

FARMERS NATIONAL BANC CORP /OH/  
Form 10-Q  
May 09, 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 March 31, 2018

Commission file number 001-35296

FARMERS NATIONAL BANC CORP.

(Exact name of registrant as specified in its charter)

|  |                    |
|--|--------------------|
| OHIO                                     | 34-1371693         |
| (State or other jurisdiction of          | (I.R.S. Employer   |
| incorporation or organization)           | Identification No) |
| 20 South Broad Street Canfield, OH       | 44406              |
| (Address of principal executive offices) | (Zip Code)         |

(330) 533-3341

(Registrant's telephone number, including area code)

Not applicable

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

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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, a smaller reporting company, or an emerging growth company. See 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 small reporting company) Small 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 practicable date.

| Class                      | Outstanding at April 30, 2018 |
|----------------------------|-------------------------------|
| Common Stock, No Par Value | 27,640,921 shares             |

PART I - FINANCIAL INFORMATION

Item 1 Financial Statements (Unaudited)

Included in Part I of this report:

Farmers National Banc Corp. and Subsidiaries

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## CONSOLIDATED BALANCE SHEETS

## FARMERS NATIONAL BANC CORP. AND SUBSIDIARIES

|   | (In Thousands of Dollars) |                     |
|---|---------------------------|---------------------|
|   | March 31,                 | December 31,        |
| (Unaudited)   | 2018                      | 2017                |
| <b>ASSETS</b>   |                           |                     |
| Cash and due from banks   | \$ 21,433                 | \$ 17,785           |
| Federal funds sold and other  | 30,716                    | 39,829              |
| <b>TOTAL CASH AND CASH EQUIVALENTS</b>  | <b>52,149</b>             | <b>57,614</b>       |
| Securities available for sale   | 384,396                   | 392,937             |
| Equity securities   | 6,009                     | 5,579               |
| Loans held for sale   | 399                       | 272                 |
| Loans   | 1,599,339                 | 1,577,381           |
| Less allowance for loan losses  | 12,550                    | 12,315              |
| <b>NET LOANS</b>  | <b>1,586,789</b>          | <b>1,565,066</b>    |
| Premises and equipment, net   | 21,992                    | 22,286              |
| Goodwill  | 38,201                    | 38,201              |
| Other intangibles   | 6,814                     | 7,168               |
| Bank owned life insurance   | 34,099                    | 33,877              |
| Other assets  | 36,669                    | 36,069              |
| <b>TOTAL ASSETS</b>   | <b>\$ 2,167,517</b>       | <b>\$ 2,159,069</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                     |                           |                     |
| Deposits:   |                           |                     |
| Noninterest-bearing   | \$ 402,499                | \$ 412,346          |
| Interest-bearing  | 1,234,660                 | 1,192,373           |
| <b>TOTAL DEPOSITS</b>   | <b>1,637,159</b>          | <b>1,604,719</b>    |
| Short-term borrowings   | 268,012                   | 289,565             |
| Long-term borrowings  | 6,804                     | 6,994               |
| Other liabilities   | 14,302                    | 15,717              |
| <b>TOTAL LIABILITIES</b>  | <b>1,926,277</b>          | <b>1,916,995</b>    |
| Commitments and contingent liabilities  |                           |                     |
| Stockholders' Equity:   |                           |                     |
| Common Stock - Authorized 35,000,000 shares; issued 28,179,598 in 2018 and 2017 | 186,594                   | 186,903             |
| Retained earnings   | 65,168                    | 59,208              |
| Accumulated other comprehensive income (loss)                                   | (6,595 )                  | 596                 |
| Treasury stock, at cost; 538,677 shares in 2018 and 635,550 in 2017             | (3,927 )                  | (4,633 )            |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>   | <b>241,240</b>            | <b>242,074</b>      |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>                               | <b>\$ 2,167,517</b>       | <b>\$ 2,159,069</b> |

See accompanying notes



## CONSOLIDATED STATEMENTS OF INCOME

## FARMERS NATIONAL BANC CORP. AND SUBSIDIARIES

|  | (In Thousands<br>except Per Share<br>Data) |               |
|--|--|---------------|
|  | For the Three<br>Months Ended              |               |
|  | March<br>31,                               | March<br>31,  |
| (Unaudited)  | 2018                                       | 2017          |
| <b>INTEREST AND DIVIDEND INCOME</b>                                |  |               |
| Loans, including fees  | \$ 18,427                                  | \$ 16,483     |
| Taxable securities   | 1,233                                      | 1,118         |
| Tax exempt securities  | 1,331                                      | 1,071         |
| Dividends  | 146  | 115           |
| Federal funds sold and other interest income                       | 145  | 63            |
| <b>TOTAL INTEREST AND DIVIDEND INCOME</b>                          | <b>21,282</b>                              | <b>18,850</b> |
| <b>INTEREST EXPENSE</b>  |  |               |
| Deposits   | 1,411                                      | 914           |
| Short-term borrowings  | 881  | 327           |
| Long-term borrowings   | 44   | 78            |
| <b>TOTAL INTEREST EXPENSE</b>                                      | <b>2,336</b>                               | <b>1,319</b>  |
| <b>NET INTEREST INCOME</b>   | <b>18,946</b>                              | <b>17,531</b> |
| Provision for loan losses  | 775  | 1,050         |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>         | <b>18,171</b>                              | <b>16,481</b> |
| <b>NONINTEREST INCOME</b>  |  |               |
| Service charges on deposit accounts                                | 1,003                                      | 951           |
| Bank owned life insurance income                                   | 222  | 201           |
| Trust fees   | 1,807                                      | 1,678         |
| Insurance agency commissions                                       | 699  | 674           |
| Security gains, including fair value changes for equity securities | 18   | 13            |
| Retirement plan consulting fees                                    | 379  | 513           |
| Investment commissions   | 256  | 222           |
| Net gains on sale of loans   | 487  | 607           |
| Debit card and EFT fees  | 806  | 653           |
| Other operating income   | 333  | 375           |
| <b>TOTAL NONINTEREST INCOME</b>                                    | <b>6,010</b>                               | <b>5,887</b>  |
| <b>NONINTEREST EXPENSES</b>  |  |               |
| Salaries and employee benefits                                     | 8,738                                      | 8,287         |
| Occupancy and equipment  | 1,704                                      | 1,587         |
| State and local taxes  | 459  | 417           |
| Professional fees  | 698  | 747           |
| Merger related costs   | 25   | 62            |
| Advertising  | 275  | 244           |

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|   |                |                |
|---|----------------|----------------|
| FDIC insurance                                | 222            | 235            |
| Intangible amortization                       | 354            | 365            |
| Core processing charges                       | 739            | 655            |
| Telephone and data                            | 237            | 241            |
| Other operating expenses                      | 1,645          | 1,773          |
| <b>TOTAL NONINTEREST EXPENSES</b>             | <b>15,096</b>  | <b>14,613</b>  |
| <b>INCOME BEFORE INCOME TAXES</b>             | <b>9,085</b>   | <b>7,755</b>   |
| <b>INCOME TAXES</b>                           | <b>1,359</b>   | <b>1,972</b>   |
| <b>NET INCOME</b>                             | <b>\$7,726</b> | <b>\$5,783</b> |
| <b>EARNINGS PER SHARE - basic and diluted</b> | <b>\$0.28</b>  | <b>\$0.21</b>  |

See accompanying notes



CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FARMERS NATIONAL BANC CORP. AND SUBSIDIARIES

|  | (In Thousands of Dollars)  |                |
|--|----------------------------|----------------|
|  | For the Three Months Ended |                |
|  | March 31,                  | March 31,      |
| (Unaudited)  | 2018                       | 2017           |
| <b>NET INCOME</b>  | <b>\$7,726</b>             | <b>\$5,783</b> |
| Other comprehensive income:  |                            |                |
| Net unrealized holding gains (losses) on available for sale securities | (8,886)                    | 375            |
| Reclassification adjustment for gains realized in income               | (2 )                       | (13 )          |
| Net unrealized holding gains (losses)                                  | (8,888)                    | 362            |
| Income tax effect  | 1,866                      | (128 )         |
| Other comprehensive income (loss), net of tax                          | (7,022)                    | 234            |
| <b>TOTAL COMPREHENSIVE INCOME</b>                                      | <b>\$704</b>               | <b>\$6,017</b> |

See accompanying notes

## CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

## FARMERS NATIONAL BANC CORP. AND SUBSIDIARIES

|   | (In Thousands of Dollars) |
|---|---------------------------|
|   | For the                   |
|   | Three Months Ended        |
| (Unaudited)   | March 31, 2018            |
| <b>COMMON STOCK</b>                                       |                           |
| Beginning balance   | \$ 186,903                |
| Issued 96,873 shares under the Long Term Incentive Plan   | (706 )                    |
| Stock compensation expense for 608,761 unvested shares    | 397                       |
| Ending balance  | 186,594                   |
| <b>RETAINED EARNINGS</b>                                  |                           |
| Beginning balance   | 59,208                    |
| Cumulative effect adjustment upon adoption of ASU 2016-01 | 169                       |
| Beginning balance adjusted                                | 59,377                    |
| Net income  | 7,726                     |
| Dividends declared at \$.07 per share                     | (1,935 )                  |
| Ending balance  | 65,168                    |
| <b>ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)</b>      |                           |
| Beginning balance   | 596                       |
| Cumulative effect adjustment upon adoption of ASU 2016-01 | (169 )                    |
| Beginning balance adjusted                                | 427                       |
| Other comprehensive loss                                  | (7,022 )                  |
| Ending balance  | (6,595 )                  |
| <b>TREASURY STOCK, AT COST</b>                            |                           |
| Beginning balance   | (4,633 )                  |
| Issued 96,873 shares under the Long Term Incentive Plan   | 706                       |
| Ending balance  | (3,927 )                  |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>                         | <b>\$ 241,240</b>         |

See accompanying notes.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

## FARMERS NATIONAL BANC CORP. AND SUBSIDIARIES

|  | (In Thousands of<br>Dollars) |                 |
|--|------------------------------|-----------------|
|  | Three Months<br>Ended        |                 |
|  | March<br>31,                 | March<br>31,    |
| (Unaudited)  | 2018                         | 2017            |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                |                              |                 |
| Net income   | \$7,726                      | \$5,783         |
| Adjustments to reconcile net income to net cash from operating activities: |                              |                 |
| Provision for loan losses  | 775                          | 1,050           |
| Depreciation and amortization  | 749                          | 879             |
| Net amortization of securities   | 756                          | 511             |
| Security gains, including fair value changes for equity securities         | (18 )                        | (13 )           |
| Stock compensation expense   | 397                          | 181             |
| (Gain) loss on sale of other real estate owned                             | (30 )                        | 33              |
| Loss on fixed asset disposal   | 0                            | 6               |
| Earnings on bank owned life insurance                                      | (222 )                       | (201 )          |
| Origination of loans held for sale   | (9,226 )                     | (15,256)        |
| Proceeds from loans held for sale  | 9,586                        | 15,120          |
| Net gains on sale of loans   | (487 )                       | (607 )          |
| Net change in other assets and liabilities                                 | (28 )                        | (1,285 )        |
| <b>NET CASH FROM OPERATING ACTIVITIES</b>                                  | <b>9,978</b>                 | <b>6,201</b>    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                |                              |                 |
| Proceeds from maturities and repayments of securities available for sale   | 12,968                       | 14,301          |
| Proceeds from sales of securities available for sale                       | 262                          | 43,263          |
| Purchases of securities available for sale                                 | (14,335)                     | (54,891)        |
| Purchase of restricted stock   | (643 )                       | (391 )          |
| Loan originations and payments, net  | (22,521)                     | (34,409)        |
| Proceeds from sale of other real estate owned                              | 165                          | 131             |
| Additions to premises and equipment  | (89 )                        | (405 )          |
| <b>NET CASH FROM INVESTING ACTIVITIES</b>                                  | <b>(24,193)</b>              | <b>(32,401)</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                |                              |                 |
| Net change in deposits   | 32,440                       | 15,464          |
| Net change in short-term borrowings  | (21,553)                     | 36,768          |
| Repayment of long-term borrowings  | (202 )                       | (5,207 )        |
| Cash dividends paid  | (1,935 )                     | (1,352 )        |
| <b>NET CASH FROM FINANCING ACTIVITIES</b>                                  | <b>8,750</b>                 | <b>45,673</b>   |
| <b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>                             | <b>(5,465 )</b>              | <b>19,473</b>   |
| Beginning cash and cash equivalents  | 57,614                       | 41,778          |
| Ending cash and cash equivalents   | \$52,149                     | \$61,251        |
| Supplemental cash flow information:  |                              |                 |

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|  |         |         |
|--|---------|---------|
| Interest paid                          | \$2,306 | \$1,319 |
| Supplemental noncash disclosures:      |         |         |
| Transfer of loans to other real estate | \$23    | \$0     |
| Security purchases not settled         | \$300   | \$9,886 |
| Issuance of stock awards               | \$706   | \$132   |

See accompanying notes

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

### Principles of Consolidation:

Farmers National Banc Corp. (“Company”) is a Financial Holding Company registered under the Bank Holding Company Act of 1956, as amended. The Company provides full banking services through its nationally chartered subsidiary, The Farmers National Bank of Canfield (“Bank”). The Bank acquired Bowers Insurance Agency, Inc. (“Bowers”) and consolidated the activity of the Bowers with Farmers National Insurance (“Insurance”) during 2016. The Company acquired Monitor Bancorp, Inc. (“Monitor”), the holding company for Monitor Bank in August of 2017 and consolidated all activity within the Bank. Farmers National Captive, Inc. (“Captive”) was formed during the third quarter of 2016 and is a wholly-owned insurance subsidiary of the Company that provides property and casualty insurance coverage to the Company and its subsidiaries. The Captive pools resources with thirteen other similar insurance company subsidiaries of financial institutions to spread a limited amount of risk among themselves and to provide insurance where not currently available or economically feasible in today’s insurance market place. The consolidated financial statements also include the accounts of the Bank’s subsidiaries; Insurance and Farmers of Canfield Investment Co. (“Investments”). The Company provides trust services through its subsidiary, Farmers Trust Company (“Trust”), retirement consulting services through National Associates, Inc. (“NAI”) and insurance services through the Bank’s subsidiary, Insurance. The consolidated financial statements include the accounts of the Company, the Bank and its subsidiaries, along with the Trust, NAI and Captive. All significant intercompany balances and transactions have been eliminated in the consolidation.

### Basis of Presentation:

The unaudited condensed consolidated financial statements have been prepared in conformity with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles (“U.S. GAAP”) for complete financial statements. The financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s 2017 Annual Report to Shareholders included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. The interim consolidated financial statements include all adjustments (consisting of only normal recurring items) that, in the opinion of management, are necessary for a fair presentation of the financial position and results of operations for the periods presented. The results of operations for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for a full year. Certain items included in the prior period financial statements were reclassified to conform to the current period presentation. There was no effect on net income or total stockholders’ equity.

### Estimates:

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Segments:

The Company provides a broad range of financial services to individuals and companies in northeastern Ohio. Operations are managed and financial performance is primarily aggregated and reported in three lines of business, the Bank segment, the Trust segment and the Retirement Consulting segment.

Equity:

The Company, with the approval of shareholders at the April 2018 annual meeting, increased the authorized shares available for issuance from 35,000,000 to 50,000,000 shares. Outstanding shares at March 31, 2018 were 27,640,921.

Comprehensive Income:

Comprehensive income consists of net income and other comprehensive income. Other comprehensive income consists of unrealized gains and losses on securities available for sale and changes in the funded status of the post-retirement health plan, which are recognized as components of stockholders equity, net of tax effect. The post-retirement health plan was eliminated during 2017 and the associated balance sheet accounts, including other comprehensive income were reduced to zero.

New Accounting Standards:

During April of 2017, the FASB issued ASU 2017-08, Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. Under current U.S. GAAP, a premium is typically amortized to the maturity date when a callable debt security is purchased at a premium, even if the holder is certain the call will be exercised. As a

result, upon the exercise of a call on a callable debt security held at a premium, the unamortized premium is recorded as a loss in earnings. The new standard shortens the amortization period for the premium to the earliest call date to more closely align interest income recorded on bonds held at a premium or a discount with the economics of the underlying instrument. The standard takes effect for public business entities for fiscal years and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted, including adoption in an interim period. The Company early adopted this ASU effective January 1, 2018 and there was no material impact on its Consolidated Financial Statements.

In June 2016, the FASB issued ASU 2016-13: Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The ASU requires an organization to measure 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. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 is effective for public companies for annual periods beginning after December 15, 2019, including interim periods within those fiscal years. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Company has begun to accumulate historical credit information, established an internal committee and engaged a software provider in preparation for testing the systems in early 2019. Adoption of ASU 2016-13 will happen on January 1, 2020. Management has not determined the full impact the new standard will have on the Consolidated Financial Statements.

In January 2016, FASB issued ASU 2016-01: Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The main objective of ASU 2016-01 is to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. ASU 2016-01 addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Some of the amendments in ASU 2016-01 include the following: 1) Require equity investments (except 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; 2) Simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; 3) Require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; and 4) 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; among others. The Company adopted this ASU 2016-01 on January 1, 2018 and recorded a cumulative effect adjustment of \$169 thousand increase to retained earnings and a decrease to accumulated other comprehensive income. The change in fair value for equity securities which is now recorded in net income rather than comprehensive income was not material for the three months ended March 31, 2018.

In May 2014, FASB issued ASU 2014-09: Revenue from Contracts with Customers (Topic 606). The ASU creates a new topic, Topic 606, to provide guidance on revenue recognition for entities that enter into contracts with customers to transfer goods or services or enter into contracts for the transfer of nonfinancial assets. 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. Additional disclosures are required to provide quantitative and qualitative information regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new guidance is effective for the Company's year ending December 31, 2018 and was adopted as of January 1, 2018. Interest

income is outside of the scope of the new standard and will not be impacted by the adoption of the standard. An evaluation of the Company's noninterest income streams resulted in no change in revenue recognition since adoption, nor is it expected to change revenue recognition prospectively in a significant way. Refer to the Revenue from Contracts with Customers footnote for further discussion on the Company's accounting for revenue sources within the scope of ASC 606.

The Company adopted ASC 606 using the modified retrospective method applied to all contracts not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606 while prior period amounts continue to be reported in accordance with legacy GAAP. The adoption of ASC 606 did not result in a change to the accounting for any of the in-scope revenue streams; as such, no cumulative effect adjustment was recorded.

#### Business Combinations:

On August 15, 2017, the Company completed the acquisition of Monitor Bancorp, Inc. ("Monitor"), the holding company for Monitor Bank. The transaction involved both cash and 465,787 shares of stock totaling \$7.5 million. Pursuant to the terms of the merger agreement, common shareholders of Monitor were entitled to elect to receive consideration in cash or in common shares, without par value, of the Farmers National Banc Corp., subject to an overall limitation of 85% of the Monitor common shares being exchanged for Farmers common shares and 15% exchanged for cash. The per share cash consideration of \$769.38 is equal to Monitor's March 31



tangible book value multiplied by 1.25. Based on the volume weighted average closing price of Farmers common shares for the 20 trading days ended August 11, 2017 of \$14.04, the final stock exchange ratio was 54.80, resulting in an implied value per Monitor common share of \$769.38.

Goodwill of \$1.0 million, which is recorded on the balance sheet, arising from the acquisition consisted largely of synergies and the cost savings resulting from the combining of the companies. The goodwill was determined not to be deductible for income tax purposes. The fair value of other intangible assets of \$673 thousand is related to core deposits.

The following table summarizes the consideration paid for Monitor and the amounts of the assets acquired and liabilities assumed on the closing date of the acquisition.

| (In Thousands of Dollars)                      |           |
|--|-----------|
| <b>Consideration</b>                           |           |
| Cash   | \$ 1,154  |
| Stock  | 6,358     |
| Fair value of total consideration transferred  | \$ 7,512  |
| <b>Fair value of assets acquired</b>           |           |
| Cash and due from financial institutions       | \$ 17,673 |
| Securities available for sale                  | 3,057     |
| Loans, net                                     | 19,315    |
| Premises and equipment                         | 192       |
| Core deposit intangible                        | 673       |
| Other assets                                   | 272       |
| Total assets                                   | 41,182    |
| <b>Fair value of liabilities assumed</b>       |           |
| Deposits                                       | 34,586    |
| Accrued interest payable and other liabilities | 121       |
| Total liabilities                              | 34,707    |
| Net assets acquired                            | \$ 6,475  |
| Goodwill created                               | 1,037     |
| Total net assets acquired                      | \$ 7,512  |

The valuation of some assets acquired or created including but not limited to net loans and goodwill are preliminary and could be subject to change. The Company does not expect any adjustments to the valuations of these acquired assets to occur and if so the adjustments are not expected to be material.

On June 1, 2016, the Bank completed the acquisition of the Bowers Insurance Agency, Inc., and merged all activity of Bowers with Insurance, the Bank's wholly-owned insurance agency subsidiary. The Bowers group is engage in selling insurance including commercial, farm, home, and auto property/casualty insurance and will help to meet the needs of all the Company's customers. The transaction involved both cash and 123,280 shares of stock totaling \$3.2 million, including up to \$1.2 million of future payments, contingent upon Bowers meeting performance targets, with an estimated fair value at the acquisition date of \$880 thousand. The first of three contingent payments of cash and stock were made, during July 2017, totaling \$316 thousand, which reduce the earnout payable to \$564 thousand. Subsequent to the payment, management conducted a valuation of the contingent consideration and found it necessary to reduce the future payment liability associated with the remaining two payments down to \$200 thousand

at year end 2017. The \$364 thousand was recorded as a reduction to acquisition related costs in the Consolidated Statements of Income as of December 31, 2017. The Company conducts this valuation work annually. The acquisition is part of the Company's plan to increase the levels of noninterest income and to complement the existing insurance services currently being offered.

Goodwill of \$1.8 million, which is recorded on the balance sheet, arising from the acquisition consisted largely of synergies and the cost savings resulting from the combining of the companies. The goodwill was determined not to be deductible for income tax purposes. The fair value of other intangible assets of \$1.6 million is related to client relationships, company name and noncompetition agreements.

The following table summarizes the consideration paid for Bowers and the amounts of the assets acquired and liabilities assumed on the closing date of the acquisition.

| (In Thousands of Dollars)                              |          |
|--|----------|
| <b>Consideration</b>                                   |          |
| Cash   | \$ 1,137 |
| Stock  | 1,138    |
| Contingent consideration                               | 880      |
| Fair value of total consideration transferred          | \$ 3,155 |
| <b>Fair value of assets acquired</b>                   |          |
| Cash   | \$64     |
| Premises and equipment                                 | 290      |
| Other assets   | 34       |
| Total assets acquired                                  | 388      |
| Fair value of liabilities assumed                      | 124      |
| Net assets acquired                                    | \$264    |
| <b>Assets and liabilities arising from acquisition</b> |          |
| Identified intangible assets                           | 1,630    |
| Deferred tax liability                                 | (588 )   |
| Goodwill created                                       | 1,849    |
| Total net assets acquired                              | \$3,155  |

The following table presents pro forma information as if the above acquisition that occurred during August 2017 actually took place at the beginning of 2017. The pro forma information includes adjustments for merger related costs, amortization of intangibles arising from the transaction and the related income tax effects. The pro forma financial information is not necessarily indicative of the results of operations that would have occurred had the transactions been effective on the assumed date.

|  | For<br>Three<br>Months<br>Ended<br>March<br>31,<br>2017 |
|--|---|
| (In thousands of dollars except per share results) |   |
| Net interest income                                | \$17,863  |
| Net income   | \$5,849   |
| Basic and diluted earnings per share               | \$0.21  |

Securities:

The following table summarizes the amortized cost and fair value of the available-for-sale investment securities portfolio at March 31, 2018 and December 31, 2017 and the corresponding amounts of unrealized gains and losses recognized in accumulated other comprehensive income:

| (In Thousands of Dollars)                            | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value     |
|--|-------------------|------------------------------|-------------------------------|-------------------|
| <b>March 31, 2018</b>                                |                   |                              |                               |                   |
| U.S. Treasury and U.S. government sponsored entities | \$ 6,166          | \$ 0                         | \$ (137 )                     | \$ 6,029          |
| State and political subdivisions                     | 191,491           | 1,728                        | (3,185 )                      | 190,034           |
| Corporate bonds                                      | 1,184             | 0                            | (23 )                         | 1,161             |
| Mortgage-backed securities - residential             | 162,503           | 37                           | (5,244 )                      | 157,296           |
| Collateralized mortgage obligations - residential    | 17,151            | 0                            | (1,018 )                      | 16,133            |
| Small Business Administration                        | 14,249            | 0                            | (506 )                        | 13,743            |
| <b>Totals</b>  | <b>\$ 392,744</b> | <b>\$ 1,765</b>              | <b>\$ (10,113 )</b>           | <b>\$ 384,396</b> |

| (In Thousands of Dollars)                            | Amortized<br>Cost | Gross               | Gross                | Fair<br>Value     |
|--|-------------------|---------------------|----------------------|-------------------|
|  |                   | Unrealized<br>Gains | Unrealized<br>Losses |                   |
| <b>December 31, 2017</b>                             |                   |                     |                      |                   |
| U.S. Treasury and U.S. government sponsored entities | \$ 8,986          | \$ 0                | \$ (69 )             | \$ 8,917          |
| State and political subdivisions                     | 188,032           | 3,614               | (643 )               | 191,003           |
| Corporate bonds                                      | 1,238             | 4                   | (8 )                 | 1,234             |
| Mortgage-backed securities - residential             | 161,635           | 419                 | (1,604 )             | 160,450           |
| Collateralized mortgage obligations - residential    | 17,898            | 0                   | (777 )               | 17,121            |
| Small Business Administration                        | 14,608            | 0                   | (396 )               | 14,212            |
| <b>Totals</b>  | <b>\$ 392,397</b> | <b>\$ 4,037</b>     | <b>\$ (3,497 )</b>   | <b>\$ 392,937</b> |

Proceeds from the sale of portfolio securities were \$262 thousand during the three month period ended March 31, 2018. Gross gains of \$4 thousand along with gross losses of \$2 thousand were realized on these sales during the three month period ended March 31, 2018. \$16 thousand of unrealized gains were recognized in the income statement for equity securities during the same three month period as a result of adoption of ASU 2016-01. Proceeds from the sale of portfolio securities were \$43.3 million during the three month period ended March 31, 2017. Gross gains were \$562 thousand and along with gross losses of \$549 thousand during the same three month period ended March 31, 2017.

The amortized cost and fair value of the debt securities portfolio are shown by expected maturity. Expected maturities may differ from contractual maturities if issuers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

| (In Thousands of Dollars)                                      | March 31, 2018    |                   |
|--|-------------------|-------------------|
|  | Amortized<br>Cost | Fair<br>Value     |
| <b>Maturity</b>  |                   |                   |
| Within one year  | \$ 11,302         | \$ 11,255         |
| One to five years  | 47,214            | 47,035            |
| Five to ten years  | 123,704           | 123,070           |
| Beyond ten years   | 16,621            | 15,864            |
| Mortgage-backed, collateralized mortgage obligations and Small |                   |                   |
| Business Administration securities                             | 193,903           | 187,172           |
| <b>Total</b>   | <b>\$ 392,744</b> | <b>\$ 384,396</b> |

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The following table summarizes the investment securities with unrealized losses at March 31, 2018 and December 31, 2017, aggregated by major security type and length of time in a continuous unrealized loss position.

| (In Thousands of Dollars)                            | Less than 12 Months |                    | 12 Months or Longer |                    | Total            |                     |
|--|---------------------|--------------------|---------------------|--------------------|------------------|---------------------|
|  | Fair Value          | Unrealized Loss    | Fair Value          | Unrealized Loss    | Fair Value       | Unrealized Loss     |
| <b>March 31, 2018</b>                                |                     |                    |                     |                    |                  |                     |
| Available-for-sale                                   |                     |                    |                     |                    |                  |                     |
| U.S. Treasury and U.S. government sponsored entities | \$4,175             | \$ (79 )           | \$1,854             | \$ (58 )           | \$6,029          | \$ (137 )           |
| State and political subdivisions                     | 70,499              | (2,019 )           | 24,947              | (1,166 )           | 95,446           | (3,185 )            |
| Corporate bonds                                      | 784                 | (12 )              | 377                 | (11 )              | 1,161            | (23 )               |
| Mortgage-backed securities - residential             | 104,615             | (2,671 )           | 50,549              | (2,573 )           | 155,164          | (5,244 )            |
| Collateralized mortgage obligations - residential    | 1,609               | (37 )              | 14,524              | (981 )             | 16,133           | (1,018 )            |
| Small Business Administration                        | 0                   | 0                  | 13,716              | (506 )             | 13,716           | (506 )              |
| <b>Total</b>   | <b>\$181,682</b>    | <b>\$ (4,818 )</b> | <b>\$105,967</b>    | <b>\$ (5,295 )</b> | <b>\$287,649</b> | <b>\$ (10,113 )</b> |

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| (In Thousands of Dollars)                            | Less than 12<br>Months |                    | 12 Months or Longer |                    | Total            |                    |
|--|------------------------|--------------------|---------------------|--------------------|------------------|--------------------|
|  | Fair<br>Value          | Unrealized<br>Loss | Fair<br>Value       | Unrealized<br>Loss | Fair<br>Value    | Unrealized<br>Loss |
| December 31, 2017                                    |                        |                    |                     |                    |                  |                    |
| Available-for-sale                                   |                        |                    |                     |                    |                  |                    |
| U.S. Treasury and U.S. government sponsored entities | \$3,970                | \$ (34 )           | \$1,912             | \$ (35 )           | \$5,882          | \$ (69 )           |
| State and political subdivisions                     | 33,188                 | (220 )             | 25,721              | (423 )             | 58,909           | (643 )             |
| Corporate bonds                                      | 397                    | (3 )               | 383                 | (5 )               | 780              | (8 )               |
| Mortgage-backed securities - residential             | 40,072                 | (400 )             | 53,760              | (1,204 )           | 93,832           | (1,604 )           |
| Collateralized mortgage obligations - residential    | 1,701                  | (22 )              | 15,420              | (755 )             | 17,121           | (777 )             |
| Small Business Administration                        | 0                      | 0                  | 14,182              | (396 )             | 14,182           | (396 )             |
| <b>Total</b>   | <b>\$79,328</b>        | <b>\$ (679 )</b>   | <b>\$111,378</b>    | <b>\$ (2,818 )</b> | <b>\$190,706</b> | <b>\$ (3,497 )</b> |

#### Other-Than-Temporary-Impairment

Management evaluates securities for other-than-temporary impairment (“OTTI”) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Investment securities are generally evaluated for OTTI under FASB Accounting Standards Codification (“ASC”) 320, Investments – Debt and Equity Securities. Consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, whether the market decline was affected by macroeconomic conditions and whether the Company has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. In analyzing an issuer’s financial condition, the Company may consider whether the securities are issued by the federal government or its agencies, or U.S. government sponsored enterprises, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer’s financial condition. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment, and is based on the information available to management at a point in time.

When OTTI occurs, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis. If an entity intends to sell or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, the OTTI shall be recognized in earnings equal to the entire difference between the investment’s amortized cost basis and its fair value at the balance sheet date. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income or loss. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

As of March 31, 2018, the Company’s security portfolio consisted of 562 securities, 312 of which were in an unrealized loss position. The majority of the unrealized losses on the Company’s securities are related to its holdings of mortgage-backed securities, collateralized mortgage obligations, state and political subdivision securities, and Small Business Administration securities as discussed below.

Unrealized losses on debt securities issued by state and political subdivisions have not been recognized into income. These securities have maintained their investment grade ratings and management does not have the intent and does not expect to be required to sell these securities before their anticipated recovery. The fair value is expected to recover as the securities approach their maturity date.

All of the Company's holdings of collateralized mortgage obligations and residential mortgage-backed securities were issued by U.S. government-sponsored entities. Unrealized losses on these securities have not been recognized into income. Because the decline in fair value is attributable to changes in interest rates and illiquidity, and not credit quality, the issues are guaranteed by the issuing entity which the U.S. government has affirmed its commitment to support, and because the Company does not have the intent to sell these residential mortgage-backed securities and it is likely that it will not be required to sell the securities before their anticipated recovery, the Company does not consider these securities to be OTTI.

Management does not believe any unrealized losses on Small Business Administration securities represent an OTTI. The securities are issued and backed by the full faith and credit of the U.S. government and the Company does not have the intent and does not anticipate that it will be required to sell these securities before their anticipated recovery. The fair value of these securities is expected to recover as they approach their maturity.



## Loans:

Loan balances were as follows:

|                             | March 31,    | December 31, |
|-----------------------------|--------------|--------------|
| (In Thousands of Dollars)   | 2018         | 2017         |
| Originated loans:           |              |              |
| Commercial real estate      |              |              |
| Owner occupied              | \$ 147,907   | \$ 140,321   |
| Non-owner occupied          | 208,306      | 199,080      |
| Farmland                    | 83,800       | 70,534       |
| Other                       | 73,101       | 89,025       |
| Commercial                  |              |              |
| Commercial and industrial   | 207,807      | 193,347      |
| Agricultural                | 29,894       | 32,587       |
| Residential real estate     |              |              |
| 1-4 family residential      | 281,002      | 272,421      |
| Home equity lines of credit | 71,449       | 71,507       |
| Consumer                    |              |              |
| Indirect                    | 160,804      | 155,950      |
| Direct                      | 27,756       | 28,519       |
| Other                       | 8,584        | 8,876        |
| Total originated loans      | \$ 1,300,410 | \$ 1,262,167 |
| Acquired loans:             |              |              |
| Commercial real estate      |              |              |
| Owner occupied              | \$ 51,157    | \$ 53,031    |
| Non-owner occupied          | 19,489       | 20,286       |
| Farmland                    | 45,552       | 47,754       |
| Other                       | 11,668       | 11,964       |
| Commercial                  |              |              |
| Commercial and industrial   | 23,691       | 27,094       |
| Agricultural                | 11,479       | 12,206       |
| Residential real estate     |              |              |
| 1-4 family residential      | 91,616       | 96,759       |
| Home equity lines of credit | 28,283       | 28,755       |
| Consumer                    |              |              |
| Direct                      | 12,837       | 14,378       |
| Other                       | 107          | 128          |
| Total acquired loans        | \$ 295,879   | \$ 312,355   |
| Net Deferred loan costs     | 3,050        | 2,859        |
| Allowance for loan losses   | (12,550 )    | (12,315 )    |
| Net loans                   | \$ 1,586,789 | \$ 1,565,066 |



## Purchased credit impaired loans

As part of past acquisitions the Company acquired various loans that displayed evidence of deterioration of credit quality since origination and which was probable that all contractually required payments would not be collected. The carrying amounts and contractually required payments of these loans which are included in the loan balances above are summarized in the following tables:

|   | March<br>31, | December<br>31, |
|---|--------------|-----------------|
| (In Thousands of Dollars)                                 | 2018         | 2017            |
| Commercial real estate                                    |              |                 |
| Owner occupied  | \$706        | \$ 670          |
| Non-owner occupied  | 378          | 387             |
| Commercial  |              |                 |
| Commercial and industrial                                 | 1,015        | 1,072           |
| Total outstanding balance                                 | \$2,099      | \$ 2,129        |
| Carrying amount, net of allowance of \$0 in 2018 and 2017 | \$1,722      | \$ 1,733        |

Accretable yield, or income expected to be collected, is shown in the table below:

|                           | Three<br>Months<br>Ended<br>March | March  |
|---------------------------|-----------------------------------|--------|
| (In Thousands of Dollars) | 2018                              | 2017   |
| Beginning balance         | \$170                             | \$ 247 |
| New loans purchased       | 0                                 | 0      |
| Accretion of income       | (19 )                             | (19 )  |
| Ending balance            | \$151                             | \$ 228 |

The key assumptions considered include probability of default and the amount of actual prepayments after the acquisition date. Prepayments affect the estimated life of the loans and could change the amount of interest income and principal expected to be collected. In reforecasting future estimated cash flows, credit loss expectations are adjusted as necessary. There were no adjustments to forecasted cash flows that impacted the allowance for loan losses for the three month period ended March 31, 2018.

The following tables present the activity in the allowance for loan losses by portfolio segment for the three month periods ended March 31, 2018 and 2017:

## Three Months Ended March 31, 2018

| (In Thousands of Dollars)      | Commercial  |            | Residential |          |             | Total    |
|--------------------------------|-------------|------------|-------------|----------|-------------|----------|
|                                | Real Estate | Commercial | Real Estate | Consumer | Unallocated |          |
| Allowance for loan losses      |             |            |             |          |             |          |
| Beginning balance              | \$ 4,260    | \$ 2,011   | \$ 2,521    | \$ 2,848 | \$ 675      | \$12,315 |
| Provision for loan losses      | 142         | 147        | 75          | 527      | (116 )      | 775      |
| Loans charged off              | 0           | (97 )      | (56 )       | (629 )   | 0           | (782 )   |
| Recoveries                     | 2           | 1          | 61          | 178      | 0           | 242      |
| Total ending allowance balance | \$ 4,404    | \$ 2,062   | \$ 2,601    | \$ 2,924 | \$ 559      | \$12,550 |

Three Months Ended March 31, 2017

| (In Thousands of Dollars)      | Commercial  |            | Residential |          |             | Total    |
|--------------------------------|-------------|------------|-------------|----------|-------------|----------|
|                                | Real Estate | Commercial | Real Estate | Consumer | Unallocated |          |
| Allowance for loan losses      |             |            |             |          |             |          |
| Beginning balance              | \$ 3,577    | \$ 1,874   | \$ 2,205    | \$ 2,766 | \$ 430      | \$10,852 |
| Provision for loan losses      | 77          | 17         | 109         | 576      | 271         | 1,050    |
| Loans charged off              | (140 )      | (102 )     | (6 )        | (695 )   | 0           | (943 )   |
| Recoveries                     | 124         | 57         | 13          | 166      | 0           | 360      |
| Total ending allowance balance | \$ 3,638    | \$ 1,846   | \$ 2,321    | \$ 2,813 | \$ 701      | \$11,319 |

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment, based on impairment method as of March 31, 2018 and December 31, 2017. The recorded investment in loans includes the unpaid principal balance and unamortized loan origination fees and costs, but excludes accrued interest receivable, which is not considered to be material:

March 31, 2018

| (In Thousands of Dollars)                            | Commercial        |                   | Residential       |                   |               | Total               |
|--|-------------------|-------------------|-------------------|-------------------|---------------|---------------------|
|  | Real Estate       | Commercial        | Real Estate       | Consumer          | Unallocated   |                     |
| <b>Allowance for loan losses:</b>                    |                   |                   |                   |                   |               |                     |
| Ending allowance balance attributable to loans:      |                   |                   |                   |                   |               |                     |
| Individually evaluated for impairment                | \$ 0              | \$ 3              | \$ 206            | \$ 1              | \$ 0          | \$ 210              |
| Collectively evaluated for impairment                | 4,352             | 2,043             | 2,350             | 2,919             | 559           | 12,223              |
| Acquired loans collectively evaluated for impairment | 52                | 16                | 45                | 4                 | 0             | 117                 |
| Acquired with deteriorated credit quality            | 0                 | 0                 | 0                 | 0                 | 0             | 0                   |
| <b>Total ending allowance balance</b>                | <b>\$ 4,404</b>   | <b>\$ 2,062</b>   | <b>\$ 2,601</b>   | <b>\$ 2,924</b>   | <b>\$ 559</b> | <b>\$ 12,550</b>    |
| <b>Loans:</b>  |                   |                   |                   |                   |               |                     |
| Loans individually evaluated for impairment          | \$ 537            | \$ 255            | \$ 4,553          | \$ 65             | \$ 0          | \$ 5,410            |
| Loans collectively evaluated for impairment          | 511,423           | 237,114           | 347,718           | 202,388           | 0             | 1,298,643           |
| Acquired loans                                       | 126,721           | 34,425            | 119,475           | 12,943            | 0             | 293,564             |
| Acquired with deteriorated credit quality            | 987               | 735               | 0                 | 0                 | 0             | 1,722               |
| <b>Total ending loans balance</b>                    | <b>\$ 639,668</b> | <b>\$ 272,529</b> | <b>\$ 471,746</b> | <b>\$ 215,396</b> | <b>\$ 0</b>   | <b>\$ 1,599,339</b> |

December 31, 2017

| (In Thousands of Dollars)                            | Commercial  |            | Residential |            |             | Unallocated  | Total |
|--|-------------|------------|-------------|------------|-------------|--------------|-------|
|  | Real Estate | Commercial | Real Estate | Consumer   | Unallocated |              |       |
| Allowance for loan losses:                           |             |            |             |            |             |              |       |
| Ending allowance balance attributable to loans:      |             |            |             |            |             |              |       |
| Individually evaluated for impairment                | \$ 0        | \$ 4       | \$ 158      | \$ 0       | \$ 0        | \$ 162       |       |
| Collectively evaluated for impairment                | 4,214       | 1,993      | 2,322       | 2,844      | 675         | 12,048       |       |
| Acquired loans collectively evaluated for impairment | 46          | 14         | 41          | 4          | 0           | 105          |       |
| Acquired with deteriorated credit quality            | 0           | 0          | 0           | 0          | 0           | 0            |       |
| Total ending allowance balance                       | \$ 4,260    | \$ 2,011   | \$ 2,521    | \$ 2,848   | \$ 675      | \$ 12,315    |       |
| Loans:   |             |            |             |            |             |              |       |
| Loans individually evaluated for impairment          | \$ 658      | \$ 260     | \$ 4,559    | \$ 59      | \$ 0        | \$ 5,536     |       |
| Loans collectively evaluated for impairment          | 497,168     | 225,312    | 339,143     | 198,370    | 0           | 1,259,993    |       |
| Acquired loans                                       | 131,926     | 38,503     | 125,182     | 14,507     | 0           | 310,118      |       |
| Acquired with deteriorated credit quality            | 948         | 786        | 0           | 0          | 0           | 1,734        |       |
| Total ending loans balance                           | \$ 630,700  | \$ 264,861 | \$ 468,884  | \$ 212,936 | \$ 0        | \$ 1,577,381 |       |

The following tables present information related to impaired loans by class of loans as of March 31, 2018 and December 31, 2017:

| (In Thousands of Dollars)           | Unpaid    |            | Allowance       |
|-------------------------------------|-----------|------------|-----------------|
|                                     | Principal | Recorded   | for Loan Losses |
|                                     | Balance   | Investment | Allocated       |
| March 31, 2018                      |           |            |                 |
| With no related allowance recorded: |           |            |                 |
| Commercial real estate              |           |            |                 |
| Owner occupied                      | \$ 536    | \$ 537     | \$ 0            |
| Commercial                          |           |            |                 |
| Commercial and industrial           | 210       | 189        | 0               |
| Residential real estate             |           |            |                 |
| 1-4 family residential              | 2,849     | 2,630      | 0               |
| Home equity lines of credit         | 331       | 319        | 0               |
| Consumer                            | 159       | 63         | 0               |
| Subtotal                            | 4,085     | 3,738      | 0               |

|                             |          |          |        |
|-----------------------------|----------|----------|--------|
| With an allowance recorded: |          |          |        |
| Commercial                  |          |          |        |
| Commercial and industrial   | 66       | 66       | 3      |
| Residential real estate     |          |          |        |
| 1-4 family residential      | 1,473    | 1,447    | 131    |
| Home equity lines of credit | 169      | 157      | 75     |
| Consumer                    | 2        | 2        | 1      |
| Subtotal                    | 1,710    | 1,672    | 210    |
| Total                       | \$ 5,795 | \$ 5,410 | \$ 210 |

|                                     | Unpaid<br>Principal | Recorded<br>Investment | Allowance<br>for<br>Loan<br>Losses<br>Allocated |
|-------------------------------------|---------------------|------------------------|---|
| (In Thousands of Dollars)           | Balance             | Investment             | Allocated                                       |
| December 31, 2017                   |                     |                        |   |
| With no related allowance recorded: |                     |                        |   |
| Commercial real estate              |                     |                        |   |
| Owner occupied                      | \$ 659              | \$ 658                 | \$ 0  |
| Commercial                          |                     |                        |   |
| Commercial and industrial           | 214                 | 192                    | 0   |
| Residential real estate             |                     |                        |   |
| 1-4 family residential              | 2,923               | 2,697                  | 0   |
| Home equity lines of credit         | 341                 | 319                    | 0   |
| Consumer                            | 145                 | 59                     | 0   |
| Subtotal                            | 4,282               | 3,925                  | 0   |
| With an allowance recorded:         |                     |                        |   |
| Commercial                          |                     |                        |   |
| Commercial and industrial           | 68                  | 68                     | 4   |
| Residential real estate             |                     |                        |   |
| 1-4 family residential              | 1,409               | 1,387                  | 84  |
| Home equity lines of credit         | 159                 | 156                    | 74  |
| Subtotal                            | 1,636               | 1,611                  | 162   |
| Total                               | \$ 5,918            | \$ 5,536               | \$ 162  |

The following tables present the average recorded investment in impaired loans by class and interest income recognized by loan class for the three month periods ended March 31, 2018 and 2017:

|                                     | Average<br>Recorded<br>Investment              |         | Interest<br>Income<br>Recognized<br>For Three<br>Months<br>Ended |      |
|-------------------------------------|--|---------|--|------|
| (In Thousands of Dollars)           | For Three<br>Months Ended<br>March 31,<br>2018 | 2017    | March 31,<br>2018  | 2017 |
| With no related allowance recorded: |  |         |  |      |
| Commercial real estate              |  |         |  |      |
| Owner occupied                      | \$420  | \$1,051 | \$ 7   | \$ 2 |
| Non-owner occupied                  | 0  | 226     | 0  | 0    |
| Commercial                          |  |         |  |      |
| Commercial and industrial           | 873  | 210     | 1  | 1    |
| Residential real estate             |  |         |  |      |



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|                             |         |         |       |       |
|-----------------------------|---------|---------|-------|-------|
| 1-4 family residential      | 2,636   | 2,380   | 49    | 37    |
| Home equity lines of credit | 325     | 227     | 4     | 4     |
| Consumer                    | 63      | 74      | 3     | 3     |
| Subtotal                    | 4,317   | 4,168   | 64    | 47    |
| With an allowance recorded: |         |         |       |       |
| Commercial real estate      |         |         |       |       |
| Owner occupied              | 0       | 422     | 0     | 2     |
| Non-owner occupied          | 0       | 1,107   | 0     | 14    |
| Commercial                  |         |         |       |       |
| Commercial and industrial   | 67      | 273     | 1     | 1     |
| Residential real estate     |         |         |       |       |
| 1-4 family residential      | 1,429   | 773     | 10    | 8     |
| Home equity lines of credit | 155     | 82      | 2     | 1     |
| Consumer                    | 1       | 1       | 0     | 0     |
| Subtotal                    | 1,652   | 2,658   | 13    | 26    |
| Total                       | \$5,969 | \$6,826 | \$ 77 | \$ 73 |

Cash basis interest recognized during the three month periods ended March 31, 2018 and 2017 was materially equal to interest income recognized.

Nonaccrual loans and loans past due 90 days or more still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following table presents the recorded investment in nonaccrual and loans past due 90 days or more still on accrual by class of loans as of March 31, 2018 and December 31, 2017:

| (In Thousands of Dollars)      | March 31, 2018    |                | December 31, 2017 |                 |
|--------------------------------|-------------------|----------------|-------------------|-----------------|
|                                | Loans Past Due    |                | Loans Past Due    |                 |
|                                | 90 Days or More   |                | 90 Days or More   |                 |
|                                | Still Nonaccruing | Still Accruing | Still Nonaccruing | Still Accruing  |
| <b>Originated loans:</b>       |                   |                |                   |                 |
| <b>Commercial real estate</b>  |                   |                |                   |                 |
| Owner occupied                 | \$381             | \$ 0           | \$501             | \$ 0            |
| Farmland                       | 41                | 0              | 45                | 0               |
| <b>Commercial</b>              |                   |                |                   |                 |
| Commercial and industrial      | 271               | 0              | 249               | 0               |
| Agricultural                   | 0                 | 35             | 2                 | 0               |
| <b>Residential real estate</b> |                   |                |                   |                 |
| 1-4 family residential         | 2,730             | 300            | 2,653             | 393             |
| Home equity lines of credit    | 651               | 7              | 602               | 8               |
| <b>Consumer</b>                |                   |                |                   |                 |
| Indirect                       | 405               | 183            | 457               | 361             |
| Direct                         | 85                | 151            | 63                | 153             |
| Other                          | 90                | 19             | 0                 | 14              |
| <b>Total originated loans</b>  | <b>\$4,654</b>    | <b>\$ 695</b>  | <b>\$4,572</b>    | <b>\$ 929</b>   |
| <b>Acquired loans:</b>         |                   |                |                   |                 |
| <b>Commercial real estate</b>  |                   |                |                   |                 |
| Non-owner occupied             | \$118             | \$ 0           | \$216             | \$ 0            |
| Farmland                       | 257               | 0              | 0                 | 0               |
| <b>Commercial</b>              |                   |                |                   |                 |
| Commercial and industrial      | 926               | 59             | 943               | 19              |
| Agricultural                   | 5                 | 0              | 9                 | 0               |
| <b>Residential real estate</b> |                   |                |                   |                 |
| 1-4 family residential         | 795               | 66             | 613               | 69              |
| Home equity lines of credit    | 167               | 0              | 170               | 0               |
| <b>Consumer</b>                |                   |                |                   |                 |
| Direct                         | 105               | 46             | 140               | 15              |
| <b>Total acquired loans</b>    | <b>\$2,373</b>    | <b>\$ 171</b>  | <b>\$2,091</b>    | <b>\$ 103</b>   |
| <b>Total loans</b>             | <b>\$7,027</b>    | <b>\$ 866</b>  | <b>\$6,663</b>    | <b>\$ 1,032</b> |



The following tables present the aging of the recorded investment in past due loans as of March 31, 2018 and December 31, 2017 by class of loans:

|                             | 30-59   | 60-89   |                 |          |             |             |
|-----------------------------|---------|---------|-----------------|----------|-------------|-------------|
|                             | Days    | Days    | 90 Days or More | Total    |             |             |
|                             | Past    | Past    | Past Due        | Past     | Loans Not   |             |
| (In Thousands of Dollars)   | Due     | Due     | and Nonaccrual  | Due      | Past Due    | Total       |
| <b>March 31, 2018</b>       |         |         |                 |          |             |             |
| Originated loans:           |         |         |                 |          |             |             |
| Commercial real estate      |         |         |                 |          |             |             |
| Owner occupied              | \$167   | \$3     | \$ 381          | \$551    | \$146,937   | \$147,488   |
| Non-owner occupied          | 0       | 0       | 0               | 0        | 207,770     | 207,770     |
| Farmland                    | 0       | 0       | 41              | 41       | 83,657      | 83,698      |
| Other                       | 0       | 0       | 0               | 0        | 72,841      | 72,841      |
| Commercial                  |         |         |                 |          |             |             |
| Commercial and industrial   | 228     | 79      | 271             | 578      | 206,788     | 207,366     |
| Agricultural                | 124     | 12      | 35              | 171      | 29,823      | 29,994      |
| Residential real estate     |         |         |                 |          |             |             |
| 1-4 family residential      | 1,235   | 76      | 3,030           | 4,341    | 276,027     | 280,368     |
| Home equity lines of credit | 60      | 106     | 658             | 824      | 70,654      | 71,478      |
| Consumer                    |         |         |                 |          |             |             |
| Indirect                    | 1,730   | 467     | 588             | 2,785    | 163,143     | 165,928     |
| Direct                      | 670     | 335     | 236             | 1,241    | 26,699      | 27,940      |
| Other                       | 122     | 25      | 109             | 256      | 8,328       | 8,584       |
| Total originated loans:     | \$4,336 | \$1,103 | \$ 5,349        | \$10,788 | \$1,292,667 | \$1,303,455 |
| Acquired loans:             |         |         |                 |          |             |             |
| Commercial real estate      |         |         |                 |          |             |             |
| Owner occupied              | \$24    | \$0     | \$ 0            | \$24     | \$51,180    | \$51,204    |
| Non-owner occupied          | 0       | 0       | 118             | 118      | 19,327      | 19,445      |
| Farmland                    | 78      | 0       | 257             | 335      | 45,218      | 45,553      |
| Other                       | 78      | 0       | 0               | 78       | 11,591      | 11,669      |
| Commercial                  |         |         |                 |          |             |             |
| Commercial and industrial   | 29      | 4       | 985             | 1,018    | 22,672      | 23,690      |
| Agricultural                | 14      | 0       | 5               | 19       | 11,460      | 11,479      |
| Residential real estate     |         |         |                 |          |             |             |
| 1-4 family residential      | 696     | 0       | 861             | 1,557    | 90,060      | 91,617      |
| Home equity lines of credit | 193     | 0       | 167             | 360      | 27,923      | 28,283      |
| Consumer                    |         |         |                 |          |             |             |
| Direct                      | 399     | 18      | 151             | 568      | 12,269      | 12,837      |
| Other                       | 0       | 1       | 0               | 1        | 106         | 107         |
| Total acquired loans        | \$1,511 | \$23    | \$ 2,544        | \$4,078  | \$291,806   | \$295,884   |
| Total loans                 | \$5,847 | \$1,126 | \$ 7,893        | \$14,866 | \$1,584,473 | \$1,599,339 |

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|                             | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | 90 Days or More<br>Past Due<br>and Nonaccrual | Total<br>Past<br>Due | Loans Not<br>Past Due | Total       |
|-----------------------------|------------------------------|------------------------------|---|----------------------|-----------------------|-------------|
| (In Thousands of Dollars)   |                              |                              |   |                      |                       |             |
| December 31, 2017           |                              |                              |   |                      |                       |             |
| Originated loans:           |                              |                              |   |                      |                       |             |
| Commercial real estate      |                              |                              |   |                      |                       |             |
| Owner occupied              | \$4                          | \$340                        | \$ 501  | \$845                | \$139,081             | \$139,926   |
| Non-owner occupied          | 0                            | 0                            | 0   | 0                    | 198,588               | 198,588     |
| Farmland                    | 0                            | 0                            | 45  | 45                   | 70,398                | 70,443      |
| Other                       | 0                            | 0                            | 0   | 0                    | 88,703                | 88,703      |
| Commercial                  |                              |                              |   |                      |                       |             |
| Commercial and industrial   | 292                          | 3                            | 249   | 544                  | 192,335               | 192,879     |
| Agricultural                | 74                           | 0                            | 2   | 76                   | 32,605                | 32,681      |
| Residential real estate     |                              |                              |   |                      |                       |             |
| 1-4 family residential      | 2,044                        | 403                          | 3,046   | 5,493                | 266,338               | 271,831     |
| Home equity lines of credit | 155                          | 18                           | 610   | 783                  | 70,754                | 71,537      |
| Consumer                    |                              |                              |   |                      |                       |             |
| Indirect                    | 2,429                        | 829                          | 818   | 4,076                | 156,772               | 160,848     |
| Direct                      | 632                          | 250                          | 216   | 1,098                | 27,608                | 28,706      |
| Other                       | 115                          | 11                           | 14  | 140                  | 8,736                 | 8,876       |
| Total originated loans      | \$5,745                      | \$1,854                      | \$ 5,501                                      | \$13,100             | \$1,251,918           | \$1,265,018 |
| Acquired loans:             |                              |                              |   |                      |                       |             |
| Commercial real estate      |                              |                              |   |                      |                       |             |
| Owner occupied              | \$0                          | \$0                          | \$ 0  | \$0                  | \$53,051              | \$53,051    |
| Non-owner occupied          | 0                            | 0                            | 216   | 216                  | 20,042                | 20,258      |
| Farmland                    | 454                          | 0                            | 0   | 454                  | 47,301                | 47,755      |
| Other                       | 0                            | 0                            | 0   | 0                    | 11,976                | 11,976      |
| Commercial                  |                              |                              |   |                      |                       |             |
| Commercial and industrial   | 327                          | 96                           | 962   | 1,385                | 25,709                | 27,094      |
| Agricultural                | 87                           | 0                            | 9   | 96                   | 12,111                | 12,207      |
| Residential real estate     |                              |                              |   |                      |                       |             |
| 1-4 family residential      | 858                          | 77                           | 682   | 1,617                | 95,144                | 96,761      |
| Home equity lines of credit | 161                          | 0                            | 170   | 331                  | 28,424                | 28,755      |
| Consumer                    |                              |                              |   |                      |                       |             |
| Direct                      | 380                          | 151                          | 155   | 686                  | 13,692                | 14,378      |
| Other                       | 0                            | 1                            | 0   | 1                    | 127                   | 128         |
| Total acquired loans        | \$2,267                      | \$325                        | \$ 2,194                                      | \$4,786              | \$307,577             | \$312,363   |
| Total loans                 | \$8,012                      | \$2,179                      | \$ 7,695                                      | \$17,886             | \$1,559,495           | \$1,577,381 |

Troubled Debt Restructurings:

Total troubled debt restructurings were \$5.3 million and \$5.0 million at March 31, 2018 and December 31, 2017, respectively. The Company has allocated \$75 thousand and \$68 thousand of specific reserves to customers whose

loan terms have been modified in troubled debt restructurings at March 31, 2018 and December 31, 2017, respectively. There were no commitments to lend additional amounts to borrowers with loans that were classified as troubled debt restructurings at March 31, 2018 and at December 31, 2017.

During the three month period ended March 31, 2018 and 2017, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; a deferral of principal and interest; or a legal concession. During the three month period ended March 31, 2018, the terms of such loans included a reduction of the stated interest rate of the loan by 1.75% and an extension of the maturity date on these and other troubled debt restructurings by 6 months. During the same three month period in 2017, the terms of such loans included a reduction of the stated interest rate of the loan by 1.89% and extensions of the maturity dates in the range of 6 to 132 months.

The following table presents loans by class modified as troubled debt restructurings that occurred during the three month periods ended March 31, 2018 and 2017:

| Three Months Ended March 31, 2018<br>(In thousands of Dollars) | Number<br>of<br>Loans | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment |
|--|-----------------------|---|--|
| <b>Originated loans:</b>                                       |                       |   |  |
| Commercial real estate   |                       |   |  |
| Owner occupied   | 1                     | \$ 360  | \$ 360   |
| Residential real estate  |                       |   |  |
| 1-4 family residential   | 3                     | \$ 43   | \$ 43  |
| Home equity lines of credit                                    | 2                     | 14  | 14   |
| Indirect   | 5                     | 29  | 29   |
| Total originated loans   | 11                    | \$ 446  | \$ 446   |
| <b>Acquired loans:</b>   |                       |   |  |
| Residential real estate  |                       |   |  |
| 1-4 family residential   | 4                     | 108   | 108  |
| Total loans  | 15                    | \$ 554  | \$ 554   |

| Three Months Ended March 31, 2017<br>(In thousands of Dollars) | Number<br>of<br>Loans | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment |
|--|-----------------------|---|--|
| <b>Originated loans:</b>                                       |                       |   |  |
| Residential real estate  |                       |   |  |
| 1-4 family residential   | 6                     | \$ 284  | \$ 287   |
| Home equity lines of credit                                    | 5                     | 94  | 94   |
| Indirect   | 4                     | 16  | 16   |
| Total originated loans   | 15                    | \$ 394  | \$ 397   |
| <b>Acquired loans:</b>   |                       |   |  |
| Residential real estate  |                       |   |  |
| Home equity lines of credit                                    | 1                     | 57  | 57   |
| Total loans  | 16                    | \$ 451  | \$ 454   |

There were \$19 thousand and \$13 thousand in charge offs and a \$19 thousand and \$13 thousand increase to the provision for loan losses during the three month period ended March 31, 2018 and 2017, respectively as a result of troubled debt restructurings.

There were three residential real estate loans for which there was a payment default within twelve months following the modification of the troubled debt restructuring during the three month period ended March 31, 2018. These loans were not past due at March 31, 2018. There was no provision recorded as a result of the defaults during 2018. A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

There were no loans for which there was a payment default within twelve months following the modification of the troubled debt restructuring during the three month period ended March 31, 2017. A loan is considered to be in payment default once it is 30 days contractually past due under the modified terms.

Credit Quality Indicators:

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 establishes a risk rating at origination for all commercial loan and commercial real estate relationships. For relationships over \$750 thousand, management monitors the loans on an ongoing basis for any changes in the borrower's ability to service their debt. Management also affirms the risk ratings for the loans and leases in their respective portfolios on an annual basis. The Company uses the following definitions for risk ratings:



**Special Mention.** Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

**Substandard.** Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Substandard loans are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

**Doubtful.** Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with 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 not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans.

As of March 31, 2018 and December 31, 2017, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

| (In Thousands of Dollars)     | Pass              | Special<br>Mention | Sub<br>standard  | Total             |
|-------------------------------|-------------------|--------------------|------------------|-------------------|
| <b>March 31, 2018</b>         |                   |                    |                  |                   |
| <b>Originated loans:</b>      |                   |                    |                  |                   |
| <b>Commercial real estate</b> |                   |                    |                  |                   |
| Owner occupied                | \$ 145,393        | \$ 1,023           | \$ 1,072         | \$ 147,488        |
| Non-owner occupied            | 207,243           | 406                | 121              | 207,770           |
| Farmland                      | 83,614            | 0                  | 84               | 83,698            |
| Other                         | 72,566            | 0                  | 275              | 72,841            |
| <b>Commercial</b>             |                   |                    |                  |                   |
| Commercial and industrial     | 198,779           | 5,423              | 3,164            | 207,366           |
| Agricultural                  | 29,423            | 340                | 231              | 29,994            |
| <b>Total originated loans</b> | <b>\$ 737,018</b> | <b>\$ 7,192</b>    | <b>\$ 4,947</b>  | <b>\$ 749,157</b> |
| <b>Acquired loans:</b>        |                   |                    |                  |                   |
| <b>Commercial real estate</b> |                   |                    |                  |                   |
| Owner occupied                | \$ 49,267         | \$ 458             | \$ 1,479         | \$ 51,204         |
| Non-owner occupied            | 19,140            | 36                 | 269              | 19,445            |
| Farmland                      | 40,596            | 3,707              | 1,250            | 45,553            |
| Other                         | 10,998            | 0                  | 671              | 11,669            |
| <b>Commercial</b>             |                   |                    |                  |                   |
| Commercial and industrial     | 21,638            | 264                | 1,788            | 23,690            |
| Agricultural                  | 10,515            | 512                | 452              | 11,479            |
| <b>Total acquired loans</b>   | <b>\$ 152,154</b> | <b>\$ 4,977</b>    | <b>\$ 5,909</b>  | <b>\$ 163,040</b> |
| <b>Total loans</b>            | <b>\$ 889,172</b> | <b>\$ 12,169</b>   | <b>\$ 10,856</b> | <b>\$ 912,197</b> |



|                           | Special    | Sub      |          |            |
|---------------------------|------------|----------|----------|------------|
| (In Thousands of Dollars) | Pass       | Mention  | standard | Total      |
| December 31, 2017         |            |          |          |            |
| Originated loans:         |            |          |          |            |
| Commercial real estate    |            |          |          |            |
| Owner occupied            | \$ 137,913 | \$442    | \$ 1,571 | \$ 139,926 |
| Non-owner occupied        | 198,043    | 419      | 126      | 198,588    |
| Farmland                  | 70,354     | 44       | 45       | 70,443     |
| Other                     | 88,421     | 36       | 246      | 88,703     |
| Commercial                |            |          |          |            |
| Commercial and industrial | 184,444    | 5,326    | 3,109    | 192,879    |
| Agricultural              | 32,291     | 192      | 198      | 32,681     |
| Total originated loans    | \$711,466  | \$6,459  | \$5,295  | \$723,220  |
| Acquired loans:           |            |          |          |            |
| Commercial real estate    |            |          |          |            |
| Owner occupied            | \$51,133   | \$466    | \$1,452  | \$53,051   |
| Non-owner occupied        | 19,823     | 63       | 372      | 20,258     |
| Farmland                  | 43,694     | 3,304    | 757      | 47,755     |
| Other                     | 11,299     | 567      | 110      | 11,976     |
| Commercial                |            |          |          |            |
| Commercial and industrial | 25,286     | 2        | 1,806    | 27,094     |
| Agricultural              | 11,200     | 554      | 453      | 12,207     |
| Total acquired loans      | \$162,435  | \$4,956  | \$4,950  | \$172,341  |
| Total loans               | \$873,901  | \$11,415 | \$10,245 | \$895,561  |

The Company considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential, consumer indirect and direct loan classes, the Company also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. In the 1-4 family residential real estate portfolio at March 31, 2018, there were \$59 thousand of other real estate owned properties and \$903 thousand of properties in foreclosure. Other real estate owned and foreclosure properties were \$171 thousand and \$336 thousand at December 31, 2017, respectively.

The following tables present the recorded investment in residential, consumer indirect and direct auto loans based on payment activity as of March 31, 2018 and December 31, 2017. Nonperforming loans are loans past due 90 days or more and still accruing interest and nonaccrual loans.

|                           | Residential Real<br>Estate | Home<br>Equity<br>Lines of<br>Credit | Consumer<br>Indirect | Direct   | Other   |
|---------------------------|----------------------------|--------------------------------------|----------------------|----------|---------|
| (In Thousands of Dollars) |                            |                                      |                      |          |         |
| March 31, 2018            |                            |                                      |                      |          |         |
| Originated loans:         |                            |                                      |                      |          |         |
| Performing                | \$277,338                  | \$70,820                             | \$165,340            | \$27,704 | \$8,475 |

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|                        |           |          |           |          |         |
|------------------------|-----------|----------|-----------|----------|---------|
| Nonperforming          | 3,030     | 658      | 588       | 236      | 109     |
| Total originated loans | \$280,368 | \$71,478 | \$165,928 | \$27,940 | \$8,584 |
| Acquired loans:        |           |          |           |          |         |
| Performing             | \$90,756  | \$28,116 | \$0       | \$12,686 | \$107   |
| Nonperforming          | 861       | 167      | 0         | 151      | 0       |
| Total acquired loans   | 91,617    | 28,283   | 0         | 12,837   | 107     |
| Total loans            | \$371,985 | \$99,761 | \$165,928 | \$40,777 | \$8,691 |

| (In Thousands of Dollars)     | Residential Real Estate |                    | Consumer         |                 |                |
|-------------------------------|-------------------------|--------------------|------------------|-----------------|----------------|
|                               | 1-4 Family Residential  | Home Equity Credit | Indirect         | Direct          | Other          |
| <b>December 31, 2017</b>      |                         |                    |                  |                 |                |
| <b>Originated loans:</b>      |                         |                    |                  |                 |                |
| Performing                    | \$268,785               | \$70,927           | \$160,030        | \$28,490        | \$8,862        |
| Nonperforming                 | 3,046                   | 610                | 818              | 216             | 14             |
| <b>Total originated loans</b> | <b>\$271,831</b>        | <b>\$71,537</b>    | <b>\$160,848</b> | <b>\$28,706</b> | <b>\$8,876</b> |
| <b>Acquired loans:</b>        |                         |                    |                  |                 |                |
| Performing                    | \$96,079                | \$28,585           | \$0              | \$14,223        | \$128          |
| Nonperforming                 | 682                     | 170                | 0                | 155             | 0              |
| <b>Total acquired loans</b>   | <b>96,761</b>           | <b>28,755</b>      | <b>0</b>         | <b>14,378</b>   | <b>128</b>     |
| <b>Total loans</b>            | <b>\$368,592</b>        | <b>\$100,292</b>   | <b>\$160,848</b> | <b>\$43,084</b> | <b>\$9,004</b> |

Revenue from Contracts with Customers

All material revenue from contracts with customers in the scope of ASC 606 is recognized within noninterest income. The following table presents the Company's noninterest income by revenue stream and reportable segment, net of eliminations, for the three months ended March 31, 2018 and 2017. Items outside the scope of ASC 606 are noted as such.

| (In Thousands of Dollars)                    | Retirement      |                 |                    | Totals         |
|--|-----------------|-----------------|--------------------|----------------|
|  | Trust Segment   | Bank Segment    | Consulting Segment |                |
| <b>For Three Months Ended March 31, 2018</b> |                 |                 |                    |                |
| Service charges on deposit accounts          | \$ 0            | \$ 1,003        | \$ 0               | \$1,003        |
| Debit card interchange fees                  | 0               | 806             | 0                  | 806            |
| Trust Fees                                   | 1,807           | 0               | 0                  | 1,807          |
| Insurance agency commissions                 | 0               | 699             | 0                  | 699            |
| Retirement plan consulting fees              | 0               | 0               | 379                | 379            |
| Investment commissions                       | 0               | 256             | 0                  | 256            |
| Other (1)                                    | 0               | 1,060           | 0                  | 1,060          |
| <b>Total noninterest income</b>              | <b>\$ 1,807</b> | <b>\$ 3,824</b> | <b>\$ 379</b>      | <b>\$6,010</b> |

(In Thousands of Dollars)

| Trust | Bank | Retirement | Totals |
|-------|------|------------|--------|
|-------|------|------------|--------|

## Segment Segment Consulting

## Segment

For Three Months Ended March 31, 2017

|                                     |          |          |        |          |
|-------------------------------------|----------|----------|--------|----------|
| Service charges on deposit accounts | \$ 0     | \$ 951   | \$ 0   | \$ 951   |
| Debit card interchange fees         | 0        | 653      | 0      | 653      |
| Trust Fees                          | 1,678    | 0        | 0      | 1,678    |
| Insurance agency commissions        | 0        | 674      | 0      | 674      |
| Retirement plan consulting fees     | 0        | 0        | 513    | 513      |
| Investment commissions              | 0        | 222      | 0      | 222      |
| Other (1)                           | 0        | 1,196    | 0      | 1,196    |
| Total noninterest income            | \$ 1,678 | \$ 3,696 | \$ 513 | \$ 5,887 |

(1) Not within the scope of ASC 606.

A description of the Company's revenue streams under ASC 606 follows:

Service charges on deposit accounts – The Company earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Management reviewed the deposit account agreements, and determined that the agreements can be terminated at any time by either the Bank or the account holder. Transaction fees, such as balance transfers, wires and overdraft charges are settled the day the performance obligation is satisfied. The Bank's monthly service charges and maintenance fees are for services provided to the customer on a monthly basis and are considered a series of services that have the same pattern of transfer each month. The review of service charges assessed on deposit accounts, included the amount of variable consideration that is a part of the

monthly charges. It was found that the waiver of service charges due to insufficient funds and dormant account fees is immaterial and would not require a change in the accounting treatment for these fees under the new revenue standards. Any amounts within the scope of ASC 606 are deemed immaterial.

**Debit Card Interchange Fees** – Customers and the Bank have an account agreement and maintain deposit balances with the Bank. Customers use a bank issued debit card to purchase goods and services, and the Bank earns interchange fees on those transactions, typically a percentage of the sale amount of the transaction. The Bank records the amount due when it receives the settlement from the payment network. Payments from the payment network are received and recorded into income on a daily basis. There are no contingent debit card interchange fees recorded by the Company that could be subject to a clawback in future periods. Any amounts within the scope of ASC 606 are deemed immaterial.

**Trust fees** – Services provided to Trust customers are a series of distinct services that have the same pattern of transfer each month. Fees for trust accounts are billed and drafted from trust accounts monthly. The Company records these fees on the income statement on a monthly basis. Fees are assessed based on the total investable assets of the customer's trust account. A signed contract between the Company and the customer is maintained for all customer trust accounts with payment terms identified. It is probable that the fees will be collectible as funds being managed are accessible by the asset manager. Past history of trust fee income recorded by the Company indicates that it is highly unlikely that a significant reversal could occur. There are no contingent incentive fees recorded by the Company that could be subject to a clawback in future periods. Any amounts within the scope of ASC 606 are deemed immaterial.

**Insurance Agency Commissions** – Insurance agency commissions are received from insurance carriers for the agency's share of commissions from customer premium payments. These commissions are recorded into income when checks are received from the insurance carriers, and there is no contingent portion associated with these commission checks. There may be a short time-lag in recording revenue when cash is received instead of recording the revenue when the policy is signed by the customer, but the time lag is insignificant and does not impact the revenue recognition process.

Insurance also receives incentive checks from the insurance carriers for achieving specified levels of production with particular carriers. These amounts are recorded into income when a check is received, and there are no contingent amounts associated with these payments that may be clawed back by the carrier in the future. Similar to the monthly commissions explained in the preceding paragraph, there may be a short time-lag in recording incentive revenue on a cash basis as opposed to estimating the amount of incentive revenue expected to be earned, this does not materially impact the recognition of Insurance revenue. If there were any amounts that would need to be refunded for one specific Insurance customer, management believes the reversal would not be significant.

Other potential situations surrounding the recognition of Insurance revenue include the estimating potential refunds due to the likely cancellation of a percentage of customers cancelling their policies and recording revenue at the time of policy renewals. Management concluded that since Insurance agency commissions represent only 2.3% of the Company's total revenue, adjusting the current practice of recording insurance revenue for these situations would not have a material impact on the reporting of total revenue. Any amounts within the scope of ASC 606 are deemed immaterial.

**Retirement Plan Consulting Fees** – The fees earned from retirement plan consulting is generated by National Associates, Inc. Revenue is recognized based on the level of work performed for the client. Any payments that are received for work to be performed in the future are recorded in a deferred revenue account, and recorded into income when the fees are earned. Retirement plan consulting fees represent only 1.8% of the Company's total revenue, and therefore management has concluded that any adjustment of revenue for one particular customer for a refund or any

other reason would be insignificant and would not materially impact the Company's total revenue. Any amounts within the scope of ASC 606 are deemed immaterial.

**Investment Commissions** – Investment commissions are earned through the sales of non-deposit investment products to customers of the Company. The sales are conducted through a third-party broker-dealer. When the commissions are received and recorded into income on the Bank's income statement, there is no contingent portion that may need to be refunded back to Cetera. Investment commissions represent only 0.9% of the Company's total revenue, and therefore management has concluded that any adjustment of revenue for a particular customer for a refund or any other reason would be insignificant and would not materially impact the Company's total revenue. Any amounts within the scope of ASC 606 are deemed immaterial.

**Other** – Income items included in "Other" are Bank owned life insurance income, security gains, net gains on the sale of loans and other operating income. There are no amounts within the scope of ASC 606.



## Interest-Rate Swaps:

The Company uses a program that utilizes interest-rate swaps as part of its asset/liability management strategy. The interest-rate swaps are used to help manage the Company's interest rate risk position and not as derivatives for trading purposes. The notional amount of the interest-rate swaps does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest-rate swap agreements.

The objective of the interest-rate swaps is to protect the related fixed rate commercial real estate loans from changes in fair value due to changes in interest rates. The Company has a program whereby it lends to its borrowers at a fixed rate with the loan agreement containing a two-way yield maintenance provision, which will be invoked in the event of prepayment of the loan, and is expected to exactly offset the fair value of unwinding the swap. The yield maintenance provision represents an embedded derivative which is bifurcated from the host loan contract and, as such, the swaps and embedded derivatives are not designated as hedges. Accordingly, both instruments are carried at fair value and changes in fair value are reported in current period earnings.

Summary information about these interest-rate swaps at periods ended March 31, 2018 and December 31, 2017 is as follows:

|  | March    |   | December |   |
|--|----------|---|----------|---|
|  | 31,      |   | 31,      |   |
|  | 2018     |   | 2017     |   |
| Notional amounts (In thousands)                      | \$37,661 |   | \$38,481 |   |
| Weighted average pay rate on interest-rate swaps     | 4.47     | % | 4.46     | % |
| Weighted average receive rate on interest-rate swaps | 4.12     | % | 3.81     | % |
| Weighted average maturity (years)                    | 4.6      |   | 3.2      |   |
| Fair value of interest-rate swaps                    | \$(859   | ) | \$(653   | ) |
| Fair value of loan yield maintenance provisions      | \$859    |   | \$653    |   |

The fair value of the yield maintenance provisions and interest-rate swaps is recorded in other assets and other liabilities, respectively, in the consolidated balance sheets. Changes in the fair value of the yield maintenance provisions and interest-rate swaps are reported in earnings, as other noninterest income in the consolidated statements of income. For the three month periods ended March 31, 2018 and 2017 there were no net gains or losses recognized in earnings.

## Earnings Per Share:

The computation of basic and diluted earnings per share is shown in the following table:

|  | Three Months Ended<br>March 31, |            |
|--|---------------------------------|------------|
|  | 2018                            | 2017       |
| <b>Basic EPS</b>   |                                 |            |
| Net income (In thousands)  | \$7,726                         | \$5,783    |
| Weighted average shares outstanding                              | 27,578,858                      | 27,278,314 |
| Basic earnings per share   | \$0.28                          | \$0.21     |
| <b>Diluted EPS</b>   |                                 |            |
| Net income (In thousands)  | \$7,726                         | \$5,783    |
| Weighted average shares outstanding for basic earnings per share | 27,578,858                      | 27,278,314 |
| Dilutive effect of restricted stock awards                       | 339,153                         | 62,668     |
| Weighted average shares for diluted earnings per share           | 27,918,011                      | 27,340,982 |
| Diluted earnings per share                                       | \$0.28                          | \$0.21     |

There were no restricted stock awards that were considered anti-dilutive for the three month periods ended March 31, 2018 and 2017.

#### Stock Based Compensation:

During 2017, the Company, with the approval of shareholders, created the 2017 Equity Incentive Plan (the “2017 Plan”). The 2017 Plan permits the award of up to 800 thousand shares to the Company’s directors and employees to attract and retain exceptional personnel, motivate performance and most importantly to help align the interests of Farmers’ executives with those of the Company’s shareholders. There were 17,729 service time based shares and 62,919 performance based shares granted under the 2017 Plan during the three month period ended March 31, 2018, as shown in the table below. The actual number of performance based stock awards issued will depend on certain performance conditions which are mainly average return on equity compared to a group of peer

companies over a three year vesting period. There are 594,734 shares that are remaining and available for future awards at March 31, 2018.

During 2012, the Company, with the approval of shareholders, created the 2012 Equity Incentive Plan (the “2012 Plan”). The 2012 Plan permitted the award of up to 500 thousand shares to the Company’s directors and employees to promote the Company’s long-term financial success by motivating performance through long-term incentive compensation and to better align the interests of its employees with those of its shareholders. There are no additional shares available to be granted under the Plan. Any new restricted stock awards will be issued under the 2017 Plan described above.

The restricted stock awards were granted with a fair value price equal to the market price of the Company’s common stock at the date of the grant. Expense recognized was \$397 thousand for the three month period ended March 31, 2018. During the prior period, the expense recognized was \$180 thousand for the three month period ended March 31, 2017. As of March 31, 2018, there was \$2.5 million of total unrecognized compensation expense related to the nonvested shares granted under the Plans. The remaining cost is expected to be recognized over 3 years.

The following is the activity under the Plans during the three month period ended March 31, 2018.

|                                      | Three Months Ended March 31, 2018 |                       |                                   |                       |
|--------------------------------------|-----------------------------------|-----------------------|-----------------------------------|-----------------------|
|                                      | Weighted Average                  |                       | Weighted Average                  |                       |
|                                      | Maximum Awarded Service Units     | Grant Date Fair Value | Maximum Awarded Performance Units | Grant Date Fair Value |
| Beginning balance - nonvested shares | 323,331                           | \$ 9.20               | 266,515                           | \$ 9.43               |
| Granted                              | 17,729                            | 14.35                 | 62,919                            | 14.31                 |
| Vested                               | (33,000 )                         | 7.88                  | (63,873 )                         | 7.76                  |
| Forfeited                            | 0                                 | 0                     | (61,733 )                         | 7.76                  |
| Ending balance - nonvested shares    | 308,060                           | \$ 9.64               | 203,828                           | \$ 11.96              |

Other Comprehensive Income (Loss):

The following table represents the details of other comprehensive income for the three month periods ended March 31, 2018 and 2017.

| (In Thousands of Dollars)  | Three Months Ended March 31, 2018 |         |            |
|--|-----------------------------------|---------|------------|
|  | Pre-tax                           | Tax     | After-Tax  |
| Unrealized holding gains (losses) on available-for-sale securities during the period | \$(8,886)                         | \$1,866 | \$(7,020 ) |

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|   |           |         |            |
|---|-----------|---------|------------|
| Reclassification adjustment for (gains) losses included in net income (1) | (2 )      | 0       | (2 )       |
| Net other comprehensive income (loss)                                     | \$(8,888) | \$1,866 | \$(7,022 ) |

| (In Thousands of Dollars)  | Three Months Ended March 31, 2017 |          |           |
|--|-----------------------------------|----------|-----------|
|  | Pre-tax                           | Tax      | After-Tax |
| Unrealized holding gains (losses) on available-for-sale securities during the period | \$375                             | \$(132 ) | \$ 243    |
| Reclassification adjustment for (gains) losses included in net income (1)            | (13 )                             | 4        | (9 )      |
| Net other comprehensive income (loss)  | \$362                             | \$(128 ) | \$ 234    |

(1) Pre-tax reclassification adjustments relating to available-for-sale securities are reported in security gains and the tax impact is included in income tax expense on the consolidated statements of income.

### Regulatory Capital Matters

Banks and bank holding companies are subject to various regulatory capital requirements administered by the federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. The new minimum capital requirements associated with the Basel Committee on capital and liquidity regulation (Basel III) are being phased in and began on January 1, 2015 and will continue through January 1, 2019. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action by regulators that, if undertaken, could

have a direct material effect on the financial statements. Management believes that as of March 31, 2018, the Company and the Bank meet all capital adequacy requirements to which they are subject.

The FDIC and other federal banking regulators revised the risk-based capital requirements applicable to financial holding companies and insured depository institutions, including the Company and the Bank, to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision (“Basel III”).

The common equity tier 1 capital, tier 1 capital and total capital ratios are calculated by dividing the respective capital amounts by risk-weighted assets. The leverage ratio is calculated by dividing tier 1 capital by adjusted average total assets.

Basel III limits capital distributions and certain discretionary bonus payments if the banking organization does not hold a “capital conservation buffer” consisting of 2.5% of common equity tier 1 capital, tier 1 capital and total capital to risk-weighted assets in addition to the amount necessary to meet minimum risk-based capital requirements. The capital conservation buffer phase in began January 1, 2016 and will increase each year until fully implemented at 2.5% on January 1, 2019. The additional capital conservation buffer is 1.875% for the year of 2018 and was 1.25% during 2017. Excluding the additional buffer, Basel III requires the Company and the Bank to maintain (i) a minimum ratio of common equity tier 1 capital to risk-weighted assets of at least 4.5%, (ii) a minimum ratio of tier 1 capital to risk-weighted assets of at least 6.0%, (iii) a minimum ratio of total capital to risk-weighted assets of at least 8.0% and (iv) a minimum leverage ratio of at least 4.0%.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If only adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At March 31, 2018 and December 31, 2017, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution’s category.

Actual and required capital amounts and ratios, which do not include the capital conservation buffer, are presented below at March 31, 2018 and December 31, 2017:

|   | Actual    |         | Requirement<br>For Capital |       | To be Well<br>Capitalized  |                       |
|---|-----------|---------|----------------------------|-------|----------------------------|-----------------------|
|   | Amount    | Ratio   | Amount                     | Ratio | Under Prompt<br>Corrective | Action<br>Provisions: |
|   | Amount    | Ratio   | Amount                     | Ratio | Amount                     | Ratio                 |
| <b>March 31, 2018</b>                     |           |         |                            |       |                            |                       |
| <b>Common equity tier 1 capital ratio</b> |           |         |                            |       |                            |                       |
| Consolidated                              | \$203,287 | 12.06 % | \$75,848                   | 4.5 % | N/A                        | N/A                   |
| Bank                                      | 190,895   | 11.29 % | 76,064                     | 4.5 % | \$109,870                  | 6.5 %                 |
| <b>Total risk based capital ratio</b>     |           |         |                            |       |                            |                       |
| Consolidated                              | 218,058   | 12.94 % | 134,841                    | 8.0 % | N/A                        | N/A                   |
| Bank                                      | 203,445   | 12.04 % | 135,225                    | 8.0 % | 169,031                    | 10.0 %                |
| <b>Tier I risk based capital ratio</b>    |           |         |                            |       |                            |                       |
| Consolidated                              | 205,508   | 12.19 % | 101,131                    | 6.0 % | N/A                        | N/A                   |
| Bank                                      | 190,895   | 11.29 % | 101,419                    | 6.0 % | 135,225                    | 8.0 %                 |
| <b>Tier I leverage ratio</b>              |           |         |                            |       |                            |                       |
| Consolidated                              | 205,508   | 9.68 %  | 84,894                     | 4.0 % | N/A                        | N/A                   |
| Bank                                      | 190,895   | 9.05 %  | 84,359                     | 4.0 % | 105,448                    | 5.0 %                 |
| <b>December 31, 2017</b>                  |           |         |                            |       |                            |                       |
| <b>Common equity tier 1 capital ratio</b> |           |         |                            |       |                            |                       |
| Consolidated                              | \$199,201 | 11.86 % | \$75,573                   | 4.5 % | N/A                        | N/A                   |
| Bank                                      | 192,080   | 11.45 % | 75,462                     | 4.5 % | \$109,001                  | 6.5 %                 |
| <b>Total risk based capital ratio</b>     |           |         |                            |       |                            |                       |
| Consolidated                              | 213,725   | 12.73 % | 134,352                    | 8.0 % | N/A                        | N/A                   |
| Bank                                      | 204,395   | 12.19 % | 134,155                    | 8.0 % | 167,694                    | 10.0 %                |
| <b>Tier I risk based capital ratio</b>    |           |         |                            |       |                            |                       |
| Consolidated                              | 201,410   | 11.99 % | 100,764                    | 6.0 % | N/A                        | N/A                   |
| Bank                                      | 192,080   | 11.45 % | 100,616                    | 6.0 % | 134,155                    | 8.0 %                 |
| <b>Tier I leverage ratio</b>              |           |         |                            |       |                            |                       |
| Consolidated                              | 201,410   | 9.50 %  | 84,800                     | 4.0 % | N/A                        | N/A                   |
| Bank                                      | 192,080   | 9.12 %  | 84,253                     | 4.0 % | 105,316                    | 5.0 %                 |

#### Fair Value

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants

on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 – Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Investment Securities: The Company uses a third party service to estimate fair value on available for sale securities on a monthly basis. ASU 2016-01 which was adopted by the Company as of January 1, 2018, requires the use of exit price notion when measuring the fair value of financial instruments for disclosure purposes. Our service provider is considered a leading evaluation pricing service for U.S. domestic fixed income securities and complies fully with ASU 2016-01's exit pricing requirements. They subscribe to multiple third-party pricing vendors, and supplement that information with matrix pricing methods. The fair values for investment securities, which consist of equity securities are recorded at fair market value to comply with ASU 2016-01, are determined by quoted

market prices in active markets, if available (Level 1). The equity securities change in fair market value is recorded in the income statements. For securities where quoted prices are not available, fair values are calculated based on quoted prices for similar assets in active markets, quoted prices for similar assets in markets that are not active or inputs other than quoted prices, which provide a reasonable basis for fair value determination. Such inputs may include interest rates and yield curves, volatilities, prepayment speeds, credit risks and default rates. Inputs used are derived principally from observable market data (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). The fair values of Level 3 investment securities are determined by using unobservable inputs to measure fair value of assets for which there is little, if any market activity at the measurement date, using reasonable inputs and assumptions based on the best information at the time, to the extent that inputs are available without undue cost and effort. For the period ended March 31, 2018 and for the year ended December 31, 2017, the fair value of Level 3 investment securities was immaterial.

**Derivative Instruments:** The fair values of derivative instruments are based on valuation models using observable market data as of the measurement date (Level 2).

**Impaired Loans:** At the time loans are considered impaired, collateral dependent impaired loans are valued at the lower of cost or fair value and non-collateral dependent loans are valued based on discounted cash flows. Impaired loans carried at fair value generally receive specific allocations of the allowance for loan losses. For collateral dependent loans fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

**Other Real Estate Owned:** Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair values are commonly based on recent real estate appraisals. These appraisals may use a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Appraisals for both collateral-dependent impaired loans and other real estate owned are performed by certified general appraisers (for commercial and commercial real estate properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, a member of the Appraisal Department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On an annual basis, the Company compares the actual selling price of collateral that has been sold to the most recent appraised value to determine what adjustments should be made to appraisals to arrive at fair value.



Assets measured at fair value on a recurring basis are summarized below:

| (In Thousands of Dollars)                            | Fair Value Measurements at March 31, 2018 Using:          |                   |             |           |
|--|---|-------------------|-------------|-----------|
|  | Quoted Prices in  |                   |             |           |
|  | Active Markets  | Significant Other | Significant |           |
|  | for Identical AssetsObservable Inputs Unobservable Inputs |                   |             |           |
|  | Carrying  |                   |             |           |
|  | Value   | (Level 1)         | (Level 2)   | (Level 3) |
| <b>Financial Assets</b>                              |   |                   |             |           |
| Investment securities available-for sale             |   |                   |             |           |
| U.S. Treasury and U.S. government sponsored entities | \$6,029   | \$ 0              | \$ 6,029    | \$ 0      |
| State and political subdivisions                     | 190,034   | 0                 | 190,034     | 0         |
| Corporate bonds                                      | 1,161   | 0                 | 1,161       | 0         |
| Mortgage-backed securities-residential               | 157,296   | 0                 | 157,289     | 7         |
| Collateralized mortgage obligations                  | 16,133  | 0                 | 16,133      | 0         |
| Small Business Administration                        | 13,743  | 0                 | 13,743      | 0         |
| Equity securities                                    | 416   | 416               | 0           | 0         |
| Other investments measured at net asset value        | 5,593   | n/a               | n/a         | n/a       |
| Total investment securities                          | \$390,405   | \$ 416            | \$ 384,389  | \$ 7      |
| Loan yield maintenance provisions                    | \$859   | \$ 0              | \$ 859      | \$ 0      |
| <b>Financial Liabilities</b>                         |   |                   |             |           |
| Interest rate swaps                                  | \$859   | \$ 0              | \$ 859      | \$ 0      |

| (In Thousands of Dollars)                            | Fair Value Measurements at December 31, 2017 Using:       |                   |             |           |
|--|---|-------------------|-------------|-----------|
|  | Quoted Prices in  |                   |             |           |
|  | Active Markets  | Significant Other | Significant |           |
|  | for Identical AssetsObservable Inputs Unobservable Inputs |                   |             |           |
|  | Carrying  |                   |             |           |
|  | Value   | (Level 1)         | (Level 2)   | (Level 3) |
| <b>Financial Assets</b>                              |   |                   |             |           |
| Investment securities available-for sale             |   |                   |             |           |
| U.S. Treasury and U.S. government sponsored entities | \$8,917   | \$ 0              | \$ 8,917    | \$ 0      |
| State and political subdivisions                     | 191,003   | 0                 | 191,003     | 0         |
| Corporate bonds                                      | 1,234   | 0                 | 1,234       | 0         |
| Mortgage-backed securities-residential               | 160,450   | 0                 | 160,442     | 8         |
| Collateralized mortgage obligations                  | 17,121  | 0                 | 17,121      | 0         |
| Small Business Administration                        | 14,212  | 0                 | 14,212      | 0         |
| Equity securities                                    | 394   | 394               | 0           | 0         |
| Other investments measured at net asset value        | 5,185   | n/a               | n/a         | n/a       |

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|                                   |           |        |            |      |
|-----------------------------------|-----------|--------|------------|------|
| Total investment securities       | \$398,516 | \$ 394 | \$ 392,929 | \$ 8 |
| Loan yield maintenance provisions | \$653     | \$ 0   | \$ 653     | \$ 0 |
| <b>Financial Liabilities</b>      |           |        |            |      |
| Interest rate swaps               | \$653     | \$ 0   | \$ 653     | \$ 0 |

There were no significant transfers between Level 1 and Level 2 during the three month periods ended March 31, 2018 and 2017. For additional information related to yield maintenance provisions and interest rate swaps see Interest –Rate Swaps note.

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

| (In Thousands of Dollars)        | Investment Securities Available-for-sale (Level 3) Three Months ended March 31, |       |
|----------------------------------|---|-------|
|                                  | 2018  | 2017  |
| Beginning Balance                | \$ 8  | \$ 12 |
| Transfers from level 2           | 0   | 0     |
| Repayments, calls and maturities | (1 )  | (1 )  |
| Ending Balance                   | \$ 7  | \$ 11 |

Assets measured at fair value on a non-recurring basis are summarized below:

| Fair Value Measurements at March 30, 2018 Using: |                      |                   |                     |        |
|--|----------------------|-------------------|---------------------|--------|
| Quoted Prices in                                 |                      |                   |                     |        |
|  | Active Markets       | Significant Other | Significant         |        |
|  | for Identical Assets | Observable Inputs | Unobservable Inputs |        |
|  | Carrying             |                   |                     |        |
| (In Thousands of Dollars)                        | Value (Level 1)      | (Level 2)         | (Level 3)           |        |
| <b>Financial Assets</b>                          |                      |                   |                     |        |
| <b>Impaired loans</b>                            |                      |                   |                     |        |
| 1-4 family residential                           | \$735                | \$ 0              | \$ 0                | \$ 735 |
| Consumer   | 4                    | 0                 | 0                   | 4      |

| Fair Value Measurements at December 31, 2017 Using: |                    |                   |                     |        |
|---|--------------------|-------------------|---------------------|--------|
| Quoted Prices in                                    |                    |                   |                     |        |
|   | Active Markets for | Significant Other | Significant         |        |
|   | Identical Assets   | Observable Inputs | Unobservable Inputs |        |
|   | Carrying           |                   |                     |        |
| (In Thousands of Dollars)                           | Value (Level 1)    | (Level 2)         | (Level 3)           |        |
| <b>Financial Assets</b>                             |                    |                   |                     |        |
| <b>Impaired loans</b>                               |                    |                   |                     |        |
| 1-4 family residential                              | \$740              | \$ 0              | \$ 0                | \$ 740 |
| Consumer  | 2                  | 0                 | 0                   | 2      |

Impaired loans that are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of \$896 thousand with a valuation allowance of \$157 thousand at March 31, 2018, resulting in \$66 thousand in additional provision for loan losses for the three month period. At December 31, 2017, impaired loans had a principal balance of \$851 thousand, with a valuation allowance of \$109 thousand. Loans measured at fair value at March 31, 2017 resulted in an additional provision for loan losses of \$4 thousand for the three month period ending March 31, 2017. Excluded from the fair value of impaired loans, at March 31, 2018 and December 31, 2017, discussed above are \$781 thousand and \$763 thousand of loans classified as troubled debt restructurings and measured using the present value of cash flows, which is not considered an exit price.

Impaired commercial real estate loans, both owner-occupied and non-owner occupied are valued by independent external appraisals. These external appraisals are prepared using the sales comparison approach and income approach valuation techniques. Management makes subsequent unobservable adjustments to the impaired loan appraisals. Impaired loans other than commercial real estate and other real estate owned are not considered material.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at the periods ended March 31, 2018 and December 31, 2017:

|                | Fair value | Valuation Technique(s) | Unobservable Input(s)                               | Range<br>(Weighted Average) |
|----------------|------------|------------------------|---|-----------------------------|
| March 31, 2018 |            |                        |   |                             |
| Impaired loans |            |                        |   | (15.76%) - 27.92%           |
| Residential    | \$ 735     | Sales comparison       | Adjustment for differences between comparable sales | 0.53%<br>(21.98%) - 21.98%  |
| Consumer       | 4          | Sales comparison       | Adjustment for differences between comparable sales | 0.00%                       |

|                   | Fair value | Valuation Technique(s) | Unobservable Input(s)                               | Range<br>(Weighted Average) |
|-------------------|------------|------------------------|---|-----------------------------|
| December 31, 2017 |            |                        |   |                             |
| Impaired loans    |            |                        |   | (15.76%) - 27.92%           |
| Residential       | \$ 740     | Sales comparison       | Adjustment for differences between comparable sales | 0.53%<br>(21.98%) - 21.98%  |
| Consumer          | 2          | Sales comparison       | Adjustment for differences between comparable sales | (0.00%)                     |

The carrying amounts and estimated fair values of financial instruments not previously disclosed at March 31, 2018 and December 31, 2017 are as follows:

| (In Thousands of Dollars)   | Carrying Amount | Fair Value Measurements at March 31, 2018 |          |           |           |
|-----------------------------|-----------------|---|----------|-----------|-----------|
|                             |                 | Level 1                                   | Level 2  | Level 3   | Total     |
| Using:                      |                 |   |          |           |           |
| Financial assets            |                 |   |          |           |           |
| Cash and cash equivalents   | \$ 52,149       | \$21,433                                  | \$30,716 | \$0       | \$52,149  |
| Restricted stock            | 11,134          | n/a                                       | n/a      | n/a       | n/a       |
| Loans held for sale         | 399             | 0   | 411      | 0         | 411       |
| Loans, net                  | 1,586,789       | 0   | 0        | 1,544,307 | 1,544,307 |
| Accrued interest receivable | 6,623           | 0   | 2,220    | 4,403     | 6,623     |
| Financial liabilities       |                 |   |          |           |           |
| Deposits                    | 1,637,159       | 1,354,581                                 | 276,247  | 0         | 1,630,828 |
| Short-term borrowings       | 268,012         | 0   | 268,012  | 0         | 268,012   |
| Long-term borrowings        | 6,804           | 0   | 6,507    | 0         | 6,507     |
| Accrued interest payable    | 663             | 46  | 617      | 0         | 663       |

| (In Thousands of Dollars)   | Carrying Amount | Fair Value Measurements at December 31, 2017 |          |           |           |
|-----------------------------|-----------------|--|----------|-----------|-----------|
|                             |                 | Level 1                                      | Level 2  | Level 3   | Total     |
| Using:                      |                 |  |          |           |           |
| Financial assets            |                 |  |          |           |           |
| Cash and cash equivalents   | \$ 57,614       | \$17,785                                     | \$39,829 | \$0       | \$57,614  |
| Restricted stock            | 10,491          | n/a  | n/a      | n/a       | n/a       |
| Loans held for sale         | 272             | 0  | 283      | 0         | 283       |
| Loans, net                  | 1,565,066       | 0  | 0        | 1,569,381 | 1,569,381 |
| Accrued interest receivable | 6,669           | 0  | 2,255    | 4,414     | 6,669     |
| Financial liabilities       |                 |  |          |           |           |
| Deposits                    | 1,604,719       | 1,340,814                                    | 259,346  | 0         | 1,600,160 |
| Short-term borrowings       | 289,565         | 0  | 289,565  | 0         | 289,565   |
| Long-term borrowings        | 6,994           | 0  | 6,690    | 0         | 6,690     |
| Accrued interest payable    | 633             | 46   | 587      | 0         | 633       |

The methods and assumptions used to estimate fair value, not previously described, are described as follows:

**Cash and Cash Equivalents:** The carrying amounts of cash and short-term instruments approximate fair values and are classified as either Level 1 or Level 2. The Company has determined that cash on hand and non-interest bearing due from bank accounts are Level 1 whereas interest bearing federal funds sold and other are Level 2.

**Restricted Stock:** It is not practical to determine the fair value of restricted stock due to restrictions placed on its transferability.

**Loans:** Fair values of loans, excluding loans held for sale, are estimated as follows: As of March 31, 2018, the Company uses a third party firm that uses cash flow analysis and current market interest rates along with adjustments for credit, liquidity and option risk to conform to the ASU 2016-01 exit price requirement. At December 31, 2017,

management used the discounted cash flow analyses and interest rates currently being offered for loans with similar terms to borrowers of similar credit quality to estimate fair market value. Impaired loans are valued at the lower of cost or fair value as described previously.

Loans held for sale: The fair value of loans held for sale is estimated based upon binding contracts and quotes from third party investors resulting in a Level 2 classification.

Accrued Interest Receivable/Payable: The carrying amounts of accrued interest receivable and payable approximate fair value resulting in a Level 1, Level 2 or Level 3 classification. The classification is the result of the association with securities, loans and deposits.

Deposits: The fair values disclosed for demand deposits – interest and non-interest checking, passbook savings, and money market accounts – are, by definition, equal to the amount payable on demand at the reporting date resulting in a Level 1 classification. The carrying amounts of variable rate certificates of deposit approximate their fair values at the reporting date resulting in a Level 2 classification. Fair value for fixed rate certificates of deposit are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

Short-term Borrowings: The carrying amounts of federal funds purchased, borrowings under repurchase agreements, and other short-term borrowings, generally maturing within ninety days, approximate their fair values resulting in a Level 2 classification.

Long-term Borrowings: The fair values of the Company's long-term borrowings are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification.

Off-balance Sheet Instruments: The fair value of commitments is not considered material.

Segment Information:

The reportable segments are determined by the products and services offered, primarily distinguished between banking, trust and retirement consulting operations. They are also distinguished by the level of information provided to the chief operating decision makers in the Company, who use such information to review performance of various components of the business, which are then aggregated. Loans, investments, and deposits provide the revenues in the banking operation. All operations are domestic. Significant segment totals are reconciled to the financial statements as follows:

|                                | Retirement |             |            |              |              |
|--------------------------------|------------|-------------|------------|--------------|--------------|
|                                | Trust      | Bank        | Consulting | Eliminations | Consolidated |
| (In Thousands of Dollars)      | Segment    | Segment     | Segment    | and Others   | Totals       |
| March 31, 2018                 |            |             |            |              |              |
| Goodwill and other intangibles | \$4,370    | \$38,868    | \$ 2,599   | \$ (822 )    | \$45,015     |
| Total assets                   | \$11,456   | \$2,150,529 | \$ 3,386   | \$ 2,146     | \$2,167,517  |

|                                | Retirement |             |            |              |              |
|--------------------------------|------------|-------------|------------|--------------|--------------|
|                                | Trust      | Bank        | Consulting | Eliminations | Consolidated |
| (In Thousands of Dollars)      | Segment    | Segment     | Segment    | and Others   | Totals       |
| December 31, 2017              |            |             |            |              |              |
| Goodwill and other intangibles | \$4,426    | \$39,120    | \$ 2,645   | \$ (822 )    | \$45,369     |
| Total assets                   | \$11,261   | \$2,140,508 | \$ 3,365   | \$ 3,935     | \$2,159,069  |

|                                       | Retirement |         |            |              |              |
|---------------------------------------|------------|---------|------------|--------------|--------------|
|                                       | Trust      | Bank    | Consulting | Eliminations | Consolidated |
| (In Thousands of Dollars)             | Segment    | Segment | Segment    | and Others   | Totals       |
| For Three Months Ended March 31, 2018 |            |         |            |              |              |

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|   |        |           |       |           |           |
|---|--------|-----------|-------|-----------|-----------|
| Net interest income                                       | \$ 31  | \$ 18,933 | \$ 0  | \$ (18 )  | \$ 18,946 |
| Provision for loan losses                                 | 0      | 775       | 0     | 0         | 775       |
| Service fees, security gains and other noninterest income | 1,838  | 3,854     | 379   | (61 )     | 6,010     |
| Noninterest expense                                       | 1,277  | 12,552    | 312   | 206       | 14,347    |
| Amortization and depreciation expense                     | 63     | 624       | 50    | 12        | 749       |
| Income before taxes                                       | 529    | 8,836     | 17    | (297 )    | 9,085     |
| Income taxes  | 111    | 1,353     | 4     | (109 )    | 1,359     |
| Net Income  | \$ 418 | \$ 7,483  | \$ 13 | \$ (188 ) | \$ 7,726  |

Retirement

|   | Trust   | Bank      | Consulting | Eliminations | Consolidated |
|---|---------|-----------|------------|--------------|--------------|
| (In Thousands of Dollars)                                 | Segment | Segment   | Segment    | and Others   | Totals       |
| For Three Months Ended March 31, 2017                     |         |           |            |              |              |
| Net interest income                                       | \$ 26   | \$ 17,525 | \$ 0       | \$ (20 )     | \$ 17,531    |
| Provision for loan losses                                 | 0       | 1,050     | 0          | 0            | 1,050        |
| Service fees, security gains and other noninterest income | 1,678   | 3,769     | 513        | (73 )        | 5,887        |
| Noninterest expense                                       | 1,199   | 12,120    | 372        | 43           | 13,734       |
| Amortization and depreciation expense                     | 69      | 735       | 63         | 12           | 879          |
| Income before taxes                                       | 436     | 7,389     | 78         | (148 )       | 7,755        |
| Income taxes  | 152     | 1,937     | 27         | (144 )       | 1,972        |
| Net Income  | \$ 284  | \$ 5,452  | \$ 51      | \$ (4 )      | \$ 5,783     |

The Bank segment includes Farmers National Insurance and Farmers of Canfield Investment Co.



## Goodwill and Intangible Assets:

Goodwill associated with the Company's recent purchases of Monitor in August 2017, Bowers in June 2016 and other past acquisitions totaled \$38.2 million at March 31, 2018 and December 31, 2017. The Monitor and Bowers acquisitions are more fully described in the Business Acquisitions footnote. Impairment exists when a reporting unit's carrying value of goodwill exceeds its fair value, which is determined through a two-step impairment test. Management performs goodwill impairment testing on an annual basis as of September 30. The fair value of the reporting unit is determined based on a discounted cash flow model.

## Acquired Intangible Assets

Acquired intangible assets were as follows:

|                                     | March 31, 2018 |                          | December 31, 2017 |                          |
|-------------------------------------|----------------|--------------------------|-------------------|--------------------------|
|                                     | Gross Carrying | Accumulated Amortization | Gross Carrying    | Accumulated Amortization |
| (In Thousands of Dollars)           | Amount         |                          | Amount            |                          |
| <b>Amortized intangible assets:</b> |                |                          |                   |                          |
| Customer relationship intangibles   | \$7,210        | \$ (5,059 )              | \$7,210           | \$ (4,919 )              |
| Non-compete contracts               | 430            | (377 )                   | 430               | (376 )                   |
| Trade name                          | 520            | (189 )                   | 520               | (175 )                   |
| Core deposit intangible             | 6,254          | (1,975 )                 | 6,254             | (1,776 )                 |
| Total                               | \$14,414       | \$ (7,600 )              | \$14,414          | \$ (7,246 )              |

Aggregate amortization expense was \$354 thousand for the three month period ended March 31, 2018. Amortization expense was \$365 thousand for the three months ended March 31, 2017.

Estimated amortization expense for each of the next five periods and thereafter:

|                    |                |
|--------------------|----------------|
| 2018 (Nine months) | \$1,064        |
| 2019               | 1,306          |
| 2020               | 1,203          |
| 2021               | 1,142          |
| 2022               | 1,025          |
| Thereafter         | 1,074          |
| <b>TOTAL</b>       | <b>\$6,814</b> |

## Short-term borrowings:

There were \$185 million in short-term Federal Home Loan Bank Advances at March 31, 2018 with a weighted average interest rate of 1.69%. Short-term Federal Home Loan Bank Advances were \$215 million at December 31, 2017. The Company had \$82.7 million and \$74.2 million in securities sold under repurchase agreements for the periods ended March 31, 2018 and December 31, 2017, respectively. In addition, the Company had no Federal funds purchased and has a \$350 thousand balance on business lines of credit with one lending institution at March 31, 2018 and December 31, 2017.

The following table provides a disaggregation of the obligation by the class of collateral pledged for short-term financing obtained through the sales of repurchase agreements. These pledged securities which are 105% of the repurchase agreement balances are shown below:

| (In Thousands of Dollars)                            | March<br>31,<br>2018 | December<br>31, 2017 |
|--|----------------------|----------------------|
| Overnight and continuous repurchase agreements       |                      |                      |
| U.S. Treasury and U.S. government sponsored entities | \$5,738              | \$ 5,051             |
| State and political subdivisions                     | 27,887               | 21,731               |
| Mortgage-backed securities - residential             | 47,668               | 46,133               |
| Collateralized mortgage obligations - residential    | 5,502                | 5,011                |
| Total repurchase agreements                          | \$86,795             | \$ 77,926            |

Management believes the risks associated with the agreements are minimal and, in the case of collateral decline, the Company has additional investment securities available to adequately pledge as guarantees for the repurchase agreements.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations Forward Looking Statements

Discussions in this report that are not statements of historical fact (including statements that include terms such as “will,” “may,” “should,” “believe,” “expect,” “anticipate,” “estimate,” “project,” “intend,” and “plan”) are forward-looking statements and involve risks and uncertainties. Any forward-looking statement is not a guarantee of future performance and actual future results could differ materially from those contained in forward-looking information. Factors that could cause or contribute to such differences include, without limitation, risks and uncertainties detailed from time to time in the Company's filings with the Securities and Exchange Commission (the “Commission”), including without limitation, the risk factors disclosed in Item 1A, “Risk Factors,” in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

Many of these factors are beyond the Company's ability to control or predict, and readers are cautioned not to put undue reliance on those forward-looking statements. The following list, which is not intended to be an all-encompassing list of risks and uncertainties affecting the Company, summarizes several factors that could cause the Company's actual results to differ materially from those anticipated or expected in these forward-looking statements:

- general economic conditions in market areas where we conduct business, which could materially impact credit quality trends;
- business conditions in the banking industry;
- the regulatory environment;
- fluctuations in interest rates;
- demand for loans in the market areas where we conduct business;
- rapidly changing technology and evolving banking industry standards;
- competitive factors, including increased competition with regional and national financial institutions;
- new service and product offerings by competitors and price pressures; and other like items.

Other factors not currently anticipated may also materially and adversely affect the Company's results of operations, cash flows and financial position. There can be no assurance that future results will meet expectations. While the Company believes that the forward-looking statements in this report are reasonable, the reader should not place undue reliance on any forward-looking statement. In addition, these statements speak only as of the date made. The Company does not undertake, and expressly disclaims, any obligation to update or alter any statements whether as a result of new information, future events or otherwise, except as may be required by applicable law.

### Overview

Net income for the three months ended March 31, 2018 was \$7.7 million, or \$0.28 per diluted share, which compares to \$5.8 million, or \$0.21 per diluted share, for the three months ended March 31, 2017.

Annualized return on average assets and return on average equity were 1.45% and 13.03%, respectively, for the three month period ending March 31, 2018, compared to 1.17% and 10.87% for the same period in 2017.

On December 22, 2017, H.R.1, known as the “Tax Cuts and Jobs Act,” was signed into law. H.R.1, among other things, reduced the corporate income tax rate to 21% effective January 1, 2018. As a result of passage of the new tax law, Farmers effective tax rate decreased from 25.43% for the quarter ended March 31, 2017 to 14.96% for the quarter ended March 31, 2018. It is important to note that also as a result of the new tax law, Farmers determined that its net deferred tax assets needed to be reduced in the fourth quarter of 2017 by approximately \$1.8 million, representing an impact on earnings per share of approximately \$0.06 per diluted share for that fourth quarter, based on that quarter's weighted average diluted shares outstanding of approximately 27.5 million.

Total loans were \$1.60 billion at March 31, 2018 compared to \$1.58 billion at December 31, 2017, representing an annualized growth rate of 5.6%. The increase in loans is a result of Farmers' focus on loan growth utilizing a talented lending and credit team, while adhering to a sound underwriting discipline. The increase in loans has occurred across each of the major loan categories but mainly the commercial real estate, residential real estate and agricultural loan categories. Loans now comprise 78.1% of the Bank's first quarter average earning assets at March 31, 2018, an improvement compared to 77.9% at the same time in 2017. This improvement along with the growth in earning assets has resulted in a 11.3% increase in tax equated loan income from the first quarter of 2017 to the same quarter in 2018.

Non-performing assets to total assets remain at a low level, currently at 0.37%. Early stage delinquencies, which are loans 30 - 89 days delinquent, also continue to remain at low levels, at \$7.0 million, or 0.44% of total loans, at March 31, 2018. Net charge-offs for the current quarter were \$540 thousand, compared to \$583 thousand in the same quarter in 2017 and net charge-offs as a percentage of average net loans outstanding is only 0.14% for the quarter ended March 31, 2018. Lending to the energy sector is insignificant and less than 1% of the loan portfolio.

The net interest margin for the three months ended March 31, 2018 was 3.92%, a 9 basis point decrease from the quarter ended March 31, 2017. In comparing the first quarter of 2018 to the same period in 2017, asset yields increased 10 basis points, while the cost of interest-bearing liabilities increased 25 basis points. The net interest margin is impacted by the additional accretion as a result of the discounted loan portfolios acquired in the NBOH and Tri-State mergers, which increased the net interest margin by 4 and 5 basis points for the quarters ended March 31, 2018 and 2017, respectively.

Noninterest income increased 2.1% to \$6.0 million for the quarter ended March 31, 2018 compared to \$5.9 million in 2017. Debit card interchange fees increased \$153 thousand or 23.4% and trust fees increased \$129 thousand or 7.7% in comparing the first quarter of 2018 to the same quarter in 2017. These increases were offset by a drop in retirement plan consulting fees of \$134 thousand or 26.1% and gains on the sale of mortgage loans of \$120 thousand or 19.8%.

Farmers has remained committed to managing its level of noninterest expenses. Total noninterest expenses for the first quarter of 2018 increased 3.3% to \$15.1 million compared to \$14.6 million in the same quarter in 2017, primarily as a result of an increase in salaries and employee benefits of \$451 thousand and occupancy and equipment expense of \$117 thousand, offset by a \$128 thousand decrease in other operating expenses and a \$49 thousand decrease in professional fees. It is important to note that annualized noninterest expenses measured as a percentage of quarterly average assets decreased from 2.92% in the first quarter of 2017 to 2.83% in the first quarter of 2018.

The efficiency ratio for the quarter ended March 31, 2018 improved to 57.98% compared to 58.79% for the same quarter in 2017. The main factors leading to this improvement were the increase in net interest income and noninterest income and the stabilization level of noninterest expenses relative to average assets as explained in the preceding paragraphs.

Farmers' return on average tangible equity (Non-GAAP) also improved to 15.84% for the quarter ended March 31, 2018 compared to 13.54% for the same quarter in 2017.

Return on average tangible equity is a non - U.S. GAAP financial measure and should be considered in addition to, not a substitute for or superior to, financial measures determined in accordance with U.S. GAAP. With respect to the calculation of the tangible equity for the three month period ended March 31, 2018 and 2017, reconciliations are displayed in the table below.

#### Results of Operations

The following is a comparison of selected financial ratios and other results at or for the three month periods ended March 31, 2018 and 2017:

At or for the Three  
Months

Ended March 31,

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| (In Thousands, except Per Share Data)       | 2018        |   | 2017        |   |
|---|-------------|---|-------------|---|
| Total Assets                                | \$2,167,517 |   | \$2,026,487 |   |
| Net Income                                  | \$7,726     |   | \$5,783     |   |
| Basic and Diluted Earnings Per Share        | \$0.28      |   | \$0.21      |   |
| Return on Average Assets (Annualized)       | 1.45        | % | 1.17        | % |
| Return on Average Equity (Annualized)       | 13.03       | % | 10.87       | % |
| Efficiency Ratio (tax equivalent basis) (1) | 57.98       | % | 58.79       | % |
| Equity to Asset Ratio                       | 11.13       | % | 10.76       | % |
| Tangible Common Equity Ratio (2)            | 9.24        | % | 8.74        | % |
| Dividends to Net Income                     | 25.05       | % | 23.40       | % |
| Net Loans to Assets                         | 73.21       | % | 71.56       | % |
| Loans to Deposits                           | 97.69       | % | 94.89       | % |

(1)The ratio is calculated by dividing noninterest expenses by the sum of net interest income and noninterest income. The Company strives for a lower efficiency ratio. This efficiency ratio measure is not required by any regulatory agency but provides meaningful information to management and investors since a lower ratio indicates the Company is using their assets more effectively to generate profits.

(2) The tangible common equity ratio is calculated by dividing total common stockholders' equity by total assets, after reducing both amounts by intangible assets. The tangible common equity ratio is not required by U.S. GAAP or by applicable bank regulatory requirements, but is a metric used by management to evaluate the adequacy of the Company's capital levels. Since there is no authoritative requirement to calculate the tangible common equity ratio, the Company's tangible common equity ratio is not necessarily comparable to similar capital measures disclosed or used by other companies in the financial services industry. Tangible common equity and tangible assets are non - U.S. GAAP financial measures and should be considered in addition to, not as a substitute for or superior to, financial measures determined in accordance with U.S. GAAP. With respect to the calculation of the actual unaudited tangible common equity ratio as of March 31, 2018 and 2017, reconciliations of tangible common equity to U.S. GAAP total common stockholders' equity and tangible assets to U.S. GAAP total assets are set forth below:

#### Reconciliation of Common Stockholders' Equity to Tangible Common Equity

| (In Thousands of Dollars)                   | March<br>31,<br>2018 | December<br>31,<br>2017 | March<br>31,<br>2017 |
|---|----------------------|-------------------------|----------------------|
| Stockholders' Equity                        | \$241,240            | \$242,074               | \$218,062            |
| Less Goodwill and Other Intangibles         | 45,015               | 45,369                  | 44,789               |
| Tangible Common Equity                      | 196,225              | 196,705                 | 173,273              |
| Average stockholders' equity                | 240,387              | 241,554                 | 215,819              |
| Less average goodwill and other intangibles | 45,248               | 45,622                  | 45,028               |
| Average tangible common equity              | \$195,139            | \$195,932               | \$170,791            |

#### Reconciliation of Total Assets to Tangible Assets

| (In Thousands of Dollars)                   | March 31,<br>2018 | December<br>31,<br>2017 | March 31,<br>2017 |
|---|-------------------|-------------------------|-------------------|
| Total Assets                                | \$2,167,517       | \$2,159,069             | \$2,026,487       |
| Less Goodwill and Other Intangibles         | 45,015            | 45,369                  | 44,789            |
| Tangible Assets                             | 2,122,502         | 2,113,700               | 1,981,698         |
| Average assets                              | 2,162,706         | 2,158,895               | 2,001,084         |
| Less average goodwill and other intangibles | 45,248            | 45,622                  | 45,028            |
| Average tangible assets                     | \$2,117,458       | \$2,113,273             | \$1,956,056       |

Net Interest Income. The following schedule details the various components of net interest income for the periods indicated. All asset yields are calculated on a tax-equivalent basis where applicable. Security yields are based on amortized cost.

## Average Balance Sheets and Related Yields and Rates

(Dollar Amounts in Thousands)

|   | Three Months Ended<br>March 31, 2018 |               |             | Three Months Ended<br>March 31, 2017 |               |             |
|---|--------------------------------------|---------------|-------------|--------------------------------------|---------------|-------------|
|   | AVERAGE                              |               | RATE        | AVERAGE                              |               | RATE        |
|   | BALANCE                              | INTEREST (1)  |             | BALANCE                              | INTEREST (1)  |             |
| <b>EARNING ASSETS</b>   |                                      |               |             |                                      |               |             |
| Loans (3) (5) (6)   | \$ 1,564,990                         | \$ 18,509     | 4.80 %      | \$ 1,436,494                         | \$ 16,638     | 4.70 %      |
| Taxable securities (4)  | 206,345                              | 1,233         | 2.42        | 211,711                              | 1,118         | 2.14        |
| Tax-exempt securities (4) (6)                                       | 185,560                              | 1,680         | 3.67        | 152,913                              | 1,639         | 4.35        |
| Equity securities (2)   | 10,887                               | 146           | 5.44        | 9,924                                | 115           | 4.70        |
| Federal funds sold and other  | 35,070                               | 145           | 1.68        | 34,234                               | 63            | 0.75        |
| <b>TOTAL EARNING ASSETS</b>   | <b>2,002,852</b>                     | <b>21,713</b> | <b>4.40</b> | <b>1,845,276</b>                     | <b>19,573</b> | <b>4.30</b> |
| <b>NONEARNING ASSETS</b>  |                                      |               |             |                                      |               |             |
| Cash and due from banks   | 33,677                               |               |             | 32,594                               |               |             |
| Premises and equipment  | 22,205                               |               |             | 23,286                               |               |             |
| Allowance for loan losses   | (12,272 )                            |               |             | (10,925 )                            |               |             |
| Unrealized gains (losses) on securities                             | (4,183 )                             |               |             | (4,323 )                             |               |             |
| Other assets (3)  | 120,427                              |               |             | 115,176                              |               |             |
| <b>TOTAL ASSETS</b>   | <b>\$2,162,706</b>                   |               |             | <b>\$2,001,084</b>                   |               |             |
| <b>INTEREST-BEARING LIABILITIES</b>                                 |                                      |               |             |                                      |               |             |
| Time deposits   | \$271,473                            | \$ 813        | 1.21 %      | \$235,153                            | \$ 500        | 0.86 %      |
| Savings deposits  | 482,404                              | 182           | 0.15        | 520,081                              | 170           | 0.13        |
| Demand deposits   | 451,295                              | 416           | 0.37        | 384,602                              | 244           | 0.26        |
| Short term borrowings   | 282,408                              | 881           | 1.26        | 249,505                              | 327           | 0.53        |
| Long term borrowings  | 6,863                                | 44            | 2.66        | 12,291                               | 78            | 2.57        |
| <b>TOTAL INTEREST-BEARING LIABILITIES</b>                           | <b>1,494,443</b>                     | <b>2,336</b>  | <b>0.63</b> | <b>1,401,632</b>                     | <b>1,319</b>  | <b>0.38</b> |
| <b>NONINTEREST-BEARING LIABILITIES<br/>AND STOCKHOLDERS' EQUITY</b> |                                      |               |             |                                      |               |             |
| Demand deposits   | 411,805                              |               |             | 369,477                              |               |             |
| Other liabilities   | 16,071                               |               |             | 14,156                               |               |             |
| Stockholders' equity  | 240,387                              |               |             | 215,819                              |               |             |
| <b>TOTAL LIABILITIES AND<br/>STOCKHOLDERS' EQUITY</b>               | <b>\$2,162,706</b>                   |               |             | <b>\$2,001,084</b>                   |               |             |
| Net interest income and interest rate spread                        |                                      | \$ 19,377     | 3.77 %      |                                      | \$ 18,254     | 3.92 %      |
| Net interest margin   |                                      |               | 3.92 %      |                                      |               | 4.01 %      |

(1) Rates are calculated on an annualized basis.

(2) Equity securities include restricted stock, which is included in other assets on the consolidated balance sheets.

(3) Non-accrual loans and overdraft deposits are included in other assets.

(4)



Includes unamortized discounts and premiums. Average balance and yield are computed using the average historical amortized cost.

- (5) Interest on loans includes fee income of \$935 thousand and \$925 thousand for 2018 and 2017, respectively, and is reduced by amortization of \$666 thousand and \$646 thousand for 2018 and 2017, respectively.
- (6) For 2018, adjustments of \$82 thousand and \$349 thousand, respectively, are made to tax equate income on tax exempt loans and tax exempt securities. For 2017, adjustments of \$155 thousand and \$568 thousand, respectively, are made to tax equate income on tax exempt loans and tax exempt securities. These adjustments are based on a marginal federal income tax rate of 21% in 2018 and 35% in 2017, less disallowances.

Net Interest Income. Tax equivalent net interest income was \$19.4 million for the first quarter of 2018 compared to \$18.3 million for the same period in 2017. The net interest margin to average earning assets on a fully taxable equivalent basis decreased 9 basis points to 3.92% for the three months ended March 31, 2018, compared to 4.01% for the same three month period in the prior year. In comparing the quarters ended March 31, 2018 and 2017, yields on earning assets increased 10 basis points, while the cost of interest bearing liabilities increased 25 basis points. The decreased margin is mainly due to the pressure on increasing deposit rates as the

Federal Reserve Bank continues to raise the federal funds interest rate. Excluding the amortization of premium on time deposits and with the accretion of the loan portfolio discount, the net interest margin would have been 4 basis points lower for the quarter ended March 31, 2018.

**Noninterest Income.** Noninterest income increased 2.1% to \$6.0 million for the quarter ended March 31, 2018 compared to \$5.9 million in 2017. Debit card interchange fees increased \$153 thousand or 23.4% and trust fees increased \$129 thousand or 7.7% in comparing the first quarter of 2018 to the same quarter in 2017. These increases were offset by a drop in retirement plan consulting fees of \$134 thousand or 26.1% and gains on the sale of mortgage loans of \$120 thousand or 19.8%.

**Noninterest Expense.** Noninterest expense totaled \$15.1 million for the three month period ended March 31, 2018, which was \$483 thousand or 3.3% more than the \$14.6 million during the same quarter in 2017. The increase is primarily the result of salaries and employee benefits which increased 5.4%, or \$451 thousand and occupancy and equipment expense which increased 7.4%, or \$117 thousand during the current quarter compared to the same quarter in 2017. More specifically, most of the increase in salaries and benefits was a \$425 thousand increase in wages and incentive stock awards expense when comparing the same three month periods in 2018 and 2017. Annualized noninterest expenses measured as a percentage of quarterly average assets decreased from 2.92% in the first quarter of 2017 to 2.83% in the first quarter of 2018.

The Company's tax equivalent efficiency ratio for the three month period ended March 31, 2018 was 58.0% compared to 58.8% for the same period in 2017. The positive change in the efficiency ratio was the result of increased net interest income and the stabilization of non-interest expenses relative to average assets as explained in the prior paragraphs.

**Income Taxes.** Income tax expense totaled \$1.4 million for the quarter ended March 31, 2018 and \$2.0 million for the quarter ended March 31, 2017. The effective tax rate for the three month period ended March 31, 2018 was 15.0% compared to the effective tax rate of 25.4% for the same period in 2017. This can be attributed to the new corporate tax rate reduction that was part of the "Tax Cuts and Jobs Act." Management continues to seek out additional tax exempt earning assets, mainly in the form of municipal bond securities, to help reduce the level of income tax liability.

**Other Comprehensive Income.** For the quarter ended March 31, 2018, the change in net unrealized gains or losses on securities, net of reclassifications, resulted in an unrealized loss, net of tax, of \$7.0 million, compared to an unrealized gain of \$234 thousand for the same period in 2017. The negative change in the fair value of securities for the three month period ended March 31, 2018 was the main factor in the other comprehensive income increase.

#### Financial Condition

**Cash and Cash Equivalents.** Cash and cash equivalents decreased \$5.5 million during the first three months of 2018 from \$57.7 million to \$52.2 million. The decrease in the cash balance is part of normal fluctuations on the Company's \$2.168 billion balance sheet. The Company expects the levels to remain constant over the next few months as new cash deposits are used for loan growth and security portfolio purchases.

**Securities.** Securities available-for-sale decreased by \$8.5 million since December 31, 2017. The Company intends to maintain the securities portfolio's current level, as a percentage of total assets, during the remaining months of 2018.

**Loans.** Gross loans increased \$22 million since December 31, 2017. The increase in loans has occurred across each of the major loan categories but especially the commercial real estate, residential real estate and agricultural loan portfolios. The Bank utilized a talented lending and credit team while adhering to sound underwriting discipline to

increase the loan portfolio. The increase in loan balances along with a steady rate of return on the portfolio help the current quarter's tax equated loan income to improve by \$1.9 million compared to the same quarter in 2017. The average tax equivalent interest rate on the loan portfolio was 4.80% for the three month period ended March 31, 2018 compared to 4.70% for the same period in 2017. The current quarter's tax equivalent interest rate is calculated using the new corporate tax rate of 21% compared to the prior year tax rate of 35%. For the three months ended March 31, 2018 the average tax equivalent rate would have been 2 basis points higher or 4.82%, using the prior year rate of 35%. On a fully tax equivalent basis, loans contributed \$18.5 million of total interest income during the three month period ended March 31, 2018 compared to \$16.6 million for the same period in 2017.

Allowance for Loan Losses. The following table indicates key asset quality ratios that management evaluates on an ongoing basis. The unpaid principal balance of non-performing loans and non-performing assets was used in the calculation of amounts and ratios on the table below for quarters prior to the current quarter ended March 31, 2018. Recorded investment amounts were used in the calculations.

## Asset Quality History

(In Thousands of Dollars)

|   | 3/31/2018 | 12/31/2017 | 9/30/2017 | 6/30/2017 | 3/31/2017 |
|---|-----------|------------|-----------|-----------|-----------|
| Nonperforming loans   | \$ 7,893  | \$ 7,695   | \$ 6,900  | \$ 6,355  | \$ 6,553  |
| Nonperforming loans as a % of total loans                   | 0.49 %    | 0.49 %     | 0.44 %    | 0.42 %    | 0.45 %    |
| Loans delinquent 30-89 days                                 | \$ 6,973  | \$ 10,191  | \$ 8,680  | \$ 7,052  | \$ 8,258  |
| Loans delinquent 30-89 days as a % of total loans           | 0.44 %    | 0.65 %     | 0.56 %    | 0.47 %    | 0.56 %    |
| Allowance for loan losses                                   | \$ 12,550 | \$ 12,315  | \$ 12,104 | \$ 11,746 | \$ 11,319 |
| Allowance for loan losses as a % of loans                   | 0.78 %    | 0.78 %     | 0.78 %    | 0.78 %    | 0.77 %    |
| Allowance for loan losses as a % of non-acquired loans      | 0.97 %    | 0.97 %     | 0.99 %    | 1.00 %    | 1.02 %    |
| Allowance for loan losses as a % of nonperforming loans     | 159.00 %  | 160.04 %   | 175.42 %  | 184.83 %  | 172.73 %  |
| Annualized net charge-offs to average net loans outstanding | 0.14 %    | 0.05 %     | 0.16 %    | 0.14 %    | 0.16 %    |
| Non-performing assets                                       | \$ 7,952  | \$ 7,866   | \$ 7,119  | \$ 6,591  | \$ 6,871  |
| Non-performing assets as a % of total assets                | 0.37 %    | 0.36 %     | 0.33 %    | 0.32 %    | 0.34 %    |
| Net charge-offs for the quarter                             | \$ 540    | \$ 189     | \$ 592    | \$ 523    | \$ 583    |

For the three months ended March 31, 2018, management recorded a \$775 thousand provision for loan losses, compared to providing \$1.1 million over the same three month period in the prior year. The smaller provision for the current quarter was mainly a result of reduced charge-offs compared to the prior year same quarter and no significant changes in economic or environmental factors during the quarter. Loan growth over the first three months of 2018 was 5.6% on an annualized basis. The allowance for loan losses as a percentage of the total loan portfolio was 0.78% at March 31, 2018 compared to 0.77% at March 31, 2017. The loan portfolios acquired at fair market value from previous acquisitions were recorded at fair market value and without an associated allowance for loan loss. When the acquired loans are excluded, the ratio of allowance for loan losses to total non-acquired loans is 0.97% at March 31, 2018 compared to 1.02% at March 31, 2017. Early stage delinquencies, which are loans 30 – 89 days delinquent, as a percentage of total loans decreased from 0.56% at March 31, 2017 to 0.44% at March 31, 2018 and non-performing loans as a percentage of total loans increased from 0.45% at March 31, 2017 to 0.49% at March 31, 2018. The allowance for loan losses to non-performing loans decreased from 172.73% at March 31, 2017 to 159.00% at March 31, 2018.

Based on the evaluation of the adequacy of the allowance for loan losses, management believes that the allowance for loan losses at March 31, 2018 is adequate and reflects probable incurred losses in the portfolio. The provision for loan losses is based on management's judgment after taking into consideration all factors connected with the collectability of the existing loan portfolio. Management evaluates the loan portfolio in light of economic conditions, changes in the nature and volume of the loan portfolio, industry standards and other relevant factors. Specific factors considered by management in determining the amounts charged to operating expenses include previous credit loss experience, the status of past due interest and principal payments, the quality of financial information supplied by loan customers and the general condition of the industries in the community to which loans have been made.

Deposits. Total deposits increased \$32.4 million from December 31, 2017 to March 31, 2018, for a balance of \$1.6 billion. The increase in deposits is the result of the Company's efforts to increase deposits without causing a

significant negative impact to the net interest margin during the first three months of 2018. Non-interest bearing demand deposits decreased while interest bearing deposits increased between December 31, 2017 and March 31, 2018. Non-interest bearing deposits decreased by \$9.9 million or 2.4% and interest bearing accounts increased \$42.3 million or 3.6% during the first three months of 2018. Money Market index accounts decreased. At December 31, 2017 the balance was \$250.2 million and at March 31, 2018 it was \$241.7 million, a decrease of 3.4%. The Company's strategy is to grow deposit balances. While there is growing pressure in the deposit market for increasing deposit rates, management understands the need to protect the net interest margin but also remain competitive within the market to help supply the needs of the growing loan portfolio. At March 31, 2018, core deposits, which include, savings and money market accounts, time deposits less than \$250 thousand, demand deposits and interest bearing demand deposits represented approximately 95.9% of total deposits.

**Borrowings.** Total borrowing balances decreased 7.3% from \$296.6 million at December 31, 2017 to \$274.8 million at March 31, 2018. During the three month period ended March 31, 2018 the Company paid back \$30 million in short-term FHLB advances.

**Capital Resources.** Total stockholders' equity decreased \$834 thousand, or 0.3%, during the three month period ended March 31, 2018. The decrease is primarily due to the market adjustment on securities available for sale portfolio. Shareholders received \$0.07

per share in cash dividends in the first quarter of 2018. The increased dividend to \$0.07 is a 16.7% increase over the \$0.06 paid in the last quarter of 2017. Book value per share decreased from \$8.79 per share at December 31, 2017 to \$8.73 per share at March 31, 2018. The Company's tangible book value per share also decreased, from \$7.14 per share at December 31, 2017 to \$7.10 per share at March 31, 2018. The decreases in book value and tangible book value per share were the result of the market adjustment on securities held.

The capital management function is a regular process that consists of providing capital for both the current financial position and the anticipated future growth of the Company. New minimum capital requirements associated with the Basel Committee on capital and liquidity regulation (Basel III) are being phased in from January 1, 2015 through January 1, 2019. The Company must hold a capital conservation buffer of 1.875% above adequately capitalized risk-based capital ratios during 2018. At March 31, 2018 the Company is required to maintain 4.5% common equity tier 1 to risk weighted assets excluding the conservation buffer to be adequately capitalized. The Company's common equity tier 1 to risk weighted assets was 12.2%, total risk-based capital ratio stood at 12.9%, and the Tier I risk-based capital ratio and Tier I leverage ratio were at 12.1% and 9.7%, respectively, at March 31, 2018. Management believes that the Company and the Bank meet all capital adequacy requirements to which they are subject, as of March 31, 2018.

#### Critical Accounting Policies

The Company follows financial accounting and reporting policies that are in accordance with U.S. GAAP. These policies are presented in Note 1 of the consolidated audited financial statements in the Company's Annual Report to Shareholders included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. Critical accounting policies are those policies that require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. The Company has identified three accounting policies that are critical accounting policies and an understanding of these policies is necessary to understand the Company's financial statements. These policies relate to determining the adequacy of the allowance for loan losses, if there is any impairment of goodwill or other intangible, and estimating the fair value of assets acquired and liabilities assumed in connection with the merger activity. Additional information regarding these policies is included in the notes to the aforementioned 2017 consolidated financial statements, Note 1 (Summary of Significant Accounting Policies), Note 2 (Business Combination), Note 4 (Loans), and the sections captioned "Loan Portfolio."

U.S. GAAP establishes standards for the amortization of acquired intangible assets and the impairment assessment of goodwill. Goodwill arising from business combinations represents the value attributable to unidentifiable intangible assets in the business acquired. The Company's goodwill relates to the value inherent in the banking industry and that value is dependent upon the ability of the Company's subsidiaries to provide quality, cost-effective services in a competitive marketplace. The goodwill value is supported by revenue that is in part driven by the volume of business transacted. A decrease in earnings resulting from a decline in the customer base or the inability to deliver cost-effective services over sustained periods can lead to impairment of goodwill that could adversely impact earnings in future periods. U.S. GAAP requires an annual evaluation of goodwill for impairment, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The fair value of the goodwill is estimated by reviewing the past and projected operating results for the subsidiaries and comparable industry information.

#### Liquidity

The Company maintains, in the opinion of management, liquidity sufficient to satisfy depositors' requirements and meet the credit needs of customers. The Company depends on its ability to maintain its market share of deposits as well as acquiring new funds. The Company's ability to attract deposits and borrow funds depends in large measure on its profitability, capitalization and overall financial condition. The Company's objective in liquidity management is to

maintain the ability to meet loan commitments, purchase securities or to repay deposits and other liabilities in accordance with their terms without an adverse impact on current or future earnings. Principal sources of liquidity for the Company include assets considered relatively liquid, such as federal funds sold, cash and due from banks, as well as cash flows from maturities and repayments of loans, and securities.

Along with its liquid assets, the Bank has additional sources of liquidity available which help to ensure that adequate funds are available as needed. These other sources include, but are not limited to, loan repayments, the ability to obtain deposits through the adjustment of interest rates and the purchasing of federal funds and borrowings on approved lines of credit at major domestic banks. At March 31, 2018, this line of credit totaled \$35 million of which the Bank had not borrowed against. In addition, the Company has two revolving lines of credit with correspondent banks totaling \$6.2 million. The outstanding balance at March 31, 2018 was \$350 thousand. Management feels that its liquidity position is adequate and continues to monitor the position on a monthly basis. As of March 31, 2018, the Bank had outstanding balances with the FHLB of \$190 million with additional borrowing capacity of approximately \$336.3 million with the FHLB, as well as access to the Federal Reserve Discount Window, which provides an additional source of funds. The Bank views its membership in the FHLB as a solid source of liquidity.

The primary investing activities of the Company are originating loans and purchasing securities. During the first three months of 2018, net cash used by investing activities amounted to \$24.2 million, compared to \$32.4 million used in the same period in 2017.

Loan originations were robust and used \$22.5 million during the first three months of 2018 compared to the \$34.4 million used during the same period in 2017. The cash used in investing activities during this period can be attributed to the strong lending activity in most of the loan types. Proceeds from the sale of securities available for sale were \$262 thousand for the quarter ended March 31, 2018 compared to \$43.3 million during the first three months of 2017. Conversely, purchases of securities available for sale amounted to \$14.3 million used during the first three months of 2018 compared to \$54.9 million used during the same period in 2017.

The primary financing activities of the Company are obtaining deposits, repurchase agreements and other borrowings. Net cash provided by financing activities amounted to \$8.8 million for the period ended March 31, 2018, compared to \$45.7 million provided in financing activities for the same period in 2017. There were large swings in two line items during the three month period ended March 31, 2018 compared to the same period last year: changes in short term borrowings used \$21.6 million in the three month period ended March 31, 2018, compared to \$36.8 million provided during the three month period ended March 31, 2017, and there was also \$15.5 million received from deposits during the three month period ended March 31, 2017 compared to providing \$32.4 million during the three month period ended March 31, 2018.

#### Off-Balance Sheet Arrangements

In the normal course of business, to meet the financial needs of our customers, we are a party to financial instruments with off-balance sheet risk. These financial instruments generally include commitments to originate mortgage, commercial and consumer loans, and involve to varying degrees, elements of credit and interest rate risk in excess of amounts recognized in the Consolidated Balance Sheets. The Bank's maximum exposure to credit loss in the event of nonperformance by the borrower is represented by the contractual amount of those instruments. Because some commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The same credit policies are used in making commitments as are used for on-balance sheet instruments. Collateral is required in instances where deemed necessary. Undisbursed balances of loans closed include funds not disbursed but committed for construction projects. Unused lines of credit include funds not disbursed, but committed for, home equity, commercial and consumer lines of credit. Financial standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Those guarantees are primarily used to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Total unused commitments were \$343.3 million at March 31, 2018 and \$339.4 at December 31, 2017. Additionally, the Company has committed up to \$8 million in subscriptions in Small Business Investment Company investment funds. At March 31, 2018 the Company had invested \$5.6 million in these funds.

#### Recent Market and Regulatory Developments

Various legislation affecting financial institutions and the financial industry will likely continue to be introduced in Congress, and such legislation may further change banking statutes and the operating environment of the Company in substantial and unpredictable ways, and could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance depending upon whether any of this potential legislation will be enacted, and if enacted, the effect that it or any implementing regulations, would have on the financial condition or results of operations of the Company or any of its subsidiaries. With the enactment of the Dodd-Frank Act, the nature and extent of future legislative and regulatory changes affecting financial institutions remains very unpredictable at this time.

Also, such statutes, regulations and policies are continually under review by Congress, state legislatures and federal and state regulatory agencies and are subject to change at any time, particularly in the current economic and regulatory environment. Any such change in statutes, regulations or regulatory policies applicable to the Company could have a



material effect on the business of the Company.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

The Company's ability to maximize net income is dependent, in part, on management's ability to plan and control net interest income through management of the pricing and mix of assets and liabilities. Because a large portion of assets and liabilities of the Company are monetary in nature, changes in interest rates and monetary or fiscal policy affect its financial condition and can have significant impact on the net income of the Company. Additionally, the Company's balance sheet is slightly asset sensitive and in the rising interest rate environment that exists today, the Company's net interest margin should maintain relatively stable levels throughout the near future.

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The Company considers the primary market exposure to be interest rate risk. Simulation analysis is used to monitor the Company's exposure to changes in interest rates, and the effect of the change to net interest income. The following table shows the effect on net interest income and the net present value of equity in the event of a sudden and sustained 300 basis point increase or 100 basis point decrease in market interest rates:

| Changes In Interest Rate<br>(basis points) | March<br>31, |      | December 31, |        | ALCO       |   |
|--|--------------|------|--------------|--------|------------|---|
|  | 2018         | 2017 | Result       | Result | Guidelines |   |
| <b>Net Interest Income Change</b>          |              |      |              |        |            |   |
| +300                                       | -3.2         | -1.9 | %            | %      | 15         | % |
| +200                                       | -1.9         | -1.0 | %            | %      | 10         | % |
| +100                                       | -0.8         | -0.5 | %            | %      | 5          | % |
| -100                                       | -2.1         | -3.3 | %            | %      | 5          | % |
| <b>Net Present Value Of Equity Change</b>  |              |      |              |        |            |   |
| +300                                       | -10.1        | -7.5 | %            | %      | 20         | % |
| +200                                       | -6.0         | -3.7 | %            | %      | 15         | % |
| +100                                       | -1.9         | 0.3  | %            | %      | 10         | % |
| -100                                       | -5.1         | -7.2 | %            | %      | 10         | % |

The results of the simulations indicate that all interest rate change results fall within internal limits established by the Company at March 31, 2018. A report on interest rate risk is presented to the Board of Directors and the Asset/Liability Committee on a quarterly basis. The Company has no market risk sensitive instruments held for trading purposes, nor does it hold derivative financial instruments, and does not plan to purchase these instruments in the near future.

#### Item 4. Controls and Procedures

Based on their evaluation, as of the end of the period covered by this Quarterly Report on Form 10-Q, the Company's Chief Executive Officer and Chief Financial Officer have concluded the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934) are effective. There were no changes in the Company's internal controls over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during the fiscal quarter ended March 31, 2018, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II - OTHER INFORMATION

#### Item 1. Legal Proceedings

In the opinion of management there are no outstanding legal actions that will have a material adverse effect on the Company's financial condition or results of operations.

Item 1A. Risk Factors

There have been no material changes to the Company's risk factors from those disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Purchases of equity securities by the issuer.

On September 28, 2012, the Company announced that its Board of Directors approved a stock repurchase program that authorizes the repurchase of up to 920,000 shares of its outstanding common stock in the open market or in privately negotiated transactions. There were no shares purchased during the three month period ended March 31, 2018. There are 245,866 shares that may still be repurchased under this program.

During the acquisition of Monitor Bank there were 465,787 shares issued as part of the transaction that was completed on August 15, 2017.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

The following exhibits are filed or incorporated by reference as part of this report:

- 3.1 Articles of Incorporation of Farmers National Banc Corp., as amended (incorporated by reference from Exhibit 4.1 to the Company's Registration Statement on Form S-3 filed with the Commission on October 3, 2001 (File No. 333-70806)).
- 3.2 Amendment to Articles of Incorporation of Farmers National Banc Corp., as amended (incorporated by reference from Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the Commission on May 1, 2013).
- 3.3 Amended Code of Regulations of Farmers National Banc Corp. (incorporated by reference from Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2011 filed with the Commission on August 9, 2011).
- 10.1 Farmers National Banc Corp. 2018 Form of Notice of Grant of Long-term Incentive Plan Awards under 2017 Equity Incentive Plan (filed herewith).
- 10.2 Farmers National Banc Corp. 2018 Form of Performance-Based Equity Award Agreement under 2017 Equity Incentive Plan (filed herewith).
- 10.3 Farmers National Banc Corp. 2018 Form of Service-Based Restricted Stock Award Agreement under 2017 Equity Incentive Plan (filed herewith).
- 10.4 Farmers National Banc Corp. 2018 Form of Performance-Based Cash Award Agreement under Long-Term Incentive Plan (filed herewith).
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of Kevin J. Helmick, President and Chief Executive Officer of the Company (filed herewith).
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Carl D. Culp, Executive Vice President, Chief Financial Officer and Treasurer of the Company (filed herewith).
- 32.1 Certification pursuant to 18 U.S.C. Section 1350 of Kevin J. Helmick, President and Chief Executive Officer of the Company (filed herewith).
- 32.2 Certification pursuant to 18 U.S.C. Section 1350 of Carl D. Culp, Executive Vice President, Chief Financial Officer and Treasurer of the Company (filed herewith).
- 101 The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2017, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Income; (iii) the Consolidated Statements of Comprehensive Income; (iv) the Consolidated Statements of Cash Flows; and (v) Notes to Unaudited Consolidated Financial Statements, tagged as blocks of text.

\*Constitutes a management contract or compensatory plan or arrangement.

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SIGNATURES

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

FARMERS NATIONAL BANC CORP.

Dated: May 9, 2018

/s/ Kevin J. Helmick  
Kevin J. Helmick  
President and Chief Executive Officer  
Dated: May 9, 2018

/s/ Carl D. Culp  
Carl D. Culp  
Executive Vice President and Treasurer