FIRST MID ILLINOIS BANCSHARES INC
Form 10-Q
November 06, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2017
Or
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____________ to ______________

Commission file number 0-13368

FIRST MID-ILLINOIS BANCSHARES, INC.
(Exact name of Registrant as specified in its charter)

Delaware	37-1103704
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)

1421 Charleston Avenue, Mattoon, Illinois	61938
(Address of principal executive offices)	(Zip code)

(217) 234-7454
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ]

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, non-accelerated filer, a 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. (Check one):

Large accelerated filer [ ]	Accelerated filer [X]
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 Act). [ ] Yes [X] No

As of November 6, 2017, 12,618,026 common shares, $4.00 par value, were outstanding.

1

PART I

ITEM 1. FINANCIAL STATEMENTS
First Mid-Illinois Bancshares, Inc.
Condensed Consolidated Balance Sheets

(In thousands, except share data)	(Unaudited) September 30, 2017	December 31, 2016
Assets		
Cash and due from banks:		
Non-interest bearing	$ 62,591	$ 57,988
Interest bearing	6,562	79,014
Federal funds sold	490	38,900
Cash and cash equivalents	69,643	175,902
Certificates of deposit investments	1,685	14,643
Investment securities:		
Available-for-sale, at fair value	621,204	619,848
Held-to-maturity, at amortized cost (estimated fair value of $69,137 and $73,096 at September 30, 2017 and December 31, 2016, respectively)	69,306	74,231
Loans held for sale	2,079	1,175
Loans	1,865,483	1,824,817
Less allowance for loan losses	(18,589)	(16,753)
Net loans	1,846,894	1,808,064
Interest receivable	10,876	10,553
Other real estate owned	2,229	1,982
Premises and equipment, net	38,638	40,292
Goodwill, net	60,150	57,791
Intangible assets, net	11,181	12,832
Bank owned life insurance	41,601	41,318
Other assets	18,970	25,904
Total assets	$ 2,794,456	$ 2,884,535
Liabilities and Stockholders' Equity		
Deposits:		
Non-interest bearing	$ 430,036	$ 471,206
Interest bearing	1,787,441	1,858,681
Total deposits	2,217,477	2,329,887
Securities sold under agreements to repurchase	116,360	185,763
Interest payable	552	535
FHLB borrowings	87,052	40,094
Other borrowings	31,250	18,063
Junior subordinated debentures	23,980	23,917
Other liabilities	6,354	5,603
Total liabilities	2,483,025	2,603,862
Stockholders' Equity:		
Common stock, $4 par value; authorized 18,000,000 shares; issued 13,167,769 and 13,020,742 shares in 2017 and 2016, respectively	54,671	54,083
Additional paid-in capital	163,067	158,671
Retained earnings	104,281	86,216

Deferred compensation	2,987	3,201
Accumulated other comprehensive income (loss)	1,999	(5,761)
Less treasury stock at cost, 549,743 shares in 2017 and 2016	(15,574)	(15,737)
Total stockholders’ equity	311,431	280,673
Total liabilities and stockholders’ equity	$ 2,794,456	$ 2,884,535

See accompanying notes to unaudited condensed consolidated financial statements.

First Mid-Illinois Bancshares, Inc.
Condensed Consolidated Statements of Income (unaudited)

(In thousands, except per share data)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Interest income:				
Interest and fees on loans	$20,385	$15,294	$61,337	$42,496
Interest on investment securities	4,179	3,229	12,585	9,622
Interest on certificates of deposit investments	9	78	41	234
Interest on federal funds sold	1	7	62	8
Interest on deposits with other financial institutions	40	15	217	125
Total interest income	24,614	18,623	74,242	52,485
Interest expense:				
Interest on deposits	1,028	623	2,840	1,777
Interest on securities sold under agreements to repurchase	51	23	137	62
Interest on FHLB borrowings	283	150	602	465
Interest on other borrowings	143	42	385	45
Interest on subordinated debentures	236	162	680	456
Total interest expense	1,741	1,000	4,644	2,805
Net interest income	22,873	17,623	69,598	49,680
Provision for loan losses	1,489	1,081	5,051	1,927
Net interest income after provision for loan losses	21,384	16,542	64,547	47,753
Other income:				
Trust revenues	925	774	2,696	2,549
Brokerage commissions	536	526	1,550	1,440
Insurance commissions	670	738	3,148	2,806
Service charges	1,758	1,824	5,160	4,977
Securities gains, net	254	466	589	1,130
Mortgage banking revenue, net	347	382	875	715
ATM / debit card revenue	1,595	1,457	4,828	4,418
Bank owned life insurance	792	201	1,355	384
Other	784	530	2,925	1,582
Total other income	7,661	6,898	23,126	20,001
Other expense:				
Salaries and employee benefits	9,648	7,844	29,685	23,293
Net occupancy and equipment expense	3,129	2,864	9,378	8,389
Net other real estate owned expense	385	32	530	23
FDIC insurance	210	294	679	841
Amortization of intangible assets	545	455	1,651	1,312
Stationery and supplies	168	221	539	612
Legal and professional	871	713	2,596	2,414
Marketing and donations	338	285	909	1,486
Other	2,618	2,612	9,102	6,264
Total other expense	17,912	15,320	55,069	44,634
Income before income taxes	11,133	8,120	32,604	23,120
Income taxes	3,538	2,812	10,545	8,077
Net income	7,595	5,308	22,059	15,043
Dividends on preferred shares	—	—	—	825

Net income available to common stockholders	$7,595	$5,308	$22,059	$14,218
Per share data:				
Basic net income per common share available to common stockholders	$0.61	$0.51	$1.76	$1.52
Diluted net income per common share available to common stockholders	$0.61	$0.51	$1.76	$1.50
Cash dividends declared per common share	$—	$0.16	$0.32	$0.46

See accompanying notes to unaudited condensed consolidated financial statements.

3

First Mid-Illinois Bancshares, Inc.
Condensed Consolidated Statements of Comprehensive Income (unaudited)

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Net income	$7,595	$5,308	$22,059	$15,043
Other Comprehensive Income				
Unrealized gains (losses) on available-for-sale securities, net of taxes of $327 and $(690) for three months ended September 30, 2017 and 2016, respectively and $(5,154) and $(3,698) for nine months ended September 30, 2017 and 2016, respectively.	(512)	1,082	8,068	5,792
Amortized holding losses on held-to-maturity securities transferred from available-for-sale, net of taxes of $(11) for three months ended September 30, 2017 and 2016, and $(32) and $(161) for nine months ended September 30, 2017 and 2016, respectively.	16	16	51	251
Less: reclassification adjustment for realized gains included in net income, net of taxes of $99 and $182 for three months ended September 30, 2017 and 2016, respectively and $230 and $440 for nine months ended September 30, 2017 and 2016, respectively.	(155)	(284)	(359)	(690)
Other comprehensive income (loss), net of taxes	(651)	814	7,760	5,353
Comprehensive income	$6,944	$6,122	$29,819	$20,396

See accompanying notes to unaudited condensed consolidated financial statements.

4

First Mid-Illinois Bancshares, Inc.

Condensed Consolidated Statements of Cash Flows (unaudited)	Nine months ended September 30,	
(In thousands)	2017	2016
Cash flows from operating activities:		
Net income	$22,059	$15,043
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	5,051	1,927
Depreciation, amortization and accretion, net	6,241	5,592
Change in cash surrender value of bank owned life insurance	(844)	(384)
Stock-based compensation expense	300	268
Gains on investment securities, net	(589)	(1,130)
Loss (gain) on sales of other real property owned, net	349	(5)
Donation of building	—	653
Loss on write down of fixed assets	337	26
Gains on sale of loans held for sale, net	(809)	(805)
Decrease in accrued interest receivable	(323)	(347)
Increase (decrease) in accrued interest payable	38	(36)
Origination of loans held for sale	(45,076)	(57,199)
Proceeds from sale of loans held for sale	44,981	55,388
Decrease (increase) in other assets	2,475	(2,713)
Decrease in other liabilities	(1,421)	(1,036)
Net cash provided by operating activities	32,769	15,242
Cash flows from investing activities:		
Proceeds from maturities of certificates of deposit investments	12,958	13,618
Purchases of certificates of deposit investments	—	(12,958)
Proceeds from sales of securities available-for-sale	96,184	68,726
Proceeds from maturities of securities available-for-sale	52,894	55,500
Proceeds from maturities of securities held-to-maturity	—	91,899
Purchases of securities available-for-sale	(134,807)	(84,102)
Purchases of securities held-to-maturity	—	(71,557)
Net increase in loans	(49,198)	(84,432)
Sale of premises and equipment	—	147
Purchases of premises and equipment	(1,304)	(449)
Proceeds from sales of other real property owned	5,356	488
Investment in bank owned life insurance	—	(25,000)
Cash received related to acquisition, net of cash and cash equivalents acquired	—	36,774
Net cash used in investing activities	(17,917)	(11,346)
Cash flows from financing activities:		
Net decrease in deposits	(112,410)	(3,996)
Increase in federal funds purchased	20,000	—
Decrease in repurchase agreements	(69,403)	(24,673)
Proceeds from FHLB advances	52,000	20,000
Repayment of FHLB advances	(5,000)	(5,000)
Proceeds from short-term debt	—	7,000
Proceeds from long-term debt	—	15,000
Repayment of other debt	(6,813)	—
Proceeds from issuance of common stock	4,195	97
Direct expenses related to capital transactions	(213)	(230)

Dividends paid on preferred stock	—	(1,286)
Dividends paid on common stock	(3,467)	(3,555)
Net cash (used in) provided by financing activities	(121,111)	3,357
(Decrease) increase in cash and cash equivalents	(106,259)	7,253
Cash and cash equivalents at beginning of period	175,902	115,784
Cash and cash equivalents at end of period	$69,643	$123,037

First Mid-Illinois Bancshares, Inc.

Condensed Consolidated Statements of Cash Flows (unaudited)	Nine months ended September 30,	
(In thousands)	2017	2016
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	$4,627	$2,568
Income taxes	7,969	9,335
Supplemental disclosures of noncash investing and financing activities		
Loans transferred to other real estate owned	5,317	115
Dividends reinvested in common stock	527	1,052
Net tax benefit related to option and deferred compensation plans	221	140
Supplemental disclosure of purchase of capital stock of First Clover Leaf		
Fair value of assets acquired		$668,905
Consideration paid:		
Cash paid		22,545
Common stock issued		65,926
Total consideration paid		88,471
Fair value of liabilities assumed		$580,434

See accompanying notes to unaudited condensed consolidated financial statements.

6

Notes to Condensed Consolidated Financial Statements
(unaudited)

Note 1 -- Basis of Accounting and Consolidation

The unaudited condensed consolidated financial statements include the accounts of First Mid-Illinois Bancshares, Inc. ("Company") and its wholly-owned subsidiaries: First Mid-Illinois Bank & Trust, N.A. ("First Mid Bank"), Mid-Illinois Data Services, Inc. ("MIDS") and The Checkley Agency, Inc. doing business as First Mid Insurance Group ("First Mid Insurance"). All significant intercompany balances and transactions have been eliminated in consolidation. The financial information reflects all adjustments which, in the opinion of management, are necessary for a fair presentation of the results of the interim periods ended September 30, 2017 and 2016, and all such adjustments are of a normal recurring nature. Certain amounts in the prior year's consolidated financial statements have been reclassified to conform to the September 30, 2017 presentation and there was no impact on net income or stockholders' equity. The results of the interim period ended September 30, 2017 are not necessarily indicative of the results expected for the year ending December 31, 2017. The Company operates as a one-segment entity for financial reporting purposes.

The 2016 year-end consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

The unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and do not include all of the information required by U.S. generally accepted accounting principles ("GAAP") for complete financial statements and related footnote disclosures although the Company believes that the disclosures made are adequate to make the information not misleading. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2016 Annual Report on Form 10-K.

Website

The Company maintains a website at www.firstmid.com. All periodic and current reports of the Company and amendments to these reports filed with the Securities and Exchange Commission ("SEC") can be accessed, free of charge, through this website as soon as reasonably practicable after these materials are filed with the SEC.

At-The-Market Program

On August 16, 2017, the Company entered into a Sales Agency Agreement, pursuant to which the Company may sell, from time to time, up to an aggregate of $20 million of it's common stock. Shares of common stock are offered pursuant to the Company's shelf registration statement filed within the SEC. During the three and nine months ended September 30, 2017, the company sold 95,310 shares of common stock at the weighted average price of approximately $35.06, representing gross proceeds of $3.34 million and net proceeds of $3.28 million. As of September 30, 2017, approximately $16.66 million of common stock remained available for issuance under the At The Market program.

Agreement and Plan of Merger

On April 26, 2016, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") with First Clover Leaf Financial Corp., a Maryland corporation ("First Clover Leaf"), pursuant to which, amongst other things, the Company agreed to acquire 100% of the issued and outstanding shares of First Clover Leaf pursuant to a business combination whereby First Clover Leaf would merge with and into the Company, with the Company as the surviving

entity (the "Merger").

On September 8, 2016, the effective time of the Merger, 25% of the shares of First Clover Leaf common stock issued and outstanding immediately prior to the effective time of the Merger converted into the right to receive $12.87 per share, for an approximate aggregate total of $22,545,000, and 75% of the shares of First Clover Leaf common stock issued and outstanding immediately prior to the effective time of the Merger converted into the right to receive 0.495 shares of the Company’s common stock, par value $4.00 per share, for an approximate aggregate total of 2,600,616 shares of the Company’s common stock. Cash in lieu of fractional shares of Company common stock were issued in connection with the Merger.

Bank Owned Life Insurance

First Mid Bank has purchased life insurance policies on certain senior management. Bank owned life insurance is 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 other amounts that are probable at settlement.

Stock Plans

At the Annual Meeting of Stockholders held April 26, 2017, the stockholders approved the First Mid-Illinois Bancshares, Inc. 2017 Stock Incentive Plan ("SI Plan"). The SI Plan was implemented to succeed the Company's 2007 Stock Incentive Plan, which had a ten-year term. The SI Plan is intended to provide a means whereby directors, employees, consultants and advisors of the Company and its subsidiaries may sustain a sense of proprietorship and personal involvement in the continued development and financial success of the Company and its subsidiaries, thereby advancing the interests of the Company and its stockholders. Accordingly, directors and selected employees, consultants and advisors may be provided the opportunity to acquire shares of common stock of the Company on the terms and conditions established in the SI Plan.

A maximum of 149,983 shares of common stock may be issued under the SI Plan. There have been no stock options awarded under any Company plan since 2008. The Company awarded 11,473 and 13,912 stock units during 2017 and 2016, respectively, under the 2007 Stock Incentive Plan.

Accumulated Other Comprehensive Income (Loss)

The components of accumulated other comprehensive income (loss) included in stockholders' equity as of September 30, 2017 and December 31, 2016 are as follows (in thousands):

	Unrealized Gain (Loss) on Securities	Securities with Other-Than-Temporary Impairment Losses	Total
September 30, 2017			
Net unrealized gains on securities available-for-sale	$ 3,817	$ —	$ 3,817
Unamortized losses on held-to-maturity securities transferred from available-for-sale	(310)	—	(310)
Securities with other-than-temporary impairment losses	—	(232)	(232)
Tax benefit (expense)	(1,366)	90	(1,276)
Balance at September 30, 2017	$ 2,141	$ (142)	$ 1,999
December 31, 2016			
Net unrealized losses on securities available-for-sale	$ (7,649)	$ —	$ (7,649)
Unamortized losses on held-to-maturity securities transferred from available-for-sale	(394)	—	(394)
Securities with other-than-temporary impairment losses	—	(1,398)	(1,398)
Tax benefit	3,135	545	3,680
Balance at December 31, 2016	$ (4,908)	$ (853)	$ (5,761)

8

Amounts reclassified from accumulated other comprehensive income and the affected line items in the statements of income during the nine months ended September 30, 2017 and 2016, were as follows (in thousands):

	Amounts Reclassified from Other Comprehensive Income				
	Three months ended September 30,		Nine months ended September 30,		Affected Line Item in the Statements of Income
	2017	2016	2017	2016	
Realized gains on available-for-sale securities	$254	$466	$589	$1,130	Securities gains, net (Total reclassified amount before tax)
	(99)	(182)	(230)	(440)	Income taxes
Total reclassifications out of accumulated other comprehensive income	$155	$284	$359	$690	Net reclassified amount

See “Note 3 – Investment Securities” for more detailed information regarding unrealized losses on available-for-sale securities.

Adoption of New Accounting Guidance

Accounting Standards Update 2017-09, Compensation-Stock Compensation (Topic 718): Scope of Modification ("ASU 2017-09"). In May 2017, FASB issued ASU 2017-09. This update provides guidance on determining which changes to the terms and conditions of share-based payment awards require the application of modification accounting under Topic 718. The guidance is effective for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted, including adoption in an interim period. The amendments should be applied on a prospective basis to an award modified on or after adoption date. ASU 2017-09 is not expected to have a significant impact on the Company's consolidated financial statement.

Accounting Standards Update 2017-08, Receivables-Nonrefundable Fees and Other Costs ("ASU 2017-08"). In March 2017, FASB issued ASU 2017-08. This update amends the amortization period for certain purchased callable debt securities held at a premium. The update shortens the premium's amortization period to the earliest call date to more closely align the amortization period of premiums to expectations incorporated in market pricing on the underlying securities. For public companies, the update is effective for annual periods beginning after December 15, 2018, and is to be applied on a modified retrospective basis with a cumulative-effect adjustment directly to retained earnings as of the beginning of the adoption period. Early adoption is permitted, including adoption in an interim period. The Company has adopted ASU 2017-08 early and there was not a significant impact on the Company's consolidated financial statements.

Accounting Standards Update 2017-04, Intangibles--Goodwill and Other (Topic 350: Simplifying the Test for Goodwill Impairment ("ASU 2017-04"). In January 2017, FASB issued ASU 2017-04. The amendments in this update simplify the measurement of goodwill by eliminating Step 2 from the goodwill impairment test. Under this guidance, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss should not exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 is effective for public companies for the reporting periods beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. Although the Company cannot anticipate future goodwill impairment, based on the most recent assessment, it is unlikely that an impairment amount would need to be calculated and, therefore, does not

anticipate a material impact on the Company's consolidated financial statements. The current accounting policies and procedures of the Company are not anticipated to change, except for the elimination of the Step 2 analysis.

Accounting Standards Update 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses of Financial Instruments (“ASU 2016-13”). In June 2016, FASB issued ASU 2016-13. The provisions of ASU 2016-13 requires an entity to utilize a new impairment model known as the current expected credit loss ("CECL") model to estimate its lifetime "expected credit loss" and record an allowance that, when deducted from the amortized cost basis of the financial asset, presents the net amount expected to be collected on the financial asset. The CECL model is expected to result in

more timely recognition of credit losses. ASU 2016-13 also requires new disclosures for financial assets measured at amortized cost, loans and available-for-sale debt securities. ASU 2016-13 is effective for annual periods beginning after December 15, 2019, including interim periods within those fiscal years. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. Management has formed an internal committee to evaluate implementation steps and assess the impact ASU 2016-13 will have on the Company’s consolidated financial statements.

Accounting Standards Update 2016-08, Revenue from Contracts with Customers (Topic 606) (“ASU 2016-08"). In March 2016, the FASB issued ASU 2016-08 which amended the accounting guidance issued by the FASB in May 2014 that revised the criteria for determining when to recognize revenue from contracts with customers and expanded disclosure requirements. The amendment defers the effective date by one year. This accounting guidance can be implemented using either a retrospective method or a cumulative-effect approach. This new guidance will be effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption is permitted but only for interim and annual reporting periods beginning after December 15, 2016. There are many aspects of the new accounting guidance that are still being interpreted, and the FASB has recently issued and proposed updates to certain aspects of the guidance. Management continues to evaluate the impact ASU 2016-08 will have on the Company’s consolidated financial statements.

Accounting Standards Update 2016-02, Leases (Topic 842) ("ASU 2016-02"). On February 25, 2016, FASB issued ASU 2016-02 which creates Topic 842, Leases and supersedes Topic 840, Leases. ASU 2016-02 is intended to improve financial reporting about leasing transactions, by increasing transparency and comparability among organizations. Under the new guidance, a lessee will be required to record all leases with lease terms of more than 12 months on their balance sheet as lease liabilities with a corresponding right-of-use asset. ASU 2016-02 maintains the dual model for lease accounting, requiring leases to be classified as either operating or finance, with lease classification determined in a manner similar to existing lease guidance. The new guidance will be effective for public companies for fiscal years beginning on or after December 15, 2018, and for private companies for fiscal years beginning on or after December 15, 2019. Early adoption is permitted for all entities. Management continues to evaluate the impact ASU 2016-02 will have on the Company's consolidated financial statements.

Accounting Standards Update 2016-01, Financial Instruments (Topic 825): Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"). In January 2016, FASB issued ASU 2016-01 which amends prior guidance to require an entity to measure its equity investments (except those accounted for under the equity method of accounting) to be measured at fair value with changes in fair value recognized in net income. An entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment of same issuer. The new guidance simplifies the impairment assessment of equity investments without readily determinable fair values, requires public entities to use the exit price notion when measuring fair value of financial instruments for disclosure purposes, requires an entity to present separately in other comprehensive income the portion of the total change in fair value of a liability resulting from changes in the instrument-specific credit risk when the entity has selected fair value option for financial instruments and requires separate presentation of financial assets and liabilities by measurement category and form of financial asset. The new guidance will be effective for reporting periods after January 1, 2018 and is not expected to have a significant impact on the Company's consolidated financial statements.

Accounting Standards Update 2014-09, Revenue from Contracts with Customers (Topic 606): ("ASU 2014-09"). In May 2014, FASB issued ASU 2014-09 which created a new topic in the FASB Accounting Standards Codification(R) ("ASC"), Topic 606. In addition to superseding and replacing nearly all existing U.S. GAAP revenue recognition guidance, including industry-specific guidance, ASU 2014-09 establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and

more detailed guidance on specific topics and expands and improves disclosures about revenue. In addition, ASU 2014-09 adds a new Subtopic to the ASC, Other Assets and Deferred Costs: Contracts with Customers ("ASC 340-40"), to provide guidance on costs related to obtaining a contract with a customer and costs incurred in fulfilling a contract with a customer that are not in the scope of another ASC Topic. The new guidance does not apply to certain contracts within the scope of other ASC Topics, such as lease contracts, insurance contracts, financing arrangements, financial instruments, guarantee other than product or service warranties, and non-monetary exchanges between entities in the same line of business to facilitate sales to customers. See ASU 2016-08, above, for the effective dates.

Note 2 -- Earnings Per Share

Basic net income per common share available to common stockholders is calculated as net income less preferred stock dividends divided by the weighted average number of common shares outstanding. Diluted net income per common share available to common stockholders is computed using the weighted average number of common shares outstanding, increased by the assumed conversion of the Company's convertible preferred stock and the Company's stock options, unless anti-dilutive.

The components of basic and diluted net income per common share available to common stockholders for the three and nine-month period ended September 30, 2017 and 2016 were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Basic Net Income per Common Share Available to Common Stockholders:				
Net income	$7,595,000	$5,308,000	$22,059,000	$15,043,000
Preferred stock dividends	—	—	—	(825,000)
Net income available to common stockholders	7,595,000	5,308,000	22,059,000	14,218,000
Weighted average common shares outstanding	12,528,674	10,497,072	12,498,913	9,372,547
Basic earnings per common share	$0.61	$0.51	$1.76	$1.52
Diluted Net Income per Common Share Available to Common Stockholders:				
Net income available to common stockholders	$7,595,000	$5,308,000	$22,059,000	$14,218,000
Effect of assumed preferred stock conversion	—	—	—	825,000
Net income applicable to diluted earnings per share	7,595,000	5,308,000	22,059,000	15,043,000
Weighted average common shares outstanding	12,528,674	10,497,072	12,498,913	9,372,547
Dilutive potential common shares:				
Assumed conversion of stock options	6,299	1,742	6,827	1,945
Restricted stock awarded	836	5,232	836	5,232
Assumed conversion of preferred stock	—	—	—	677,674
Dilutive potential common shares	7,135	6,974	7,663	684,851
Diluted weighted average common shares outstanding	12,535,809	10,504,046	12,506,576	10,057,398
Diluted earnings per common share	$0.61	$0.51	$1.76	$1.50

The following shares were not considered in computing diluted earnings per share for the three and nine-month periods ended September 30, 2017 and 2016 because they were anti-dilutive:

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Stock options to purchase shares of common stock	—	24,500	—	24,500

11

Note 3 -- Investment Securities

The amortized cost, gross unrealized gains and losses and estimated fair values for available-for-sale and held-to-maturity securities by major security type at September 30, 2017 and December 31, 2016 were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
September 30, 2017				
Available-for-sale:				
U.S. Treasury securities and obligations of U.S. government corporations & agencies	$126,931	$ 484	$(1,014)	$126,401
Obligations of states and political subdivisions	169,526	3,486	(486)	172,526
Mortgage-backed securities: GSE residential	314,195	2,223	(1,061)	315,357
Trust preferred securities	2,933	—	(232)	2,701
Other securities	4,034	185	—	4,219
Total available-for-sale	$617,619	$ 6,378	$(2,793)	$621,204
Held-to-maturity:				
U.S. Treasury securities and obligations of U.S. government corporations & agencies	$69,306	$ 328	$(497)	$69,137
December 31, 2016				
Available-for-sale:				
U.S. Treasury securities and obligations of U.S. government corporations & agencies	$138,819	$ 13	$(2,508)	$136,324
Obligations of states and political subdivisions	164,163	1,346	(2,804)	162,705
Mortgage-backed securities: GSE residential	318,829	531	(4,369)	314,991
Trust preferred securities	3,050	—	(1,398)	1,652
Other securities	4,034	147	(5)	4,176
Total available-for-sale	$628,895	$ 2,037	$(11,084)	$619,848
Held-to-maturity:				
U.S. Treasury securities and obligations of U.S. government corporations & agencies	$74,231	$ 203	$(1,338)	$73,096

Trust preferred securities represents one trust preferred pooled security issued by First Tennessee Financial ("FTN"). The unrealized loss of this security, which has a remaining maturity of twenty years, is primarily due to its long-term nature, a lack of demand or inactive market for the security, and concerns regarding the underlying financial institutions that have issued the trust preferred security. See the heading "Trust Preferred Securities" for further information regarding this security.

Realized gains and losses resulting from sales of securities were as follows during the nine months ended September 30, 2017 and 2016 (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Gross gains	$394	$446	$746	$1,130

Gross losses	(140)	—	(157)	—

The following table indicates the expected maturities of investment securities classified as available-for-sale presented at fair value, and held-to-maturity presented at amortized cost, at September 30, 2017 and the weighted average yield for each range of maturities (dollars in thousands):

	One year or less	After 1 through 5 years	After 5 through 10 years	After ten years	Total
Available-for-sale:					
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$75,846	$39,439	$11,116	$—	$126,401
Obligations of state and political subdivisions	19,153	81,336	70,371	1,666	172,526
Mortgage-backed securities: GSE residential	423	213,894	101,040	—	315,357
Trust preferred securities	—	—	—	2,701	2,701
Other securities	—	2,006	2,038	175	4,219
Total available-for-sale investments	$95,422	$336,675	$184,565	$4,542	$621,204
Weighted average yield	2.23 %	2.56 %	2.68 %	2.57 %	2.55 %
Full tax-equivalent yield	2.65 %	3.02 %	3.47 %	3.41 %	3.10 %
Held to Maturity:					
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$39,993	$29,313	$—	$—	$69,306
Weighted average yield	1.76 %	2.08 %	— %	— %	1.90 %
Full tax-equivalent yield	1.76 %	2.08 %	— %	— %	1.90 %

The weighted average yields are calculated on the basis of the amortized cost and effective yields weighted for the scheduled maturity of each security. Tax-equivalent yields have been calculated using a 35% tax rate. With the exception of obligations of the U.S. Treasury and other U.S. government agencies and corporations, there were no investment securities of any single issuer, the book value of which exceeded 10% of stockholders' equity at September 30, 2017.

Investment securities carried at approximately $463 million and $509 million at September 30, 2017 and December 31, 2016, respectively, were pledged to secure public deposits and repurchase agreements and for other purposes as permitted or required by law.

The following table presents the aging of gross unrealized losses and fair value by investment category as of September 30, 2017 and December 31, 2016 (in thousands):

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2017						
Available-for-sale:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$73,135	$(1,009)	$1,003	$(5)	$74,138	$(1,014)
Obligations of states and political subdivisions	25,250	(274)	9,339	(212)	34,589	(486)
Mortgage-backed securities: GSE residential	86,744	(810)	9,084	(251)	95,828	(1,061)
Trust preferred securities	—	—	2,701	(232)	2,701	(232)
Other securities	—	—	—	—	—	—
Total	$185,129	$(2,093)	$22,127	$(700)	$207,256	$(2,793)
Held-to-maturity:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$29,336	$(229)	$14,725	$(268)	$44,061	$(497)
December 31, 2016						
Available-for-sale:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$125,257	$(2,508)	$—	$—	$125,257	$(2,508)
Obligations of states and political subdivisions	93,405	(2,804)	—	—	93,405	(2,804)
Mortgage-backed securities: GSE residential	266,319	(4,099)	5,878	(270)	272,197	(4,369)
Trust preferred securities	—	—	1,652	(1,398)	1,652	(1,398)
Other securities	—	—	1,995	(5)	1,995	(5)
Total	$484,981	$(9,411)	$9,525	$(1,673)	$494,506	$(11,084)
Held-to-maturity:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$53,295	$(1,338)	$—	$—	$53,295	$(1,338)

U.S. Treasury Securities and Obligations of U.S. Government Corporations and Agencies. At September 30, 2017 there was one available-for sale U.S. Treasury securities and obligations of U.S. government corporations and agencies with a fair value of $1,003,000 and unrealized losses of $5,000 in a continuous unrealized loss position for twelve months or more. At December 31, 2016 , there were no available-for sale U.S. Treasury securities and obligations of U.S. government corporations and agencies in a continuous unrealized loss position for twelve months or more. At September 30, 2017 there were three held-to-maturity U.S. Treasury securities and obligations of U.S. government corporations and agencies with a fair value of $14,725,000 and unrealized losses of $268,000 in a continuous unrealized loss position for twelve months or more. At December 31, 2016 there were also no held-to-maturity U.S. Treasury securities and obligations of U.S. government corporations and agencies in a continuous unrealized loss position for twelve months or more.

Obligations of states and political subdivisions. At September 30, 2017 there were twenty-two obligations of states and political subdivisions with a fair value of $9,339,000 and unrealized losses of $212,000 in a continuous loss position for twelve months or more. At December 31, 2016, there were no obligations of states and political subdivisions in a continuous unrealized loss position for twelve months or more.

Mortgage-backed Securities: GSE Residential. At September 30, 2017 there were five mortgage-backed securities with a fair value of $9,084,000 and unrealized losses of $251,000 in a continuous unrealized loss position for twelve months or more. At December 31, 2016, there were two mortgage-backed securities with a fair value of $5,878,000

and unrealized losses of $270,000 in a continuous unrealized loss position for twelve months or more.

Trust Preferred Securities. At September 30, 2017, there was one trust preferred security with a fair value of $2,701,000 and unrealized loss of $232,000 in a continuous unrealized loss position for twelve months or more. At December 31, 2016, there was one trust preferred security with a fair value of $1,652,000 and unrealized loss of $1,398,000 in a continuous unrealized loss position for twelve months or more. The unrealized loss was primarily due to the long-term nature of the trust preferred security, a lack of demand or inactive market for the security, the impending change to the regulatory treatment of these securities, and concerns regarding the underlying financial institutions that have issued the trust preferred securities.

The Company recorded no other-than-temporary impairment (OTTI) for these securities during 2017 or 2016. Because it is not more-likely-than-not that the Company will be required to sell the remaining security before recovery of its new, lower amortized cost basis, which may be maturity, the Company does not consider the remainder of the investment to be other-than-temporarily impaired at September 30, 2017. However, future downgrades or additional deferrals and defaults in this security, could result in additional OTTI and consequently, have a material impact on future earnings.

Following are the details for the currently impaired trust preferred security (in thousands):

	Book Value	Fair Value	Unrealized Gains (Losses)	Other-than-temporary Impairment Recorded To-date
PreTSL XXVIII	$2,933	$2,701	$ (232)	$ (1,111)

Other securities. At September 30, 2017 there were no other securities in a continuous unrealized loss position for twelve months or more. At December 31, 2016, there was one other security with a fair value of $1,995,000 and unrealized losses of $5,000 in a continuous unrealized loss position for twelve months or more.

The Company does not believe any other individual unrealized loss as of September 30, 2017 represents OTTI. However, given the continued disruption in the financial markets, the Company may be required to recognize OTTI losses in future periods with respect to its available for sale investment securities portfolio. The amount and timing of any additional OTTI will depend on the decline in the underlying cash flows of the securities. Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss recognized in the period the other-than-temporary impairment is identified.

Other-than-temporary Impairment. Upon acquisition of a security, the Company determines whether it is within the scope of the accounting guidance for investments in debt and equity securities or whether it must be evaluated for impairment under the accounting guidance for beneficial interests in securitized financial assets.

The Company conducts periodic reviews to evaluate its investment securities to determine whether OTTI has occurred. While all securities are considered, the securities primarily impacted by OTTI evaluation are pooled trust preferred securities. For the pooled trust preferred security currently in the investment portfolio, an extensive review is conducted to determine if any additional OTTI has occurred. The Company utilizes an independent third-party to perform the OTTI evaluation. The Company's management reviews the assumption inputs and methodology with the third-party to obtain an understanding of them and determine if they are appropriate for the evaluation. Economic models are used to project future cash flows for the security based on current assumptions for discount rate, prepayments, default and deferral rates and recoveries. These assumptions are determined based on the structure of the issuance, the specific collateral underlying the security, historical performance of trust preferred securities and general state of the economy. The OTTI test compares the present value of the cash flows from quarter to quarter to determine

if there has been an adverse change which could indicate additional OTTI.

The discount rate assumption used in the cash flow model is equal to the current yield used to accrete the beneficial interest. The Company's current trust preferred security investment has a floating rate coupon of 3-month LIBOR plus 90 basis points. Since the estimate of 3-month LIBOR is based on the forward curve on the measurement date, and is therefore variable, the discount assumption for this security is a range of projected coupons over the expected life of the security.

The Company considers the likelihood that issuers will prepay their securities which changes the amount of expected cash flows. Factors such as the coupon rates of collateral, economic conditions and regulatory changes, such as the Dodd-Frank Act and Basel III, are considered.

The trust preferred security includes collateral issued by financial institutions and insurance companies. To identify bank issuers with a high risk of near term default or deferral, a credit model developed by the third-party is utilized that scores each bank issuer based on 29 different ratios covering capital adequacy, asset quality, earnings, liquidity, the Texas Ratio, and sensitivity to interest rates. To account for longer term bank default risk not captured by the credit model, it is assumed that banks will default at a rate of 2% annually for the first two years of the cash flow projection, and 36 basis points in each year thereafter. To project defaults for insurance issuers, each issuer's credit rating is mapped to its idealized default rate, which is AM Best's estimate of the historical default rate for insurance companies with that rating.

Lastly, it is assumed that trust preferred securities issued by banks that have already failed will have no recoveries, and that banks projected to default will have recoveries of 10%. Additionally, the 10% recovery assumption, incorporates the potential for cures by banks that are currently in deferral.

If the Company determines that a given pooled trust preferred security position will be subject to a write-down or loss, the Company records the expected credit loss as a charge to earnings.

Credit Losses Recognized on Investments. As described above, the Company's investment in trust preferred security has experienced fair value deterioration due to credit losses but is not otherwise other-than-temporarily impaired. The following table provides information about the trust preferred security for which only a credit loss was recognized in income and other losses are recorded in other comprehensive income (loss) for the nine months ended September 30, 2017 and 2016 (in thousands).

	Accumulated Credit Losses	
	September 30, 2017	September 30, 2016
Credit losses on trust preferred securities held		
Beginning of period	$1,111	$ 1,111
Additions related to OTTI losses not previously recognized	—	—
Reductions due to sales / (recoveries)	—	—
Reductions due to change in intent or likelihood of sale	—	—
Additions related to increases in previously recognized OTTI losses	—	—
Reductions due to increases in expected cash flows	—	—
End of period	$1,111	$ 1,111

16

Note 4 – Loans and Allowance for Loan Losses

Loans are stated at the principal amount outstanding net of unearned discounts, unearned income and allowance for loan losses. Unearned income includes deferred loan origination fees reduced by loan origination costs and is amortized to interest income over the life of the related loan using methods that approximated the effective interest rate method. Interest on substantially all loans is credited to income based on the principal amount outstanding. A summary of loans at September 30, 2017 and December 31, 2016 follows (in thousands):

	September 30, 2017	December 31, 2016
Construction and land development	$ 77,325	$ 49,366
Agricultural real estate	126,164	126,216
1-4 Family residential properties	302,889	328,119
Multifamily residential properties	72,491	83,478
Commercial real estate	650,059	633,694
Loans secured by real estate	1,228,928	1,220,873
Agricultural loans	81,367	86,735
Commercial and industrial loans	444,836	412,637
Consumer loans	30,394	38,404
All other loans	89,117	77,602
Total Gross loans	1,874,642	1,836,251
Less: Loans held for sale	2,079	1,175
	1,872,563	1,835,076
Less:		
Net deferred loan fees, premiums and discounts	7,080	10,259
Allowance for loan losses	18,589	16,753
Net loans	$ 1,846,894	$ 1,808,064

Net loans increased $38.8 million as of September 30, 2017 compared to December 31, 2016. The increase was primarily due to increases in construction and land development and commercial and industrial loans offset by decreases in 1-4 family and multifamily residential properties. Loans expected to be sold are classified as held for sale in the consolidated financial statements and are recorded at the lower of aggregate cost or market value, taking into consideration future commitments to sell the loans. These loans are primarily for 1-4 family residential properties.

Most of the Company’s business activities are with customers located near the Company's branch locations in Illinois and Missouri. At September 30, 2017, the Company’s loan portfolio included $207.5 million of loans to borrowers whose businesses are directly related to agriculture. Of this amount, $166.4 million was concentrated in other grain farming. Total loans to borrowers whose businesses are directly related to agriculture decreased $5.5 million from $213.0 million at December 31, 2016 due to seasonal paydowns based upon timing of cash flow requirements. Loans concentrated in other grain farming decreased $4.9 million from $171.3 million at December 31, 2016. While the Company adheres to sound underwriting practices, including collateralization of loans, any extended period of low commodity prices, drought conditions, significantly reduced yields on crops and/or reduced levels of government assistance to the agricultural industry could result in an increase in the level of problem agriculture loans and potentially result in loan losses within the agricultural portfolio.

In addition, the Company has $120.3 million of loans to motels and hotels. The performance of these loans is dependent on borrower specific issues as well as the general level of business and personal travel within the region. While the Company adheres to sound underwriting standards, a prolonged period of reduced business or personal travel could result in an increase in nonperforming loans to this business segment and potentially in loan losses. The Company also has $168.3 million of loans to lessors of non-residential buildings, $129.4 million of loans

to lessors of residential buildings and dwellings, and $81.4 million of loans to other gambling industries.

The structure of the Company’s loan approval process is based on progressively larger lending authorities granted to individual loan officers, loan committees, and ultimately the board of directors. Outstanding balances to one borrower or affiliated borrowers are limited by federal regulation and the vast majority of borrowers are below regulatory thresholds. The Company can occasionally have outstanding balances to one borrower up to but not exceeding the regulatory threshold should
underwriting guidelines warrant. The vast majority of the Company’s loans are to businesses located in the geographic market areas served by the Company’s branch bank system. Additionally, a significant portion of the collateral securing the loans in the portfolio is located within the Company’s primary geographic footprint. In general, the Company adheres to loan underwriting standards consistent with industry guidelines for all loan segments.

The Company’s lending can be summarized into the following primary areas:

Commercial Real Estate Loans. Commercial real estate loans are generally comprised of loans to small business entities to purchase or expand structures in which the business operations are housed, loans to owners of real estate who lease space to non-related commercial entities, loans for construction and land development, loans to hotel operators, and loans to owners of multi-family residential structures, such as apartment buildings. Commercial real estate loans are underwritten based on historical and projected cash flows of the borrower and secondarily on the underlying real estate pledged as collateral on the debt. For the various types of commercial real estate loans, minimum criteria have been established within the Company’s loan policy regarding debt service coverage while maximum limits on loan-to-value and amortization periods have been defined. Maximum loan-to-value ratios range from 65% to 80% depending upon the type of real estate collateral, while the desired minimum debt coverage ratio is 1.20x. Amortization periods for commercial real estate loans are generally limited to twenty years. The Company’s commercial real estate portfolio is well below the thresholds that would designate a concentration in commercial real estate lending, as established by the federal banking regulators.

Commercial and Industrial Loans. Commercial and industrial loans are primarily comprised of working capital loans used to purchase inventory and fund accounts receivable that are secured by business assets other than real estate. These loans are generally written for one year or less. Also, equipment financing is provided to businesses with these loans generally limited to 80% of the value of the collateral and amortization periods limited to seven years. Commercial loans are often accompanied by a personal guaranty of the principal owners of a business. Like commercial real estate loans, the underlying cash flow of the business is the primary consideration in the underwriting process. The financial condition of commercial borrowers is monitored at least annually with the type of financial information required determined by the size of the relationship. Measures employed by the Company for businesses with higher risk profiles include the use of government-assisted lending programs through the Small Business Administration and U.S. Department of Agriculture.

Agricultural and Agricultural Real Estate Loans. Agricultural loans are generally comprised of seasonal operating lines to cash grain farmers to plant and harvest corn and soybeans and term loans to fund the purchase of equipment. Agricultural real estate loans are primarily comprised of loans for the purchase of farmland. Specific underwriting standards have been established for agricultural-related loans including the establishment of projections for each operating year based on industry developed estimates of farm input costs and expected commodity yields and prices. Operating lines are typically written for one year and secured by the crop. Loan-to-value ratios on loans secured by farmland generally do not exceed 65% and have amortization periods limited to twenty five years. Federal government-assistance lending programs through the Farm Service Agency are used to mitigate the level of credit risk when deemed appropriate.

Residential Real Estate Loans. Residential real estate loans generally include loans for the purchase or refinance of residential real estate properties consisting of one-to-four units and home equity loans and lines of credit. The Company sells the vast majority of its long-term fixed rate residential real estate loans to secondary market

investors. The Company also releases the servicing of these loans upon sale. The Company retains all residential real estate loans with balloon payment features. Balloon periods are limited to five years. Residential real estate loans are typically underwritten to conform to industry standards including criteria for maximum debt-to-income and loan-to-value ratios as well as minimum credit scores. Loans secured by first liens on residential real estate held in the portfolio typically do not exceed 80% of the value of the collateral and have amortization periods of twenty five years or less. The Company does not originate subprime mortgage loans.

Consumer Loans. Consumer loans are primarily comprised of loans to individuals for personal and household purposes such as the purchase of an automobile or other living expenses. Minimum underwriting criteria have been established that consider credit score, debt-to-income ratio, employment history, and collateral coverage. Typically, consumer loans are set up on monthly payments with amortization periods based on the type and age of the collateral.

Other Loans. Other loans consist primarily of loans to municipalities to support community projects such as infrastructure improvements or equipment purchases. Underwriting guidelines for these loans are consistent with those established for commercial loans with the additional repayment source of the taxing authority of the municipality.

Purchase Credit-Impaired Loans. Loans acquired with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered to be credit impaired. Evidence of credit quality deterioration as of the purchase date may include information such as past-due and nonaccrual status, borrower credit scores and recent loan to value percentages. Purchase credit-impaired ("PCI") loans are accounted for under ASC 310-30, Receivables--Loans and Debt Securities Acquired with Deteriorated Credit Quality ("ASC 310-30"), and are initially measured at fair value, which includes the estimated future credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for credit losses related to these loans is not carried over and recorded at the acquisition date. The cash flows expected to be collected were estimated using current key assumptions, such as default rates, value of underlying collateral, severity and prepayment speeds.

Allowance for Loan Losses

The allowance for loan losses represents the Company’s best estimate of the reserve necessary to adequately account for probable losses existing in the current portfolio. The provision for loan losses is the charge against current earnings that is determined by the Company as the amount needed to maintain an adequate allowance for loan losses. In determining the adequacy of the allowance for loan losses, and therefore the provision to be charged to current earnings, the Company relies predominantly on a disciplined credit review and approval process that extends to the full range of the Company’s credit exposure. The review process is directed by the overall lending policy and is intended to identify, at the earliest possible stage, borrowers who might be facing financial difficulty. Factors considered by the Company in evaluating the overall adequacy of the allowance include historical net loan losses, the level and composition of nonaccrual, past due and troubled debt restructurings, trends in volumes and terms of loans, effects of changes in risk selection and underwriting standards or lending practices, lending staff changes, concentrations of credit, industry conditions and the current economic conditions in the region where the Company operates. The Company estimates the appropriate level of allowance for loan losses by separately evaluating large impaired loans and nonimpaired loans.

The Company has loans acquired from business combinations with uncollected principal balances. These loans are carried net of a fair value adjustment for credit risk and interest rates and are only included in the allowance calculation to the extent that the reserve requirement exceeds the fair value adjustment. However, as the acquired loans renew, it is necessary to establish an allowance which represents an amount that, in management’s opinion, will be adequate to absorb probable credit losses inherent in such loans.

Impaired loans
The Company individually evaluates certain loans for impairment. In general, these loans have been internally identified via the Company’s loan grading system as credits requiring management’s attention due to underlying problems in the borrower’s business or collateral concerns. This evaluation considers expected future cash flows, the value of collateral and also other factors that may impact the borrower’s ability to make payments when due. For loans greater than $250,000, impairment is individually measured each quarter using one of three alternatives: (1) the present value of expected future cash flows discounted at the loan’s effective interest rate; (2) the loan’s observable market price, if available; or (3) the fair value of the collateral less costs to sell for collateral dependent loans and loans for which foreclosure is deemed to be probable. A specific allowance is assigned when expected cash flows or collateral do not justify the carrying amount of the loan. The carrying value of the loan reflects reductions from prior charge-offs.

Non-Impaired loans

Non-impaired loans comprise the vast majority of the Company's total loan portfolio and include loans in accrual status and those credits not identified as troubled debt restructurings. A small portion of these loans are considered "criticized" due to the risk rating assigned reflecting elevated credit risk due to characteristics, such as a strained cash flow position, associated with the individual borrowers. Criticized loans are those assigned risk ratings of Special Mention, Substandard, or Doubtful. Determining the appropriate level of the allowance for loan losses for all non-impaired loans is based on a migration analysis of net losses over a rolling twelve quarter period by loan segment. A weighted average of the net losses is determined by assigning more weight to the most recent quarters in order to recognize current risk factors influencing the various segments of the loan portfolio more prominently than past periods. Environmental factors including changes in economic conditions, changes in

credit policies or underwriting standards, and changes in the level of credit risk associated with specific industries and markets are evaluated each quarter to determine if adjustments to the weighted average historical net losses is appropriate given these current influences on the risk profile of each loan segment. Because the economic and business climate in any given industry or market, and its impact on any given borrower, can change rapidly, the risk profile of the loan portfolio is periodically assessed and adjusted when appropriate. Consumer loans are evaluated for adverse classification based primarily on the Uniform Retail Credit Classification and Account Management Policy established by the federal banking regulators. Classification standards are generally based on delinquency status, collateral coverage, bankruptcy and the presence of fraud.

Due to weakened economic conditions during prior years, the Company established qualitative factor adjustments for each of the loan segments at levels above the historical net loss averages. Some of the economic factors included the potential for reduced cash flow for commercial operating loans from reduction in sales or increased operating costs, decreased occupancy rates for commercial buildings, reduced levels of home sales for commercial land developments, the uncertainty regarding grain prices and increased operating costs for farmers, and increased levels of unemployment and bankruptcy impacting consumer’s ability to pay. Each of these economic uncertainties was taken into consideration in developing the level of the allowance for loan losses.

The Company has not materially changed any aspect of its overall approach in the determination of the allowance for loan losses. However, on an on-going basis the Company continues to refine the methods used in determining management’s best estimate of the allowance for loan losses.

The following tables present the balance in the allowance for loan losses and the recorded investment in loans based on portfolio segment and impairment method for the three and nine-months ended September 30, 2017 and 2016 and for the year ended December 31, 2016 (in thousands):

	Commercial/ Commercial Real Estate	Agricultural/ Agricultural Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Three months ended September 30, 2017						
Allowance for loan losses:						
Balance, beginning of period	$ 14,747	$ 1,743	$ 969	$ 716	$ 34	$18,209
Provision charged to expense	1,440	(57)	(2)	72	36	1,489
Losses charged off	(1,242)	—	(7)	(160)	—	(1,409)
Recoveries	158	1	78	63	—	300
Balance, end of period	$ 15,103	$ 1,687	$ 1,038	$ 691	$ 70	$18,589
Ending balance:						
Individually evaluated for impairment	$ 168	$ —	$ 125	$ 2	$ —	$295
Collectively evaluated for impairment	$ 14,935	$ 1,687	$ 913	$ 689	$ 70	$18,294
Acquired with deteriorated credit quality	$ —	$ —	$ —	$ —	$ —	$—

	Commercial/ Commercial Real Estate	Agricultural/ Agricultural Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Three months ended September 30, 2016						
Allowance for loan losses:						
Balance, beginning of period	$ 12,025	$ 1,419	$ 924	$ 733	$ 63	$15,164
Provision charged to expense	445	476	(36)	248	(52)	1,081
Losses charged off	—	—	—	(271)	—	(271)
Recoveries	128	2	1	56	—	187
Balance, end of period	$ 12,598	$ 1,897	$ 889	$ 766	$ 11	$16,161
Ending balance:						
Individually evaluated for impairment	$ 272	$ 329	$ —	$ —	$ —	$601
Collectively evaluated for impairment	$ 12,326	$ 1,568	$ 889	$ 766	$ 11	$15,560
Acquired with deteriorated credit quality	$ —	$ —	$ —	$ —	$ —	$—
Nine months ended September 30, 2017						
Allowance for loan losses:						