ServisFirst Bancshares, Inc.
Form 10-Q
October 31, 2017

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

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**FORM 10-Q**

**(Mark one)**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2017**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the transition period from _______to_______**

**Commission file number 001-36452**

**SERVISFIRST BANCSHARES, INC.**

(Exact Name of Registrant as Specified in Its Charter)

| | |
|---|---|
| Delaware | 26-0734029 |
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |

2500 Woodcrest Place, Birmingham, Alabama ***35209***
(Address of Principal Executive Offices) (Zip Code)

**(205) 949-0302**

*(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 Section 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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, 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 Non-accelerated filer Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

| Class | Outstanding as of October 27, 2017 |
|---|---|
| Common stock, $.001 par value | 52,979,310 |

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**PART 1. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

SERVISFIRST BANCSHARES, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share amounts)

| | September 30, 2017 (Unaudited) | December 31, 2016 (1) |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 79,431 | $ 56,855 |
| Interest-bearing balances due from depository institutions | 86,719 | 566,707 |
| Federal funds sold | 182,841 | 160,435 |
| Cash and cash equivalents | 348,991 | 783,997 |
| Available for sale debt securities, at fair value | 435,325 | 422,375 |
| Held to maturity debt securities (fair value of $89,329 and $63,302 at September 30, 2017 and December 31, 2016, respectively) | 87,399 | 62,564 |
| Restricted equity securities | 1,038 | 1,024 |
| Mortgage loans held for sale | 4,971 | 4,675 |
| Loans | 5,628,765 | 4,911,770 |
| Less allowance for loan losses | (58,459) | (51,893) |
| Loans, net | 5,570,306 | 4,859,877 |
| Premises and equipment, net | 55,104 | 40,314 |
| Accrued interest and dividends receivable | 20,334 | 15,801 |
| Deferred tax assets | 26,326 | 27,132 |
| Other real estate owned and repossessed assets | 3,888 | 4,988 |
| Bank owned life insurance contracts | 126,722 | 114,388 |
| Goodwill and other identifiable intangible assets | 14,787 | 14,996 |
| Other assets | 16,912 | 18,317 |
| Total assets | $ 6,712,103 | $ 6,370,448 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Liabilities: | | |
| Deposits: | | |
| Noninterest-bearing | $ 1,405,965 | $ 1,281,605 |
| Interest-bearing | 4,390,936 | 4,138,706 |
| Total deposits | 5,796,901 | 5,420,311 |
| Federal funds purchased | 254,880 | 355,944 |
| Other borrowings | 54,975 | 55,262 |
| Accrued interest payable | 4,353 | 4,401 |
| Other liabilities | 10,781 | 11,641 |

| | | |
|---|---|---|
| Total liabilities | 6,121,890 | 5,847,559 |
| Stockholders' equity: | | |
| Preferred stock, Series A Senior Non-Cumulative Perpetual, par value $0.001 (liquidation preference $1,000), net of discount; no shares authorized or outstanding at September 30, 2017 and December 31, 2016 | - | - |
| Preferred stock, par value $0.001 per share; 1,000,000 authorized and undesignated at September 30, 2017 and December 31, 2016 | - | - |
| Common stock, par value $0.001 per share; 100,000,000 shares authorized; 52,970,310 shares issued and outstanding at September 30, 2017, and 52,636,896 shares issued and outstanding at December 31, 2016 | 53 | 53 |
| Additional paid-in capital | 217,483 | 215,932 |
| Retained earnings | 371,127 | 307,151 |
| Accumulated other comprehensive income | 1,048 | (624) |
| Total stockholders' equity attributable to ServisFirst Bancshares, Inc. | 589,711 | 522,512 |
| Noncontrolling interest | 502 | 377 |
| Total stockholders' equity | 590,213 | 522,889 |
| Total liabilities and stockholders' equity | $ 6,712,103 | $ 6,370,448 |

(1) Derived from audited financial statements.

See Notes to Consolidated Financial Statements.

SERVISFIRST BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except share and per share amounts)

(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Interest income: | | | | |
| Interest and fees on loans | $ 63,857 | $ 51,473 | $ 179,325 | $ 147,930 |
| Taxable securities | 2,288 | 1,232 | 6,649 | 3,739 |
| Nontaxable securities | 729 | 823 | 2,246 | 2,515 |
| Federal funds sold | 379 | 347 | 1,185 | 630 |
| Other interest and dividends | 388 | 816 | 1,291 | 1,888 |
| Total interest income | 67,641 | 54,691 | 190,696 | 156,702 |
| Interest expense: | | | | |
| Deposits | 7,574 | 5,358 | 19,877 | 14,352 |
| Borrowed funds | 1,671 | 1,415 | 4,804 | 4,362 |
| Total interest expense | 9,245 | 6,773 | 24,681 | 18,714 |
| Net interest income | 58,396 | 47,918 | 166,015 | 137,988 |
| Provision for loan losses | 4,803 | 3,464 | 14,170 | 9,323 |
| Net interest income after provision for loan losses | 53,593 | 44,454 | 151,845 | 128,665 |
| Noninterest income: | | | | |
| Service charges on deposit accounts | 1,467 | 1,367 | 4,203 | 3,980 |
| Mortgage banking | 978 | 1,112 | 2,941 | 2,681 |
| Credit card income | 1,149 | 1,114 | 3,517 | 2,159 |
| Securities losses | - | - | - | (3 ) |
| Increase in cash surrender value life insurance | 825 | 770 | 2,334 | 2,049 |
| Other operating income | 371 | 428 | 1,146 | 1,207 |
| Total noninterest income | 4,790 | 4,791 | 14,141 | 12,073 |
| Noninterest expenses: | | | | |
| Salaries and employee benefits | 12,428 | 10,958 | 36,172 | 32,758 |
| Equipment and occupancy expense | 1,947 | 2,100 | 6,452 | 6,108 |
| Professional services | 805 | 1,182 | 2,384 | 2,919 |
| FDIC and other regulatory assessments | 810 | 775 | 2,888 | 2,328 |
| OREO expense | 31 | 178 | 163 | 668 |
| Other operating expenses | 5,476 | 4,969 | 16,580 | 14,175 |
| Total noninterest expenses | 21,497 | 20,162 | 64,639 | 58,956 |
| Income before income taxes | 36,886 | 29,083 | 101,347 | 81,782 |
| Provision for income taxes | 11,627 | 8,174 | 29,405 | 22,041 |
| Net income | 25,259 | 20,909 | 71,942 | 59,741 |
| Preferred stock dividends | - | - | 31 | 23 |
| Net income available to common stockholders | $ 25,259 | $ 20,909 | $ 71,911 | $ 59,718 |

| | | | | |
|---|---|---|---|---|
| Basic earnings per common share | $ 0.48 | $ 0.40 | $ 1.36 | $ 1.14 |
| Diluted earnings per common share | $ 0.47 | $ 0.39 | $ 1.33 | $ 1.12 |

See Notes to Consolidated Financial Statements.

SERVISFIRST BANCSHARES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Net income | $ 25,259 | $ 20,909 | $ 71,942 | $ 59,741 |
| Other comprehensive income (loss), net of tax: | | | | |
| Unrealized holding gains (losses) arising during period from securities available for sale, net of tax of $165 and $896 for the three and nine months ended September 30, 2017, respectively, and $(415) and $844 for the three and nine months ended September 30, 2016, respectively | 305 | (771 ) | 1,672 | 1,583 |
| Reclassification adjustment for net losses on sale of securities, net of tax of $1 for the nine months ended September 30, 2016 | - | - | - | 2 |
| Other comprehensive income, net of tax | 305 | (771 ) | 1,672 | 1,585 |
| Comprehensive income | $ 25,564 | $ 20,138 | $ 73,614 | $ 61,326 |

See Notes to Consolidated Financial Statements.

SERVISFIRST BANCSHARES, INC.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

(In thousands, except share amounts)

(Unaudited)

| | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income | Noncontrolling Interest | Total Stockholders' Equity |
|---|---|---|---|---|---|---|
| Balance, December 31, 2015 | $ 52 | $ 211,546 | $ 234,124 | $ 3,048 | $ 377 | $ 449,147 |
| Common dividends paid, $0.08 per share | - | - | (4,194) | - | - | (4,194) |
| Common dividends declared, $.04 per share | - | - | (2,106) | - | - | (2,106) |
| Preferred dividends paid | - | - | (23) | - | - | (23) |
| Issue 656,500 shares of common stock upon exercise of stock options | - | 2,785 | - | - | - | 2,785 |
| Stock based compensation expense | - | 931 | - | - | - | 931 |
| Other comprehensive income, net of tax | - | - | - | 1,585 | - | 1,585 |
| Net income | - | - | 59,741 | - | - | 59,741 |
| Balance, September 30, 2016 | $ 52 | $ 215,262 | $ 287,542 | $ 4,633 | $ 377 | $ 507,866 |
| | | | | | | |
| Balance, December 31, 2016 | $ 53 | $ 215,932 | $ 307,151 | $ (624) | $ 377 | $ 522,889 |
| Common dividends paid, $0.10 per share | - | - | (5,286) | - | - | (5,286) |
| Common dividends declared, $0.05 per share | - | - | (2,649) | - | - | (2,649) |
| Preferred dividends paid | - | - | (31) | - | - | (31) |
| Issue 328,214 shares of common stock upon exercise of stock options | - | 635 | - | - | - | 635 |
| Issue 125 shares of REIT preferred stock | - | - | - | - | 125 | 125 |
| Stock based compensation expense | - | 916 | - | - | - | 916 |
| Other comprehensive income, net of tax | - | - | - | 1,672 | - | 1,672 |
| Net income | - | - | 71,942 | - | - | 71,942 |
| Balance, September 30, 2017 | $ 53 | $ 217,483 | $ 371,127 | $ 1,048 | $ 502 | $ 590,213 |

See Notes to Consolidated Financial Statements.

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SERVISFIRST BANCSHARES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands) (Unaudited)

| | Nine Months Ended September 30, 2017 | 2016 |
|---|---|---|
| OPERATING ACTIVITIES | | |
| Net income | $ 71,942 | $ 59,741 |
| Adjustments to reconcile net income to net cash provided by | | |
| Deferred tax | (3,099) | 350 |
| Provision for loan losses | 14,170 | 9,323 |
| Depreciation | 2,281 | 2,211 |
| Accretion on acquired loans | (374) | (819) |
| Amortization of core deposit intangible | 209 | 257 |
| Net amortization of debt securities available for sale | 2,874 | 2,034 |
| Increase in accrued interest and dividends receivable | (4,533) | (950) |
| Stock-based compensation expense | 916 | 931 |
| (Decrease) increase in accrued interest payable | (48) | 1,257 |
| Proceeds from sale of mortgage loans held for sale | 105,940 | 97,868 |
| Originations of mortgage loans held for sale | (103,295) | (92,964) |
| Loss on sale of debt securities available for sale | - | 3 |
| Gain on sale of mortgage loans held for sale | (2,941) | (2,681) |
| Net (gain) loss on sale of other real estate owned and repossessed assets | (33) | 27 |
| Write down of other real estate owned and repossessed assets | 5 | 557 |
| Losses of tax credit partnerships | 42 | 178 |
| Increase in cash surrender value of life insurance contracts | (2,334) | (2,049) |
| Net change in other assets, liabilities, and other operating activities | (551) | (4,633) |
| Net cash provided by operating activities | 81,171 | 70,641 |
| INVESTMENT ACTIVITIES | | |
| Purchase of debt securities available for sale | (77,567) | (84,106) |
| Proceeds from sale of debt securities available for sale | - | 6,085 |
| Proceeds from maturities, calls and paydowns of debt securities available for sale | 65,734 | 71,425 |
| Purchase of debt securities held to maturity | (29,782) | (627) |
| Proceeds from maturities, calls and paydowns of debt securities held to maturity | 4,947 | 2,200 |
| Purchase of equity securities | (10) | (708) |
| Increase in loans | (724,626) | (443,771) |
| Purchase of premises and equipment | (17,071) | (7,809) |
| Purchase of bank-owned life insurance contracts | (10,000) | (20,000) |
| Expenditures to complete construction of other real estate owned | - | (3) |
| Proceeds from sale of other real estate owned and repossessed assets | 1,529 | 1,648 |
| Investment in tax credit partnerships | - | (2,491) |
| Net cash used in investing activities | (786,846) | (478,157) |
| FINANCING ACTIVITIES | | |
| Net increase in non-interest-bearing deposits | 124,360 | 216,259 |

| | | |
|---|---|---|
| Net increase in interest-bearing deposits | 252,230 | 640,981 |
| Net decrease in federal funds purchased | (101,064) | (7,970) |
| Repayment of Federal Home Loan Bank advances | (300) | (300) |
| Proceeds from sale of preferred stock, net | 125 | - |
| Proceeds from exercise of stock options and warrants | 635 | 2,785 |
| Dividends paid on common stock | (5,286) | (4,194) |
| Dividends paid on preferred stock | (31) | (23) |
| Net cash provided by financing activities | 270,669 | 847,538 |
| Net (decrease) increase in cash and cash equivalents | (435,006) | 440,022 |
| Cash and cash equivalents at beginning of period | 783,997 | 352,235 |
| Cash and cash equivalents at end of period | $ 348,991 | $ 792,257 |
| SUPPLEMENTAL DISCLOSURE | | |
| Cash paid for: | | |
| Interest | $ 24,729 | $ 17,457 |
| Income taxes | 30,651 | 22,666 |
| Income tax refund | (492) | (929) |
| NONCASH TRANSACTIONS | | |
| Other real estate acquired in settlement of loans | $ 586 | $ 2,033 |
| Internally financed sales of other real estate owned | 185 | 2,161 |
| Dividends declared | 2,649 | 2,106 |

See Notes to Consolidated Financial Statements.

**SERVISFIRST BANCSHARES, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2017**

**(Unaudited)**

## NOTE 1 - GENERAL

The accompanying consolidated financial statements in this report have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission, including Regulation S-X and the instructions for Form 10-Q, and have not been audited. These consolidated financial statements do not include all of the information and footnotes required by U.S. generally accepted accounting principles (“U.S. GAAP”) for complete financial statements. In the opinion of management, all adjustments necessary to present fairly the consolidated financial position and the consolidated results of operations for the interim periods have been made. All such adjustments are of a normal nature. The consolidated results of operations are not necessarily indicative of the consolidated results of operations which ServisFirst Bancshares, Inc. (the “Company”) and its consolidated subsidiaries, including ServisFirst Bank (the “Bank”), may achieve for future interim periods or the entire year. For further information, refer to the consolidated financial statements and footnotes included in the Company’s Form 10-K for the year ended December 31, 2016.

On December 20, 2016, the Company effected a two-for-one split of its common stock in the form of a stock dividend. Except where specifically indicated otherwise, all reported amounts in this Form 10-Q have been adjusted to give effect to this stock split.

All reported amounts are in thousands except share and per share data.

## NOTE 2 - CASH AND CASH EQUIVALENTS

Cash on hand, cash items in process of collection, amounts due from banks, and federal funds sold are included in cash and cash equivalents.

## NOTE 3 - EARNINGS PER COMMON SHARE

Basic earnings per common share are computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per common share include the dilutive effect of additional potential common shares issuable under stock options and warrants. All reported amounts in this Form 10-Q have been adjusted to give effect to the two-for-one stock split discussed above.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | (In Thousands, Except Shares and Per Share Data) | | | |
| Earnings per common share | | | | |
| Weighted average common shares outstanding | 52,950,644 | 52,554,918 | 52,854,332 | 52,557,910 |
| Net income available to common stockholders | $25,259 | $20,909 | $ 71,911 | $ 59,718 |
| Basic earnings per common share | $0.48 | $0.40 | $ 1.36 | $ 1.14 |
| | | | | |
| Weighted average common shares outstanding | 52,950,644 | 52,554,918 | 52,854,332 | 52,557,910 |
| Dilutive effects of assumed conversions and exercise of stock options and warrants | 1,149,028 | 1,324,410 | 1,256,580 | 932,008 |
| Weighted average common and dilutive potential common shares outstanding | 54,099,672 | 53,879,328 | 54,110,912 | 53,489,918 |
| Net income available to common stockholders | $25,259 | $20,909 | $ 71,911 | $ 59,718 |
| Diluted earnings per common share | $0.47 | $0.39 | $ 1.33 | $ 1.12 |

**NOTE 4 - SECURITIES**

The amortized cost and fair value of available-for-sale and held-to-maturity securities at September 30, 2017 and December 31, 2016 are summarized as follows:

| | Amortized Cost | Gross Unrealized Gain | Gross Unrealized Loss | Market Value |
|---|---|---|---|---|
| September 30, 2017 | (In Thousands) | | | |
| Securities Available for Sale | | | | |
| U.S. Treasury and government sponsored agencies | $56,518 | $ 335 | $ (75 ) | $56,778 |
| Mortgage-backed securities | 243,465 | 1,457 | (1,179 ) | 243,743 |
| State and municipal securities | 133,729 | 1,201 | (126 ) | 134,804 |
| Total | 433,712 | 2,993 | (1,380 ) | 435,325 |
| Securities Held to Maturity | | | | |
| Mortgage-backed securities | 31,165 | 393 | (179 ) | 31,379 |
| State and municipal securities | 5,726 | 300 | - | 6,026 |
| Corporate debt | 50,508 | 1,416 | - | 51,924 |
| Total | $87,399 | $ 2,109 | $ (179 ) | $89,329 |
| | | | | |
| December 31, 2016 | | | | |
| Securities Available for Sale | | | | |
| U.S. Treasury and government sponsored agencies | $45,998 | $ 382 | $ (126 ) | $46,254 |
| Mortgage-backed securities | 228,843 | 1,515 | (3,168 ) | 227,190 |
| State and municipal securities | 139,504 | 1,120 | (694 ) | 139,930 |
| Corporate debt | 8,985 | 16 | - | 9,001 |

| | | | | |
|---|---|---|---|---|
| Total | 423,330 | 3,033 | (3,988 ) | 422,375 |
| Securities Held to Maturity | | | | |
| Mortgage-backed securities | 19,164 | 321 | (245 ) | 19,240 |
| State and municipal securities | 5,888 | 315 | (12 ) | 6,191 |
| Corporate debt | 37,512 | 374 | (15 ) | 37,871 |
| Total | $62,564 | $ 1,010 | $ (272 ) | $63,302 |

The amortized cost and fair value of debt securities as of September 30, 2017 by contractual maturity are shown below. Actual maturities may differ from contractual maturities of mortgage-backed securities since the mortgages underlying the securities may be called or prepaid with or without penalty. Therefore, these securities are not included in the maturity categories along with the other categories of debt securities.

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| | September 30, 2017 Amortized Cost | Fair Value | December 31, 2016 Amortized Cost | Fair Value |
|---|---|---|---|---|
| | (In thousands) | | | |
| Debt securities available for sale | | | | |
| Due within one year | $25,961 | $26,035 | $28,270 | $28,400 |
| Due from one to five years | 151,842 | 153,099 | 152,347 | 153,003 |
| Due from five to ten years | 12,054 | 12,058 | 13,870 | 13,782 |
| Due after ten years | 390 | 390 | - | - |
| Mortgage-backed securities | 243,465 | 243,743 | 228,843 | 227,190 |
| | $433,712 | $435,325 | $423,330 | $422,375 |
| | | | | |
| Debt securities held to maturity | | | | |
| Due from one to five years | $3,250 | $3,280 | $250 | $250 |
| Due from five to ten years | 48,997 | 50,450 | 34,251 | 34,617 |
| Due after ten years | 3,987 | 4,220 | 8,899 | 9,195 |
| Mortgage-backed securities | 31,165 | 31,379 | 19,164 | 19,240 |
| | $87,399 | $89,329 | $62,564 | $63,302 |

All mortgage-backed securities are with government-sponsored enterprises (GSEs) such as Federal National Mortgage Association, Government National Mortgage Association, Federal Home Loan Bank, and Federal Home Loan Mortgage Corporation.

The following table identifies, as of September 30, 2017 and December 31, 2016, the Company’s investment securities that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 or more months. At September 30, 2017, 52 of the Company’s 807 debt securities had been in an unrealized loss position for 12 or more months. The Company does not intend to sell these securities and it is more likely than not that the Company will not be required to sell the securities before recovery of their amortized cost, which may be maturity; accordingly, the Company does not consider these securities to be other-than-temporarily impaired at September 30, 2017. Further, the Company believes any deterioration in value of its current investment securities is attributable to changes in market interest rates and not credit quality of the issuer.

| | Less Than Twelve Months | | Twelve Months or More | | Total | |
|---|---|---|---|---|---|---|
| | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value |
| | (In Thousands) | | | | | |
| September 30, 2017 | | | | | | |
| U.S. Treasury and government sponsored agencies | $(75) | $9,670 | $ - | $ - | $(75) | $9,670 |
| Mortgage-backed securities | (596) | 77,553 | (762) | 43,721 | (1,358) | 121,274 |
| State and municipal securities | (76) | 22,069 | (50) | 7,041 | (126) | 29,110 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total | $(747 ) | $109,292 | $ (812 ) | $ 50,762 | $(1,559) | $160,054 |
| | | | | | | |
| December 31, 2016 | | | | | | |
| U.S. Treasury and government sponsored agencies | $(126 ) | $10,865 | $ - | $ - | $(126 ) | $10,865 |
| Mortgage-backed securities | (3,413) | 174,225 | - | - | (3,413) | 174,225 |
| State and municipal securities | (698 ) | 64,502 | (8 ) | 1,021 | (706 ) | 65,523 |
| Corporate debt | (15 ) | 3,034 | - | - | (15 ) | 3,034 |
| Total | $(4,252) | $252,626 | $ (8 ) | $ 1,021 | $(4,260) | $253,647 |

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**NOTE 5 – LOANS**

The following table details the Company's loans at September 30, 2017 and December 31, 2016:

| | September 30, 2017 | December 31, 2016 |
|---|---|---|
| | (Dollars In Thousands) | |
| Commercial, financial and agricultural | $2,223,910 | $1,982,267 |
| Real estate - construction | 467,838 | 335,085 |
| Real estate - mortgage: | | |
| Owner-occupied commercial | 1,323,383 | 1,171,719 |
| 1-4 family mortgage | 593,180 | 536,805 |
| Other mortgage | 962,690 | 830,683 |
| Subtotal: Real estate - mortgage | 2,879,253 | 2,539,207 |
| Consumer | 57,764 | 55,211 |
| Total Loans | 5,628,765 | 4,911,770 |
| Less: Allowance for loan losses | (58,459) | (51,893) |
| Net Loans | $5,570,306 | $4,859,877 |

| | | |
|---|---|---|
| Commercial, financial and agricultural | 39.51 % | 40.36 % |
| Real estate - construction | 8.31 % | 6.82 % |
| Real estate - mortgage: | | |
| Owner-occupied commercial | 23.51 % | 23.86 % |
| 1-4 family mortgage | 10.54 % | 10.93 % |
| Other mortgage | 17.10 % | 16.91 % |
| Subtotal: Real estate - mortgage | 51.15 % | 51.70 % |
| Consumer | 1.03 % | 1.12 % |
| Total Loans | 100.00 % | 100.00 % |

The credit quality of the loan portfolio is summarized no less frequently than quarterly using categories similar to the standard asset classification system used by the federal banking agencies. The following table presents credit quality indicators for the loan loss portfolio segments and classes. These categories are utilized to develop the associated allowance for loan losses using historical losses adjusted for current economic conditions defined as follows:

- Pass – loans which are well protected by the current net worth and paying capacity of the obligor (or obligors, if any) or by the fair value, less cost to acquire and sell, of any underlying collateral.
- Special Mention – loans with potential weakness that may, if not reversed or corrected, weaken the credit or inadequately protect the Company's position at some future date. These loans are not adversely classified and do not expose an institution to sufficient risk to warrant an adverse classification.

- Substandard – loans that exhibit well-defined weakness or weaknesses that currently jeopardize debt repayment. These loans are characterized by the distinct possibility that the institution will sustain some loss if the weaknesses are not corrected.
- Doubtful – loans that have all the weaknesses inherent in loans classified substandard, plus the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values highly questionable and improbable.

Loans by credit quality indicator as of September 30, 2017 and December 31, 2016 were as follows:

| September 30, 2017 | Pass | Special Mention | Substandard | Doubtful | Total |
|---|---|---|---|---|---|
| | (In Thousands) | | | | |
| Commercial, financial and agricultural | $2,144,426 | $49,079 | $ 30,405 | $ - | $2,223,910 |
| Real estate - construction | 457,188 | 7,367 | 3,283 | - | 467,838 |
| Real estate - mortgage: | | | | | |
| Owner-occupied commercial | 1,305,408 | 11,814 | 6,161 | - | 1,323,383 |
| 1-4 family mortgage | 587,451 | 1,492 | 4,237 | - | 593,180 |
| Other mortgage | 945,548 | 14,118 | 3,024 | - | 962,690 |
| Total real estate mortgage | 2,838,407 | 27,424 | 13,422 | - | 2,879,253 |
| Consumer | 57,672 | 4 | 88 | - | 57,764 |
| Total | $5,497,693 | $83,874 | $ 47,198 | $ - | $5,628,765 |

| December 31, 2016 | Pass | Special Mention | Substandard | Doubtful | Total |
|---|---|---|---|---|---|
| | (In Thousands) | | | | |
| Commercial, financial and agricultural | $1,893,664 | $61,035 | $ 27,568 | $ - | $1,982,267 |
| Real estate - construction | 324,958 | 5,861 | 4,266 | - | 335,085 |
| Real estate - mortgage: | | | | | |
| Owner-occupied commercial | 1,158,615 | 6,037 | 7,067 | - | 1,171,719 |
| 1-4 family mortgage | 531,868 | 2,065 | 2,872 | - | 536,805 |
| Other mortgage | 818,724 | 11,224 | 735 | - | 830,683 |
| Total real estate mortgage | 2,509,207 | 19,326 | 10,674 | - | 2,539,207 |
| Consumer | 55,135 | 76 | - | - | 55,211 |
| Total | $4,782,964 | $86,298 | $ 42,508 | $ - | $4,911,770 |

Loans by performance status as of September 30, 2017 and December 31, 2016 were as follows:

| September 30, 2017 | Performing | Nonperforming | Total |
|---|---|---|---|
| | (In Thousands) | | |
| Commercial, financial and agricultural | $2,216,004 | $ 7,906 | $2,223,910 |
| Real estate - construction | 465,553 | 2,285 | 467,838 |
| Real estate - mortgage: | | | |
| Owner-occupied commercial | 1,320,886 | 2,497 | 1,323,383 |
| 1-4 family mortgage | 591,544 | 1,636 | 593,180 |
| Other mortgage | 962,260 | 430 | 962,690 |
| Total real estate mortgage | 2,874,690 | 4,563 | 2,879,253 |
| Consumer | 57,656 | 108 | 57,764 |
| Total | $5,613,903 | $ 14,862 | $5,628,765 |

| December 31, 2016 | Performing | Nonperforming | Total |
|---|---|---|---|
| | (In Thousands) | | |
| Commercial, financial and agricultural | $1,974,975 | $ 7,292 | $1,982,267 |
| Real estate - construction | 331,817 | 3,268 | 335,085 |
| Real estate - mortgage: | | | |
| Owner-occupied commercial | 1,165,511 | 6,208 | 1,171,719 |
| 1-4 family mortgage | 536,731 | 74 | 536,805 |
| Other mortgage | 830,683 | - | 830,683 |
| Total real estate mortgage | 2,532,925 | 6,282 | 2,539,207 |
| Consumer | 55,166 | 45 | 55,211 |
| Total | $4,894,883 | $ 16,887 | $4,911,770 |

Loans by past due status as of September 30, 2017 and December 31, 2016 were as follows:

| September 30, 2017 | Past Due Status (Accruing Loans) | | | | | | |
|---|---|---|---|---|---|---|---|
| | 30-59 Days | 60-89 Days | 90+ Days | Total Past Due | Non-Accrual | Current | Total Loans |
| | (In Thousands) | | | | | | |
| Commercial, financial and agricultural | $5,317 | $ 12,081 | $ 2,108 | $ 19,506 | $ 5,798 | $2,198,606 | $2,223,910 |
| Real estate - construction | 997 | 618 | - | 1,615 | 2,285 | 463,938 | 467,838 |
| Real estate - mortgage: | | | | | | | |
| Owner-occupied commercial | 310 | 3,354 | - | 3,664 | 2,497 | 1,317,222 | 1,323,383 |
| 1-4 family mortgage | 1,132 | 295 | 328 | 1,755 | 1,308 | 590,117 | 593,180 |
| Other mortgage | - | - | - | - | 430 | 962,260 | 962,690 |
| Total real estate - mortgage | 1,442 | 3,649 | 328 | 5,419 | 4,235 | 2,869,599 | 2,879,253 |
| Consumer | 102 | 13 | 70 | 185 | 38 | 57,541 | 57,764 |
| Total | $7,858 | $ 16,361 | $ 2,506 | $ 26,725 | $ 12,356 | $5,589,684 | $5,628,765 |

| December 31, 2016 | Past Due Status (Accruing Loans) | | | | | | |
|---|---|---|---|---|---|---|---|
| | 30-59 Days | 60-89 Days | 90+ Days | Total Past Due | Non-Accrual | Current | Total Loans |
| | (In Thousands) | | | | | | |
| Commercial, financial and agricultural | $710 | $ 40 | $ 10 | $ 760 | $ 7,282 | $1,974,225 | $1,982,267 |
| Real estate - construction | 59 | - | - | 59 | 3,268 | 331,758 | 335,085 |
| Real estate - mortgage: | | | | | | | |
| Owner-occupied commercial | - | - | 6,208 | 6,208 | - | 1,165,511 | 1,171,719 |
| 1-4 family mortgage | 160 | 129 | - | 289 | 74 | 536,442 | 536,805 |
| Other mortgage | 95 | 811 | - | 906 | - | 829,777 | 830,683 |
| Total real estate - mortgage | 255 | 940 | 6,208 | 7,403 | 74 | 2,531,730 | 2,539,207 |
| Consumer | 52 | 17 | 45 | 114 | - | 55,097 | 55,211 |
| Total | $1,076 | $ 997 | $ 6,263 | $ 8,336 | $ 10,624 | $4,892,810 | $4,911,770 |

The allowance for loan losses is maintained at a level which, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio. The amount of the allowance is based on management's evaluation of the collectability of the loan portfolio, including the nature of the portfolio, credit concentrations, trends in historical loss experience, specific impaired loans, economic conditions and other risks inherent in the portfolio. Allowances for impaired loans are generally determined based on collateral values or the present value of the estimated cash flows. The allowance is increased by a provision for loan losses, which is charged to expense, and reduced by charge-offs, net of recoveries. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for losses on loans. Such agencies may require the Company to recognize adjustments to the allowance based on their judgments about information available to them at the time of their examination.

The methodology utilized for the calculation of the allowance for loan losses is divided into four distinct categories. Those categories include allowances for non-impaired loans (ASC 450), impaired loans (ASC 310), external qualitative factors, and internal qualitative factors. A description of each category of the allowance for loan loss methodology is listed below.

*Non-Impaired Loans.* Non-impaired loans are grouped into homogeneous loan pools by loan type and are the following: commercial and industrial, construction and development, commercial real estate, second lien home equity lines of credit, and all other loans. Each loan pool is stratified by internal risk rating and multiplied by a loss allocation percentage derived from the loan pool historical loss rate. The historical loss rate is based on an age weighted five year history of net charge-offs experienced by pool, with the most recent net charge-off experience given a greater weighting. This results in the expected loss rate per year, adjusted by a qualitative adjustment factor and a years-to-impairment factor, for each pool of loans to derive the total amount of allowance for non-impaired loans.

*Impaired Loans.* Loans are considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the original terms of the loan agreement. The collection of all amounts due according to contractual terms means that both the contractual interest and principal payments of a loan will be collected as scheduled in the loan agreement. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, at the loan's observable market price or the fair value of the underlying collateral. The fair value of collateral, reduced by costs to sell on a discounted basis, is used if a loan is collateral-dependent. Fair value estimates for specifically impaired collateral-dependent loans are derived from appraised values based on the current market value or "as is" value of the property, normally from recently received and reviewed appraisals. Appraisals are obtained from certified and licensed appraisers and are based on certain assumptions, which may include construction or development status and the highest and best use of the property. These appraisals are reviewed by our credit administration department, and values are adjusted downward to reflect anticipated disposition costs. Once this estimated net realizable value has been determined, the value used in the impairment assessment is updated for each impaired loan. As subsequent events dictate and estimated net realizable values decline, required reserves may be established or further adjustments recorded.

*External Qualitative Factors*. The determination of the portion of the allowance for loan losses relating to external qualitative factors is based on consideration of the following factors: gross domestic product growth rate, changes in prime rate, delinquency trends, peer delinquency trends, year-over-year loan growth and state unemployment rate trends. Data for the three most recent periods is utilized in the calculation for each external qualitative component. The factors have a consistent weighted methodology to calculate the amount of allowance due to external qualitative factors.

*Internal Qualitative Factors*. The determination of the portion of the allowance for loan losses relating to internal qualitative factors is based on the consideration of criteria which includes the following: number of extensions and deferrals, single pay and interest only loans, current financial information, credit concentrations and risk grade accuracy. A self-assessment for each of the criteria is made with a consistent weighted methodology used to calculate the amount of allowance required for internal qualitative factors.

The following table presents an analysis of the allowance for loan losses by portfolio segment and changes in the allowance for loan losses for the three and nine months ended September 30, 2017 and September 30, 2016. The total allowance for loan losses is disaggregated into those amounts associated with loans individually evaluated and those associated with loans collectively evaluated.

| | Commercial financial and agricultural | Real estate - construction | Real estate - mortgage | Consumer | Total |
|---|---|---|---|---|---|
| | (In Thousands) | | | | |
| | Three Months Ended September 30, 2017 | | | | |
| Allowance for loan losses: | | | | | |
| Balance at June 30, 2017 | $29,127 | $5,138 | $20,392 | $402 | $55,059 |
| Charge-offs | (924) | (16) | (550) | (65) | (1,555) |
| Recoveries | 67 | 12 | 59 | 14 | 152 |
| Provision | 3,431 | 197 | 1,065 | 110 | 4,803 |
| Balance at September 30, 2017 | $31,701 | $5,331 | $20,966 | $461 | $58,459 |
| | Three Months Ended September 30, 2016 | | | | |
| Allowance for loan losses: | | | | | |
| Balance at June 30, 2016 | $23,655 | $5,279 | $17,600 | $464 | $46,998 |
| Charge-offs | (1,270) | (79) | (144) | (81) | (1,574) |
| Recoveries | 35 | 9 | 1 | - | 45 |
| Provision | 3,560 | (394) | 282 | 16 | 3,464 |
| Balance at September 30, 2016 | $25,980 | $4,815 | $17,739 | $399 | $48,933 |
| | Nine Months Ended September 30, 2017 | | | | |
| Allowance for loan losses: | | | | | |
| Balance at December 31, 2016 | $28,872 | $5,125 | $17,504 | $392 | $51,893 |
| Charge-offs | (6,846) | (56) | (922) | (173) | (7,997) |
| Recoveries | 273 | 42 | 62 | 16 | 393 |
| Provision | 9,402 | 220 | 4,322 | 226 | 14,170 |
| Balance at September 30, 2017 | $31,701 | $5,331 | $20,966 | $461 | $58,459 |
| | Nine Months Ended September 30, 2016 | | | | |
| Allowance for loan losses: | | | | | |
| Balance at December 31, 2015 | $21,495 | $5,432 | $16,061 | $431 | $43,419 |
| Charge-offs | (2,732) | (815) | (335) | (130) | (4,012) |
| Recoveries | 39 | 64 | 100 | - | 203 |
| Provision | 7,178 | 134 | 1,913 | 98 | 9,323 |
| Balance at September 30, 2016 | $25,980 | $4,815 | $17,739 | $399 | $48,933 |
| | As of September 30, 2017 | | | | |
| Allowance for loan losses: | | | | | |
| Individually Evaluated for Impairment | $5,725 | $829 | $1,892 | $50 | $8,496 |
| Collectively Evaluated for Impairment | 25,976 | 4,502 | 19,074 | 411 | 49,963 |
| Loans: | | | | | |
| Ending Balance | $2,223,910 | $467,838 | $2,879,253 | $57,764 | $5,628,765 |
| Individually Evaluated for Impairment | 30,405 | 3,328 | 15,789 | 88 | 49,610 |
| Collectively Evaluated for Impairment | 2,193,505 | 464,510 | 2,863,464 | 57,676 | 5,579,155 |

| | As of December 31, 2016 | | | | |
|---|---|---|---|---|---|
| Allowance for loan losses: | | | | | |
| Individually Evaluated for Impairment | $6,607 | $ 923 | $622 | $ - | $8,152 |
| Collectively Evaluated for Impairment | 22,265 | 4,202 | 16,882 | 392 | 43,741 |
| | | | | | |
| Loans: | | | | | |
| Ending Balance | $1,982,267 | $ 335,085 | $2,539,207 | $55,211 | $4,911,770 |
| Individually Evaluated for Impairment | 27,922 | 4,314 | 13,350 | 3 | 45,589 |
| Collectively Evaluated for Impairment | 1,954,345 | 330,771 | 2,525,857 | 55,208 | 4,866,181 |

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The following table presents details of the Company's impaired loans as of September 30, 2017 and December 31, 2016, respectively. Loans which have been fully charged off do not appear in the tables.

| | September 30, 2017 | | | For the three months ended September 30, 2017 | | For the nine months ended September 30, 2017 | |
|---|---|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized in Period | Average Recorded Investment | Interest Income Recognized in Period |
| | (In Thousands) | | | | | | |
| With no allowance recorded: | | | | | | | |
| Commercial, financial and agricultural | $4,671 | $4,671 | $ - | $ 4,770 | $ 52 | $ 4,998 | $ 164 |
| Real estate - construction | 45 | 48 | - | 48 | 1 | 49 | 2 |
| Real estate - mortgage: | | | | | | | |
| Owner-occupied commercial | 2,366 | 2,532 | - | 2,551 | 37 | 2,584 | 113 |
| 1-4 family mortgage | 1,752 | 1,752 | - | 1,756 | 22 | 1,781 | 67 |
| Other mortgage | 732 | 732 | - | 732 | 10 | 733 | 32 |
| Total real estate - mortgage | 4,850 | 5,016 | - | 5,039 | 69 | 5,098 | 212 |
| Consumer | 38 | 40 | - | 41 | 1 | 42 | 2 |
| Total with no allowance recorded | 9,604 | 9,775 | - | 9,898 | 123 | 10,187 | 380 |
| With an allowance recorded: | | | | | | | |
| Commercial, financial and agricultural | 25,734 | 27,719 | 5,725 | 26,129 | 256 | 27,021 | 800 |
| Real estate - construction | 3,283 | 3,283 | 829 | 3,357 | 14 | 3,369 | 42 |
| Real estate - mortgage: | | | | | | | |
| Owner-occupied commercial | 8,024 | 8,024 | 1,512 | 8,024 | 75 | 7,873 | 217 |
| 1-4 family mortgage | 2,485 | 2,485 | 328 | 2,485 | 10 | 2,506 | 56 |
| Other mortgage | 430 | 980 | 52 | 974 | (4) | 984 | 21 |
| Total real estate - mortgage | 10,939 | 11,489 | 1,892 | 11,483 | 81 | 11,363 | 294 |
| Consumer | 50 | 50 | 50 | 50 | 1 | 39 | 2 |
| Total with allowance recorded | 40,006 | 42,541 | 8,496 | 41,019 | 352 | 41,792 | 1,138 |
| Total Impaired Loans: | | | | | | | |
| Commercial, financial and agricultural | 30,405 | 32,390 | 5,725 | 30,899 | 308 | 32,019 | 964 |
| Real estate - construction | 3,328 | 3,331 | 829 | 3,405 | 15 | 3,418 | 44 |
| Real estate - mortgage: | | | | | | | |
| Owner-occupied commercial | 10,390 | 10,556 | 1,512 | 10,575 | 112 | 10,457 | 330 |
| 1-4 family mortgage | 4,237 | 4,237 | 328 | 4,241 | 32 | 4,287 | 123 |
| Other mortgage | 1,162 | 1,712 | 52 | 1,706 | 6 | 1,717 | 53 |
| Total real estate - mortgage | 15,789 | 16,505 | 1,892 | 16,522 | 150 | 16,461 | 506 |
| Consumer | 88 | 90 | 50 | 91 | 2 | 81 | 4 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Total impaired loans | $49,610 | $52,316 | $ 8,496 | $ 50,917 | $ 475 | $ 51,979 | $ 1,518 |

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| | December 31, 2016 | | | For the twelve months ended December 31, 2016 | |
|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized in Period |
| | (In Thousands) | | | | |
| With no allowance recorded: | | | | | |
| Commercial, financial and agricultural | $1,003 | $1,003 | $ - | $992 | $ 64 |
| Real estate - construction | 938 | 1,802 | - | 1,159 | 3 |
| Real estate - mortgage: | | | | | |
| Owner-occupied commercial | 2,615 | 2,778 | - | 2,884 | 166 |
| 1-4 family mortgage | 1,899 | 1,899 | - | 1,901 | 102 |
| Other mortgage | 940 | 940 | - | 965 | 60 |
| Total real estate - mortgage | 5,454 | 5,617 | - | 5,750 | 328 |
| Consumer | 3 | 5 | - | 6 | - |
| Total with no allowance recorded | 7,398 | 8,427 | - | 7,907 | 395 |
| | | | | | |
| With an allowance recorded: | | | | | |
| Commercial, financial and agricultural | 26,919 | 31,728 | 6,607 | 26,955 | 1,162 |
| Real estate - construction | 3,376 | 3,376 | 923 | 3,577 | 68 |
| Real estate - mortgage: | | | | | |
| Owner-occupied commercial | 6,924 | 6,924 | 348 | 6,934 | 362 |
| 1-4 family mortgage | 972 | 972 | 274 | 313 | 19 |
| Other mortgage | - | - | - | - | - |
| Total real estate - mortgage | 7,896 | 7,896 | 622 | 7,247 | 381 |
| Consumer | - | - | - | - | - |
| Total with allowance recorded | 38,191 | 43,000 | 8,152 | 37,779 | 1,611 |
| | | | | | |
| Total Impaired Loans: | | | | | |
| Commercial, financial and agricultural | 27,922 | 32,731 | 6,607 | 27,947 | 1,226 |
| Real estate - construction | 4,314 | 5,178 | 923 | 4,736 | 71 |
| Real estate - mortgage: | | | | | |
| Owner-occupied commercial | 9,539 | 9,702 | 348 | 9,818 | 528 |
| 1-4 family mortgage | 2,871 | 2,871 | 274 | 2,214 | 121 |
| Other mortgage | 940 | 940 | - | 965 | 60 |
| Total real estate - mortgage | 13,350 | 13,513 | 622 | 12,997 | 709 |
| Consumer | 3 | 5 | - | 6 | - |
| Total impaired loans | $45,589 | $51,427 | $ 8,152 | $45,686 | $ 2,006 |

Troubled Debt Restructurings ("TDR") at September 30, 2017, December 31, 2016 and September 30, 2016 totaled $16.4 million, $7.3 million and $6.7 million, respectively. At September 30, 2017, the Company had a related allowance for loan losses of $4.0 million allocated to these TDRs, compared to $2.3 million at December 31, 2016 and $1.7 million at September 30, 2016. TDR activity by portfolio segment for the three and nine months ended September 30, 2017 is presented in the table below.

| | Three Months Ended September 30, 2017 | | | Nine Months Ended September 30, 2017 | | |
|---|---|---|---|---|---|---|
| | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| | (In Thousands) | | | | | |
| Troubled Debt Restructurings | | | | | | |
| Commercial, financial and agricultural | - | $ - | $ - | 5 | $ 7,205 | $ 7,205 |
| Real estate - construction | - | - | - | 1 | 997 | 997 |
| Real estate - mortgage: | | | | | | |
| Owner-occupied commercial | - | - | - | 2 | 3,664 | 3,664 |
| 1-4 family mortgage | - | - | - | 1 | 850 | 850 |
| Other mortgage | - | - | - | - | - | - |
| Total real estate mortgage | - | - | - | 3 | 4,514 | 4,514 |
| Consumer | - | - | - | - | - | - |
| | - | $ - | $ - | 9 | $ 12,716 | $ 12,716 |

| | Three Months Ended September 30, 2016 | | | Nine Months Ended September 30, 2016 | | |
|---|---|---|---|---|---|---|
| | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| | (In Thousands) | | | | | |
| Troubled Debt Restructurings | | | | | | |
| Commercial, financial and agricultural | - | $ - | $ - | 1 | $ 366 | $ 366 |
| Real estate - construction | - | - | - | - | - | - |
| Real estate - mortgage: | | | | | | |
| Owner-occupied commercial | - | - | - | - | - | - |
| 1-4 family mortgage | - | - | - | - | - | - |
| Other mortgage | - | - | - | 1 | 234 | 234 |
| Total real estate mortgage | - | - | - | 1 | 234 | 234 |
| Consumer | - | - | - | - | - | - |
| | - | $ - | $ - | 2 | $ 600 | $ 600 |

There were no TDRs which defaulted during the three and nine months ended September 30, 2017 and 2016, and which were modified in the previous twelve months (i.e., the twelve months prior to default). For purposes of this disclosure, default is defined as 90 days past due and still accruing or placement on nonaccrual status. As of September 30, 2017, the Company’s TDRs have all resulted from term extensions, rather than from interest rate reductions or debt forgiveness.

**NOTE 6 - EMPLOYEE AND DIRECTOR BENEFITS**

**Stock Options**

At September 30, 2017, the Company had stock-based compensation plans, as described below. The compensation cost that has been charged to earnings for the plans was approximately $294,000 and $916,000 for the three and nine months ended September 30, 2017, respectively, and $291,000 and $931,000 for the three and nine months ended September 30, 2016, respectively.

The Company’s 2005 Amended and Restated Stock Option Plan allows for the grant of stock options to purchase up to 6,150,000 shares of the Company’s common stock. The Company’s 2009 Amended and Restated Stock Incentive Plan authorizes the grant of up to 5,550,000 shares and allows for the issuance of Stock Appreciation Rights, Restricted Stock, Stock Options, Performance Shares or Performance Units. Both plans allow for the grant of incentive stock options and non-qualified stock options, and option awards are granted with an exercise price equal to the market value of the Company’s common stock at the date of grant. The maximum term of the options granted under the plans is ten years.

The Company estimates the fair value of each stock option award using a Black-Scholes-Merton valuation model that uses the assumptions noted in the following table. These assumptions are highly subjective and changes to them can materially affect the fair value estimate. Expected market price volatility and expected term of options are based on historical data and other factors. The risk-free rate for periods within the contractual life of the option is based on the U. S. Treasury yield curve in effect at the time of grant.

| | 2017 | 2016 |
|---|---|---|
| Expected volatility | 29.00 % | 29.00 % |
| Expected dividends | 0.44 % | 0.64 % |
| Expected term (in years) | 6.25 | 6.25 |
| Risk-free rate | 2.08 % | 1.86 % |

The weighted average grant-date fair value of options granted during the nine months ended September 30, 2017 and September 30, 2016 was $11.83 and $5.95, respectively.

The following table summarizes stock option activity during the nine months ended September 30, 2017 and September 30, 2016:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| | | | | (In Thousands) |
| Nine Months Ended September 30, 2017: | | | | |
| Outstanding at January 1, 2017 | 2,026,334 | $ 9.00 | 6.2 | $ 57,636 |
| Granted | 52,500 | 37.93 | 9.4 | (35 ) |
| Exercised | (359,000 ) | 4.97 | 4.2 | 11,590 |
| Forfeited | (32,000 ) | 21.96 | 8.4 | 489 |
| Outstanding at September 30, 2017 | 1,687,834 | 10.51 | 5.7 | $ 45,136 |
| Exercisable at September 30, 2017 | 810,736 | $ 5.22 | 4.2 | $ 25,971 |
| Nine Months Ended September 30, 2016: | | | | |
| Outstanding at January 1, 2016 | 2,498,834 | $ 6.66 | 6.3 | $ 42,743 |
| Granted | 234,000 | 19.98 | 9.5 | 1,398 |
| Exercised | (656,500 ) | 4.25 | 4.2 | 14,254 |
| Forfeited | (13,000 ) | 19.41 | 9.0 | 85 |
| Outstanding at September 30, 2016 | 2,063,334 | 8.86 | 6.5 | $ 35,277 |
| Exercisable at September 30, 2016 | 594,536 | $ 6.45 | 6.0 | $ 13,901 |

As of September 30, 2017, there was approximately $2.1 million of total unrecognized compensation cost related to non-vested stock options. The cost is expected to be recognized on the straight-line method over the next 2.7 years.

**Restricted Stock**

The Company periodically grants restricted stock awards that vest upon service conditions. Dividend payments are made during the vesting period. The value of restricted stock is determined to be the current value of the Company's stock, and this total value will be recognized as compensation expense over the vesting period. As of September 30, 2017, there was $543,000 of total unrecognized compensation cost related to non-vested restricted stock. The cost is expected to be recognized evenly over the remaining 1.2 years of the restricted stock's vesting period.

The following table summarizes restricted stock activity during the nine months ended September 30, 2017 and September 30, 2016:

| | Shares | Weighted Average Grant Date Fair Value |
|---|---|---|
| Nine Months Ended September 30, 2017: | | |
| Non-vested at January 1, 2017 | 118,676 | $ 8.88 |
| Granted | 7,000 | 38.02 |
| Vested | (4,200) | 15.74 |
| Forfeited | (800) | 15.74 |
| Non-vested at September 30, 2017 | 120,676 | 10.29 |
| | | |
| Nine Months Ended September 30, 2016: | | |
| Non-vested at January 1, 2016 | 294,176 | $ 6.44 |
| Granted | 9,000 | 19.58 |
| Vested | (178,500) | 5.59 |
| Forfeited | - | - |
| Non-vested at September 30, 2016 | 124,676 | 8.66 |

**NOTE 7 - DERIVATIVES**

The Company has entered into agreements with secondary market investors to deliver loans on a “best efforts delivery” basis. When a rate is committed to a borrower, it is based on the best price that day and locked with the investor for the customer for a 30-day period. In the event the loan is not delivered to the investor, the Company has no risk or exposure with the investor. The interest rate lock commitments related to loans that are originated for later sale are classified as derivatives. The fair values of the Company’s agreements with investors and rate lock commitments to customers as of September 30, 2017 and December 31, 2016 were not material.

**NOTE 8 – RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS**

In March 2016, the FASB issued ASU 2016-09, *Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting* (“ASU 2016-09”), which is intended to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption was permitted. The Company elected to early adopt the provisions of this ASU during the second quarter of 2016, and retrospectively apply the changes in accounting for stock compensation back to the first quarter of 2016. Accordingly, the Company recognized a reduction in its provision for income taxes during the quarter and nine months ended September 30, 2017 of $1.4 million and $3.5 million, respectively, compared to $1.2 million and $3.5 million during the quarter and nine months ended September 30, 2016, respectively. Prior to the adoption of ASU 2016-09, such tax benefits were recorded as an increase to additional paid-in capital.

In March 2016, the FASB issued ASU 2016-07*, Investments – Equity Method and Joint Ventures (Topic 323), Simplifying the Transition to the Equity Method of Accounting*. The amendments eliminate the requirement that when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence, an investor must adjust the investment, results of operations, and retained earnings retroactively on a step-by-step basis as if the equity method had been in effect during all previous periods that the investment had been held. The amendments require that the equity method investor add the cost of acquiring the additional interest in the investee to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting. The amendments require that an entity that has an available-for-sale equity security that becomes qualified for the equity method of accounting recognize through earnings the unrealized holding gain or loss in accumulated other comprehensive income at the date the investment becomes qualified for use of the equity method. The amendments became effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The amendments should be applied prospectively upon their effective date to increase the level of ownership interest or degree of influence that results in the adoption of the equity method. Adoption of this standard has not affected the consolidated financial statements.

In January 2017, the FASB issued ASU 2017-03, *Accounting Changes and Error Corrections* (Topic 250) and *Investments – Equity Method and Joint Ventures* (Topic 323) *– Amendments to SEC Paragraphs Pursuant to Staff Announcements at the September 22, 2016 and November 17, 2016 EITF Meetings.* ASU 2017-03 provides amendments that add paragraph 250-10-S99-6 which includes the text of "SEC Staff Announcement: Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of a Registrant When Such Standards Are Adopted in a Future Period" (in accordance with Staff Accounting Bulletin (SAB) Topic 11.M). Registrants are required to disclose the effect that recently issued accounting standards will have on their financial statements when adopted in a future period. In cases where a registrant cannot reasonably estimate the impact of the adoption, then additional qualitative disclosures should be considered to assist the reader in assessing the significance of the standard's impact on its financial statements. The Company has enhanced its disclosures regarding the impact recently issued accounting standards adopted in a future period will have on its accounting and disclosures.

**NOTE 9 - RECENT ACCOUNTING PRONOUNCEMENTS**

In May 2014, the FASB issued ASU No. 2014-09, *Revenue From Contracts With Customers* (Topic 606). These amendments affect any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (e.g., insurance contracts or lease contracts). This ASU will supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance, and creates a Topic 606, Revenue from Contracts with Customers. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. The ASU allows for either full retrospective or modified retrospective adoption. In August 2015, the FASB issued ASU 2015-14, *Revenue From Contracts With Customers (Topic 606): Deferral of the Effective Date.* This ASU defers the effective date of ASU 2014-09, *Revenue From Contracts With Customers (Topic 606)*, by one year. The new guidance is effective for interim and annual reporting periods beginning after December 15, 2017. The Company's revenue has been more significantly weighted towards net interest income on financial assets and liabilities, which is explicitly excluded from the scope of the new standard, and noninterest income has not been as significant. The Company is continuing to assess its revenue streams and reviewing its contracts with customers that are potentially affected by the new guidance including fees on deposits, gains and losses on the sale of other real estate owned, credit and debit card interchange fees, and credit card revenue, to determine the potential impact the new guidance is expected to have on the Company's consolidated financial statements. However, the Company's revenue recognition pattern for these revenue streams is not expected to change materially from current practice. In addition, the Company continues to follow implementation issues specific to financial institutions which are still under discussion by the FASB's Transition Resource Group. The Company is currently planning to adopt the ASU on January 1, 2018 utilizing the modified retrospective approach.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments Overall (Topic 825): Recognition and Measurement of Financial Assets and Financial Liabilities*. The amendments in ASU 2016-1: (a) require equity investments (except for those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (b) simplify the impairment assessment of equity securities without readily determinable fair values by requiring a qualitative assessment to identify impairment; (c) eliminate the requirement for public business entities to disclose the method 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; (d) require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (e) require 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; (f) require separate presentation of financial assets and financial liabilities by measurement category and form of financial assets on the balance sheet or the notes to the financial statements; and (g) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. The amendments in this ASU are effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is evaluating the provisions of this ASU to determine the potential impact the new standard will have on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The FASB issued this ASU to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet by lessees for those leases classified as operating leases under current U.S. GAAP and disclosing key information about leasing arrangements. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. Early application of this ASU is permitted for all entities. The Company leases many of its banking offices under lease agreements it classifies as operating leases. The Company is currently evaluating the impact that the new guidance will have on its consolidated financial statements. Management currently anticipates recognizing a right-of-use asset and a lease liability associated with its long-term operating leases. Additionally, the inclusion of these right-of-use lease assets in our balance sheet will impact our total risk-weighted assets.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, which is essentially the final rule on use of the so-called CECL model, or current expected credit losses. Among other things, the amendments in this ASU require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For SEC filers, the amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with later effective dates for non-SEC registrant public companies and other organizations. Early adoption will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company is currently evaluating the impact of the amendments in this ASU on its consolidated financial statements, and is collecting data that will be needed to produce historical inputs into any models created as a result of adopting this ASU.

In March 2017, the FASB issued ASU 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities.* The amendments shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The amendments in this ASU are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. The amendments should be applied on a modified retrospective basis, with a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The amendments in this ASU will not impact the Company's financial statements as it has always amortized premiums to the first call date.

In May 2017, the FASB issued ASU No. 2017-09, *Compensation - Stock Compensation (Topic 718)*, *Scope of Modification Accounting*. The amendments provide guidance on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718. The guidance is effective for all entities 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 in this ASU should be applied prospectively to an award modified on or after the adoption date. The Company is currently evaluating the impact of the amendments in the ASU on the its consolidated financial statements.

**NOTE 10 - FAIR VALUE MEASUREMENT**

Measurement of fair value under U.S. GAAP establishes a hierarchy that prioritizes observable and unobservable inputs used to measure fair value, as of the measurement date, into three broad levels, which are described below:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible and also considers counterparty credit risk in its assessment of fair value.

*Debt Securities*. Where quoted prices are available in an active market, securities are classified within Level 1 of the hierarchy. Level 1 securities include highly liquid government securities such as U.S. Treasuries and exchange-traded equity securities. For securities traded in secondary markets for which quoted market prices are not available, the Company generally relies on pricing services provided by independent vendors. Such independent pricing services are to advise the Company on the carrying value of the securities available for sale portfolio. As part of the Company's procedures, the price provided from the service is evaluated for reasonableness given market changes. When a questionable price exists, the Company investigates further to determine if the price is valid. If needed, other market participants may be utilized to determine the correct fair value. The Company has also reviewed and confirmed its determinations in discussions with the pricing source regarding their methods of price discovery. Securities measured with these techniques are classified within Level 2 of the hierarchy and often involve using quoted market prices for similar securities, pricing models or discounted cash flow calculations using inputs observable in the market where available. Examples include U.S. government agency securities, mortgage-backed securities, obligations of states and political subdivisions and certain corporate, asset-backed and other securities. In cases where Level 1 or Level 2 inputs are not available, securities are classified in Level 3 of the hierarchy.

*Impaired Loans*. Impaired loans are measured and reported at fair value when full payment under the loan terms is not probable. Impaired loans are carried at the present value of expected future cash flows using the loan's existing rate in a discounted cash flow calculation, or the fair value of the collateral if the loan is collateral-dependent. Expected cash flows are based on internal inputs reflecting expected default rates on contractual cash flows. This method of estimating fair value does not incorporate the exit-price concept of fair value described in ASC 820-10 and would generally result in a higher value than the exit-price approach. For loans measured using the estimated fair value of collateral less costs to sell, fair value is generally determined based on appraisals performed by certified and licensed appraisers using inputs such as absorption rates, capitalization rates and market comparables, adjusted for estimated costs to sell. Management modifies the appraised values, if needed, to take into account recent developments in the market or other factors, such as changes in absorption rates or market conditions from the time of valuation, and anticipated sales values considering management's plans for disposition. Such modifications to the appraised values could result in lower valuations of such collateral. Estimated costs to sell are based on current amounts of disposal costs for similar assets. These measurements are classified as Level 3 within the valuation hierarchy. Impaired loans are subject to nonrecurring fair value adjustment upon initial recognition or subsequent impairment. A portion of the allowance for loan losses is allocated to impaired loans if the value of such loans is deemed to be less than the unpaid balance. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly based on the same factors identified above. The amount recognized as an impairment charge related to impaired loans that are measured at fair value on a nonrecurring basis was $2,660,000 and $7,967,000 during the three and nine months ended September 30, 2017, respectively, and $3,544,000 and $6,090,000 during the three and nine months ended September 30, 2016, respectively.

*Other Real Estate Owned*. Other real estate assets ("OREO") acquired through, or in lieu of, foreclosure are held for sale and are initially recorded at the lower of cost or fair value, less selling costs. Any write-downs to fair value at the time of transfer to OREO are charged to the allowance for loan losses subsequent to foreclosure. Values are derived from appraisals of underlying collateral and discounted cash flow analysis. Appraisals are performed by certified and licensed appraisers. Subsequent to foreclosure, valuations are updated periodically and assets are marked to current fair value, not to exceed the new cost basis. In the determination of fair value subsequent to foreclosure, management also considers other factors or recent developments, such as changes in absorption rates and market conditions from the time of valuation, and anticipated sales values considering management's plans for disposition, which could result in adjustment to lower the property value estimates indicated in the appraisals. These measurements are classified as Level 3 within the valuation hierarchy. A gain on the sale of OREO of $20,000 and $56,000 was recognized for the three and nine months ended September 30, 2017, respectively, and a loss on the sale and write-downs of $148,000 and $584,000 for the three and nine months ended September 30, 2016, respectively. These charges were for write-downs in the value of OREO subsequent to foreclosure and gains or losses on the disposal of OREO. OREO is classified within Level 3 of the hierarchy.

There were no residential real estate loan foreclosures classified as OREO as of September 30, 2017, compared to $189,000 as of December 31, 2016.

One residential real estate loan with a balance of $921,000 was in the process of being foreclosed as of September 30, 2017.

The following table presents the Company's financial assets and financial liabilities carried at fair value on a recurring basis as of September 30, 2017 and December 31, 2016:

| | Fair Value Measurements at September 30, 2017, Using | | | |
|---|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
| Assets Measured on a Recurring Basis: | (In Thousands) | | | |
| Available-for-sale securities: | | | | |
| U.S. Treasury and government sponsored agencies | $ - | $ 56,778 | $ - | $ 56,778 |
| Mortgage-backed securities | - | 243,743 | - | 243,743 |

| | | | | | | |
|---|---|---|---|---|---|---|
| State and municipal securities | | - | | 134,804 | - | | 134,804 |
| Total assets at fair value | $ | - | $ | 435,325 | $ - | $ | 435,325 |

| | Fair Value Measurements at December 31, 2016, Using | | | |
|---|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
| Assets Measured on a Recurring Basis: | (In Thousands) | | | |
| Available-for-sale securities | | | | |
| U.S. Treasury and government sponsored agencies | $ - | $ 46,254 | $ - | $ 46,254 |
| Mortgage-backed securities | - | 227,190 | - | 227,190 |
| State and municipal securities | - | 139,930 | - | 139,930 |
| Corporate debt | - | 9,001 | - | 9,001 |
| Total assets at fair value | $ - | $ 422,375 | $ - | $ 422,375 |

The following table presents the Company's financial assets and financial liabilities carried at fair value on a nonrecurring basis as of September 30, 2017 and December 31, 2016:

| | Fair Value Measurements at September 30, 2017, Using | | | |
|---|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
| Assets Measured on a Nonrecurring Basis: | (In Thousands) | | | |
| Impaired loans | $ - | $ - | $ 41,114 | $ 41,114 |
| Other real estate owned and repossessed assets | - | - | 3,888 | 3,888 |
| Total assets at fair value | $ - | $ - | $ 45,002 | $ 45,002 |

| | Fair Value Measurements at December 31, 2016, Using | | | |
|---|---|---|---|---|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
| Assets Measured on a Nonrecurring Basis: | (In Thousands) | | | |
| Impaired loans | $ - | $ - | $ 37,437 | $ 37,437 |
| Other real estate owned and repossessed assets | - | - | 4,988 | 4,988 |
| Total assets at fair value | $ - | $ - | $ 42,425 | $ 42,425 |

The fair value of a financial instrument is the current amount that would be exchanged in a sale between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Current U.S. GAAP excludes certain financial instruments and all nonfinancial instruments from its fair value disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

**Cash and due from banks:** The carrying amounts reported in the statements of financial condition approximate those assets' fair values.

**Debt securities:** Where quoted prices are available in an active market, securities are classified within Level 1 of the hierarchy. Level 1 securities include highly liquid government securities such as U.S. treasuries and exchange-traded equity securities. For securities traded in secondary markets for which quoted market prices are not available, the Company generally relies on prices obtained from independent vendors. Such independent pricing services are to advise the Company on the carrying value of the securities available for sale portfolio. As part of the Company's procedures, the price provided from the service is evaluated for reasonableness given market changes. When a questionable price exists, the Company investigates further to determine if the price is valid. If needed, other market participants may be utilized to determine the correct fair value. The Company has also reviewed and confirmed its determinations in discussions with the pricing service regarding their methods of price discovery. Securities measured with these techniques are classified within Level 2 of the hierarchy and often involve using quoted market prices for similar securities, pricing models or discounted cash flow calculations using inputs observable in the market where available. Examples include U.S. government agency securities, mortgage-backed securities, obligations of states and political subdivisions, and certain corporate, asset-backed and other securities. In cases where Level 1 or Level 2 inputs are not available, securities are classified in Level 3 of the fair value hierarchy.

**Equity securities:** Fair values for other investments are considered to be their cost as they are redeemed at par value.

**Federal funds sold:** The carrying amounts