funding sources are supplemented by the use of FHLB borrowings, brokered deposits and other wholesale deposit sources outside the immediate market area. Internal policies have been updated to monitor the use of various core and non-core funding sources, and to balance ready access with risk and cost. Through various asset/liability management strategies, a balance is maintained among goals of liquidity, safety and earnings potential. Internal policies that are consistent with regulatory liquidity guidelines are monitored and enforced by the Bank.

The investment portfolio provides a ready means to raise cash if liquidity needs arise. As of September 30, 2018, the available for sale bond portfolio totaled \$318.0 million. At December 31, 2017, the available for sale bond portfolio totaled \$354.2 million. Only marketable investment grade bonds are purchased. Although a good portion of the banks' bond portfolios are encumbered as pledges to secure various public funds deposits, repurchase agreements, and for other purposes, management can restructure and free up investment securities for a sale if required to meet liquidity needs.

Management continually monitors the relationship of loans to deposits as it primarily determines the Company's liquidity posture. The Company had ratios of loans to deposits of 77.1 percent as of September 30, 2018 and 71.6 percent at December 31, 2017. Management employs alternative funding sources when deposit balances will not meet loan demands. The ratios of loans to all funding sources (excluding Subordinated Debentures) at September 30, 2018 and December 31, 2017 were 72.9 percent and 68.6 percent, respectively.



**Part I (Continued)**

Item 2 (Continued)

Management continues to emphasize programs to generate local core deposits as our Company's primary funding sources. The stability of the banks' core deposit base is an important factor in Colony's liquidity position. A heavy percentage of the deposit base is comprised of accounts of individuals and small businesses with comprehensive banking relationships and limited volatility. At September 30, 2018 and December 31, 2017, the Company had \$39.5 million and \$38.9 million in certificates of deposit of \$250,000 or more. These larger deposits represented 3.9 percent and 3.6 percent of respective total deposits. Management seeks to monitor and control the use of these larger certificates, which tend to be more volatile in nature, to ensure an adequate supply of funds as needed. Relative interest costs to attract local core relationships are compared to market rates of interest on various external deposit sources to help minimize the Company's overall cost of funds.

The Company supplemented deposit sources with brokered deposits. As of September 30, 2018, the Company had \$77.7 million, or 7.68 percent of total deposits, in CDARS. Additional information is provided in the Notes to the Consolidated Financial Statements regarding these brokered deposits. Additionally, the Company uses external deposit listing services to obtain out-of-market certificates of deposit at competitive interest rates when funding is needed. These deposits obtained from listing services are often referred to as wholesale or internet CDs. As of September 30, 2018, the Company had \$11.21 million, or 1.11 percent of total deposits, in internet certificates of deposit obtained through deposit listing services.

To plan for contingent sources of funding not satisfied by both local and out-of-market deposit balances, the Company and the Bank have established multiple borrowing sources to augment their funds management. The Company has borrowing capacity through membership of the Federal Home Loan Bank program. The Bank has also established overnight borrowing for Federal Funds purchased through various correspondent banks. Management believes the various funding sources discussed above are adequate to meet the Company's liquidity needs in the future without any material adverse impact on operating results.

Liquidity measures the ability to meet current and future cash flow needs as they become due. The liquidity of a financial institution reflects its ability to meet loan requests, to accommodate possible outflows in deposits and to take advantage of interest rate market opportunities. The ability of a financial institution to meet its current financial obligations is a function of balance sheet structure, the ability to liquidate assets, and the availability of alternative sources of funds. The Company seeks to ensure its funding needs are met by maintaining a level of liquid funds through asset/liability management.

Asset liquidity is provided by liquid assets which are readily marketable or pledgeable or which will mature in the near future. Liquid assets include cash, interest-bearing deposits in banks, securities available for sale, federal funds

sold and securities purchased under resale agreements.

Liability liquidity is provided by access to funding sources which include core deposits. Should the need arise, the Company also maintains relationships with the Federal Home Loan Bank, Federal Reserve Bank and three correspondent banks.

Since the Company is a bank holding company and does not conduct operations, its primary sources of liquidity are dividends up streamed from the Bank and borrowings from outside sources.

The liquidity position of the Company is continuously monitored and adjustments are made to the balance between sources and uses of funds as deemed appropriate. Management is not aware of any events that are reasonably likely to have a material adverse effect on the Company's liquidity, capital resources or operations. In addition, management is not aware of any regulatory recommendations regarding liquidity, which if implemented, would have a material adverse effect on the Company.

### **Impact of Inflation and Changing Prices**

The Company's financial statements included herein have been prepared in accordance with accounting principles generally accepted in the United States (GAAP). GAAP presently requires the Company to measure financial position and operating results primarily in terms of historic dollars. Changes in the relative value of money due to inflation or recession are generally not considered. The primary effect of inflation on the operations of the Company is reflected in increased operating costs, though given recent economic conditions, the Company has not experienced any material effects of inflation during the last three fiscal years. In management's opinion, changes in interest rates affect the financial condition of a financial institution to a far greater degree than changes in the inflation rate. While interest rates are greatly influenced by changes in the inflation rate, they do not necessarily change at the same rate or in the same magnitude as the inflation rate. Interest rates are highly sensitive to many factors that are beyond the control of the Company, including changes in the expected rate of inflation, the influence of general and local economic conditions and the monetary and fiscal policies of the United States government, its agencies and various other governmental regulatory authorities, among other things, as further discussed in the next section.

**Part I (Continued)**

Item 2 (Continued)

**Regulatory and Economic Policies**

The Company's business and earnings are affected by general and local economic conditions and by the monetary and fiscal policies of the United States government, its agencies and various other governmental regulatory authorities, among other things. The Federal Reserve Board regulates the supply of money in order to influence general economic conditions. Among the instruments of monetary policy available to the Federal Reserve Board are (i) conducting open market operations in United States government obligations, (ii) changing the discount rate on financial institution borrowings, (iii) imposing or changing reserve requirements against financial institution deposits, and (iv) restricting certain borrowings and imposing or changing reserve requirements against certain borrowings by financial institutions and their affiliates. These methods are used in varying degrees and combinations to affect directly the availability of bank loans and deposits, as well as the interest rates charged on loans and paid on deposits. For that reason alone, the policies of the Federal Reserve Board have a material effect on the earnings of the Company.

Governmental policies have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future; however, the Company cannot accurately predict the nature, timing or extent of any effect such policies may have on its future business and earnings.

**Recently Issued Accounting Pronouncements**

See Note 1 - Summary of Significant Accounting Policies under the section headed Changes in Accounting Principles and Effects of New Accounting Pronouncements included in the Notes to the Consolidated Financial Statements.

**Market Risk and Interest Rate Sensitivity**

Our financial performance is impacted by, among other factors, interest rate risk and credit risk. We do not utilize derivatives to mitigate our credit risk, relying instead on an extensive loan review process and our allowance for loan losses.



Interest rate risk is the change in value due to changes in interest rates. The Company is exposed only to U.S. dollar interest rate changes and, accordingly, the Company manages exposure by considering the possible changes in the net interest margin. The Company does not have any trading instruments nor does it classify any portion of its investment portfolio as held for trading. The Company does not engage in any hedging activity or utilize any derivatives. The Company has no exposure to foreign currency exchange rate risk, commodity price risk and other market risks. Interest rate risk is addressed by our Asset & Liability Management Committee (ALCO) which includes senior management representatives. The ALCO monitors interest rate risk by analyzing the potential impact to the net portfolio of equity value and net interest income from potential changes to interest rates and considers the impact of alternative strategies or changes in balance sheet structure.

Interest rates play a major part in the net interest income of financial institutions. The repricing of interest earnings assets and interest-bearing liabilities can influence the changes in net interest income. The timing of repriced assets and liabilities is Gap management and our Company has established its policy to maintain a Gap ratio in the one-year time horizon of .80 to 1.20.

Our exposure to interest rate risk is reviewed at least quarterly by our Board of Directors and the ALCO. Interest rate risk exposure is measured using interest rate sensitivity analysis to determine our change in net portfolio value in the event of assumed changes in interest rates. In order to reduce the exposure to interest rate fluctuations, we have implemented strategies to more closely match our balance sheet composition. The Company has engaged FTN Financial to run a quarterly asset/liability model for interest rate risk analysis. We are generally focusing our investment activities on securities with terms or average lives in the 3 ½ - 5 ½ year range.

Market risk reflects the risk of economic loss resulting from adverse changes in market prices and interest rates. This risk of loss can be reflected in either reduced current market values or reduced current and potential net income. Colony's most significant market risk is interest rate risk. This risk arises primarily from Colony's extension of loans and acceptance of deposits.

Managing interest rate risk is a primary goal of the asset liability management function. Colony attempts to achieve stability in net interest income while limiting volatility arising from changes in interest rates. Colony seeks to achieve this goal by balancing the maturity and repricing characteristics of assets and liabilities. Colony manages its exposure to fluctuations in interest rates through policies established by ALCO and approved by the Board of Directors. ALCO meets at least quarterly and has responsibility for developing asset liability management policies, reviewing the interest rate sensitivity of Colony, and developing and implementing strategies to improve balance sheet structure and interest rate risk positioning.

**Part I (Continued)**

## Item 2 (Continued)

Colony measures the sensitivity of net interest income to changes in market interest rates through the utilization of Asset/Liability simulation modeling. On at least a quarterly basis, the following twenty-four month time period is simulated to determine a baseline net interest income forecast and the sensitivity of this forecast to changes in interest rates. These simulations include all of Colony's earning assets and liabilities. Forecasted balance sheet changes, primarily reflecting loan and deposit growth and forecasts, are included in the periods modeled. Projected rates for loans and deposits are based on management's outlook and local market conditions.

The magnitude and velocity of rate changes among the various asset and liability groups exhibit different characteristics for each possible interest rate scenario; additionally, customer loan and deposit preferences can vary in response to changing interest rates. Simulation modeling enables Colony to capture the expected effect of these differences. Assumptions utilized in the model are updated on an ongoing basis and are reviewed and approved by the ALCO Committee of the Board of Directors.

Colony has modeled its baseline net interest income forecast assuming a flat interest rate environment with the federal funds rate at the Federal Reserve's current targeted range of 2.00% to 2.25% and the current prime rate of 5.25%. Colony has modeled the impact of a gradual increase in short-term rates of 100 and 200 basis points and a decline of 100 basis points to determine the sensitivity of net interest income for the next twelve months. As illustrated in the table below, the net interest income sensitivity model indicates that, compared with a net interest income forecast assuming stable rates, net interest income is projected to increase by 1.19% and increase by 1.97% if interest rates increased by 100 and 200 basis points, respectively. Net interest income is projected to decline by 2.06% if interest rates decreased by 100 basis points. These changes were within Colony's policy limit of a maximum 15% negative change.

**Twelve Month Net Interest Income Sensitivity**

Change in Short-term Interest Rates (in basis points)	Estimated Change in Net Interest Income	
	September 30,	December 31,
	2018	2017
+200	1.97%	0.27%
+100	1.19%	0.58%
Flat	-%	-%

-100

**-2.06%** -2.57%

The measured interest rate sensitivity indicates an asset sensitive position over the next year, which could serve to improve net interest income in a rising interest rate environment. The actual realized change in net interest income would depend on several factors, some of which could serve to reduce or eliminate the asset sensitivity noted above. These factors include a higher than projected level of deposit customer migration to higher cost deposits, such as certificates of deposit, which would increase total interest expense and serve to reduce the realized level of asset sensitivity. Another factor which could impact the realized interest rate sensitivity in a rising rate environment is the repricing behavior of interest bearing non-maturity deposits. Assumptions for repricing are expressed as a beta relative to the change in the prime rate. For instance, a 25% beta would correspond to a deposit rate that would increase 0.25% for every 1% increase in the prime rate. Projected betas for interest bearing non-maturity deposit repricing are a key component of determining the Company's interest rate risk position. Should realized betas be higher than projected betas, the expected benefit from higher interest rates would be reduced.

The net interest income simulation model is the primary tool utilized to evaluate potential interest rate risks over a shorter term time horizon. Colony also evaluates potential longer term interest rate risk through modeling and evaluation of economic value of equity (EVE). This EVE modeling allows Colony to capture longer-term repricing risk and options risk embedded in the balance sheet. Simulation modeling is utilized to measure the economic value of equity and its sensitivity to immediate changes in interest rates. These simulations value only the current balance sheet and do not incorporate growth assumptions used in the net interest income simulation. The economic value of equity is the net fair value of assets and liabilities derived from the present value of future cash flows discounted at current market interest rates. From this baseline valuation, Colony evaluates changes in the value of each of these items in various interest rate scenarios to determine the net impact on the economic value of equity. Key assumptions utilized in the model, namely loan prepayments, deposit pricing betas, and non-maturity deposit durations have a significant impact on the results of the EVE simulations.

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**Part I (Continued)**

## Item 2 (Continued)

As illustrated in the table below, the economic value of equity model indicates that, compared with a valuation assuming stable rates, EVE is projected to increase by 5.87% and 9.48%, assuming an immediate and sustained increase in interest rates of 100 and 200 basis points, respectively. The primary reason for the increase in asset sensitivity from the prior year is a more aggressive assumption regarding non-maturity deposit durations. Assuming an immediate 100 basis point decline in rates, EVE is projected to decrease by 8.32%. These changes were within Colony's policy except in the -100 basis point change, which limits the maximum negative change in EVE to 10% of the base EVE. We believe this projection outside of policy is mitigated by the unlikely reduction in interest rates due to the current rate environment.

**Economic Value of Equity Sensitivity**

Immediate Change in Interest Rates  (in basis points)	Estimated Change in EVE	
	September 30, 2018	December 31, 2017
+200a	9.48%	13.13%
+100a	5.87%	7.93%
-100a	-8.32%	-11.73%

Colony is also subject to market risk in certain of its fee income business lines. Financial management services revenues, which include trust, brokerage, and asset management fees, can be affected by risk in the securities markets, primarily the equity securities market. A significant portion of the fees in this unit are determined based upon a percentage of asset values. Weaker securities markets and lower equity values have an adverse impact on the fees generated by these operations. Trading account assets, maintained to facilitate brokerage customer activity, are also subject to market risk. This risk is not considered significant, as trading activities are limited and subject to risk policy limits. Mortgage banking income is also subject to market risk. Mortgage loan originations are sensitive to levels of mortgage interest rates and therefore, mortgage banking income could be negatively impacted during a period of rising interest rates. The extension of commitments to customers to fund mortgage loans also subjects Colony to market risk. This risk is primarily created by the time period between making the commitment and closing and delivering the loan. Colony seeks to minimize this exposure by utilizing various risk management tools, the primary of which are forward sales commitments and best efforts commitments.

**Part I (Continued)**

## Item 2 (Continued)

The following table is an analysis of the Company's interest rate-sensitivity position at September 30, 2018. The interest-bearing rate-sensitivity gap, which is the difference between interest-earning assets and interest-bearing liabilities by repricing period, is based upon maturity or first repricing opportunity, along with a cumulative interest rate-sensitivity gap. It is important to note that the table indicates a position at a specific point in time and may not be reflective of positions at other times during the year or in subsequent periods. Major changes in the gap position can be, and are, made promptly as market outlooks change.

	Assets and Liabilities Repricing Within					Total
	3 Months or Less	4 to 12 Months	1 Year	1 to 5 Years	Over 5 Years	
<b>INTEREST-EARNING ASSETS:</b>						
Interest-Bearing Deposits	\$21,764	\$-	\$21,764	\$-	\$-	\$21,764
Investment Securities	1,572	9,686	11,258	165,206	141,568	318,032
Loans, Net of Unearned Income	163,453	148,465	311,918	430,369	37,156	779,443
Other Interest- Earning Assets	3,594	-	3,594	-	-	3,594
<b>Total Interest-Earning Assets</b>	<b>\$190,383</b>	<b>\$158,151</b>	<b>\$348,534</b>	<b>\$595,575</b>	<b>\$178,724</b>	<b>\$1,122,833</b>
<b>INTEREST-BEARING LIABILITIES:</b>						
Interest-Bearing Demand Deposits (1)	438,241	-	438,241	-	-	438,241
Savings (1)	78,532	-	78,532	-	-	78,532
Time Deposits	58,466	148,795	207,261	109,628	136	317,025
Other Borrowings	14,500	21,000	35,500	23,000	-	58,500
Subordinated Debentures	24,229	-	24,229	-	-	24,229
<b>Total Interest-Bearing Liabilities</b>	<b>613,968</b>	<b>169,795</b>	<b>783,763</b>	<b>132,628</b>	<b>136</b>	<b>916,527</b>
<b>Interest Rate-Sensitivity Gap</b>	<b>(423,585)</b>	<b>(11,644 )</b>	<b>(435,229)</b>	<b>462,947</b>	<b>178,588</b>	<b>\$206,306</b>
<b>Cumulative Interest-Sensitivity Gap</b>	<b>\$(423,585)</b>	<b>\$(435,229)</b>	<b>\$(435,229)</b>	<b>\$27,718</b>	<b>\$206,306</b>	
<b>Interest Rate-Sensitivity Gap as a Percentage of Interest-Earning Assets</b>	<b>(37.72 )%</b>	<b>(1.04 )%</b>	<b>(38.76 )%</b>	<b>41.23 %</b>	<b>15.90 %</b>	
	<b>(37.72 )%</b>	<b>(38.76 )%</b>	<b>(38.76 )%</b>	<b>2.47 %</b>	<b>18.37 %</b>	

Cumulative Interest  
Rate-Sensitivity as a Percentage  
of Interest-Earning

(1) Interest-bearing Demand and Savings Accounts for repricing purposes are considered to reprice within 3 months or less.

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**Part I (Continued)**

## Item 2 (Continued)

The foregoing table indicates that we had a one year negative gap of \$435.2 million, or 38.76 percent of total interest-earning assets at September 30, 2018. In theory, this would indicate that at September 30, 2018, \$435.2 million more in liabilities than assets would reprice if there were a change in interest rates over the next 365 days. Thus, if interest rates were to decline, the gap would indicate a resulting increase in net interest margin. However, changes in the mix of interest-earning assets or supporting liabilities can either increase or decrease the net interest margin without affecting interest rate sensitivity. In addition, the interest rate spread between an asset and our supporting liability can vary significantly while the timing of repricing of both the assets and our supporting liability can remain the same, thus impacting net interest income. This characteristic is referred to as a basis risk and, generally, relates to the repricing characteristics of short-term funding sources such as certificates of deposits.

Gap analysis has certain limitations. Measuring the volume of repricing or maturing assets and liabilities does not always measure the full impact on the portfolio value of equity or net interest income. Gap analysis does not account for rate caps on products; dynamic changes such as increasing prepay speeds as interest rates decrease, basis risk, or the benefit of non-rate funding sources. The majority of our loan portfolio reprices quickly and completely following changes in market rates, while non-term deposit rates in general move slowly and usually incorporate only a fraction of the change in rates. Products categorized as non-rate sensitive, such as our noninterest-bearing demand deposits, in the gap analysis behave like long term fixed rate funding sources. Both of these factors tend to make our actual behavior more asset sensitive than is indicated in the gap analysis. In fact, we experience higher net interest income when rates rise, opposite what is indicated by the gap analysis. Therefore, management uses gap analysis, net interest margin analysis and market value of portfolio equity as our primary interest rate risk management tools. The Company has established its one year gap to be 80 percent to 120 percent. The most recent analysis as of September 30, 2018 indicates a one year gap of 1.17 percent. The analysis reflects slight net interest margin compression in both a declining and increasing interest rate environment. Given that interest rates have shown a gradual increase with the Federal Reserve's actions since 2015, the Company is anticipating interest rates to increase in the future though we believe that interest rates will increase modestly in 2018. The Company is focusing on areas to minimize margin compression in the future by minimizing longer term fixed rate loans, shortening on the yield curve with investments, securing longer term FHLB advances, securing certificates of deposit for longer terms and focusing on reduction of nonperforming assets.

The Company utilizes FTN Financial Asset/Liability Management Analysis for a more dynamic analysis of balance sheet structure. The Company has established policies for rate shock per basis point (bp) for earnings at risk for net interest income and for equity at risk. The following table shows the policy limits with the rate shock for earnings at risk and equity at risk September 30, 2018.

Immediate Shock	Immediate Shock
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	Rate Shock	Policy	(-) decrease bp	(+) increase bp
Net Interest Income –	+/- 100 bp	+/- 10%	-1.34%	0.42%
Earnings at Risk	+/- 200 bp	+/- 15%	-7.55	1.97
	+/- 300 bp	+/- 20%	-12.37	0.16
	+/- 400 bp	+/- 25%	-15.72	3.14
Equity at Risk	+/- 100 bp	+/- 10%	-8.32	5.87
	+/- 200 bp	+/- 20%	-20.96	9.48
	+/- 300 bp	+/- 30%	-36.47	11.32
	+/- 400 bp	+/- 40%	-39.86	12.24

### Return on Assets and Stockholders' Equity

The following table presents selected financial ratios for each of the periods indicated.

	Three Months Ended September 30 2018		2017		Nine Months Ended September 30 2018		2017	
Return on Average Assets (1)	<b>0.90</b>	%	0.88	%	<b>1.00</b>	%	0.78	%
Return on Average Total Equity (1)	<b>12.10</b>	%	11.57	%	<b>13.37</b>	%	10.23	%
Average Total Equity to Average Assets	<b>7.48</b>	%	7.58	%	<b>7.48</b>	%	7.58	%

(1) Computed using annualized net income available to common shareholders.



**Part I (Continued)**

Item 3

**ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The information required by Item 305 of Regulation S-K is contained in the Management’s Discussion and Analysis of Financial Condition and Results of Operations of this Quarterly Report on Form 10-Q under the heading “Market Risk and Interest Rate Sensitivity”, which information is incorporated herein by reference.

**ITEM 4 – CONTROLS AND PROCEDURES**

The Company’s Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of the Company’s “disclosure controls and procedures,” as such term is defined in Rule 13a-15(e) or 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Based upon their evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, the Company’s disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (the “SEC”) (1) is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and (2) is accumulated and communicated to the Company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. In addition, no change in the Company’s internal control over financial reporting occurred during the quarter ended September 30, 2018 that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

**Part II – OTHER INFORMATION**

**ITEM 1 – LEGAL PROCEEDINGS**

None

**ITEM 1A – RISK FACTORS**

There have been no material changes to the risk factors disclosed in Item 1A of Part I in our Annual Report on Form 10-K for the year ended December 31, 2017.

**ITEM 2 – UNREGISTERED SALE OF EQUITY SECURITIES AND USE OF PROCEEDS**

There were no shares of the Company's common stock sold during the three-month period ended September 30, 2018.

**ITEM 3 – DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 4 – MINE SAFETY DISCLOSURES**

Not applicable

**ITEM 5 – OTHER INFORMATION**

None

## **ITEM 6 – EXHIBITS**

### **3.1 Articles of Incorporation, As Amended**

-filed as Exhibit 99.1 to the Registrant's 10-Q for the period ended June 30, 2014 (File No. 0-12436), filed with the Commission on August 4, 2014 and incorporated herein by reference.

### **3.2 Bylaws, as Amended**

-filed as Exhibit 3(b) to the Registrant's Registration Statement on Form 10 (File No. 0-18486), filed with the Commission on April 25, 1990 and incorporated herein by reference.

### **3.3 Article of Amendment to the Company's Articles of Incorporation Authorizing Additional Capital Stock in the Form of Ten Million Shares of Preferred Stock**

-filed as Exhibit 3.1 to the Registrant's Current Report on Form 8-K (File No. 000-12436) filed with the Commission on January 13, 2009 and incorporated herein by reference.

### **3.4 Articles of Amendment to the Company's Articles of Incorporation Establishing the Terms of the Series A Preferred Stock**

-filed as Exhibit 3.2 to the Registrant's Current Report on Form 8-K (File No. 000-12436) filed with the Commission on January 13, 2009 and incorporated herein by reference.

### **3.5 Amendment to the Company's Bylaws**

-filed as Exhibit 99.1 to the Registrant's 8-K (File No.000-12436) , filed with the Commission on May 29, 2015 and incorporated herein by reference.

**4.1 Warrant to Purchase up to 500,000 shares of Common Stock**

-filed as Exhibit 4.1 to the Registrant's Current Report on Form 8-K (File No. 000-12436), filed with the Commission on January 13, 2009 and incorporated herein by reference.

**Part II (Continued)**

Item 6 (Continued)

**4.2 Form of Series A Preferred Stock Certificate**

-filed as Exhibit 4.2 to the Registrant's Current Report on Form 8-K (File No. 000-12436), filed with the Commission on January 13, 2009 and incorporated herein by reference.

**10.1 Deferred Compensation Plan and Sample Director Agreement**

-filed as Exhibit 10(a) to the Registrant's Registration Statement on Form 10 (File No. 0-18486), filed with the Commission on April 25, 1990 and incorporated herein by reference.

**10.2 Profit-Sharing Plan Dated January 1, 1979**

-filed as Exhibit 10(b) to the Registrant's Registration Statement on Form 10 (File No. 0-18486), filed with the Commission on April 25, 1990 and incorporated herein by reference.

**10.3 1999 Restricted Stock Grant Plan and Restricted Stock Grant Agreement**

-filed as Exhibit 10(c) the Registrant's Annual Report on Form 10-K (File No. 000-12436), filed with the Commission on March 30, 2001 and incorporated herein by reference.

**10.4 2004 Restricted Stock Grant Plan and Restricted Stock Grant Agreement**

- filed as Exhibit C to the Registrant's Definitive Proxy Statement for Annual Meeting of Shareholders held on April 27, 2004, filed with the Securities and Exchange Commission on March 3, 2004 (File No. 000-12436) and

incorporated herein by reference.

**10.5 Lease Agreement – Mobile Home Tracts, LLC c/o Stafford Properties, Inc. and Colony Bank Worth**

- filed as Exhibit 10.5 to the Registrant's Quarterly Report on Form 10Q (File No. 000-12436), filed with Securities and Exchange Commission on November 5, 2004 and incorporated herein by reference.

**10.6 Letter Agreement, Dated January 9, 2009, Including Securities Purchase Agreement – Standard Terms Incorporated by Reference Therein, Between the Company and the United States Department of the Treasury**

- filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 000-12436), filed with the Commission on January 13, 2009 and incorporated herein by reference.

**10.7 Form of Waiver, Executed by Al D. Ross**

- filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K (File No. 000-12436), filed with the Commission on January 13, 2009 and incorporated herein by reference.

**10.8 Form of Waiver, Executed by Terry L. Hester**

- filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K (File No. 000-12436), filed with the Commission on January 13, 2009 and incorporated herein by reference.

**10.9 Form of Waiver, Executed by Henry F. Brown, Jr.**

- filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K (File No. 000-12436), filed with the Commission on January 13, 2009 and incorporated herein by reference.

**10.10 Form of Waiver, Executed by Walter F. Patten**

- filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K (File No. 000-12436), filed with the Commission on January 13, 2009 and incorporated herein by reference.

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**Part II (Continued)**

Item 6 (Continued)

**10.11 Form of Waiver, Executed by Larry E. Stevenson**

- filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K (File No. 000-12436), filed with the Commission on January 13, 2009 and incorporated herein by reference.

**10.12 Employment Agreement, Dated April 27, 2012 Between Edward P. Loomis, Jr. and Colony Bankcorp, Inc.**

-filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 000-12436), filed with the Commission on May 2, 2012 and incorporated herein by reference.

**10.13 Restricted Stock Award Between T. Heath Fountain and Colony Bankcorp, Inc.**

-filed as Exhibit 10.1 to the Registrant's Registration Statement on Form S-8 (File No. 000-12436), filed with the Commission on August 23, 2018 and incorporated herein by reference.

**99.1 Retention Agreement**

-filed as Exhibit 99.1 to the Registrant's 10-Q for the period ended March 31, 2015 (File No. 000-12436), filed with the Commission on May 4, 2015 and incorporated herein by reference.

**99.2 Retention Agreement**



-filed as Exhibit 99.2 to the Registrant's 10-Q for the period ended June 30, 2016 (File No. 000-12436), filed with the Commission on May 31, 2016 and incorporated herein by reference.

**99.3 Retention Agreement**

-filed as Exhibit 99.3 to the Registrant's 10-Q for the period ended March 31, 2018 (File No. 000-12436), filed with the Commission on May 4, 2018 and incorporated herein by reference.

**99.4 Employment Agreement, Dated July 27, 2018 Between T. Heath Fountain and Colony Bankcorp, Inc.**

-filed as Exhibit 99.4 to the Registrant's 10-Q for the period ended September 30, 2018 (File No. 000-12436), filed with the Commission on November 2, 2018.

**31.1 Certificate of Chief Executive Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002**

**31.2 Certificate of Chief Financial Officer Pursuant to Section 302 of Sarbanes – Oxley Act of 2002**

**32.1 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

**101.INS XBRL Instance Document**

**101.SCH XBRL Schema Document**

**101.CAL XBRL Calculation Linkbase Document**

**101.DEF XBRL Definition Linkbase Document**

**101.LAB XBRL Label Linkbase Document**

**101.PRE XBRL Presentation Linkbase Document**

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**SIGNATURES**

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Colony Bankcorp, Inc.

Date: November 2, 2018 /s/ T. Heath Fountain  
T. Heath Fountain  
President/Director/Chief Executive Officer

Date: November 2, 2018 /s/ Terry L. Hester  
Terry L. Hester  
Executive Vice-President/Director/Chief Financial Officer