FIRST COMMUNITY BANCSHARES INC /NV/
Form 10-Q
August 03, 2018

Table of Contents

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 **June 30, 2018**
or

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

Commission file number: **000-19297**

FIRST COMMUNITY BANCSHARES, INC.
(Exact name of registrant as specified in its charter)

Nevada	**55-0694814**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
P.O. Box 989 Bluefield, Virginia	**24605-0989**
(Address of principal executive offices)	(Zip Code)

(276) 326-9000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes 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 the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

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

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

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

As of July 27, 2018, there were 16,574,758 shares outstanding of the registrant’s Common Stock, $1.00 par value.

Table of Contents

FIRST COMMUNITY BANCSHARES, INC.
FORM 10-Q
INDEX

PART I.	**FINANCIAL INFORMATION**	**Page**
Item 1.	Financial Statements	
	Condensed Consolidated Balance Sheets as of June 30, 2018 (Unaudited) and December 31, 2017	4
	Condensed Consolidated Statements of Income for the Three and Six Months Ended June 30, 2018 and 2017 (Unaudited)	5
	Condensed Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2018 and 2017 (Unaudited)	6
	Condensed Consolidated Statements of Changes in Stockholders' Equity for the Six Months Ended June 30, 2018 and 2017 (Unaudited)	7
	Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2018 and 2017 (Unaudited)	8
	Notes to Condensed Consolidated Financial Statements (Unaudited)	9
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	40
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	55
Item 4.	Controls and Procedures	55
PART II.	**OTHER INFORMATION**	
Item 1.	Legal Proceedings	56
Item 1A.	Risk Factors	56
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	56
Item 3.	Defaults Upon Senior Securities	57
Item 4.	Mine Safety Disclosures	57
Item 5.	Other Information	57
Item 6.	Exhibits	57
Signatures		59

Table of Contents

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Forward-looking statements in filings with the Securities and Exchange Commission, including this Quarterly Report on Form 10-Q and the accompanying Exhibits, filings incorporated by reference, reports to shareholders, and other communications that represent the Company’s beliefs, plans, objectives, goals, guidelines, expectations, anticipations, estimates, and intentions are made in good faith pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict. The words “may,” “could,” “should,” “would,” “believe,” “anticipat “estimate,” “expect,” “intend,” “plan,” and other similar expressions identify forward-looking statements. The following factors, among others, could cause financial performance to differ materially from that expressed in such forward-looking statements:

- the strength of the U.S. economy in general and the strength of the local economies in which we conduct operations;
- the effects of, and changes in, trade, monetary, and fiscal policies and laws, including interest rate policies of the Federal Reserve System;
- inflation, interest rate, market and monetary fluctuations;
- timely development of competitive new products and services and the acceptance of these products and services by new and existing customers;
- the willingness of customers to substitute competitors’ products and services for the Company’s products and services and vice versa;
- the impact of changes in financial services laws and regulations, including laws about taxes, banking, securities, and insurance, and the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act;
- the impact of the U.S. Department of the Treasury and federal banking regulators’ continued implementation of programs to address capital and liquidity in the banking system;
- further, future, and proposed rules, including those that are part of the process outlined in the Basel Committee on Banking Supervision’s “Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems,” which require banking institutions to increase levels of capital;
- technological changes;
- the effect of acquisitions, including, without limitation, the failure to achieve the expected revenue growth and/or expense savings from such acquisitions;
- the growth and profitability of noninterest, or fee, income being less than expected;
- unanticipated regulatory or judicial proceedings;
- changes in consumer spending and saving habits; and
- the Company’s success at managing the risks mentioned above.

This list of important factors is not exclusive. If one or more of the factors affecting these forward-looking statements proves incorrect, actual results, performance, or achievements could differ materially from those expressed in, or implied by, forward-looking statements contained in this Quarterly Report on Form 10-Q and other reports we file with the Securities and Exchange Commission. Therefore, the Company cautions you not to place undue reliance on forward-looking information and statements. The Company does not intend to update any forward-looking statements, whether written or oral, to reflect changes. These cautionary statements expressly qualify all forward-looking statements that apply to the Company including the risk factors presented in Part II, Item 1A, “Risk Factors,” of this report and Part I, Item 1A, “Risk Factors,” of the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

**FIRST COMMUNITY BANCSHARES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS**

	June 30, 2018	**December 31, 2017[(1)]**
(Amounts in thousands, except share and per share data)	(Unaudited)	
Assets		
Cash and due from banks	$39,091	$37,115
Federal funds sold	67,921	119,891
Interest-bearing deposits in banks	945	945
Total cash and cash equivalents	107,957	157,951
Debt securities available for sale	196,425	165,525
Debt securities held to maturity	25,082	25,149
Loans held for investment, net of unearned income		
Non-covered	1,776,112	1,789,236
Covered	22,919	27,948
Allowance for loan losses	(19,583)	(19,276)
Loans held for investment, net	1,779,448	1,797,908
FDIC indemnification asset	6,390	7,161
Premises and equipment, net	45,547	48,126
Other real estate owned, non-covered	4,805	2,409
Other real estate owned, covered	44	105
Interest receivable	5,580	5,778
Goodwill	95,779	95,779
Other intangible assets	5,628	6,151
Other assets	75,435	76,418
Total assets	$2,348,120	$2,388,460
Liabilities		
Deposits		
Noninterest-bearing	$462,851	$454,143
Interest-bearing	1,441,887	1,475,748

Total deposits	1,904,738	1,929,891
Securities sold under agreements to repurchase	27,869	30,086
FHLB borrowings	50,000	50,000
Interest, taxes, and other liabilities	26,392	27,769
Total liabilities	2,008,999	2,037,746
Stockholders' equity		
Preferred stock, undesignated par value; 1,000,000 shares authorized; Series A Noncumulative Convertible Preferred Stock, $0.01 par value; 25,000 shares authorized; none outstanding	-	-
Common stock, $1 par value; 50,000,000 shares authorized; 21,381,779 shares issued at June 30, 2018, and December 31, 2017; 4,802,475 and 4,383,553 shares in treasury at June 30, 2018, and December 31, 2017, respectively	21,382	21,382
Additional paid-in capital	228,949	228,750
Retained earnings	184,279	180,543
Treasury stock, at cost	(92,904)	(79,121)
Accumulated other comprehensive loss	(2,585)	(840)
Total stockholders' equity	339,121	350,714
Total liabilities and stockholders' equity	$2,348,120	$2,388,460

(1) Derived from audited financial statements

See Notes to Condensed Consolidated Financial Statements.

4

Table of Contents

FIRST COMMUNITY BANCSHARES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(Amounts in thousands, except share and per share data)	**Three Months Ended June 30, 2018**	**2017**	**Six Months Ended June 30, 2018**	**2017**
Interest income				
Interest and fees on loans	$22,422	$22,914	$45,177	$44,741
Interest on securities -- taxable	649	407	1,038	816
Interest on securities -- tax-exempt	712	763	1,427	1,560
Interest on deposits in banks	514	221	985	380
Total interest income	24,297	24,305	48,627	47,497
Interest expense				
Interest on deposits	1,327	1,233	2,578	2,399
Interest on short-term borrowings	202	211	402	421
Interest on long-term debt	506	567	1,006	1,242
Total interest expense	2,035	2,011	3,986	4,062
Net interest income	22,262	22,294	44,641	43,435
Provision for loan losses	495	934	990	1,426
Net interest income after provision for loan losses	21,767	21,360	43,651	42,009
Noninterest income				
Wealth management	823	791	1,617	1,581
Service charges on deposits	3,612	3,360	7,080	6,473
Other service charges and fees	1,991	1,748	3,791	3,447
Insurance commissions	338	325	667	698
Net loss on sale of securities	-	(657)	-	(657)
Net FDIC indemnification asset amortization	(575)	(1,586)	(957)	(2,918)
Other operating income	827	1,074	1,429	1,743
Total noninterest income	7,016	5,055	13,627	10,367
Noninterest expense				
Salaries and employee benefits	8,993	9,022	18,434	17,770
Occupancy expense	1,083	1,341	2,333	2,589
Furniture and equipment expense	945	1,087	1,991	2,178
Service fees	851	1,095	1,679	1,940
Advertising and public relations	461	544	983	1,149
Professional fees	430	817	737	1,639
Amortization of intangibles	263	263	524	524
FDIC premiums and assessments	252	227	463	471
Other operating expense	3,939	2,642	7,132	5,482

Total noninterest expense	17,217	17,038	34,276	33,742
Income before income taxes	11,566	9,377	23,002	18,634
Income tax expense	2,500	2,959	5,068	6,014
Net income	9,066	6,418	17,934	12,620
Earnings per common share				
Basic	$0.54	$0.38	$1.06	$0.74
Diluted	0.54	0.38	1.06	0.74
Cash dividends per common share	0.18	0.16	0.84	0.32
Weighted average shares outstanding				
Basic	16,689,398	17,012,189	16,821,842	17,005,196
Diluted	16,788,615	17,082,832	16,912,872	17,075,961

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

FIRST COMMUNITY BANCSHARES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	**2017**	**2018**	**2017**
(Amounts in thousands)				
Net income	$9,066	$6,418	$17,934	$12,620
Other comprehensive income, before tax				
Available-for-sale debt securities:				
Change in net unrealized (losses) gains on debt securities without other-than-temporary impairment	(296)	1,645	(2,443)	2,296
Reclassification adjustment for net losses recognized in net income	-	657	-	657
Net unrealized (losses) gains on available-for-sale debt securities	(296)	2,302	(2,443)	2,953
Employee benefit plans:				
Net actuarial gain	93	1	92	134
Reclassification adjustment for amortization of prior service cost and net actuarial loss recognized in net income	71	65	142	129
Net unrealized gains on employee benefit plans	164	66	234	263
Other comprehensive (loss) income, before tax	(132)	2,368	(2,209)	3,216
Income tax (benefit) expense	(28)	888	(464)	1,206
Other comprehensive (loss) income, net of tax	(104)	1,480	(1,745)	2,010
Total comprehensive income	$8,962	$7,898	$16,189	$14,630

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

FIRST COMMUNITY BANCSHARES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)

(Amounts in thousands, except share and per share data)	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Balance January 1, 2017	$ -	$ 21,382	$ 228,142	$ 170,377	$ (78,833)	$ (2,011)	$ 339,057
Net income	-	-	-	12,620	-	-	12,620
Other comprehensive income	-	-	-	-	-	2,010	2,010
Common dividends declared -- $0.32 per share	-	-	-	(5,441)	-	-	(5,441)
Equity-based compensation expense	-	-	124	-	378	-	502
Common stock options exercised -- 3,566 shares	-	-	(17)	-	64	-	47
Issuance of treasury stock to 401(k) plan -- 8,869 shares	-	-	77	-	159	-	236
Purchase of treasury shares -- 10,602 shares at $24.16 per share	-	-	-	-	(256)	-	(256)
Balance June 30, 2017	$ -	$ 21,382	$ 228,326	$ 177,556	$ (78,488)	$ (1)	$ 348,775
Balance January 1, 2018	$ -	$ 21,382	$ 228,750	$ 180,543	$ (79,121)	$ (840)	$ 350,714
Net income	-	-	-	17,934	-	-	17,934
Other comprehensive loss	-	-	-	-	-	(1,745)	(1,745)
Common dividends declared -- $0.36 per share	-	-	-	(6,064)	-	-	(6,064)
Special common dividend declared -- $0.48 per share	-	-	-	(8,134)	-	-	(8,134)
Equity-based compensation expense	-	-	151	-	594	-	745
Common stock options exercised -- 10,350 shares	-	-	(38)	-	195	-	157
Issuance of treasury stock to 401(k) plan -- 7,652 shares	-	-	86	-	143	-	229
Purchase of treasury shares -- 474,240 shares at $31.03 per share	-	-	-	-	(14,715)	-	(14,715)
Balance June 30, 2018	$ -	$ 21,382	$ 228,949	$ 184,279	$ (92,904)	$ (2,585)	$ 339,121

See Notes to Condensed Consolidated Financial Statements.

7

Table of Contents

FIRST COMMUNITY BANCSHARES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended June 30,	
(Amounts in thousands)	**2018**	**2017**
Operating activities		
Net income	$17,934	$12,620
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	990	1,426
Depreciation and amortization of premises and equipment	1,521	1,775
Amortization (accretion) of premiums on investments, net	131	(8)
Amortization of FDIC indemnification asset, net	957	2,918
Amortization of intangible assets	524	524
Accretion on acquired loans	(3,204)	(2,880)
Equity-based compensation expense	745	502
Issuance of treasury stock to 401(k) plan	229	236
Loss on sale of premises and equipment, net	6	14
Loss on sale of other real estate owned	771	386
Loss on sale of securities	-	657
Decrease in accrued interest receivable	198	481
Decrease (increase) in other operating activities	340	(4,273)
Net cash provided by operating activities	21,142	14,378
Investing activities		
Proceeds from sale of securities available for sale	55	12,273
Proceeds from maturities, prepayments, and calls of securities available for sale	33,948	14,823
Proceeds from maturities and calls of securities held to maturity	-	21,840
Payments to acquire securities available for sale	(67,355)	(16,990)
Proceeds from loans, net	16,783	12,457
Proceeds from bank owned life insurance	458	2,639
Proceeds from FHLB stock, net	3	694
Proceeds from the FDIC	208	368
Proceeds from premises and equipment	489	28
Payments to acquire premises and equipment	(384)	(1,438)
Proceeds from sale of other real estate owned	785	1,736
Net cash (used in) provided by investing activities	(15,010)	48,430
Financing activities		
Increase in noninterest-bearing deposits, net	8,708	16,095
Increase in interest-bearing deposits, net	(33,861)	(59)

Repayments of securities sold under agreements to repurchase, net	(2,217)	(11,994)
Repayments of FHLB and other borrowings, net	-	(30,708)
Proceeds from stock options exercised	157	47
Payments for repurchase of treasury stock	(14,715)	(256)
Payments of common dividends	(14,198)	(5,441)
Net cash used in financing activities	(56,126)	(32,316)
Net (decrease) increase in cash and cash equivalents	(49,994)	30,492
Cash and cash equivalents at beginning of period	157,951	76,307
Cash and cash equivalents at end of period	$107,957	$106,799
Supplemental disclosure -- cash flow information		
Cash paid for interest	$4,001	$4,284
Cash paid for income taxes	4,000	9,812
Supplemental transactions -- noncash items		
Transfer of loans to other real estate owned	3,928	775
(Increase) decrease in accumulated other comprehensive loss	(1,745)	2,010

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1. Basis of Presentation

General

First Community Bancshares, Inc. (the “Company”), a financial holding company, was founded in 1989 and incorporated under the laws of Nevada in 1997. The Company’s principal executive office is located at One Community Place, Bluefield, Virginia. The Company provides banking products and services to individual and commercial customers through its wholly owned subsidiary First Community Bank (the “Bank”), a Virginia-chartered banking institution founded in 1874. The Bank operates as First Community Bank in Virginia, West Virginia, and North Carolina and People’s Community Bank, a Division of First Community Bank, in Tennessee. The Bank provides insurance services through its wholly owned subsidiary First Community Insurance Services (“FCIS”) and offers wealth management and investment advice through its Trust Division and wholly owned subsidiary First Community Wealth Management (“FCWM”). Unless the context suggests otherwise, the terms “First Community,” “Company,” “we,” “our,” and “ refer to First Community Bancshares, Inc. and its subsidiaries as a consolidated entity.

Principles of Consolidation

The Company’s accounting and reporting policies conform with U.S. generally accepted accounting principles (“GAAP”) and prevailing practices in the banking industry. The consolidated financial statements include all accounts of the Company and its wholly owned subsidiaries and eliminate all intercompany balances and transactions. The Company operates in one business segment, Community Banking, which consists of all operations, including commercial and consumer banking, lending activities, wealth management, and insurance services. Operating results for interim periods are not necessarily indicative of results that may be expected for other interim periods or for the full year. In management’s opinion, the accompanying unaudited interim condensed consolidated financial statements contain all necessary adjustments, including normal recurring accruals, and disclosures for a fair presentation.

These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 (the “2017 Form 10-K”), as filed with the Securities and Exchange Commission (the “SEC”) on March 5, 2018. The condensed consolidated balance sheet as of December 31, 2017, has been derived from the audited consolidated financial statements.

Reclassifications

Certain amounts reported in prior years have been reclassified to conform to the current year's presentation. These reclassifications had no effect on the Company's results of operations, financial position, or cash flow.

Use of Estimates

Preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that require the most subjective or complex judgments relate to fair value measurements, investment securities, the allowance for loan losses, goodwill and other intangible assets, and income taxes. A discussion of the Company's application of critical accounting estimates is included in "Critical Accounting Estimates" in Item 2 of this report.

Significant Accounting Policies

A complete and detailed description of the Company's significant accounting policies is included in Note 1, "Basis of Presentation," of the Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2018, and in Note 1, "Basis of Presentation and Significant Accounting Policies," of the Notes to Consolidated Financial Statements in Part II, Item 8 of the Company's 2017 Form 10-K.

Recent Accounting Standards

Standards Adopted in 2018

In May 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Updated ("ASU") 2017-09, "Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting." This ASU clarifies when to account for a change to the terms or conditions of a share-based payment award as a modification. Under the new guidance, modification accounting is required only if the fair value, the vesting conditions, or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions. The Company adopted ASU 2017-09 in the first quarter of 2018. The adoption of the standard did not have a material effect on the Company's financial statements.

In March 2017, the FASB issued ASU 2017-08, “Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Securities.” This ASU amends the amortization period for certain purchased callable debt securities. The Company early adopted ASU 2017-08 in the first quarter of 2018. The adoption of the standard did not have a material effect on the Company’s financial statements since securities held at a premium were already being amortized to the earliest call date.

In March 2017, the FASB issued ASU 2017-07, “Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.” This ASU intends to improve the presentation of net periodic pension cost and net periodic postretirement benefit costs in the income statement and to narrow the amounts eligible for capitalization in assets. The Company adopted ASU 2017-07 in the first quarter of 2018. The adoption of the standard did not have a material effect on the Company’s financial statements. In accordance with the standard, the Company reclassified the non-service components of the net periodic benefit costs from salaries and employee benefits to other expense on a retrospective basis which totaled $158 thousand for the three months ended June 30, 2017, and $315 thousand for the six months ended June 30, 2017.

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash Flows (Topic 230): Restricted Cash.” This ASU requires that a statement of cash flows explains the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The Company adopted ASU 2016-18 in the first quarter of 2018. The adoption of the standard did not have a material effect on the Company’s financial statements.

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments.” This ASU makes eight targeted changes to how cash receipts and cash payments are presented and classified in the statement of cash flows. The update should be applied on a retrospective basis, if practicable. The Company adopted ASU 2016-15 in the first quarter of 2018. The adoption of the standard did not have a material effect on the Company’s financial statements. In accordance with the standard, the Company reclassified proceeds from bank owned life insurance from operating activities to investing activities on a retrospective basis.

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.” This ASU significantly revises how entities account and disclose financial assets and liabilities. The guidance (1) requires most equity investments to be measured at fair value with changes in fair value recognized in net income; (2) simplifies the impairment assessment of equity investments without a readily determinable fair value; (3) eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost on the balance sheet; (4) requires public business entities to use exit price notion, rather than entry prices, when measuring fair value of financial instruments for disclosure purposes; (5) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial assets on the balance sheet or the accompanying notes to the financial statements; (6) requires separate presentation in other comprehensive income of 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 organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; and (7) states that a valuation allowance on deferred tax assets related to available-for-sale securities should be evaluated in combination with other deferred tax assets. In February 2018, the FASB issued ASU 2018-03, which included technical corrections and improvements to clarify the guidance in ASU 2016-01. The Company adopted ASU 2016-01 in the first quarter of 2018. The adoption of the standard did not have a material effect on the Company's financial statements. In accordance with the prospective application of the standard, the Company measured the fair value of loans using an exit price notion as of March 31, 2018. For additional information, see Note 13, "Fair Value" to the Condensed Consolidated Financial Statements of this report.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)." This ASU's core principle is that an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under existing guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. In August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers" deferring the effective date of ASU 2014-09 for the Company until fiscal years beginning after December 15, 2017, with early adoption permitted for fiscal years beginning after December 15, 2016. The Company adopted Topic 606, and related updates, in the first quarter of 2018 using the modified retrospective method. The Company's primary source of revenue is interest income, which is excluded from the scope of this guidance; however, the Company evaluated the impact on other income; which includes fees for services, commissions on sales, and various deposit service charges; revenue contracts; and disclosures and determined that no cumulative-effect adjustment to retained earnings was necessary. The adoption of the standard did not have a material effect on the Company's financial statements.

Table of Contents

Revenue Recognition

Accounting Standards Codification Topic 606 (“ASC 606”), “Revenue from Contracts with Customers,” establishes principles for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the Company's contracts to provide goods or services to customers. The core principle requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it expects to be entitled to receive in exchange for those goods or services recognized as performance obligations are satisfied.

The great majority of the Company’s revenue-generating transactions are not subject to ASC 606, including revenue generated from financial instruments, such as loans, letters of credit, and derivatives and investment securities, as these activities are subject to other GAAP discussed elsewhere within our disclosures. Descriptions of the Company’s revenue-generating activities that are within the scope of ASC 606, which are discussed below, are presented in the Company’s consolidated statements of income as components of noninterest income.

Wealth management. Wealth management income represents monthly fees due from wealth management customers as consideration for managing the customers' assets. Wealth management and trust services include custody of assets, investment management, escrow services, fees for trust services and similar fiduciary activities. Revenue is recognized when the performance obligation is completed each month, which is generally the time that payment is received. Income also includes fees received from a third party broker-dealer as part of a revenue-sharing agreement for fees earned from customers that are referred to the third party. These fees are paid to the Company by the third party on a quarterly basis and recognized ratably throughout the quarter as the performance obligation is satisfied.

Service charges on deposits and other service charges and fees. Service charges on deposits and other service charges and fees represent general service fees for account maintenance and activity and transaction-based fees that consist of transaction-based revenue, time-based revenue (service period), item-based revenue, or some other individual attribute-based revenue. Revenue is recognized when the performance obligation is completed, which is generally monthly for account maintenance services or when a transaction has been completed. Payment for such performance obligations is generally received at the time the performance obligations are satisfied. Other service charges and fees include interchange income from debit and credit card transaction fees. In accordance with the adoption of ASC 606, the Company reclassified interchange expense, which was previously a component of noninterest expense, to net against interchange income. Net interchange income totaled $1.47 million, which included interchange income of $1.95 million and interchange expense of $487 thousand for the three months ended June 30, 2018. Net interchange income totaled $2.80 million, which included interchange income of $3.72 million and interchange expense of $915 thousand for the six months ended June 30, 2018. Net interchange income totaled $1.30 million, which included interchange income of $1.72 million and interchange expense of $421 thousand for the three months ended June 30, 2017. Net interchange income totaled $2.53 million, which included interchange income of $3.33 million and interchange expense of $799 thousand for the six months ended June 30, 2017.

Other operating income. Other operating income consists primarily of dividends received and income on life insurance contracts, which are not subject to the requirements of ASC 606.

Standards Not Yet Adopted

In July 2018, the FASB issued ASU 2018-09, "Codification Improvements." This ASU makes changes to a variety of topics to clarify, correct errors in, or make minor improvements to the Accounting Standards Codification. The majority of the amendments in ASU 2018-09 will be effective for the Company for fiscal years beginning after December 15, 2018. The Company expects to adopt ASU 2018-09 in the first quarter of 2019. The Company is evaluating the impact of the standard and does not expect the guidance to have a material effect on its financial statements.

In August 2017, the FASB issued ASU 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities." This ASU intends to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements and simplify the application of hedge accounting guidance. ASU 2017-12 will be effective for the Company for fiscal years beginning after December 15, 2018. The Company expects to adopt ASU 2017-12 in the first quarter of 2019. The Company is evaluating the impact of the standard and does not expect the guidance to have a material effect on its financial statements.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." This ASU intends to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. This 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 and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. In addition, the update amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 will be effective for the Company for fiscal years beginning after December 15, 2019, with early adoption permitted for fiscal years beginning after December 15, 2018. The Company expects to adopt ASU 2016-13 in the first quarter of 2020 and recognize a cumulative adjustment to retained earnings as of the beginning of the year of adoption. The Company is evaluating the impact of the standard.

Table of Contents

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." This ASU increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and requiring more disclosures related to leasing transactions. In July 2018, the FASB issued ASU 2018-10, "Codification Improvements to Topic 842, Leases," which updates narrow aspects of the guidance issued in ASU 2016-02. ASU 2016-02 will be effective for the Company for fiscal years beginning after December 15, 2018, with early adoption permitted. The Company expects to adopt ASU 2016-02 in the first quarter of 2019. The Company leases certain banking offices under lease agreements it classifies as operating leases. The Company is evaluating the impact of the standard and expects an increase in assets and liabilities; however, the Company does not expect the guidance to have a material effect on its financial statements or resulting operations.

The Company does not expect other recent accounting standards issued by the FASB or other standards-setting bodies to have a material impact on the consolidated financial statements.

Note 2. Debt Securities

The following tables present the amortized cost and fair value of available-for-sale debt securities, including gross unrealized gains and losses, as of the dates indicated:

	June 30, 2018			
	Amortized Cost	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**
(Amounts in thousands)				
U.S. Agency securities	$1,166	$ 4	$ -	$1,170
U.S. Treasury securities	49,827	-	(19)	49,808
Municipal securities	99,451	1,063	(909)	99,605
Single issue trust preferred securities	9,374	-	(391)	8,983
Mortgage-backed Agency securities	37,816	34	(991)	36,859
Total	$197,634	$ 1,101	$ (2,310)	$196,425

	December 31, 2017			
	Amortized Cost	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**
(Amounts in thousands)				
U.S. Agency securities	$11,289	$ 17	$ (10)	$11,296
U.S. Treasury securities	19,987	-	(16)	19,971
Municipal securities	101,552	2,203	(107)	103,648
Single issue trust preferred securities	9,367	-	(483)	8,884
Mortgage-backed Agency securities	22,095	46	(415)	21,726

Total	$164,290	$ 2,266	$ (1,031)	$165,525

Table of Contents

The following tables present the amortized cost and fair value of held-to-maturity debt securities, including gross unrealized gains and losses, as of the dates indicated:

	June 30, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
(Amounts in thousands)				
U.S. Agency securities	$17,913	$ -	$ (74)	$17,839
Corporate securities	7,169	-	(28)	7,141
Total	$25,082	$ -	$ (102)	$24,980

	December 31, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
(Amounts in thousands)				
U.S. Agency securities	$17,937	$ -	$ (49)	$17,888
Corporate securities	7,212	-	(16)	7,196
Total	$25,149	$ -	$ (65)	$25,084

The following table presents the amortized cost and aggregate fair value of available-for-sale debt securities and held-to-maturity debt securities, by contractual maturity, as of the date indicated. Actual maturities could differ from contractual maturities because issuers may have the right to call or prepay obligations with or without penalties.

	June 30, 2018	
(Amounts in thousands)	Amortized Cost	Fair Value
Available-for-sale debt securities		
Due within one year	$49,827	$49,808
Due after one year but within five years	9,902	10,014
Due after five years but within ten years	97,955	97,590
Due after ten years	2,134	2,154
	159,818	159,566
Mortgage-backed securities	37,816	36,859
Total debt securities available for sale	$197,634	$196,425
Held-to-maturity debt securities		
Due within one year	$25,082	$24,980
Due after one year but within five years	-	-
Due after five years but within ten years	-	-
Due after ten years	-	-
Total debt securities held to maturity	$25,082	$24,980

The following tables present the fair values and unrealized losses for available-for-sale debt securities in a continuous unrealized loss position for less than 12 months and for 12 months or longer as of the dates indicated:

	June 30, 2018					
	Less than 12 Months		**12 Months or Longer**		**Total**	
	Fair Value	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
(Amounts in thousands)						
U.S. Agency securities	$-	$ -	$-	$ -	$-	$ -
U.S. Treasury securities	49,808	(19)	-	-	49,808	(19)
Municipal securities	27,572	(803)	1,569	(106)	29,141	(909)
Single issue trust preferred securities	-	-	8,983	(391)	8,983	(391)
Mortgage-backed Agency securities	19,744	(257)	12,690	(734)	32,434	(991)
Total	$97,124	$ (1,079)	$23,242	$ (1,231)	$120,366	$ (2,310)

Table of Contents

	December 31, 2017					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(Amounts in thousands)						
U.S. Agency securities	$10,054	$ (10)	$-	$ -	$10,054	$ (10)
U.S. Treasury securities	19,972	(16)	-	-	19,972	(16)
Municipal securities	8,047	(55)	2,314	(52)	10,361	(107)
Single issue trust preferred securities	-	-	8,884	(483)	8,884	(483)
Mortgage-backed Agency securities	4,276	(25)	14,069	(390)	18,345	(415)
Total	$42,349	$ (106)	$25,267	$ (925)	$67,616	$ (1,031)

The following tables present the fair values and unrealized losses for held-to-maturity debt securities in a continuous unrealized loss position for less than 12 months and for 12 months or longer as of the dates indicated:

	June 30, 2018					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(Amounts in thousands)						
U.S. Agency securities	$17,839	$ (74)	$ -	$ -	$17,839	$ (74)
Corporate securities	7,141	(28)	-	-	7,141	(28)
Total	$24,980	$ (102)	$ -	$ -	$24,980	$ (102)

	December 31, 2017					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(Amounts in thousands)						
U.S. Agency securities	$17,888	$ (49)	$ -	$ -	$17,888	$ (49)
Corporate securities	7,196	(16)	-	-	7,196	(16)
Total	$25,084	$ (65)	$ -	$ -	$25,084	$ (65)

There were 111 individual debt securities in an unrealized loss position as of June 30, 2018, and their combined depreciation in value represented 1.09% of the debt securities portfolio. There were 45 individual debt securities in an unrealized loss position as of December 31, 2017, and their combined depreciation in value represented 0.57% of the debt securities portfolio.

The Company reviews its investment portfolio quarterly for indications of other-than-temporary impairment (“OTTI”). The initial indicator of OTTI for debt securities is a decline in fair value below book value and the severity and duration of the decline. The credit-related OTTI is recognized as a charge to noninterest income and the noncredit-related OTTI is recognized in other comprehensive income (“OCI”). During the three and six months ended June 30, 2018 and 2017, the Company incurred no OTTI charges on debt securities. Temporary impairment on debt securities is primarily related to changes in benchmark interest rates, changes in pricing in the credit markets, and other current economic factors.

The following table presents gross realized gains and losses from the sale of available-for-sale debt securities for the periods indicated:

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2018	**2017**	**2018**	**2017**
(Amounts in thousands)				
Gross realized gains	$-	$-	$-	$-
Gross realized losses	-	(657)	-	(657)
Net loss on sale of securities	$-	$(657)	$-	$(657)

The carrying amount of securities pledged for various purposes totaled $47.76 million as of June 30, 2018, and $51.34 million as of December 31, 2017.

Table of Contents

Note 3. Loans

The Company groups loans held for investment into three segments (commercial loans, consumer real estate loans, and consumer and other loans) with each segment divided into various classes. Covered loans are those loans acquired in Federal Deposit Insurance Corporation ("FDIC") assisted transactions that are covered by loss share agreements. Customer overdrafts reclassified as loans totaled $1.70 million as of June 30, 2018, and $1.71 million as of December 31, 2017. Deferred loan fees, net of loan costs, totaled $4.42 million as of June 30, 2018, and $4.44 million as of December 31, 2017. For information about off-balance sheet financing, see Note 14, "Litigation, Commitments, and Contingencies," to the Condensed Consolidated Financial Statements of this report.

The following table presents loans, net of unearned income, with the non-covered portfolio by loan class, as of the dates indicated:

	June 30, 2018		December 31, 2017	
(Amounts in thousands)	**Amount**	**Percent**	**Amount**	**Percent**
Non-covered loans held for investment				
Commercial loans				
Construction, development, and other land	$57,986	3.22 %	$60,017	3.30 %
Commercial and industrial	96,614	5.37 %	92,188	5.07 %
Multi-family residential	110,067	6.12 %	125,202	6.89 %
Single family non-owner occupied	142,076	7.90 %	141,670	7.80 %
Non-farm, non-residential	624,999	34.74 %	616,633	33.93 %
Agricultural	8,895	0.49 %	7,035	0.39 %
Farmland	22,055	1.23 %	25,649	1.41 %
Total commercial loans	1,062,692	59.07 %	1,068,394	58.79 %
Consumer real estate loans				
Home equity lines	100,194	5.57 %	103,205	5.68 %
Single family owner occupied	517,058	28.74 %	502,686	27.66 %
Owner occupied construction	22,647	1.26 %	39,178	2.16 %
Total consumer real estate loans	639,899	35.57 %	645,069	35.50 %
Consumer and other loans				
Consumer loans	68,885	3.83 %	70,772	3.89 %
Other	4,636	0.26 %	5,001	0.28 %
Total consumer and other loans	73,521	4.09 %	75,773	4.17 %
Total non-covered loans	1,776,112	98.73 %	1,789,236	98.46 %
Total covered loans	22,919	1.27 %	27,948	1.54 %
Total loans held for investment, net of unearned income	$1,799,031	100.00 %	$1,817,184	100.00 %

The following table presents the covered loan portfolio, by loan class, as of the dates indicated:

	June 30, 2018	**December 31, 2017**
(Amounts in thousands)		
Covered loans		
Commercial loans		
Construction, development, and other land	$35	$ 39
Single family non-owner occupied	252	284
Non-farm, non-residential	8	9
Total commercial loans	295	332
Consumer real estate loans		
Home equity lines	19,151	23,720
Single family owner occupied	3,473	3,896
Total consumer real estate loans	22,624	27,616
Total covered loans	$22,919	$ 27,948

The Company identifies certain purchased loans as impaired when fair values are established at acquisition and groups those purchased credit impaired (“PCI”) loans into loan pools with common risk characteristics. The Company estimates cash flows to be collected on PCI loans and discounts those cash flows at a market rate of interest.

Table of Contents

The following table presents the recorded investment and contractual unpaid principal balance of PCI loans, by acquisition, as of the dates indicated:

	June 30, 2018		December 31, 2017	
(Amounts in thousands)	Recorded Investment	Unpaid Principal Balance	Recorded Investment	Unpaid Principal Balance
PCI Loans, by acquisition				
Peoples	$5,443	$ 7,772	$5,278	$ 8,111
Waccamaw	9,815	26,137	12,176	31,335
Other acquired	923	949	986	1,012
Total PCI Loans	$16,181	$ 34,858	$18,440	$ 40,458

The following table presents the changes in the accretable yield on PCI loans, by acquisition, during the periods indicated:

	Peoples	Waccamaw	Total
(Amounts in thousands)			
Balance January 1, 2017	$4,392	$ 21,834	$26,226
Accretion	(606)	(3,325)	(3,931)
Reclassifications from nonaccretable difference(1)	681	1,621	2,302
Other changes, net	(41)	(624)	(665)
Balance June 30, 2017	$4,426	$ 19,506	$23,932
Balance January 1, 2018	$3,388	$ 19,465	$22,853
Accretion	(686)	(3,167)	(3,853)
Reclassifications (to) from nonaccretable difference(1)	(22)	1,221	1,199
Other changes, net	212	(74)	138
Balance June 30, 2018	$2,892	$ 17,445	$20,337

(1) Represents changes attributable to expected loss assumptions

Note 4. Credit Quality

The Company uses a risk grading matrix to assign a risk grade to each loan in its portfolio. Loan risk ratings may be upgraded or downgraded to reflect current information identified during the loan review process. The general characteristics of each risk grade are as follows:

Pass -- This grade is assigned to loans with acceptable credit quality and risk. The Company further segments this grade based on borrower characteristics that include capital strength, earnings stability, liquidity, leverage, and industry conditions.
Special Mention -- This grade is assigned to loans that require an above average degree of supervision and attention. These loans have the characteristics of an asset with acceptable credit quality and risk; however, adverse economic or financial conditions exist that create potential weaknesses deserving of management's close attention. If potential weaknesses are not corrected, the prospect of repayment may worsen.
Substandard -- This grade is assigned to loans that have well defined weaknesses that may make payment default, or principal exposure, possible. These loans will likely be dependent on collateral liquidation, secondary repayment sources, or events outside the normal course of business to meet repayment terms.
Doubtful -- This grade is assigned to loans that have the weaknesses inherent in substandard loans; however, the weaknesses are so severe that collection or liquidation in full is unlikely based on current facts, conditions, and values. Due to certain specific pending factors, the amount of loss cannot yet be determined.
Loss -- This grade is assigned to loans that will be charged off or charged down when payments, including the timing and value of payments, are uncertain. This risk grade does not imply that the asset has no recovery or salvage value, but simply means that it is not practical or desirable to defer writing off, either all or a portion of, the loan balance even though partial recovery may be realized in the future.

Table of Contents

The following tables present the recorded investment of the loan portfolio, by loan class and credit quality, as of the dates indicated. Losses on covered loans are generally reimbursable by the FDIC at the applicable loss share percentage, 80%; therefore, covered loans are disclosed separately.

	June 30, 2018					
(Amounts in thousands)	**Pass**	**Special Mention**	**Substandard**	**Doubtful**	**Loss**	**Total**
Non-covered loans						
Commercial loans						
Construction, development, and other land	$55,999	$835	$ 1,152	$ -	$-	$57,986
Commercial and industrial	93,472	2,602	540	-	-	96,614
Multi-family residential	105,533	3,877	657	-	-	110,067
Single family non-owner occupied	132,858	5,309	3,909	-	-	142,076
Non-farm, non-residential	604,886	9,807	10,160	146	-	624,999
Agricultural	8,517	202	176	-	-	8,895
Farmland	19,154	321	2,444	-	136	22,055
Consumer real estate loans						
Home equity lines	97,813	597	1,784	-	-	100,194
Single family owner occupied	486,660	4,824	25,574	-	-	517,058
Owner occupied construction	22,280	-	367	-	-	22,647
Consumer and other loans						
Consumer loans	68,592	7	281	-	5	68,885
Other	4,636	-	-	-	-	4,636
Total non-covered loans	1,700,400	28,381	47,044	146	141	1,776,112
Covered loans						
Commercial loans						
Construction, development, and other land	-	35	-	-	-	35
Single family non-owner occupied	235	-	17	-	-	252
Non-farm, non-residential	-	-	8	-	-	8
Consumer real estate loans						
Home equity lines	10,341	7,954	856	-	-	19,151
Single family owner occupied	2,708	378	387	-	-	3,473
Total covered loans	13,284	8,367	1,268	-	-	22,919
Total loans	$1,713,684	$36,748	$ 48,312	$ 146	$141	$1,799,031

Table of Contents

	December 31, 2017					
(Amounts in thousands)	**Pass**	**Special Mention**	**Substandard**	**Doubtful**	**Loss**	**Total**
Non-covered loans						
Commercial loans						
Construction, development, and other land	$57,768	$1,367	$ 882	$ -	$ -	$60,017
Commercial and industrial	87,181	3,721	1,286	-	-	92,188
Multi-family residential	118,509	5,663	1,030	-	-	125,202
Single family non-owner occupied	130,689	7,271	3,710	-	-	141,670
Non-farm, non-residential	596,616	12,493	7,351	173	-	616,633
Agricultural	6,639	294	102	-	-	7,035
Farmland	22,875	210	2,564	-	-	25,649
Consumer real estate loans						
Home equity lines	100,833	618	1,754	-	-	103,205
Single family owner occupied	471,382	5,480	25,824	-	-	502,686
Owner occupied construction	38,947	-	231	-	-	39,178
Consumer and other loans						
Consumer loans	70,448	13	311	-	-	70,772
Other	5,001	-	-	-	-	5,001
Total non-covered loans	1,706,888	37,130	45,045	173	-	1,789,236
Covered loans						
Commercial loans						
Construction, development, and other land	1	38	-	-	-	39
Single family non-owner occupied	265	-	19	-	-	284
Non-farm, non-residential	-	-	9	-	-	9
Consumer real estate loans						
Home equity lines	11,338	11,685	697	-	-	23,720
Single family owner occupied	2,996	411	489	-	-	3,896
Total covered loans	14,600	12,134	1,214	-	-	27,948
Total loans	$1,721,488	$49,264	$ 46,259	$ 173	$ -	$1,817,184

The Company identifies loans for potential impairment through a variety of means, including, but not limited to, ongoing loan review, renewal processes, delinquency data, market communications, and public information. If the Company determines that it is probable all principal and interest amounts contractually due will not be collected, the loan is generally deemed impaired.

Table of Contents

The following table presents the recorded investment, unpaid principal balance, and related allowance for loan losses for impaired loans, excluding PCI loans, as of the dates indicated:

	June 30, 2018			December 31, 2017		
(Amounts in thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
Impaired loans with no related allowance						
Commercial loans						
Construction, development, and other land	$820	$835	$ -	$727	$988	$ -
Commercial and industrial	230	249	-	315	1,142	-
Multi-family residential	290	412	-	499	1,010	-
Single family non-owner occupied	2,117	2,385	-	2,042	3,521	-
Non-farm, non-residential	4,012	4,883	-	3,022	5,955	-
Agricultural	176	181	-	102	107	-
Farmland	1,335	1,405	-	395	414	-
Consumer real estate loans						
Home equity lines	1,833	1,954	-	1,621	1,770	-
Single family owner occupied	14,132	15,470	-	16,633	18,964	-
Owner occupied construction	292	292	-	231	231	-
Consumer and other loans						
Consumer loans	198	207	-	141	144	-
Total impaired loans with no allowance	25,435	28,273	-	25,728	34,246	-
Impaired loans with a related allowance						
Commercial loans						
Commercial and industrial	-	-	-	343	343	270
Single family non-owner occupied	-	-	-	446	446	62
Non-farm, non-residential	1,378	1,378	473	262	263	15
Farmland	410	418	105	936	974	233
Consumer real estate loans						
Home equity lines	67	69	67	-	-	-
Single family owner occupied	7,043	7,053	2,434	5,586	5,606	1,978
Total impaired loans with an allowance	8,898	8,918	3,079	7,573	7,632	2,558
Total impaired loans[(1)]	$34,333	$37,191	$ 3,079	$33,301	$41,878	$ 2,558

(1) Total impaired loans include loans totaling $24.92 million as of June 30, 2018, and $20.13 million as of December 31, 2017, that do not meet the Company's evaluation threshold for individual impairment and are therefore collectively evaluated for impairment. During the first quarter of 2018, the Company changed the threshold for quarterly reviews of individual loans that are deemed to be impaired from $250 thousand to $500 thousand or greater.

Table of Contents

The following table presents the average recorded investment and interest income recognized on impaired loans, excluding PCI loans, for the periods indicated:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2018		2017		2018		2017	
(Amounts in thousands)	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment
Impaired loans with no related allowance:								
Commercial loans								
Construction, development, and other land	$1	$ 823	$-	$ 10	$14	$ 969	$-	$ 11
Commercial and industrial	2	237	1	321	3	411	3	325
Multi-family residential	-	296	3	557	10	547	3	457
Single family non-owner occupied	25	2,307	34	3,308	48	2,634	77	3,317
Non-farm, non-residential	-	4,048	21	3,330	39	5,579	25	3,027
Agricultural	-	175	-	128	-	229	-	127
Farmland	6	1,336	-	1,003	15	887	-	1,005
Consumer real estate loans								
Home equity lines	10	1,837	5	1,052	17	1,822	20	1,047
Single family owner occupied	86	14,247	93	15,943	193	14,917	180	14,074
Owner occupied construction	3	292	2	234	6	259	5	233
Consumer and other loans								
Consumer loans	5	207	2	43	6	141	2	46
Total impaired loans with no related allowance	138	25,805	161	25,929	351	28,395	315	23,669
Impaired loans with a related allowance:								
Commercial loans								
Construction, development, and other land	-	-	-	-	-	-	-	214
Commercial and industrial	-	-	38	2,352	-	-	53	1,332
Single family non-owner occupied	-	-	5	344	7	439	13	344
Non-farm, non-residential	-	1,374	5	867	-	770	15	1,011
Farmland	-	409	-	411	-	407	-	205
Consumer real estate loans								
Home equity lines	2	68	-	-	2	70	-	209
Single family owner occupied	59	7,040	33	3,393	91	6,257	68	4,883
Owner occupied construction	-	-	-	-	-	-	-	-
Total impaired loans with a related allowance	61	8,891	81	7,367	100	7,943	149	8,198
Total impaired loans	$199	$ 34,696	$242	$ 33,296	$451	$ 36,338	$464	$ 31,867

There were no impaired PCI loan pools as of June 30, 2018, or December 31, 2017. The following table provides information on impaired PCI loan pools for the dates indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
(Amounts in thousands)				
Interest income recognized	$-	$10	$-	$20
Average recorded investment	-	1,053	-	1,064

20

Table of Contents

The Company generally places a loan on nonaccrual status when it is 90 days or more past due. PCI loans are generally not classified as nonaccrual due to the accrual of interest income under the accretion method of accounting. The following table presents nonaccrual loans, by loan class, as of the dates indicated:

	June 30, 2018			**December 31, 2017**		
(Amounts in thousands)	**Non-covered**	**Covered**	**Total**	**Non-covered**	**Covered**	**Total**
Commercial loans						
Construction, development, and other land	$397	$ -	$397	$-	$ -	$-
Commercial and industrial	212	-	212	211	-	211
Multi-family residential	290	-	290	498	-	498
Single family non-owner occupied	954	17	971	851	19	870
Non-farm, non-residential	4,665	-	4,665	2,448	-	2,448
Agricultural	176	-	176	102	-	102
Farmland	1,361	-	1,361	805	-	805
Consumer real estate loans						
Home equity lines	883	484	1,367	882	306	1,188
Single family owner occupied	12,417	-	12,417	13,108	17	13,125
Owner occupied construction	64	8	72	-	-	-
Consumer and other loans						
Consumer loans	48	-	48	92	-	92
Total nonaccrual loans	$21,467	$ 509	$21,976	$18,997	$ 342	$19,339

Table of Contents

The following tables present the aging of past due loans, by loan class, as of the dates indicated. Nonaccrual loans 30 days or more past due are included in the applicable delinquency category. Loans acquired with credit deterioration, with a discount, continue to accrue interest based on expected cash flows; therefore, PCI loans are not generally considered nonaccrual. There were no non-covered accruing loans contractually past due 90 days or more as of June 30, 2018, compared to $1 thousand as of December 31, 2017.

	June 30, 2018					
(Amounts in thousands)	**30 - 59 Days Past Due**	**60 - 89 Days Past Due**	**90+ Days Past Due**	**Total Past Due**	**Current Loans**	**Total Loans**
Non-covered loans						
Commercial loans						
Construction, development, and other land	$33	$-	$388	$421	$57,565	$57,986
Commercial and industrial	221	182	98	501	96,113	96,614
Multi-family residential	-	371	-	371	109,696	110,067
Single family non-owner occupied	789	78	686	1,553	140,523	142,076
Non-farm, non-residential	1,920	40	3,954	5,914	619,085	624,999
Agricultural	-	-	74	74	8,821	8,895
Farmland	216	-	995	1,211	20,844	22,055
Consumer real estate loans						
Home equity lines	162	156	558	876	99,318	100,194
Single family owner occupied	3,344	1,233	7,322	11,899	505,159	517,058
Owner occupied construction	-	-	64	64	22,583	22,647
Consumer and other loans						
Consumer loans	479	141	-	620	68,265	68,885
Other	-	-	-	-	4,636	4,636
Total non-covered loans	7,164	2,201	14,139	23,504	1,752,608	1,776,112
Covered loans						
Commercial loans						
Construction, development, and other land	-	-	-	-	35	35
Single family non-owner occupied	17	-	-	17	235	252
Non-farm, non-residential	-	-	-	-	8	8
Consumer real estate loans						
Home equity lines	191	130	297	618	18,533	19,151
Single family owner occupied	-	-	-	-	3,473	3,473
Total covered loans	208	130	297	635	22,284	22,919
Total loans	$7,372	$2,331	$14,436	$24,139	$1,774,892	$1,799,031

Table of Contents

(Amounts in thousands)	December 31, 2017 30 - 59 Days Past Due	60 - 89 Days Past Due	90+ Days Past Due	Total Past Due	Current Loans	Total Loans
Non-covered loans						
Commercial loans						
Construction, development, and other land	$20	$365	$-	$385	$59,632	$60,017
Commercial and industrial	232	40	142	414	91,774	92,188
Multi-family residential	544	-	185	729	124,473	125,202
Single family non-owner occupied	223	302	331	856	140,814	141,670
Non-farm, non-residential	2,433	383	1,536	4,352	612,281	616,633
Agricultural	123	-	-	123	6,912	7,035
Farmland	113	-	692	805	24,844	25,649
Consumer real estate loans						
Home equity lines	226	198	485	909	102,296	103,205
Single family owner occupied	6,959	2,418	8,186	17,563	485,123	502,686
Owner occupied construction	326	79	-	405	38,773	39,178
Consumer and other loans						
Consumer loans	439	97	17	553	70,219	70,772
Other	-	-	-	-	5,001	5,001
Total non-covered loans	11,638	3,882	11,574	27,094	1,762,142	1,789,236
Covered loans						
Commercial loans						
Construction, development, and other land	-	-	-	-	39	39
Single family non-owner occupied	-	-	-	-	284	284
Non-farm, non-residential	-	-	-	-	9	9
Consumer real estate loans						
Home equity lines	402	-	173	575	23,145	23,720
Single family owner occupied	70	-	-	70	3,826	3,896
Total covered loans	472	-	173	645	27,303	27,948
Total loans	$12,110	$3,882	$11,747	$27,739	$1,789,445	$1,817,184

The Company may make concessions in interest rates, loan terms and/or amortization terms when restructuring loans for borrowers experiencing financial difficulty. Restructured loans in excess of $250 thousand are evaluated for a specific reserve based on either the collateral or net present value method, whichever is most applicable. Restructured loans under $250 thousand are subject to the reserve calculation at the historical loss rate for classified loans. Certain TDRs are classified as nonperforming at the time of restructuring and are returned to performing status after six months of satisfactory payment performance; however, these loans remain identified as impaired until full payment or other satisfaction of the obligation occurs. PCI loans are generally not considered TDRs as long as the loans remain in the assigned loan pool. No covered loans were recorded as TDRs as of June 30, 2018, or December 31, 2017.

Table of Contents

The following table presents loans modified as TDRs, by loan class and accrual status, as of the dates indicated:

(Amounts in thousands)	**June 30, 2018**			**December 31, 2017**		
	Nonaccrual (1)	**Accruing**	**Total**	**Nonaccrual (1)**	**Accruing**	**Total**
Commercial loans						
Single family non-owner occupied	$339	$ 314	$653	$364	$ 528	$892
Non-farm, non-residential	-	289	289	-	295	295
Consumer real estate loans						
Home equity lines	-	135	135	-	145	145
Single family owner occupied	1,675	5,978	7,653	1,565	6,496	8,061
Owner occupied construction	-	228	228	-	233	233
Consumer and other loans						
Consumer loans	-	36	36	-	37	37
Total TDRs	$2,014	$ 6,980	$8,994	$1,929	$ 7,734	$9,663
Allowance for loan losses related to TDRs			$581			$642

(1) Nonaccrual TDRs are included in total nonaccrual loans disclosed in the nonaccrual table above.

The following table presents interest income recognized on TDRs for the periods indicated:

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2018	**2017**	**2018**	**2017**
(Amounts in thousands)				
Interest income recognized	$64	$ 1	$134	$ 85

The following tables present loans modified as TDRs, by type of concession made and loan class, that were restructured during the periods indicated:

(Amounts in thousands)	**Three Months Ended June 30, 2018**			**2017**		
	Total Contracts	**Pre-modification Recorded Investment**	**Post-modification Recorded Investment (1)**	**Total Contracts**	**Pre-modification Recorded Investment**	**Post-modification Recorded Investment (1)**
Below market interest rate						
Single family owner occupied	-	$ -	$ -	1	$ 241	$ 241

Below market interest rate and extended payment term								
Single family owner occupied	-		-		-	5		949		949
Total	-	$	-	$	-	6	$	1,190	$	1,190

(1) Represents the loan balance immediately following modification

(Amounts in thousands)	**Six Months Ended June 30, 2018** Total Contracts	Pre-modification Recorded Investment		Post-modification Recorded Investment(1)	**2017** Total Contracts	Pre-modification Recorded Investment		Post-modification Recorded Investment(1)
Below market interest rate								
Single family owner occupied	-	$	-	$ -	1	$	241	$ 241
Below market interest rate and extended payment term								
Single family owner occupied	-		-	-	5		949	949
Total	-	$	-	$ -	6	$	1,190	$ 1,190

(1) Represents the loan balance immediately following modification

There were no payment defaults on loans modified as TDRs that were restructured within the previous 12 months as of June 30, 2018 or 2017.

24

Table of Contents

The following table provides information about other real estate owned ("OREO"), which consists of properties acquired through foreclosure, as of the dates indicated:

(Amounts in thousands)	June 30, 2018	December 31, 2017
Non-covered OREO	$4,805	$ 2,409
Covered OREO	44	105
Total OREO	$4,849	$ 2,514
Non-covered OREO secured by residential real estate	$3,384	$ 2,209
Residential real estate loans in the foreclosure process[1]	8,338	9,921

(1) The recorded investment in consumer mortgage loans collateralized by residential real estate that are in the process of foreclosure according to local requirements of the applicable jurisdiction

Note 5. Allowance for Loan Losses

The following tables present the changes in the allowance for loan losses, by loan segment, during the periods indicated. There was no allowance related to PCI loans as of June 30, 2018, or December 31, 2017.

	Three Months Ended June 30, 2018			
(Amounts in thousands)	Commercial	Consumer Real Estate	Consumer and Other	Total Allowance
Total allowance				
Beginning balance	$11,778	$ 6,963	$ 759	$ 19,500
(Recovery of) provision for loan losses charged to operations	(684)	906	273	495
Charge-offs	(328)	(124)	(298)	(750)
Recoveries	136	122	80	338
Net charge-offs	(192)	(2)	(218)	(412)
Ending balance	$10,902	$ 7,867	$ 814	$ 19,583

	Six Months Ended June 30, 2018			
(Amounts in thousands)	Commercial	Consumer Real Estate	Consumer and Other	Total Allowance
Total allowance				

Beginning balance	$ 11,672	$ 6,810	$ 794	$ 19,276
(Recovery of) provision for loan losses charged to operations	(725)	1,143	572	990
Charge-offs	(469)	(255)	(724)	(1,448)
Recoveries	424	169	172	765
Net charge-offs	(45)	(86)	(552)	(683)
Ending balance	$ 10,902	$ 7,867	$ 814	$ 19,583

Table of Contents

	Three Months Ended June 30, 2017			
(Amounts in thousands)	Commercial	Consumer Real Estate	Consumer and Other	Total Allowance
Allowance, excluding PCI				
Beginning balance	$11,972	$ 5,734	$ 740	$ 18,446
Provision for loan losses charged to operations	379	240	319	938
Charge-offs	(257)	(321)	(324)	(902)
Recoveries	189	149	58	396
Net charge-offs	(68)	(172)	(266)	(506)
Ending balance	$12,283	$ 5,802	$ 793	$ 18,878
PCI allowance				
Beginning balance	$-	$ 12	$ -	$ 12
Recovery of loan losses	-	(4)	-	(4)
Benefit attributable to the FDIC indemnification asset	-	-	-	-
Recovery of loan losses charged to operations	-	(4)	-	(4)
Recovery of loan losses recorded through the FDIC indemnification asset	-	-	-	-
Ending balance	$-	$ 8	$ -	$ 8
Total allowance				
Beginning balance	$11,972	$ 5,746	$ 740	$ 18,458
Provision for loan losses	379	236	319	934
Benefit attributable to the FDIC indemnification asset	-	-	-	-
Provision for loan losses charged to operations	379	236	319	934
Recovery of loan losses recorded through the FDIC indemnification asset	-	-	-	-
Charge-offs	(257)	(321)	(324)	(902)
Recoveries	189	149	58	396
Net charge-offs	(68)	(172)	(266)	(506)
Ending balance	$12,283	$ 5,810	$ 793	$ 18,886

Table of Contents

	Six Months Ended June 30, 2017			
(Amounts in thousands)	Commercial	Consumer Real Estate	Consumer and Other	Total Allowance
Allowance, excluding PCI				
Beginning balance	$11,690	$ 5,487	$ 759	$ 17,936
Provision for loan losses charged to operations	464	486	480	1,430
Charge-offs	(286)	(398)	(575)	(1,259)
Recoveries	415	227	129	771
Net recoveries (charge-offs)	129	(171)	(446)	(488)
Ending balance	$12,283	$ 5,802	$ 793	$ 18,878
PCI allowance				
Beginning balance	$-	$ 12	$ -	$ 12
Recovery of loan losses	-	(4)	-	(4)
Benefit attributable to the FDIC indemnification asset	-	-	-	-
Recovery of loan losses charged to operations	-	(4)	-	(4)
Recovery of loan losses recorded through the FDIC indemnification asset	-	-	-	-
Ending balance	$-	$ 8	$ -	$ 8
Total allowance				
Beginning balance	$11,690	$ 5,499	$ 759	$ 17,948
Provision for loan losses	464	482	480	1,426
Benefit attributable to the FDIC indemnification asset	-	-	-	-
Provision for loan losses charged to operations	464	482	480	1,426
Recovery of loan losses recorded through the FDIC indemnification asset	-	-	-	-
Charge-offs	(286)	(398)	(575)	(1,259)
Recoveries	415	227	129	771
Net recoveries (charge-offs)	129	(171)	(446)	(488)
Ending balance	$12,283	$ 5,810	$ 793	$ 18,886

Table of Contents

The following tables present the allowance for loan losses and recorded investment in loans evaluated for impairment, excluding PCI loans, by loan class, as of the dates indicated:

(Amounts in thousands)	June 30, 2018 Loans Individually Evaluated for Impairment[(1)]	Allowance for Loans Individually Evaluated	Loans Collectively Evaluated for Impairment	Allowance for Loans Collectively Evaluated
Commercial loans				
Construction, development, and other land	$-	$ -	$ 57,375	$ 369
Commercial and industrial	-	-	96,602	538
Multi-family residential	-	-	110,067	997
Single family non-owner occupied	-	-	139,813	1,416
Non-farm, non-residential	1,378	473	618,953	6,783
Agricultural	-	-	8,895	100
Farmland	929	105	21,126	121
Total commercial loans	2,307	578	1,052,831	10,324
Consumer real estate loans				
Home equity lines	67	67	111,616	680
Single family owner occupied	7,043	2,434	512,818	4,525
Owner occupied construction	-	-	22,647	161
Total consumer real estate loans	7,110	2,501	647,081	5,366
Consumer and other loans				
Consumer loans	-	-	68,885	814
Other	-	-	4,636	-
Total consumer and other loans	-	-	73,521	814
Total loans, excluding PCI loans	$9,417	$ 3,079	$ 1,773,433	$ 16,504

(Amounts in thousands)	December 31, 2017 Loans Individually Evaluated for Impairment[(1)]	Allowance for Loans Individually Evaluated	Loans Collectively Evaluated for Impairment	Allowance for Loans Collectively Evaluated
Commercial loans				
Construction, development, and other land	$-	$ -	$ 59,386	$ 830
Commercial and industrial	343	270	91,845	492
Multi-family residential	-	-	125,202	1,094
Single family non-owner occupied	770	62	139,093	1,914
Non-farm, non-residential	1,367	15	611,477	6,582
Agricultural	-	-	7,035	51
Farmland	1,219	233	24,430	129
Total commercial loans	3,699	580	1,058,468	11,092

Consumer real estate loans				
Home equity lines	-	-	115,807	803
Single family owner occupied	9,471	1,978	496,348	3,732
Owner occupied construction	-	-	39,178	297
Total consumer real estate loans	9,471	1,978	651,333	4,832
Consumer and other loans				
Consumer loans	-	-	70,772	794
Other	-	-	5,001	-
Total consumer and other loans	-	-	75,773	794
Total loans, excluding PCI loans	$13,170	$ 2,558	$ 1,785,574	$ 16,718

Table of Contents

The following table presents the recorded investment in PCI loans and the allowance for loan losses on PCI loans, by loan pool, as of the dates indicated:

	June 30, 2018		December 31, 2017	
(Amounts in thousands)	**Recorded Investment**	**Allowance for Loan Pools With Impairment**	**Recorded Investment**	**Allowance for Loan Pools With Impairment**
Commercial loans				
Waccamaw commercial	$1,330	$ -	$64	$ -
Peoples commercial	4,479	-	4,279	-
Other	923	-	986	-
Total commercial loans	6,732	-	5,329	-
Consumer real estate loans				
Waccamaw serviced home equity lines	7,662	-	11,118	-
Waccamaw residential	823	-	994	-
Peoples residential	964	-	999	-
Total consumer real estate loans	9,449	-	13,111	-
Total PCI loans	$16,181	$ -	$18,440	$ -

Management believed the allowance was adequate to absorb probable loan losses inherent in the loan portfolio as of June 30, 2018.

Note 6. FDIC Indemnification Asset

In connection with the FDIC-assisted acquisition of Waccamaw Bank (“Waccamaw”) in 2012, the Company entered into loss share agreements with the FDIC that covered $22.92 million of loans and $44 thousand of OREO as of June 30, 2018, compared to $27.95 million of loans and $105 thousand of OREO as of December 31, 2017. Under the loss share agreements, the FDIC agrees to cover 80% of most loan and foreclosed real estate losses and reimburse certain expenses incurred in relation to these covered assets. Loss share coverage expired June 30, 2017, for commercial loans, with recoveries continuing until June 30, 2019. Loss share coverage will expire June 30, 2022, for single family loans. The Company’s consolidated statements of income include the expense on covered assets net of estimated reimbursements. The following table presents the changes in the FDIC indemnification asset during the periods indicated:

	Three Months Ended June 30,	Six Months Ended June 30,

	2018	2017	2018	2017
(Amounts in thousands)				
Beginning balance	$6,884	$9,931	$7,161	$12,173
Increase in estimated losses on covered OREO	-	61	-	67
Reimbursable expenses from the FDIC	(15)	159	(21)	61
Net amortization	(575)	(1,586)	(957)	(2,918)
Payments to (reimbursements from) the FDIC	96	(406)	207	(1,224)
Ending balance	$6,390	$8,159	$6,390	$8,159

29

Table of Contents

Note 7. Deposits

The following table presents the components of deposits as of the dates indicated:

	June 30, 2018	December 31, 2017
(Amounts in thousands)		
Noninterest-bearing demand deposits	$462,851	$454,143
Interest-bearing deposits:		
Interest-bearing demand deposits	462,334	465,407
Money market accounts	156,421	170,731
Savings deposits	352,693	342,064
Certificates of deposit	350,582	374,373
Individual retirement accounts	119,857	123,173
Total interest-bearing deposits	1,441,887	1,475,748
Total deposits	$1,904,738	$1,929,891

Note 8. Borrowings

The following table presents the components of borrowings as of the dates indicated:

	June 30, 2018		December 31, 2017	
(Amounts in thousands)	Balance	Weighted Average Rate	Balance	Weighted Average Rate
Short-term borrowings				
Retail repurchase agreements	$2,869	0.06 %	$5,086	0.07 %
Long-term borrowings				
Wholesale repurchase agreements	25,000	3.18 %	25,000	3.18 %
FHLB advances	50,000	4.00 %	50,000	4.00 %
Total borrowings	$77,869		$80,086	

The Company pledged certain securities to secure repurchase agreements. Pledged securities remain under the Company’s control during the agreements’ terms. The counterparties may redeem callable repurchase agreements, which could substantially shorten the borrowings’ lives. The prepayment or early termination of a repurchase agreement may result in substantial penalties based on market conditions.

The following schedule presents the contractual maturities of repurchase agreements, by type of collateral pledged, as of June 30, 2018:

	U.S. Agency Securities	**Municipal Securities**	**Single Issue Trust Preferred Securities**	**Mortgage-backed Agency Securities**	**Corporate Securities**	**Total**
(Amounts in thousands)						
Overnight and continuous	$ -	$ 1,235	$ -	$ 1,557	$ -	$2,792
Up to 30 days	-	-	-	-	-	-
30 - 90 days	-	-	-	-	-	-
Greater than 90 days	5,154	-	8,072	10,845	1,006	25,077
	$ 5,154	$ 1,235	$ 8,072	$ 12,402	$ 1,006	$27,869

30

Table of Contents

The following schedule presents the contractual and weighted average maturities of long-term borrowings, by year, as of June 30, 2018:

(Amounts in thousands)	Wholesale Repurchase Agreements	FHLB Borrowings	Total
2018	$ -	$ -	$ -
2019	25,000	-	25,000
2020	-	-	-
2021	-	50,000	50,000
2022	-	-	-
2023 and thereafter	-	-	-
Total	$ 25,000	$ 50,000	$ 75,000
Weighted average maturity (in years)	0.66	2.52	1.90

The Company pledged certain loans to secure the FHLB advance and letters of credit totaling $888.31 million as of June 30, 2018. The FHLB letters of credit provide an attractive alternative to pledging securities for public unit deposits. Unused borrowing capacity with the FHLB totaled $371.96 million, net of FHLB letters of credit of $139.18 million, as of June 30, 2018. The prepayment of the advance may result in substantial penalties based on the differential between the contractual note and current advance rate for similar maturities.

The Company maintains a $15.00 million unsecured, committed line of credit with an unrelated financial institution with an interest rate of one-month LIBOR plus 2.00% that matures in April 2019. There was no outstanding balance on the line as of June 30, 2018, or December 31, 2017.

Note 9. Derivative Instruments and Hedging Activities

As of June 30, 2018, the Company’s derivative instruments consisted of interest rate swaps. Generally, derivative instruments help the Company manage exposure to market risk and meet customer financing needs. Market risk represents the possibility that fluctuations in external factors such as interest rates, market-driven loan rates, prices, or other economic factors will adversely affect economic value or net interest income.

The Company uses interest rate swap contracts to modify its exposure to interest rate risk caused by changes in the LIBOR curve in relation to certain designated fixed rate loans. These instruments are used to convert these fixed rate loans to an effective floating rate. If the LIBOR rate falls below the loan's stated fixed rate for a given period, the Company will owe the floating rate payer the notional amount times the difference between LIBOR and the stated fixed rate. If LIBOR is above the stated rate for a given period, the Company will receive payments based on the notional amount times the difference between LIBOR and the stated fixed rate. The Company's interest rate swaps qualify as fair value hedging instruments; therefore, fair value changes in the derivative and hedged item attributable to the hedged risk are recognized in earnings in the same period.

The Company enters into various interest rate swap agreements for individual loan hedging. The swap agreements, which are accounted for as fair value hedges, and the loans hedged by the agreements are recorded at fair value. The fair value hedges were effective as of June 30, 2018. The following table presents the notional, or contractual, amounts and fair values of derivative instruments as of the dates indicated:

	June 30, 2018			**December 31, 2017**		
	Notional or	**Fair Value**		**Notional or**	**Fair Value**	
(Amounts in thousands)	**Contractual Amount**	**Derivative Assets**	**Derivative Liabilities**	**Contractual Amount**	**Derivative Assets**	**Derivative Liabilities**
Derivatives designated as hedges						
Interest rate swaps	$5,649	$ 99	$ -	$5,813	$ -	$ 90
Total derivatives	$5,649	$ 99	$ -	$5,813	$ -	$ 90

Table of Contents

The following table presents the effect of derivative and hedging activity, if applicable, on the consolidated statements of income for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,		
(Amounts in thousands)	**2018**	**2017**	**2018**	**2017**	**Income Statement Location**
Derivatives designated as hedges					
Interest rate swaps	$ 8	$ 19	$ 21	$ 41	Interest and fees on loans
Total derivative expense	$ 8	$ 19	$ 21	$ 41	

Note 10. Employee Benefit Plans

The Company maintains two nonqualified domestic, noncontributory defined benefit plans (the "Benefit Plans") for key members of senior management and non-management directors. The Company's unfunded Benefit Plans include the Supplemental Executive Retention Plan and the Directors' Supplemental Retirement Plan. The following table presents the components of net periodic pension cost and the effect on the consolidated statements of income for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,		
	2018	**2017**	**2018**	**2017**	**Income Statement Location**
(Amounts in thousands)					
Service cost	$ 55	$ 58	$ 123	$ 116	Salaries and employee benefits
Interest cost	90	93	179	186	Other expense
Amortization of prior service cost	55	57	114	114	Other expense
Amortization of losses	16	8	28	15	Other expense
Net periodic cost	$ 216	$ 216	$ 444	$ 431	

Note 11. Earnings per Share

The following table presents the calculation of basic and diluted earnings per common share for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	**2017**	**2018**	**2017**
(Amounts in thousands, except share and per share data)				
Net income	$9,066	$6,418	$17,934	$12,620
Weighted average common shares outstanding, basic	16,689,398	17,012,189	16,821,842	17,005,196
Dilutive effect of potential common shares				
Stock options	69,914	47,591	62,384	50,356
Restricted stock	29,303	23,052	28,646	20,409
Total dilutive effect of potential common shares	99,217	70,643	91,030	70,765
Weighted average common shares outstanding, diluted	16,788,615	17,082,832	16,912,872	17,075,961
Basic earnings per common share	$0.54	$0.38	$1.06	$0.74
Diluted earnings per common share	0.54	0.38	1.06	0.74
Antidilutive potential common shares				
Stock options	-	71,592	-	59,473
Restricted stock	1,793	5,276	867	3,565
Total potential antidilutive shares	1,793	76,868	867	63,038

Table of Contents

Note 12. Accumulated Other Comprehensive Income (Loss)

The following tables present the changes in accumulated other comprehensive income ("AOCI"), net of tax and by component, during the periods indicated:

	Three Months Ended June 30, 2018		
(Amounts in thousands)	**Unrealized Gains (Losses) on Available-for-Sale Securities**	**Employee Benefit Plans**	**Total**
Beginning balance	$(722)	$ (1,759)	$(2,481)
Other comprehensive (loss) income before reclassifications	(233)	73	(160)
Reclassified from AOCI	-	56	56
Other comprehensive (loss) income, net	(233)	129	(104)
Ending balance	$(955)	$ (1,630)	$(2,585)

	Three Months Ended June 30, 2017		
(Amounts in thousands)	**Unrealized Gains (Losses) on Available-for-Sale Securities**	**Employee Benefit Plans**	**Total**
Beginning balance	$(137)	$ (1,344)	$(1,481)
Other comprehensive income before reclassifications	1,028	-	1,028
Reclassified from AOCI	411	41	452
Other comprehensive income, net	1,439	41	1,480
Ending balance	$1,302	$ (1,303)	$(1)

	Six Months Ended June 30, 2018		
	Unrealized Gains (Losses) on	**Employee Benefit Plans**	**Total**

(Amounts in thousands)	**Available-for-Sale Securities**		
Beginning balance	$975	$ (1,815)	$(840)
Other comprehensive (loss) income before reclassifications	(1,930)	73	(1,857)
Reclassified from AOCI	-	112	112
Other comprehensive (loss) income, net	(1,930)	185	(1,745)
Ending balance	$(955)	$ (1,630)	$(2,585)

	Six Months Ended June 30, 2017		
(Amounts in thousands)	**Unrealized Gains (Losses) on Available-for-Sale Securities**	**Employee Benefit Plans**	**Total**
Beginning balance	$(544)	$ (1,467)	$(2,011)
Other comprehensive income before reclassifications	1,435	83	1,518
Reclassified from AOCI	411	81	492
Other comprehensive income, net	1,846	164	2,010
Ending balance	$1,302	$ (1,303)	$(1)

Table of Contents

The following table presents reclassifications out of AOCI, by component, during the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,		Income Statement
(Amounts in thousands)	2018	2017	2018	2017	Line Item Affected
Available-for-sale securities					
Loss recognized	$-	$657	$-	$657	Net loss on sale of securities
Reclassified out of AOCI, before tax	-	657	-	657	Income before income taxes
Income tax expense	-	246	-	246	Income tax expense
Reclassified out of AOCI, net of tax	-	411	-	411	Net income
Employee benefit plans					
Amortization of prior service cost	$55	$57	$114	$114	(1)
Amortization of net actuarial benefit cost	16	8	28	15	(1)
Reclassified out of AOCI, before tax	71	65	142	129	Income before income taxes
Income tax expense	15	24	30	48	Income tax expense
Reclassified out of AOCI, net of tax	56	41	112	81	Net income
Total reclassified out of AOCI, net of tax	$56	$452	$112	$492	Net income

(1) Amortization is included in net periodic pension cost. See Note 10, "Employee Benefit Plans."

Note 13. Fair Value

Financial Instruments Measured at Fair Value

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. The fair value hierarchy ranks the inputs used in measuring fair value as follows:

Level 1 – Observable, unadjusted quoted prices in active markets
Level 2 – Inputs other than quoted prices included in Level 1 that are directly or indirectly observable for the asset or liability
Level 3 – Unobservable inputs with little or no market activity that require the Company to use reasonable inputs and assumptions

The Company uses fair value measurements to record adjustments to certain financial assets and liabilities on a recurring basis. The Company may be required to record certain assets at fair value on a nonrecurring basis in specific circumstances, such as evidence of impairment. Methodologies used to determine fair value might be highly subjective and judgmental in nature; therefore, valuations may not be precise. If the Company determines that a valuation technique change is necessary, the change is assumed to have occurred at the end of the respective reporting period. The following discussion describes the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments under the valuation hierarchy.

Assets and Liabilities Reported at Fair Value on a Recurring Basis

Available-for-Sale Debt Securities. Debt securities available for sale are reported at fair value on a recurring basis. The fair value of Level 1 securities is based on quoted market prices in active markets, if available. If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are primarily derived from or corroborated by observable market data. Level 2 securities use fair value measurements from independent pricing services obtained by the Company. These fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and bond terms and conditions. The Company’s Level 2 securities include U.S. Agency and Treasury securities, municipal securities, single issue trust preferred securities, and mortgage-backed securities. Securities are based on Level 3 inputs when there is limited activity or less transparency to the valuation inputs. In the absence of observable or corroborated market data, internally developed estimates that incorporate market-based assumptions are used when such information is available.

Fair value models may be required when trading activity has declined significantly or does not exist, prices are not current, or pricing variations are significant. For Level 3 securities, the Company obtains the cash flow of specific securities from third parties that use modeling software to determine cash flows based on market participant data and knowledge of the structures of each individual security. The fair values of Level 3 securities are determined by applying proper market observable discount rates to the cash flow derived from third-party models. Discount rates are developed by determining credit spreads above a benchmark rate, such as LIBOR, and adding premiums for illiquidity, which are based on a comparison of initial issuance spread to LIBOR versus a financial sector curve for recently issued debt to LIBOR. Securities with increased uncertainty about the receipt of cash flows are discounted at higher rates due to the addition of a deal specific credit premium based on assumptions about the performance of the underlying collateral. Finally, internal fair value model pricing and external pricing observations are combined by assigning weights to each pricing observation. Pricing is reviewed for reasonableness based on the direction of specific markets and the general economic indicators.

Table of Contents

Equity Securities. Equity securities are recorded at fair value on a recurring basis and included in other assets in the consolidated balance sheets. The Company uses Level 1 inputs to value equity securities that are traded in active markets. Equity securities that are not actively traded are classified in Level 2.

Loans Held for Investment. Loans held for investment are reported at fair value using the exit price notion, which is derived from third-party models. Loans related to fair value hedges are recorded at fair value on a recurring basis.

Deferred Compensation Assets and Liabilities. Securities held for trading purposes are recorded at fair value on a recurring basis and included in other assets in the consolidated balance sheets. These securities include assets related to employee deferred compensation plans, which are generally invested in Level 1 equity securities. The liability associated with these deferred compensation plans is carried at the fair value of the obligation to the employee, which corresponds to the fair value of the invested assets.

Derivative Assets and Liabilities. Derivatives are recorded at fair value on a recurring basis. The Company obtains dealer quotes, Level 2 inputs, based on observable data to value derivatives.

The following tables summarize financial assets and liabilities recorded at fair value on a recurring basis, by the level of valuation inputs in the fair value hierarchy, as of the dates indicated:

	June 30, 2018			
	Total	**Fair Value Measurements Using**		
(Amounts in thousands)	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Available-for-sale debt securities				
U.S. Agency securities	$1,170	$-	$1,170	$-
U.S. Treasury securities	49,808	-	49,808	-
Municipal securities	99,605	-	99,605	-
Single issue trust preferred securities	8,983	-	8,983	-
Mortgage-backed Agency securities	36,859	-	36,859	-
Total available-for-sale debt securities	196,425	-	196,425	-
Equity securities	55	55	-	-
Fair value loans	5,765	-	-	5,765
Deferred compensation assets	3,652	3,652	-	-
Derivative assets	99	-	99	-
Deferred compensation liabilities	3,652	3,652	-	-

	December 31, 2017			
	Total	**Fair Value Measurements Using**		
(Amounts in thousands)	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Available-for-sale debt securities				
U.S. Agency securities	$11,296	$-	$11,296	$ -
U.S. Treasury securities	19,971	-	19,971	-
Municipal securities	103,648	-	103,648	-
Single issue trust preferred securities	8,884	-	8,884	-
Mortgage-backed Agency securities	21,726	-	21,726	-
Total available-for-sale debt securities	165,525	-	165,525	-
Equity securities	55	55	-	-
Fair value loans	5,739	-	5,739	-
Deferred compensation assets	4,002	4,002	-	-
Deferred compensation liabilities	4,002	4,002	-	-
Derivative liabilities	90	-	90	-

Beginning in 2018, the Company measured the fair value of loans held for investment using an exit price notion in according with the adoption of ASU 2016-01. Prior to 2018, loans held for investment were reported at fair value using discounted future cash flows that apply current interest rates for loans with similar terms and borrower credit quality. As a result of using the exit price, certain loans were transferred from Level 2 into Level 3 of the fair value hierarchy during the six months ended June 30, 2018. No transfers into or out of Level 3 of the fair value hierarchy occurred during the six months ended June 30, 2017.

Assets Measured at Fair Value on a Nonrecurring Basis

Impaired Loans. Impaired loans are recorded at fair value on a nonrecurring basis when repayment is expected solely from the sale of the loan’s collateral. Fair value is based on appraised value adjusted for customized discounting criteria, Level 3 inputs.

The Company maintains an active and robust problem credit identification system. The impairment review includes obtaining third-party collateral valuations to help management identify potential credit impairment and determine the amount of impairment to record. The Company’s Special Assets staff manages and monitors all impaired loans. Internal collateral valuations are generally performed within two to four weeks of identifying the initial potential impairment. The internal valuation compares the original appraisal to current local real estate market conditions and considers experience and expected liquidation costs. The Company typically receives a third-party valuation within thirty to forty-five days of completing the internal valuation. When a third-party valuation is received, it is reviewed for reasonableness. Once the valuation is reviewed and accepted, discounts are applied to fair market value, based on, but not limited to, our historical liquidation experience for like collateral, resulting in an estimated net realizable value. The estimated net realizable value is compared to the outstanding loan balance to determine the appropriate amount of specific impairment reserve.

Specific reserves are generally recorded for impaired loans while third-party valuations are in process and for impaired loans that continue to make some form of payment. While waiting to receive the third-party appraisal, the Company regularly reviews the relationship to identify any potential adverse developments and begins the tasks necessary to gain control of the collateral and prepare it for liquidation, including, but not limited to, engagement of counsel, inspection of collateral, and continued communication with the borrower. Generally, the only difference between the current appraised value, less liquidation costs, and the carrying amount of the loan, less the specific reserve, is any downward adjustment to the appraised value that the Company deems appropriate, such as the costs to sell the property. Impaired loans that do not meet certain criteria and do not have a specific reserve have typically been written down through partial charge-offs to net realizable value. Based on prior experience, the Company rarely returns loans to performing status after they have been partially charged off. Credits identified as impaired move quickly through the process towards ultimate resolution, except in cases involving bankruptcy and various state judicial processes that may extend the time for ultimate resolution.

OREO. OREO is recorded at fair value on a nonrecurring basis using Level 3 inputs. The Company calculates the fair value of OREO from current or prior appraisals that have been adjusted for valuation declines, estimated selling costs, and other proprietary qualitative adjustments that are deemed necessary.

The following tables present assets measured at fair value on a nonrecurring basis, by the level of valuation inputs in the fair value hierarchy, as of the dates indicated:

	June 30, 2018			
	Total	**Fair Value Measurements Using**		
	Fair Value	**Level 1**	**Level 2**	**Level 3**
(Amounts in thousands)				
Impaired loans, non-covered	$5,819	$-	$ -	$5,819
OREO, non-covered	4,389	-	-	4,389
OREO, covered	32	-	-	32

	December 31, 2017			
	Total	**Fair Value Measurements Using**		
	Fair Value	**Level 1**	**Level 2**	**Level 3**
(Amounts in thousands)				
Impaired loans, non-covered	$5,015	$-	$ -	$5,015
OREO, non-covered	2,359	-	-	2,359
OREO, covered	105	-	-	105

Quantitative Information about Level 3 Fair Value Measurements

The following table provides quantitative information for assets measured at fair value on a nonrecurring basis using Level 3 valuation inputs as of the dates indicated:

	Valuation Technique	**Unobservable Input**	**Discount Range (Weighted Average) June 30, 2018**	**December 31, 2017**
Impaired loans, non-covered	Discounted appraisals(1)	Appraisal adjustments(2)	7% to 100% (35%)	6% to 79% (34%)
OREO, non-covered	Discounted appraisals(1)	Appraisal adjustments(2)	10% to 100% (31%)	8% to 47% (32%)
OREO, covered	Discounted appraisals(1)	Appraisal adjustments(2)	49% to 49% (49%)	0% to 65% (52%)

(1) Fair value is generally based on appraisals of the underlying collateral.

(2) Appraisals may be adjusted by management for customized discounting criteria, estimated sales costs, and proprietary qualitative adjustments.

Fair Value of Financial Instruments

The Company uses various methodologies and assumptions to estimate the fair value of certain financial instruments. A description of valuation methodologies used for instruments not previously discussed is as follows:

Cash and Cash Equivalents. Cash and cash equivalents are reported at their carrying amount, which is considered a reasonable estimate due to the short-term nature of these instruments.

Held-to-Maturity Debt Securities. Securities held to maturity are reported at fair value using quoted market prices or dealer quotes.

FDIC Indemnification Asset. The FDIC indemnification asset is reported at fair value using discounted future cash flows that apply current discount rates.

Accrued Interest Receivable/Payable. Accrued interest receivable/payable is reported at its carrying amount, which is considered a reasonable estimate due to the short-term nature of these instruments.

Deposits and Securities Sold Under Agreements to Repurchase. Deposits and repurchase agreements with fixed maturities and rates are reported at fair value using discounted future cash flows that apply interest rates available in the market for instruments with similar characteristics and maturities.

FHLB and Other Borrowings. FHLB and other borrowings are reported at fair value using discounted future cash flows that apply interest rates available to the Company for borrowings with similar characteristics and maturities. Trust preferred obligations are reported at fair value using current credit spreads in the market for similar issues.

Off-Balance Sheet Instruments. The Company believes that fair values of unfunded commitments to extend credit, standby letters of credit, and financial guarantees are not meaningful; therefore, off-balance sheet instruments are not addressed in the fair value disclosures. The Company believes it is not feasible or practical to accurately disclose the fair values of off-balance sheet instruments due to the uncertainty and difficulty in assessing the likelihood and timing of advancing available proceeds, the lack of an established market for these instruments, and the diversity in fee structures. For additional information about the unfunded, contractual value of off-balance sheet financial instruments, see Note 14, “Litigation, Commitments, and Contingencies,” to the Condensed Consolidated Financial Statements of this report.

Table of Contents

The following tables present the carrying amounts and fair values of financial instruments, by the level of valuation inputs in the fair value hierarchy, as of the dates indicated:

	June 30, 2018				
	Carrying		Fair Value Measurements Using		
(Amounts in thousands)	Amount	Fair Value	Level 1	Level 2	Level 3
Assets					
Cash and cash equivalents	$107,957	$107,957	$107,957	$-	$-
Debt securities available for sale	196,425	196,425	-	196,425	-
Debt securities held to maturity	25,082	24,980	-	24,980	-
Equity securities	55	55	55	-	-
Loans held for investment, net of allowance	1,779,448	1,740,502	-	-	1,740,502
FDIC indemnification asset	6,390	3,216	-	-	3,216
Interest receivable	5,580	5,580	-	5,580	-
Derivative financial assets	99	99	-	99	-
Deferred compensation assets	3,652	3,652	3,652	-	-
Liabilities					
Time deposits	470,439	459,771	-	459,771	-
Securities sold under agreements to repurchase	27,869	27,978	-	27,978	-
Interest payable	1,089	1,089	-	1,089	-
FHLB and other borrowings	50,000	51,399	-	51,399	-
Deferred compensation liabilities	3,652	3,652	3,652	-	-

	December 31, 2017				
	Carrying		Fair Value Measurements Using		
(Amounts in thousands)	Amount	Fair Value	Level 1	Level 2	Level 3
Assets					
Cash and cash equivalents	$157,951	$157,951	$157,951	$-	$-
Debt securities available for sale	165,525	165,525	-	165,525	-
Debt securities held to maturity	25,149	25,084	-	25,084	-
Equity securities	55	55	55	-	-
Loans held for investment, net of allowance	1,797,908	1,760,606	-	5,739	1,754,867
FDIC indemnification asset	7,161	3,927	-	-	3,927
Interest receivable	5,778	5,778	-	5,778	-
Deferred compensation assets	4,002	4,002	4,002	-	-
Liabilities					
Demand deposits	454,143	454,143	-	454,143	-
Interest-bearing demand deposits	465,407	465,407	-	465,407	-
Savings deposits					