SB FINANCIAL GROUP, INC.
Form 10-Q
November 08, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2018

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 1-36785

SB FINANCIAL GROUP, INC.

(Exact name of registrant as specified in its charter)

Ohio	34-1395608
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

401 Clinton Street, Defiance, Ohio 43512

(Address of principal executive offices)

(Zip Code)

(419) 783-8950

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report.)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
		Emerging growth company

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Title of each class	**Name of each exchange on which registered**
Common Shares, No Par Value	The NASDAQ Stock Market, LLC
6,503,250 Outstanding at November 8, 2018	(NASDAQ Capital Market)

SB FINANCIAL GROUP, INC.

FORM 10-Q

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

SB Financial Group, Inc.

Consolidated Balance Sheets

($ in thousands)	September 2018 **(unaudited)**	December 2017 **(audited)**
ASSETS		
Cash & due from banks	$ 45,515	$ 26,616
Securities available for sale, at fair value	84,114	82,790
Other securities - FRB and FHLB Stock	4,123	3,748
Loans held for sale	6,888	3,940
Loans, net of unearned income	771,698	696,615
Allowance for loan losses	(8,489)	(7,930)
Premises and equipment, net	21,900	21,277
Cash surrender value of life insurance	16,745	16,479
Goodwill & other intangibles	16,404	16,411
Foreclosed assets held for sale, net	105	26
Mortgage servicing rights	11,129	9,907
Accrued interest receivable	2,433	1,825
Other assets	6,615	4,923
Total assets	$ 979,180	$ 876,627
LIABILITIES AND EQUITY		
Deposits		
Non interest bearing demand	$ 134,747	$ 135,592
Interest bearing demand	130,897	131,079
Savings	114,213	103,267
Money market	170,190	141,844
Time deposits	239,379	217,818
Total deposits	789,426	729,600
Repurchase agreements	15,539	15,082
Advances from Federal Home Loan Bank	24,500	18,500

Trust preferred securities	10,310	10,310
Accrued interest payable	891	592
Other liabilities	11,405	8,543
Total liabilities	852,071	782,627
Commitments & Contingent Liabilities	-	-
Stockholder’s Equity		
Preferred stock, Series A	13,979	13,983
Common stock	40,485	12,569
Additional paid-in capital	15,160	15,405
Retained earnings	61,854	55,439
Accumulated other comprehensive loss	(1,654)	(141)
Treasury stock, at cost	(2,715)	(3,255)
Total stockholder’s equity	127,109	94,000
Total liabilities and stockholder’s equity	$ 979,180	$ 876,627

See notes to condensed consolidated financial statements (unaudited)

Note: The balance sheet at December 31, 2017 has been derived from the audited consolidated financial statements at that date

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Sb Financial Group, Inc.

Consolidated Statements of Income - (Unaudited)

	Three Months Ended		Nine Months Ended	
	September	September	September	September
($ in thousands, except per share data)	2018	2017	2018	2017
Interest income				
Loans				
Taxable	$9,499	$ 7,653	$26,607	$ 21,696
Tax exempt	42	21	99	62
Securities				
Taxable	610	532	1,795	1,562
Tax exempt	107	132	339	398
Total interest income	10,258	8,338	28,840	23,718
Interest expense				
Deposits	1,472	907	3,538	2,518
Repurchase agreements & other	11	4	27	10
Federal Home Loan Bank advances	140	86	329	235
Trust preferred securities	106	78	293	223
Total interest expense	1,729	1,075	4,187	2,986
Net interest income	8,529	7,263	24,653	20,732
Provision for loan losses	-	-	600	200
Net interest income after provision for loan losses	8,529	7,263	24,053	20,532
Noninterest income				
Wealth management fees	705	688	2,155	2,059
Customer service fees	672	674	1,991	1,981
Gain on sale of mortgage loans & OMSR’s	2,066	2,211	5,224	5,524
Mortgage loan servicing fees, net	273	227	991	851
Gain on sale of non-mortgage loans	125	294	935	1,093
Data service fees	-	182	-	559
Net gain on sale of securities	70	119	70	119
Gain/(loss) on sale/disposal of assets	-	8	21	10
Other income	291	458	1,308	929
Total noninterest income	4,202	4,861	12,695	13,125
Noninterest expense				
Salaries and employee benefits	5,372	4,844	15,513	13,897
Net occupancy expense	588	566	1,797	1,678
Equipment expense	667	688	2,133	2,012
Data processing fees	489	429	1,345	1,195
Professional fees	393	502	1,316	1,282
Marketing expense	197	180	622	581

Telephone and communications	124	120	374	349
Postage and delivery expense	83	103	221	336
State, local and other taxes	177	198	538	535
Employee expense	243	242	629	570
Other expenses	456	412	1,507	1,037
Total noninterest expense	8,789	8,284	25,995	23,472
Income before income tax expense	3,942	3,840	10,753	10,185
Income tax expense	824	1,117	2,074	3,152
Net income	$3,118	$ 2,723	$8,679	$ 7,033
Preferred Stock Dividends	244	244	732	731
Net income available to common shareholders	$2,874	$ 2,479	$7,947	$ 6,302
Common share data:				
Basic earnings per common share	$0.45	$ 0.52	$1.30	$ 1.31
Diluted earnings per common share	$0.39	$ 0.43	$1.14	$ 1.11
Average common shares outstanding (in thousands):				
Basic:	6,503	4,797	6,106	4,825
Diluted:	8,022	6,326	7,626	6,356

See notes to condensed consolidated financial statements (unaudited)

SB Financial Group, Inc.

Condensed Consolidated Statements of Comprehensive Income (unaudited)

($ in thousands)	**Three Months Ended September 30, 2018**	**2017**	**Nine Months Ended September 30, 2018**	**2017**
Net income	$3,118	$2,723	$8,679	$7,033
Other comprehensive income:				
Available for sale investment securities:				
Unrealized holding gain (loss) arising in the period	(524)	112	(1,914)	550
Related tax (expense) benefit	110	(38)	401	(187)
Less: Reclassification for gain realized in income	(70)	(119)	(70)	(119)
Related tax expense	15	40	15	40
Net effect on other comprehensive income	(469)	(5)	(1,568)	284
Total comprehensive income	$2,649	$2,718	$7,111	$7,317

See notes to condensed consolidated financial statements (unaudited)

SB Financial Group, Inc.

Condensed Consolidated Statements of Shareholders' Equity (unaudited)

($ in thousands, except per share data)	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total
Balance, January 1, 2018	$ 13,983	$ 12,569	$ 15,405	$ 55,439	$ (141)	$ (3,255)	$ 94,000
Net income				8,679			8,679
Common stock issuance (1,666,666 shares)		27,912					27,912
Conversion of preferred to common	(4)	4					-
Other comprehensive loss					(1,513)		(1,513)
Dividends on common, $0.235 per share				(1,532)			(1,532)
Dividends on preferred, $0.4875 per share				(732)			(732)
Restricted stock vesting			(257)			257	-
Stock options exercised			(200)			392	192
Repurchased stock						(109)	(109)
Stock based compensation expense			212				212
Balance, September 30, 2018	$ 13,979	$ 40,485	$ 15,160	$ 61,854	$ (1,654)	$ (2,715)	$ 127,109
Balance, January 1, 2017	$ 13,983	$ 12,569	$ 15,362	$ 46,688	$ 51	$ (2,105)	$ 86,548
Net income				7,033			7,033
Other comprehensive income					284		284
Dividends on common, $0.205 per share				(998)			(998)
Dividends on preferred, $0.4875 per share				(732)			(732)
Restricted stock vesting			(163)			163	-
Stock options exercised			(77)			416	339
Stock buyback						(1,778)	(1,778)
Share based compensation expense			213				213
Balance, September 30, 2017	$ 13,983	$ 12,569	$ 15,335	$ 51,991	$ 335	$ (3,304)	$ 90,909

See notes to condensed consolidated financial statements (unaudited)

SB Financial Group, Inc.

Consolidated Statements of Cash Flows (Unaudited)

	Nine Months Ended September 30,	
($ in thousands)	2018	2017
Operating Activities		
Net Income	$8,679	$7,033
Items providing/(using) cash		
Depreciation and amortization	1,261	1,152
Provision for loan losses	600	200
Expense of share-based compensation plan	212	213
Amortization of premiums and discounts on securities	275	437
Amortization of intangible assets	7	8
Amortization of originated mortgage servicing rights	931	863
Impairment (recovery) of mortgage servicing rights	(8)	40
Proceeds from sale of loans held for sale	200,306	203,999
Originations of loans held for sale	(200,364)	(202,652)
Gain from sale of loans	(6,159)	(6,617)
(Gain)/loss on sale of assets	(21)	47
Changes in		
Interest receivable	(608)	368
Other assets	(1,367)	(2,726)
Interest payable and other liabilities	3,161	1,551
Net cash provided by operating activities	6,905	3,916
Investing Activities		
Purchases of available-for-sale securities	(16,248)	(25,785)
Proceeds from maturities of available-for-sale securities	10,619	16,234
Proceeds from sales of availabe-for-sale-securities	2,115	14,369
Purchase of FRB stock	(375)	-
Proceeds from bank owned life insurance	-	386
Net change in loans	(75,034)	(30,901)
Purchase of premises and equipment and software	(1,383)	(3,294)
Proceeds from sale of equipment	134	-
Proceeds from sale of foreclosed assets	152	945
Net cash used in investing activities	(80,020)	(28,046)
Financing Activities		
Net increase in demand deposits, money market, interest checking and savings accounts	38,265	19,561
Net increase in certificates of deposit	21,561	24,173
Net increase in securities sold under agreements to repurchase	457	811

Proceeds from Federal Home Loan Bank advances	13,000	5,000
Repayment of Federal Home Loan Bank advances	(7,000)	(11,000)
Share repurchase	(109)	(1,778)
Exercise of Stock Options	192	339
Issuance of Common Stock	27,912	-
Dividends on Common Stock	(1,532)	(998)
Dividends on Preferred Stock	(732)	(732)
Net cash provided by financing activities	92,014	35,376
Increase in Cash and Cash Equivalents	18,899	11,246
Cash and Cash Equivalents, Beginning of Year	26,616	17,012
Cash and Cash Equivalents, End of Period	$45,515	$28,258
Supplemental Cash Flows Information		
Interest paid	$3,888	$2,783
Income taxes paid	$2,290	$2,863
Transfer of loans to foreclosed assets	$175	$94

See notes to condensed consolidated financial statements (unaudited)

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SB FINANCIAL GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 – BASIS OF PRESENTATION

SB Financial Group, Inc., an Ohio corporation (the "Company") is a bank holding company whose principal activity is the ownership and management of its wholly-owned subsidiaries, The State Bank and Trust Company ("State Bank"), RFCBC, Inc. ("RFCBC"), Rurbanc Data Services, Inc. dba RDSI Banking Systems ("RDSI"), and Rurban Statutory Trust II ("RST II"). In addition, State Bank owns all of the outstanding stock of Rurban Mortgage Company ("RMC") and State Bank Insurance, LLC ("SBI").

The consolidated financial statements include the accounts of the Company, State Bank, RFCBC, RDSI, RMC, and SBI. All significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions for Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The financial statements reflect all adjustments that are, in the opinion of management, necessary to fairly present the financial position, results of operations and cash flows of the Company. Those adjustments consist only of normal recurring adjustments. Results of operations for the nine months ended September 30, 2018, are not necessarily indicative of results for the complete year.

The condensed consolidated balance sheet of the Company as of December 31, 2017 has been derived from the audited consolidated balance sheet of the Company as of that date.

For further information, refer to the consolidated financial statements and footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

The following paragraphs summarize the impact of new accounting pronouncements:

Accounting Standards Update (ASU) No. 2018-07: Compensation – Stock Compensation (Topic 718)

This ASU expands scope of Topic 718, to include share-based payments issued to nonemployees for goods or services. Consequently, the accounting for share-based payments to nonemployees and employees will be substantially aligned. This ASU supersedes Subtopic 505-50, Equity-Based Payments to Non-Employees. The amendments in this ASU are effective for periods beginning after December 15, 2018. At this time, the Company does not recognize the existence of any nonemployee relationships involving share-based payments.

ASU No. 2018-02: Income Statement – Reporting Comprehensive Income (Topic 220)

This ASU provides for the reclassification of stranded tax effects in accumulated other comprehensive income (AOCI) an option rather than a requirement; however, disclosure is required if not elected. The reclassification from accumulated other comprehensive income to retained earnings results from the newly elected federal corporate income tax rate resulting from the Tax Cuts and Jobs Acts enacted in December 2017. The Company has adopted this ASU on December 31, 2017 and reclassified approximately $23 thousand into retained earnings.

ASU No. 2017-04: Intangibles – Goodwill and Other (Topic 350)

This ASU simplifies the test for goodwill impairment. Specifically, these amendments eliminate Step 2 from the goodwill impairment test, and also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. The amendments in this ASU are effective for annual goodwill impairment tests in fiscal years beginning after December 15, 2019, and management does not believe the changes will have a material effect on the Company's accounting and disclosures.

ASU No. 2016-15: Statement of Cash Flows (Topic 230)

This ASU provides specific guidance for eight cash flow classifications. The intention is to ensure that this ASU will eliminate any current or future diversity in classification and reporting. The amendments in this ASU were effective for the Company for reporting periods beginning after December 15, 2017 and did not have a significant impact on the consolidated financial statements.

ASU No. 2016-13: Financial Instruments – Credit Losses (Topic 326)

This ASU replaces the current GAAP incurred impairment methodology regarding credit losses with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendments in this update affect an entity to varying degrees depending on the credit quality of the assets held by the entity, their duration, and how the entity applies current GAAP. The amendments in this ASU are effective for reporting periods beginning after December 15, 2019, and management will need further study to determine the impact on the Company's consolidated financial statements. The Company implemented a process to track required data by utilizing accounting software in preparation for compliance.

The adoption of ASU 2016-13 is likely to result in an increase in the allowance for loan losses as a result of changing from an "incurred loss" model, which encompasses allowances for current known and inherent losses within the portfolio, to an "expected loss" model, which encompasses allowances for losses expected to be incurred over the life of the portfolio. Furthermore, ASU 2016-13 will necessitate that we establish an allowance for expected credit losses on debt securities. While we are currently unable to reasonably estimate the impact of adopting ASU 2016-13, we expect that the impact of adoption will be significantly influenced by the composition, characteristics and quality of our loan and securities portfolios as well as the prevailing economic conditions and forecasts as of the adoption date. We anticipate being fully prepared for implementation by December 15, 2019.

ASU No. 2016-02: Leases (Topic 842)

This ASU is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The amendments in this ASU are effective for reporting periods beginning after December 15, 2018. The Company has little leasing activity and management has determined that the impact on the Company's consolidated financial statements will be immaterial.

ASU No. 2016-01: Recognition and Measurement of Financial Assets and Liabilities (Topic 825)

This ASU has a number of provisions including the requirements that public business entities use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, a separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e. securities or loans receivables), and eliminating the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The amendment was effective for the Company in the first quarter of 2018 and did not have a significant impact on the consolidated financial statements or on fair value and other required disclosures.

ASU No. 2014-09: Revenue from Contracts with Customers (Topic 606)

This ASU implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of the amendment 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 and services. ASU 2014-09 establishes a five-step model, which entities must follow to recognize revenue and removes inconsistencies and weaknesses in existing guidance. The majority of our revenue-generating transactions are not subject to ASC 606, including revenue generated from financial instruments, such as our loans, letters of credit, derivatives and investment securities, as well as revenue related to our mortgage servicing activities, as these activities are subject to other GAAP discussed elsewhere within our disclosures. ASU 2014-09 became effective on January 1, 2018 and had no material effect on how we recognize revenue or to our consolidated financial statements and disclosures.

Interest Income – The largest source of revenue for the Company is interest income, which is primarily recognized on an accrual basis according to nondiscretionary formulas in written contracts, such as loan and lease agreements or investment securities contracts.

Noninterest Income – The Company earns noninterest income through a variety of financial and transaction services provided to corporate and consumer clients such as Wealth Management, deposit account, debit card and mortgage banking. Revenue is recorded for noninterest income based on the contractual terms for the service or transaction performed. In certain circumstances, noninterest income is reported net of associated expenses.

NOTE 2 – EARNINGS PER SHARE

Earnings per share (EPS) have been computed based on the weighted average number of common shares outstanding during the periods presented. There were no anti-dilutive shares in 2018 or 2017. Included in the diluted EPS for September 30, 2018 is the impact of the full conversion of the Company's depository shares. Based upon the current conversion price of $10.2059, the 1,499,500 outstanding depository shares are convertible into an aggregate of 1,469,247 common shares. The average number of common shares used in the computation of basic and diluted earnings per share were:

	Three Months Ended September 30,	
($ and outstanding shares in thousands - except per share data)	**2018**	**2017**
Distributed earnings allocated to common shares	$524	$340
Undistributed earnings allocated to common shares	2,346	2,136
Net earnings allocated to common shares	2,870	2,476
Net earnings allocated to participating securities	4	3
Dividends on convertible preferred shares	244	244
Net Income allocated to common shares and participating securities	$3,118	$2,723
Weighted average shares outstanding for basic earnings per share	6,503	4,797
Dilutive effect of stock compensation	58	70
Dilutive effect of convertible shares	1,461	1,459
Weighted average shares outstanding for diluted earnings per share	8,022	6,326
Basic earnings per common share	$0.45	$0.52
Diluted earnings per common share	$0.39	$0.43

	Nine Months Ended September 30,	
($ and outstanding shares in thousands - except per share data)	**2018**	**2017**
Distributed earnings allocated to common shares	$1,532	$999
Undistributed earnings allocated to common shares	6,404	5,294
Net earnings allocated to common shares	7,936	6,293

Net earnings allocated to participating securities	11	9
Dividends on convertible preferred shares	732	731
Net Income allocated to common shares and participating securities	$8,679	$7,033
Weighted average shares outstanding for basic earnings per share	6,106	4,825
Dilutive effect of stock compensation	63	73
Dilutive effect of convertible shares	1,457	1,458
Weighted average shares outstanding for diluted earnings per share	7,626	6,356
Basic earnings per common share	$1.30	$1.31
Diluted earnings per common share	$1.14	$1.11

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Note 3 – Securities

The amortized cost and appropriate fair values, together with gross unrealized gains and losses, of securities at September 30, 2018 and December 31, 2017 were as follows:

($ in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for Sale Securities:				
September 30, 2018				
U.S. Treasury and Government agencies	$ 11,897	$ 5	$ (326)	$ 11,576
Mortgage-backed securities	63,312	34	(1,876)	61,470
State and political subdivisions	10,998	127	(57)	11,068
	$ 86,207	$ 166	$ (2,259)	$ 84,114

($ in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for Sale Securities:				
December 31, 2017:				
U.S. Treasury and Government agencies	$ 12,715	$ 62	$ (69)	$ 12,708
Mortgage-backed securities	57,355	97	(690)	56,762
State and political subdivisions	12,829	439	(18)	13,250
Equity securities	70	-	-	70
	$ 82,969	$ 598	$ (777)	$ 82,790

The amortized cost and fair value of securities available for sale at September 30, 2018, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale	
($ in thousands)	Amortized Cost	Fair Value
Within one year	$2,118	$2,135

Due after one year through five years	7,516	7,444
Due after five years through ten years	9,692	9,486
Due after ten years	3,569	3,579
	22,895	22,644
Mortgage-backed securities	63,312	61,470
Totals	$86,207	$84,114

The fair value of securities pledged as collateral, to secure public deposits and for other purposes, was $44.0 million at September 30, 2018 and $38.9 million at December 31, 2017. The fair value of securities delivered for repurchase agreements was $18.7 million at September 30, 2018 and $19.1 million at December 31, 2017.

For the nine months ended September 30, 2018, there were gross gains of $0.07 million resulting from sales of available-for-sale securities, which was a reclassification from accumulated other comprehensive income (OCI) and was included in the net gain on sale of securities. The related $0.02 million in tax expense was a reclassification from OCI and was included in the income tax expense line item in the income statement. For the nine months ended September 30, 2017, there were gross gains of $0.12 million resulting from sales of available-for-sale securities, which was a reclassification from accumulated other comprehensive income (OCI) and was included in the net gain on sale of securities. The related $0.04 million in tax expense was a reclassification from OCI and was included in the income tax expense line item in the income statement.

Certain investments in debt securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments was $74.4 million at September 30, 2018, and $59.3 million at December 31, 2017, which was approximately 88 and 72 percent, respectively, of the Company’s available-for-sale investment portfolio at such dates. Based on evaluation of available evidence, including recent changes in market interest rates, credit rating information and information obtained from regulatory filings, management believes the declines in fair value for these securities are temporary. 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 net income in the period the other-than-temporary impairment is identified.

Securities with unrealized losses, aggregated by investment class and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2018 and December 31, 2017 are as follows:

	Less than 12 Months		12 Months or Longer		Total	
($ in thousands) September 30, 2018	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities:						
U.S. Treasury and Government agencies	$7,409	$ (224)	$3,660	$ (103)	$11,069	$ (327)
Mortgage-backed securities	31,685	(701)	28,312	(1,174)	59,997	(1,875)
State and Political subdivisions	2,942	(32)	440	(25)	3,382	(57)
	$42,036	$ (957)	$32,412	$ (1,302)	$74,448	$ (2,259)

	Less than 12 Months		12 Months or Longer		Total	

($ in thousands) December 31, 2017	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities:						
U.S. Treasury and Government agencies	$5,675	$ (27)	$2,559	$ (42)	$8,234	$ (69)
Mortgage-backed securities	35,205	(319)	14,673	(371)	49,878	(690)
State and political subdivisions	905	(4)	326	(14)	1,231	(18)
	$41,785	$ (350)	$17,558	$ (427)	$59,343	$ (777)

The total potential unrealized loss as of September 30, 2018 in the securities portfolio was $2.3 million, compared to a $0.78 million unrealized loss at December 31, 2017. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concern warrants such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent of the Company to not sell the investment and whether it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost. Management has determined there is no other-than-temporary-impairment on these securities.

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NOTE 4 – LOANS AND ALLOWANCE FOR LOAN LOSSES

Loans that management has the intent and ability to hold for the foreseeable future, or until maturity or payoffs, are reported at their outstanding principal balances adjusted for any charge-offs, the allowance for loan losses, any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans. Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term. Generally, all loan classes are placed on non-accrual status not later than 90 days past due, unless the loan is well-secured and in the process of collection. All interest accrued, but not collected, for loans that are placed on non-accrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Loan losses are charged against the allowance when management believes the non-collectability of a loan balance is probable. Subsequent recoveries, if any, are credited to the allowance.

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

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers nonclassified loans and is based on historical charge-off experience and expected loss given default derived from the Company's internal risk rating process. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected on the historical loss or risk rating data.

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

When State Bank moves a loan to non-accrual status, total unpaid interest accrued to date is reversed from income. Subsequent payments are applied to the outstanding principal balance with the interest portion of the payment recorded on the balance sheet as a contra-loan. Interest received on impaired loans may be realized once all contractual principal amounts are received or when a borrower establishes a history of six consecutive timely principal and interest payments. It is at the discretion of management to determine when a loan is placed back on accrual status upon receipt of six consecutive timely payments.

Large groups of smaller balance homogenous loans are collectively evaluated for impairment. Accordingly, State Bank does not separately identify individual consumer and residential loans for impairment measurements, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

Categories of loans at September 30, 2018 and December 31, 2017 include:

($ in thousands)	Total Loans September 2018	Total Loans December 2017	Non-Accrual Loans September 2018	Non-Accrual Loans December 2017
Commercial & Industrial	$119,242	$101,554	360	121
Commercial RE & Construction	356,563	332,154	228	1,322
Agricultural & Farmland	52,814	51,947	-	-
Residential Real Estate	178,033	150,854	1,541	1,123
Consumer & Other	64,478	59,619	252	138
Total Loans	$771,130	$696,128	$2,381	$2,704
Net deferred costs	$568	$487		
Total Loans, net deferred costs	$771,698	$696,615		
Allowance for loan losses	$(8,489)	$(7,930)		

The following tables present the activity in the allowance for loan losses and the recorded investment in loans based on portfolio segment and impairment method as of September 30, 2018, December 31, 2017 and September 30, 2017.

($ in thousands)	Commercial & Industrial	Commercial RE & Construction	Agricultural & Farmland	Residential Real Estate	Consumer & Other	Total
ALLOWANCE FOR LOAN AND LEASE LOSSES						
For the Three Months Ended - September 30, 2018						
Beginning balance	$ 1,061	$ 3,720	$ 488	$ 2,550	$ 675	$8,494
Charge Offs	-	-	-	-	(11)	$(11)
Recoveries	-	-	-	-	6	6
Provision	13	5	(9)	(39)	30	-
Ending Balance	$ 1,074	$ 3,725	$ 479	$ 2,511	$ 700	$8,489
For the Nine Months Ended -September 30, 2018						
Beginning balance	$ 823	$ 3,779	$ 505	$ 2,129	$ 694	$7,930
Charge Offs	-	(36)	-	(26)	(23)	$(85)
Recoveries	-	29	-	2	13	44

Provision	251	(47)	(26)	406	16	600
Ending Balance	$ 1,074	$ 3,725	$ 479	$ 2,511	$ 700	$8,489

($ in thousands)	Commercial & Industrial	Commercial RE & Construction	Agricultural & Farmland	Residential Real Estate	Consumer & Other	Total
Loans Receivable at September 30, 2018						
Allowance:						
Ending balance: individually evaluated for impairment	$ -	$ -	$ -	$ 77	$ 4	$81
Ending balance: collectively evaluated for impairment	$ 1,074	$ 3,725	$ 479	$ 2,434	$ 696	$8,408
Loans:						
Ending balance: individually evaluated for impairment	$ 329	$ 287	$ -	$ 1,889	$ 177	$2,682
Ending balance: collectively evaluated for impairment	$ 118,913	$ 356,276	$ 52,814	$ 176,144	$ 64,301	$768,448

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($ in thousands)	Commercial & Industrial	Commercial RE & Construction	Agricultural & Farmland	Residential Real Estate	Consumer & Other	Total
Loans Receivable at December 31, 2017						
Allowance:						
Ending balance: individually evaluated for impairment	$ -	$ 146	$ -	$ 178	$ 5	$ 329
Ending balance: collectively evaluated for impairment	$ 823	$ 3,633	$ 505	$ 1,951	$ 689	$ 7,601
Loans:						
Ending balance: individually evaluated for impairment	$ -	$ 1,385	$ -	$ 1,830	$ 197	$ 3,412
Ending balance: collectively evaluated for impairment	$ 101,554	$ 330,769	$ 51,947	$ 149,024	$ 59,422	$ 692,716

($ in thousands)	Commercial & Industrial	Commercial RE & Construction	Agricultural & Farmland	Residential Real Estate	Consumer & Other	Total
ALLOWANCE FOR LOAN AND LEASE LOSSES						
For the Three Months Ended - September 30, 2017						
Beginning balance	$ 995	$ 3,452	$ 512	$ 1,988	$ 878	$ 7,825
Charge Offs	-	(26)	-	(20)	(29)	$ (75)
Recoveries	-	-	1	2	7	10
Provision	(138)	195	(17)	44	(84)	-
Ending Balance	$ 857	$ 3,621	$ 496	$ 2,014	$ 772	$ 7,760

($ in thousands)	Commercial & Industrial	Commercial RE & Construction	Agricultural & Farmland	Residential Real Estate	Consumer & Other	Total
ALLOWANCE FOR LOAN AND LEASE LOSSES						
For the Nine Months Ended - September 30, 2017						
Beginning balance	$ 1,204	$ 3,321	$ 347	$ 1,963	$ 890	$ 7,725
Charge Offs	(50)	(26)	-	(42)	(77)	$ (195)
Recoveries	6	2	3	6	13	30
Provision	(303)	324	146	87	(54)	200
Ending Balance	$ 857	$ 3,621	$ 496	$ 2,014	$ 772	$ 7,760

The risk characteristics of each loan portfolio segment are as follows:

Commercial and Agricultural

Commercial and agricultural loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets, such as accounts receivable or inventory, and may include a personal guarantee. Short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial Real Estate including Construction

Commercial real estate loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The characteristics of properties securing the Company’s commercial real estate portfolio are diverse, but with geographic location almost entirely in the Company’s market area. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. In general, the Company avoids financing single purpose projects unless other underwriting factors are present to help mitigate risk. In addition, management tracks the level of owner-occupied commercial real estate versus non-owner-occupied loans.

Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews and financial analysis of the developers and property owners. Construction loans are generally based on estimates of costs and value associated with the completed project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

Residential and Consumer

Residential and consumer loans consist of two segments – residential mortgage loans and personal loans. Residential mortgage loans are secured by 1-4 family residences and are generally owner-occupied, and the Company generally establishes a maximum loan-to-value ratio and requires private mortgage insurance if that ratio is exceeded. Home equity loans are typically secured by a subordinate interest in 1-4 family residences, and consumer personal loans are secured by consumer personal assets, such as automobiles or recreational vehicles. Some consumer personal loans are unsecured, such as small installment loans and certain lines of credit. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas, such as unemployment levels. Repayment can also be impacted by changes in property values on residential properties. Risk is mitigated by the fact that these loans are of smaller individual amounts and spread over a large number of borrowers.

The following tables present the credit risk profile of the Company's loan portfolio based on rating category and payment activity as of September 30, 2018 and December 31, 2017.

September 30, 2018	**Commercial**	**Commercial RE**	**Agricultural**	**Residential**	**Consumer**	
($ in thousands)	**& Industrial**	**& Construction**	**& Farmland**	**Real Estate**	**& Other**	**Total**
1-2	$ -	$ -	$ -	$ -	$ -	$-
3	17,929	99,297	7,564	134,491	62,095	321,376
4	97,591	255,261	44,747	41,564	1,982	441,145
Total Pass (1 - 4)	115,520	354,558	52,311	176,055	64,077	762,521
Special Mention (5)	737	1,056	503	-	62	2,358
Substandard (6)	2,625	683	-	1,978	339	5,625
Doubtful (7)	360	266	-	-	-	626
Loss (8)	-	-	-	-	-	-

Total Loans	$ 119,242	$ 356,563	$ 52,814	$ 178,033	$ 64,478	$771,130

December 31, 2017	**Commercial**	**Commercial RE**	**Agricultural**	**Residential**	**Consumer**	
($ in thousands)	**& Industrial**	**& Construction**	**& Farmland**	**Real Estate**	**& Other**	**Total**
1-2	$ 96	$ 13	$ -	$ 832	$ 1	$942
3	19,883	93,222	8,080	114,130	57,204	292,519
4	80,448	236,217	43,735	34,271	2,151	396,822
Total Pass (1 - 4)	100,427	329,452	51,815	149,233	59,356	690,283
Special Mention (5)	512	1,100	132	-	66	1,810
Substandard (6)	7	580	-	1,583	197	2,367
Doubtful (7)	608	1,022	-	38	-	1,668
Loss (8)	-	-	-	-	-	-
Total Loans	$ 101,554	$ 332,154	$ 51,947	$ 150,854	$ 59,619	$696,128

The Company evaluates the loan risk grading system definitions and allowance for loan loss methodology on an ongoing basis.

Credit Risk Profile

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes loans with an outstanding balance greater than $100 thousand and non-homogeneous loans, such as commercial and commercial real estate loans. This analysis is performed on a quarterly basis. The Company uses the following definitions for risk ratings:

Pass (grades 1 – 4): Loans which management has determined to be performing as expected and in agreement with the terms established at the time of loan origination.

Special Mention (5): Assets have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Company's credit position at some future date. Special mention assets are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification. Ordinarily, special mention credits have characteristics which corrective management action would remedy.

Substandard (6): Loans are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful (7): Loans classified as doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of current known facts, conditions and values, highly questionable and improbable.

Loss (8): Loans are considered uncollectable and of such little value that continuing to carry them as assets on the Company's financial statement is not feasible. Loans will be classified Loss when it is neither practical nor desirable to defer writing off or reserving all or a portion of a basically worthless asset, even though partial recovery may be possible at some time in the future.

The following tables present the Company's loan portfolio aging analysis as of September 30, 2018 and December 31, 2017.

Loan Portfolio Aging Analysis

As of September 30, 2018 and December 31, 2017

($ in thousands) September 30, 2018	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable
Commercial & Industrial	$ -	$ 125	$ 329	$ 454	$ 118,788	$ 119,242
Commercial RE & Construction	75	-	7	82	356,481	356,563
Agricultural & Farmland	-	-	-	-	52,814	52,814
Residential Real Estate	215	310	471	996	177,037	178,033
Consumer & Other	146	46	141	333	64,145	64,478
Total Loans	$ 436	$ 481	$ 948	$ 1,865	$ 769,265	$ 771,130

($ in thousands) December 31, 2017	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable
Commercial & Industrial	$ 85	$ -	$ 88	$ 173	$ 101,381	$ 101,554
Commercial RE & Construction	110	-	1,086	1,196	330,958	332,154
Agricultural & Farmland	-	-	-	-	51,947	51,947
Residential Real Estate	484	379	433	1,296	149,558	150,854
Consumer & Other	182	21	103	306	59,313	59,619
Total Loans	$ 861	$ 400	$ 1,710	$ 2,971	$ 693,157	$ 696,128

All loans past due 90 days are systematically placed on nonaccrual status.

A loan is considered impaired, in accordance with the impairment accounting guidance (ASC 310-10-35-16), when based on current information and events, it is probable State Bank will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include nonperforming commercial loans but also include loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection.

The following tables present impaired loan information as of and for the three and nine months ended September 30, 2018 and 2017, and for the twelve months ended December 31, 2017:

Nine Months Ended September 30, 2018 ($ in thousands)	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**	**Average Recorded Investment**	**Interest Income Recognized**
With no related allowance recorded:					
Commercial & Industrial	$ 329	$ 329	$ -	$ 777	$ 19
Commercial RE & Construction	287	287	-	336	17
Agricultural & Farmland	-	-	-	-	-
Residential Real Estate	1,021	1,064	-	1,745	57
Consumer & Other	97	97	-	106	5
With a specific allowance recorded:					
Commercial & Industrial	-	-	-	-	-
Commercial RE & Construction	-	-	-	-	-
Agricultural & Farmland	-	-	-	-	-
Residential Real Estate	868	894	77	428	15
Consumer & Other	80	80	4	92	4
Totals:					
Commercial & Industrial	329	329	-	777	19
Commercial RE & Construction	287	287	-	336	17
Agricultural & Farmland	-	-	-	-	-
Residential Real Estate	1,889	1,958	77	2,173	72
Consumer & Other	$ 177	$ 177	$ 4	$ 198	$ 9

Three Months Ended September 30, 2018 ($ in thousands)	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:		
Commercial & Industrial	$ 763	$ (9)
Commercial RE & Construction	336	5

Agricultural & Farmland	-	-
Residential Real Estate	1,733	16
Consumer & Other	102	2
With a specific allowance recorded:		
Commercial & Industrial	-	-
Commercial RE & Construction	-	-
Agricultural & Farmland	-	-
Residential Real Estate	424	5
Consumer & Other	90	1
Totals:		
Commercial & Industrial	763	(9)
Commercial RE & Construction	336	5
Agricultural & Farmland	-	-
Residential Real Estate	2,157	21
Consumer & Other	$ 192	$ 3

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Twelve Months Ended **December 31, 2017** **($ in thousands)**	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**	**Average Recorded Investment**	**Interest Income Recognized**
With no related allowance recorded:					
Commercial & Industrial	$ -	$ -	$ -	$ -	$ -
Commercial RE & Construction	696	722	-	756	34
Agricultural & Farmland	-	-	-	-	-
Residential Real Estate	752	795	-	1,460	67
Consumer & Other	110	110	-	128	9
With a specific allowance recorded:					
Commercial & Industrial	-	-	-	-	-
Commercial RE & Construction	689	689	146	713	-
Agricultural & Farmland	-	-	-	-	-
Residential Real Estate	1,078	1,097	178	628	25
Consumer & Other	87	87	5	91	5
Totals:					
Commercial & Industrial	-	-	-	-	-
Commercial RE & Construction	1,385	1,411	146	1,469	34
Agricultural & Farmland	-	-	-	-	-
Residential Real Estate	1,830	1,892	178	2,088	92
Consumer & Other	$ 197	$ 197	$ 5	$ 219	$ 14

September 30, 2017 ($ in thousands)	Nine Months Ended Average Recorded Investment	 Unpaid Principal Balance	Three Months Ended Average Recorded Investment	 Interest Income Recognized
With no related allowance recorded:				
Commercial & Industrial	$-	$ -	$-	$ -
Commercial RE & Construction	757	29	754	7
Agricultural & Farmland	-	-	-	-
Residential Real Estate	539	20	535	5
Consumer & Other	130	7	126	2
With a specific allowance recorded:				
Commercial & Industrial	-	-	-	-
Commercial RE & Construction	721	(2)	689	-
Agricultural & Farmland	-	-	-	-
Residential Real Estate	631	20	625	7
Consumer & Other	95	4	92	1
Totals:				
Commercial & Industrial	$-	$ -	$-	$ -
Commercial RE & Construction	$1,478	$ 27	$1,443	$ 7
Agricultural & Farmland	$-	$ -	$-	$ -
Residential Real Estate	$1,170	$ 40	$1,160	$ 12
Consumer & Other	$225	$ 11	$218	$ 3

Impaired loans less than $100,000 are included in groups of homogenous loans. These loans are evaluated based on delinquency status.

Interest income recognized on a cash basis does not materially differ from interest income recognized on an accrual basis.

Troubled Debt Restructured (TDR) Loans

TDRs are modified loans where a concession was provided to a borrower experiencing financial difficulties. Loan modifications are considered TDRs when the concessions provided are not available to the borrower through either normal channels or other sources. However, not all loan modifications are TDRs.