MIDDLEFIELD BANC CORP
Form 10-Q
August 07, 2018

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

FORM 10-Q

(Mark One)	
X	**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 For the transition period from ___________ to ___________

Commission file number 001-36613

Middlefield Banc Corp.
(Exact Name of Registrant as Specified in its Charter)

Ohio	34-1585111
State or Other Jurisdiction of	I.R.S. Employer Identification No.

Incorporation or Organization

15985 East High Street, Middlefield, Ohio	44062-0035
Address of Principal Executive Offices	Zip Code

440-632-1666
Registrant's Telephone Number, Including Area Code

Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes **X** 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 **X** 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 **X**
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company

Emerging growth company

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

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

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

Class: Common Stock, without par value
Outstanding at August 7, 2018: **3,233,924**

MIDDLEFIELD BANC CORP.

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MIDDLEFIELD BANC CORP.

CONSOLIDATED BALANCE SHEET

(Dollar amounts in thousands, except share data)

(Unaudited)

	June 30, 2018	December 31, 2017
ASSETS		
Cash and due from banks	$42,451	$39,886
Federal funds sold	28,795	-
Cash and cash equivalents	71,246	39,886
Equity securities, at fair value	656	-
Investment securities available for sale, at fair value	100,028	95,283
Loans held for sale	1,132	463
Loans	943,674	923,213
Less allowance for loan and lease losses	7,502	7,190
Net loans	936,172	916,023
Premises and equipment, net	12,978	11,853
Goodwill	15,071	15,071
Core deposit intangibles	2,571	2,749
Bank-owned life insurance	15,862	15,652
Other real estate owned	181	212
Accrued interest receivable and other assets	10,182	9,144
TOTAL ASSETS	$1,166,079	$1,106,336
LIABILITIES		
Deposits:		
Noninterest-bearing demand	$207,791	$192,438
Interest-bearing demand	92,116	83,990
Money market	137,572	150,277
Savings	204,408	208,502
Time	290,359	242,987
Total deposits	932,246	878,194
Short-term borrowings	87,833	74,707
Other borrowings	18,996	29,065
Accrued interest payable and other liabilities	4,288	4,507
TOTAL LIABILITIES	1,043,363	986,473
STOCKHOLDERS' EQUITY		

Common stock, no par value; 10,000,000 shares authorized, 3,619,843 and 3,603,881 shares issued; 3,233,678 and 3,217,716 shares outstanding	*85,544*	*84,859*
Retained earnings	*51,121*	*47,431*
Accumulated other comprehensive (loss) income	*(431*)	*1,091*
Treasury stock, at cost; 386,165 shares	*(13,518*)	*(13,518*)
TOTAL STOCKHOLDERS' EQUITY	*122,716*	*119,863*
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$*1,166,079*	$*1,106,336*

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF INCOME

(Dollar amounts in thousands, except per share data)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
INTEREST AND DIVIDEND INCOME				
Interest and fees on loans	$11,234	$9,916	$22,288	$19,096
Interest-bearing deposits in other institutions	115	92	234	141
Federal funds sold	7	1	21	4
Investment securities:				
Taxable interest	170	223	339	441
Tax-exempt interest	550	630	1,075	1,267
Dividends on stock	53	40	112	152
Total interest and dividend income	12,129	10,902	24,069	21,101
INTEREST EXPENSE				
Deposits	1,973	1,227	3,613	2,352
Short-term borrowings	192	273	468	450
Other borrowings	118	125	240	265
Total interest expense	2,283	1,625	4,321	3,067
NET INTEREST INCOME	9,846	9,277	19,748	18,034
Provision for loan losses	210	170	420	335
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	9,636	9,107	19,328	17,699
NONINTEREST INCOME				
Service charges on deposit accounts	472	449	925	918
Investment securities gains on sale, net	-	-	-	488
Gain on equity securities	13	-	31	-
Earnings on bank-owned life insurance	98	98	210	207
Gain on sale of loans	117	231	121	465
Other income	305	211	504	422
Total noninterest income	1,005	989	1,791	2,500
NONINTEREST EXPENSE				
Salaries and employee benefits	3,866	3,203	7,845	6,899

Occupancy expense	472	433	1,008	921
Equipment expense	201	266	434	547
Data processing costs	402	588	879	908
Ohio state franchise tax	244	186	359	372
Federal deposit insurance expense	150	135	300	203
Professional fees	327	423	772	796
Advertising expense	230	164	458	412
Software amortization expense	155	80	305	162
Core deposit intangible amortization	87	103	178	175
Merger expense	-	307	-	694
Other expense	929	816	1,870	1,882
Total noninterest expense	7,063	6,704	14,408	13,971
Income before income taxes	3,578	3,392	6,711	6,228
Income taxes	481	885	1,009	1,621
NET INCOME	$3,097	$2,507	$5,702	$4,607
EARNINGS PER SHARE				
Basic	$0.96	$0.84	$1.77	$1.62
Diluted	0.96	0.83	1.76	1.61
DIVIDENDS DECLARED PER SHARE	$0.28	$0.27	$0.61	$0.54

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(Dollar amounts in thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	$*3,097*	$*2,507*	$*5,702*	$*4,607*
Other comprehensive (loss) gain:				
Net unrealized holding (loss) gain on available-for-sale investment securities	*(73*)	*1,186*	*(1,985*)	*1,417*
Tax effect	*15*	*(403*)	*417*	*(481*)
Reclassification adjustment for investment securities gains included in net income	-	-	-	*(488*)
Tax effect	-	-	-	*166*
Total other comprehensive (loss) gain	*(58*)	*783*	*(1,568*)	*614*
Comprehensive income	$*3,039*	$*3,290*	$*4,134*	$*5,221*

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

(Dollar amounts in thousands, except share and per share data)

(Unaudited)

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2017	$ 84,859	$ 47,431	$ 1,091	$ (13,518)	$ 119,863
Change in accounting principle for adoption of ASU 2016-01		141	(141)		-
Change in accounting principle for adoption of ASU 2018-02		(187)	187		-
Net income		5,702			5,702
Other comprehensive loss			(1,568)		(1,568)
Dividend reinvestment and purchase plan (5,902 shares)	301				301
Stock options exercised (4,500 shares)	104				104
Stock-based compensation expense (5,560 shares)	280				280
Cash dividends ($0.61 per share)		(1,966)			(1,966)
Balance, June 30, 2018	$ 85,544	$ 51,121	$ (431)	$ (13,518)	$ 122,716

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

CONSOLIDATED STATEMENT OF CASH FLOWS

(Dollar amounts in thousands)

(Unaudited)

	Six Months Ended June 30, 2018	2017
OPERATING ACTIVITIES		
Net income	$5,702	$4,607
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision for loan losses	420	335
Investment securities gains on sale, net	-	(488)
Gain on equity securities	(31)	-
Depreciation and amortization of premises and equipment, net	457	535
Software amortization expense	305	162
Amortization of premium and discount on investment securities, net	208	220
Accretion of deferred loan fees, net	(564)	(295)
Amortization of core deposit intangibles	178	175
Stock-based compensation expense	280	-
Origination of loans held for sale	(6,694)	(10,035)
Proceeds from sale of loans	6,146	3,866
Gain on sale of loans	(121)	(148)
Origination of student loans held for sale	-	(222,526)
Proceeds from sale of student loans	-	225,956
Gain on sale of student loans	-	(317)
Earnings on bank-owned life insurance	(210)	(207)
Deferred income tax	132	(245)
Net (gain) loss on other real estate owned	5	(158)
(Increase) decrease in accrued interest receivable	(7)	102
Increase in accrued interest payable	83	56
Other, net	(1,268)	(4,208)
Net cash provided by (used in) operating activities	5,021	(2,613)
INVESTING ACTIVITIES		
Investment securities available for sale:		
Proceeds from repayments and maturities	2,304	7,364
Proceeds from sale of securities	-	2,678
Purchases	(9,862)	-
Increase in loans, net	(20,005)	(64,390)
Proceeds from the sale of other real estate owned	26	1,463
Purchase of bank-owned life insurance	-	(4)

Purchase of premises and equipment	(1,582)	(518)
Purchase of restricted stock	(90)	(899)
Redemption of restricted stock	-	795
Acquisition, net of cash paid	-	5,431
Net cash used in investing activities	(29,209)	(48,080)
FINANCING ACTIVITIES		
Net increase in deposits	54,052	18,805
Increase (decrease) in short-term borrowings, net	13,126	(4,971)
Repayment of other borrowings	(10,069)	(91)
Proceeds from other borrowings	-	30,000
Proceeds from common stock issued	-	15,377
Stock options exercised	104	-
Proceeds from dividend reinvestment and purchase plan	301	272
Cash dividends	(1,966)	(1,623)
Net cash provided by financing activities	55,548	57,769
Increase in cash and cash equivalents	31,360	7,076
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	39,886	32,495
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$71,246	$39,571

See accompanying notes to unaudited consolidated financial statements.

	Six Months Ended June 30, 2018	2017
SUPPLEMENTAL INFORMATION		
Cash paid during the year for:		
Interest on deposits and borrowings	$4,238	$3,011
Income taxes	1,075	3,555
Noncash investing transactions:		
Transfers from loans to other real estate owned	$-	$1,021
Common stock issued in business acquisition	-	20,995
Transfer of equity securities from investment securities available for sale, at fair value	(625)	-
Acquisition of Liberty Bank, N.A.		
Noncash assets acquired		
Loans	$-	$195,388
Loans held for sale	-	5,953
Premises and equipment, net	-	325
Accrued interest receivable	-	440
Bank-owned life insurance	-	1,681
Core deposit intangible	-	3,087
Other assets	-	997
Goodwill	-	10,740
Total noncash assets acquired	-	218,611
Liabilities assumed		
Time deposits	-	(30,744)
Deposits other than time deposits	-	(167,300)
Accrued interest payable	-	(47)
Deferred taxes	-	(1,134)
Other liabilities	-	(2,754)
Total liabilities assumed	-	(201,979)
Liberty stock acquired in business combination	-	(1,068)
Net noncash assets acquired	$-	$15,564
Cash and cash equivalents acquired, net	$-	$5,431

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE *1* - BASIS OF PRESENTATION

The consolidated financial statements of Middlefield Banc Corp. ("Company") include its bank subsidiary, The Middlefield Banking Company ("MBC" or "Middlefield Bank"), and a nonbank asset resolution subsidiary EMORECO, Inc. All significant inter-company items have been eliminated.

The accompanying unaudited financial statements have been prepared in accordance with U.S. generally accepted accounting principles and the instructions for Form *10*-Q and Article *10* of Regulation S-*X.* In management's opinion, the financial statements include all adjustments, consisting of normal recurring adjustments, that the Company considers necessary to fairly state the Company's financial position and the results of operations and cash flows. The consolidated balance sheet at *December 31, 2017,* has been derived from the audited financial statements at that date but does *not* include all of the necessary informational disclosures and footnotes as required by U.S. generally accepted accounting principles. The accompanying financial statements should be read in conjunction with the financial statements and notes thereto included with the Company's Form *10*-K for the year ended *December 31, 2017.* The results of the Company's operations for any interim period are *not* necessarily indicative for the results of the Company's operations for any other interim period or for a full fiscal year.

Recent Accounting Pronouncements –

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 Update applies to all entities that hold financial assets or owe financial liabilities and is intended to provide more useful information on the recognition, measurement, presentation, and disclosure of financial instruments. Among other things, this Update (a) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (b) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (c) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are *not* public business entities; (d) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (e) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (f) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (g) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. For public business entities, the amendments in this Update are effective for fiscal years beginning after *December 15, 2017,* including interim periods within those fiscal years. For all other entities, including *not*-for-profit entities and employee benefit plans within the scope of Topics *960* through *965* on plan accounting, the amendments in this Update are effective for fiscal years beginning after *December 15, 2018,* and interim periods within fiscal years beginning after *December 15, 2019.* All entities that are *not* public business entities *may* adopt the amendments in this Update earlier as of the fiscal years beginning after *December 15, 2017,* including interim periods within those fiscal years. In *February 2018,* the FASB issued ASU *No. 2018-03* which includes technical corrections and improvements to clarify the guidance in ASU *No. 2016-01.* On *January 1, 2018,* the Company adopted ASU *2016-01* which resulted in a reclassification of *$141,000* between accumulated other comprehensive income and retained earnings on the Consolidated Balance Sheet and Consolidated Statement of Changes in Stockholders' Equity.

In *February 2016,* the FASB issued ASU *2016-02, Leases (Topic 842).* The standard requires lessees to recognize the assets and liabilities that arise from leases on the balance sheet. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. A short-term lease is defined as *one* in which (a) the lease term is *12* months or less and (b) there is *not* an option to purchase the underlying asset that the lessee is reasonably certain to exercise. For short-term leases, lessees *may* elect to recognize lease payments over the lease term on a straight-line basis. For public business entities, the amendments in this Update are effective for fiscal years beginning after *December 15, 2018,* and interim periods within those years. For all other entities, the amendments in this Update are effective for fiscal years beginning after *December 15, 2019,* and for interim periods within fiscal years beginning after *December 15, 2020.* The amendments should be applied at the beginning of the earliest period presented using a modified retrospective approach with earlier application permitted as of the beginning of an interim or annual reporting period. The Company is currently assessing the practical expedients it *may* elect at adoption, but does *not* anticipate the amendments will have a significant impact on the financial statements. Based on the Company's preliminary analysis of its current portfolio, the impact to the Company's balance sheet is estimated to result in less than a *1* percent increase in assets and liabilities. The Company also anticipates additional disclosures to be provided at adoption.

In *June 2016,* the FASB issued ASU *2016-13, Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments ("CECL")*, which changes the impairment model for most financial assets. This Update is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The underlying premise of the Update is that financial assets measured at amortized cost should be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The allowance for credit losses should reflect management's current estimate of credit losses that are expected to occur over the remaining life of a financial asset. The income statement will be effected for the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. ASU *2016-13* is effective for annual and interim periods beginning after *December 15, 2019,* and early adoption is permitted for annual and interim periods beginning after *December 15, 2018.* With certain exceptions, transition to the new requirements will be through a cumulative effect adjustment to opening retained earnings as of the beginning of the *first* reporting period in which the guidance is adopted. Management is currently evaluating the impact of the adoption of this guidance on the Company's consolidated financial statements. Management will oversee the implementation of CECL and is currently in the process of implementing a software solution to assist in the adoption of this ASU. Management plans to run the current incurred loss model and the CECL model concurrently for *12* months prior to the adoption of this guidance on *January 1, 2020.*

In *February 2018,* the FASB issued ASU *2018-02, Income Statement – Reporting Comprehensive Income (Topic 220)*, to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. Consequently, the amendments eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act and will improve the usefulness of information reported to financial statement users. The amendments in this Update are effective for all entities for fiscal years beginning after *December 15, 2018,* and interim periods within those fiscal years. Early adoption of the amendments in this Update is permitted, including adoption in any interim period, (*1*) for public business entities for reporting periods for which financial statements have *not* yet been issued and (*2*) for all other entities for reporting periods for which financial statements have *not* yet been made available for issuance. The amendments in this Update should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. On *January 1, 2018,* the Company adopted this standard which resulted in a reclassification of *$187,000* between accumulated other comprehensive income and retained earnings on the Consolidated Balance Sheet and Consolidated Statement of Changes in Stockholders' Equity.

In *February 2018,* the FASB issued ASU *2018-03, Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities*, to clarify certain aspects of the guidance issued in ASU *2016-01.* (*1*) An entity measuring an equity security using the measurement alternative *may* change its measurement approach to a fair value method in accordance with Topic *820,* Fair Value Measurement, through an irrevocable election that would apply to that security and all identical or similar investments of the same issuer. Once an entity makes this election, the entity should measure all future purchases of identical or similar investments of the same issuer using a fair value method in accordance with Topic *820.* (*2*) Adjustments made under the measurement alternative are intended to reflect the fair value of the security as of the date that the observable transaction for a similar security took place. (*3*) Remeasuring the entire value of forward contracts and purchased options is required when observable transactions occur on the underlying equity securities. (*4*) When the fair value option is elected for a financial liability, the guidance in paragraph *825-10- 45-5* should be applied, regardless of whether the fair value option was elected under either Subtopic *815-15,* Derivatives and

Hedging—Embedded Derivatives, or *825-10,* Financial Instruments—Overall. (*5*) Financial liabilities for which the fair value option is elected, the amount of change in fair value that relates to the instrument specific credit risk should *first* be measured in the currency of denomination when presented separately from the total change in fair value of the financial liability. Then, both components of the change in the fair value of the liability should be remeasured into the functional currency of the reporting entity using end-of-period spot rates. (*6*) The prospective transition approach for equity securities without a readily determinable fair value in the amendments in Update *2016-01* is meant only for instances in which the measurement alternative is applied. An insurance entity subject to the guidance in Topic *944,* Financial Services— Insurance, should apply a prospective transition method when applying the amendments related to equity securities without readily determinable fair values. An insurance entity should apply the selected prospective transition method consistently to the entity's entire population of equity securities for which the measurement alternative is elected. For public business entities, the amendments in this Update are effective for fiscal years beginning after *December 15, 2017,* and interim periods within those fiscal years beginning after *June 15, 2018.* Public business entities with fiscal years beginning between *December 15, 2017,* and *June 15, 2018,* are *not* required to adopt these amendments until the interim period beginning after *June 15, 2018,* and public business entities with fiscal years beginning between *June 15, 2018,* and *December 15, 2018,* are *not* required to adopt these amendments before adopting the amendments in Update *2016-01.* For all other entities, the effective date is the same as the effective date in Update *2016-01.* All entities *may* early adopt these amendments for fiscal years beginning after *December 15, 2017,* including interim periods within those fiscal years, as long as they have adopted Update *2016-01.* The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

ASU *2018-04, Investments – Debt Securities (Topic 320) and Regulated Operations (Topic 980*) - Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin *No. 117* and SEC Release *No. 33-9273,* ASU *2018-04* supersedes various SEC paragraphs and adds an SEC paragraph pursuant to the issuance of Staff Accounting Bulletin *No. 117.* This Update is *not* expected to have a significant impact on the Company's financial statements.

In *June 2018,* the FASB issued ASU *2018-07, Compensation – Stock Compensation (Topic 718)*, which simplified the accounting for nonemployee share-based payment transactions. The amendments in this update expand the scope of Topic *718* to include share-based payment transactions for acquiring goods and services from nonemployees. The amendments in this Update improve the following areas of nonemployee share-based payment accounting; (a) the overall measurement objective, (b) the measurement date, (c) awards with performance conditions, (d) classification reassessment of certain equity-classified awards, (e) calculated value (nonpublic entities only), and (f) intrinsic value (nonpublic entities only). The amendments in this Update are effective for public business entities for fiscal years beginning after *December 15, 2018,* including interim periods within that fiscal year. For all other entities, the amendments are effective for fiscal years beginning after *December 15, 2019,* and interim periods within fiscal years beginning after *December 15, 2020.* The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

ASU *2018-10, Codification Improvements to Topic 842, Leases*, represents changes to clarify, correct errors in, or make minor improvements to the Codification. The amendments in this ASU affect the amendments in ASU *2016-02,* which are *not* yet effective, but for which early adoption upon issuance is permitted. For entities that early adopted Topic *842,* the amendments are effective upon issuance of this ASU, and the transition requirements are the same as those in Topic *842.* For entities that have *not* adopted Topic *842,* the effective date and transition requirements will be the same as the effective date and transition requirements in Topic *842.* The Company is currently evaluating the impact the adoption of the standard will have on the Company's financial position or results of operations.

NOTE *2* – REVENUE RECOGNITION

Effective *January 1, 2017,* the Company adopted ASU *2014-09 Revenue from Contracts with Customers-Topic 606* and all subsequent ASUs that modified ASC *606.* The implementation of the new standard had *no* material impact to the measurement or recognition of revenue of prior periods and did *not* require any cumulative effect adjustment for adoption.

Management determined that the primary sources of revenue, which emanate from interest income on loans and investments, along with noninterest revenue resulting from investment security gains, gains on the sale of loans, and BOLI income, are *not* within the scope of ASC *606.* As a result, *no* changes were made during the period related to these sources of revenue, which cumulatively comprise *93.1%* of the total revenue of the Company.

The main types of noninterest income within the scope of the standard are as follows:

Service charges on deposit accounts – The Company has contracts with its deposit customers where fees are charged if the account balance falls below predetermined levels defined as compensating balances. These agreements can be cancelled at any time by either the Company or the deposit customer. Revenue from these transactions is recognized on a monthly basis as the Company has an unconditional right to the fee consideration. The Company also has transaction fees related to specific transactions or activities resulting from a customer request or activity that include overdraft fees, online banking fees, and other transaction fees. All of these fees are attributable to specific performance obligations of the Company where the revenue is recognized at a defined point in time, which is completion of the requested service/transaction.

Gains (losses) on sale of other real estate owned – Gains and losses are recognized at the completion of the property sale when the buyer obtains control of the real estate and all of the performance obligations of the Company have been satisfied. Evidence of the buyer obtaining control of the asset include transfer of the property title, physical possession of the asset, and the buyer obtaining control of the risks and rewards related to the asset. In situations where the Company agrees to provide financing to facilitate the sale, additional analysis is performed to ensure that the contract for sale identifies the buyer and seller, the asset to be transferred, payment terms, and that the contract has a true commercial substance and that collection of amounts due from the buyer is reasonable. In situations where financing terms are *not* reflective of current market terms, the transaction price is discounted impacting the gain/loss and the carrying value of the asset.

The following table depicts the disaggregation of revenue derived from contracts with customers to depict the nature, amount, timing, and uncertainty of revenue and cash flows:

	For the Three Months		For the Six Months	
	Ended June 30,		Ended June 30,	
Noninterest Income	2018	2017	2018	2017
(Dollar amounts in thousands)				
Service charges on deposit accounts:				
Overdraft fees	$*197*	$*182*	$*390*	$*374*
ATM banking fees	*214*	*205*	*415*	*319*
Service charges and other fees	*61*	*62*	*120*	*225*
Investment securities gains on sale, net [(a)]	-	-	-	*488*
Equity securities, unrealized gains [(a)]	*13*	-	*31*	-
Earnings on bank-owned life insurance [(a)]	*98*	*98*	*210*	*207*
Gain on sale of loans [(a)]	*117*	*231*	*121*	*465*
Other income	*305*	*211*	*504*	*422*
Total noninterest income	$*1,005*	$*989*	$*1,791*	$*2,500*

(a) *Not* within scope of ASC *606*

NOTE *3* - STOCK-BASED COMPENSATION

The Company had *no* unvested stock options outstanding as of *June 30, 2018* and *2017.*

Stock option activity during the *six* months ended *June 30* is as follows:

	Shares	Weighted-average Exercise Price
	2018	Per Share
Outstanding, January 1	*19,750*	$ *20.94*

Exercised	*(6,000)*		*23.00*
Outstanding, June 30	*13,750*	$	*20.05*
Exercisable, June 30	*13,750*	$	*20.05*

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The following table presents the activity during the *six* months ended *June 30, 2018* related to awards of restricted stock:

	Shares	Weighted-average Grant Date Fair Value Per Share
Nonvested at January 1, 2018	*14,601*	$ *35.14*
Granted	*9,952*	*48.20*
Forfeited	*(223*)	*35.31*
Vested	*(3,905*)	*33.61*
Nonvested at June 30, 2018	*20,425*	$ *41.80*
Expected to vest at June 30, 2018	*10,473*	$ *35.71*

The Company recognizes restricted stock forfeitures in the period they occur.

Share-based compensation expense of *$91,000* and *$45,000* was recognized for the *three*-month periods ended *June 30, 2018* and *2017,* respectively. Share-based compensation expense of *$136,000* and *$90,000* was recognized for the *six*-month periods ended *June 30, 2018* and *2017,* respectively.

The expected remaining compensation expense that will be recognized on restricted stock totals *$141,000,* of which *$70,000* will be recognized in *2018* and *$71,000* will be recognized in *2019.*

NOTE *4* - EARNINGS PER SHARE

The Company provides dual presentation of basic and diluted earnings per share. Basic earnings per share is calculated by dividing net income by the average shares outstanding. Diluted earnings per share adds the dilutive effects of stock options and restricted stock to average shares outstanding.

The following table sets forth the composition of the weighted-average common shares (denominator) used in the basic and diluted earnings-per-share computation.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Weighted-average common shares outstanding	*3,611,891*	*3,386,616*	*3,609,174*	*3,227,184*
Average treasury stock shares	*(386,165*)	*(386,165*)	*(386,165*)	*(386,165*)
Weighted-average common shares and common stock equivalents used to calculate basic earnings per share	*3,225,726*	*3,000,451*	*3,223,009*	*2,841,019*
Additional common stock equivalents (stock options and restricted stock) used to calculate diluted earnings per share	*14,603*	*13,689*	*15,227*	*13,139*
Weighted-average common shares and common stock equivalents used to calculate diluted earnings per share	*3,240,329*	*3,014,140*	*3,238,236*	*2,854,158*

Options to purchase *13,750* shares of common stock, at prices ranging from *$17.55* to *$23.00,* were outstanding during the *three* and *six* months ended *June 30, 2018.* Also outstanding were *20,425* shares of restricted stock. *None* of the outstanding options or restricted stock were anti-dilutive.

Options to purchase *21,375* shares of common stock, at prices ranging from *$17.55* to *$37.48,* were outstanding during the *three* and *six* months ended *June 30, 2017.* Also outstanding were *9,975* shares of restricted stock. *None* of the outstanding options or restricted stock were anti-dilutive.

NOTE *5* - FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants at the measurement date. GAAP establishes a fair value hierarchy that prioritizes the use of inputs used in valuation methodologies into the following levels:

Level I: Quoted prices are available in active markets for identical assets or liabilities as of the reported date.

Level II: Pricing inputs are other than the quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities includes items for which quoted prices are available but traded less frequently and items that are fair valued using other financial instruments, the parameters of which can be directly observed.

Level III:	Assets and liabilities that have little to *no* pricing observability as of the reported date. These items do *not* have *two*-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

The following tables present the assets measured on a recurring basis on the Consolidated Balance Sheet at their fair value by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	June 30, 2018			
(Dollar amounts in thousands)	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
U.S. government agency securities	$-	$*7,988*	$ -	$*7,988*
Obligations of states and political subdivisions	-	*75,397*	-	*75,397*
Mortgage-backed securities in government-sponsored entities	-	*16,643*	-	*16,643*
Total debt securities	-	*100,028*	-	*100,028*
Equity securities in financial institutions	*406*	*250*	-	*656*
Total	$*406*	$*100,278*	$ -	$*100,684*

	December 31, 2017			
(Dollar amounts in thousands)	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
U.S. government agency securities	$-	$*8,719*	$ -	$*8,719*
Obligations of states and political subdivisions	-	*67,429*	-	*67,429*
Mortgage-backed securities in government-sponsored entities	-	*18,510*	-	*18,510*
Total debt securities	-	*94,658*	-	*94,658*
Equity securities in financial institutions	*375*	*250*	-	*625*
Total	$*375*	$*94,908*	$ -	$*95,283*

Investment Securities Available for Sale - The Company obtains fair values from an independent pricing service which represent quoted prices for similar assets, fair values determined by pricing models using a market approach that considers observable market data, such as interest rate volatilities, LIBOR yield curve, credit spreads and prices from market makers and live trading systems (Level II).

Equity Securities - Equity securities that are traded on a national securities exchange are valued at their last reported sales price as of the measurement date. Equity securities traded in the over-the-counter ("OTC") markets and listed securities for which *no* sale was reported on that date are generally valued at their last reported "bid" price if held long, and last reported "ask" price if sold short. To the extent equity securities are actively traded and valuation adjustments are *not* applied, they are categorized in Level I of the fair value hierarchy. Equity securities traded on inactive markets or valued by reference to similar instruments are generally categorized in Level II of the fair value hierarchy. Equity securities are carried at fair value through net income at *June 30, 2018*.

The following tables present the assets measured on a nonrecurring basis on the Consolidated Balance Sheet at their fair value by level within the fair value hierarchy. Collateral-dependent impaired loans are carried at fair value if they have been charged down to fair value or if a specific valuation allowance has been established. A new cost basis is established at the time a property is initially recorded in OREO. OREO properties are carried at fair value if a devaluation has been taken to the property's value subsequent to the initial measurement. *No* such devaluation occurred in the *six* months ended *June 30, 2018.*

		June 30, 2018		
(Dollar amounts in thousands)	Level I	Level II	Level III	Total
Assets measured on a non-recurring basis:				
Impaired loans	$ -	$ -	$ *1,134*	$ *1,134*

		December 31, 2017		
(Dollar amounts in thousands)	Level I	Level II	Level III	Total
Assets measured on a non-recurring basis:				
Impaired loans	$ -	$ -	$ *3,072*	$ *3,072*
Other real estate owned	-	-	*32*	*32*

Impaired Loans – The Company has measured impairment on collateral-dependent impaired loans generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent *third*-party appraisals of the properties. In some cases, management *may* adjust the appraised value due to the age of the appraisal, changes in market conditions, or observable deterioration of the property since the appraisal was completed. Additionally, management makes estimates about expected costs to sell the property which are also included in the net realizable value. If the fair value of the collateral-dependent loan is less than the carrying amount of the loan, a specific reserve for the loan is made in the allowance for loan losses or a charge-off is taken to reduce the loan to the fair value of the collateral (less estimated selling costs) and the loan is included in the above table as a Level III measurement. If the fair value of the collateral exceeds the carrying amount of the loan, then the loan is *not* included in the above table as it is *not* currently being carried at its fair value. The fair values in the above table exclude estimated selling costs of *$419,000* at *June 30, 2018.*

Other Real Estate Owned (OREO) – OREO is carried at the lower of cost or fair value, which is measured at the date of foreclosure. If the fair value of the collateral exceeds the carrying amount of the loan, *no* charge-off or adjustment is necessary, the loan is *not* considered to be carried at fair value, and is therefore *not* included in the above table. If the fair value of the collateral is less than the carrying amount of the loan, management will charge the loan down to its estimated realizable value. The fair value of OREO is based on the appraised value of the property, which is generally unadjusted by management and is based on comparable sales for similar properties in the same geographic region as the subject property, and is included in the above table as a Level II measurement. In some cases, management *may* adjust the appraised value due to the age of the appraisal, changes in market conditions, or observable deterioration of the property since the appraisal was completed. In these cases, the loans are categorized in the above table as a Level III measurement since these adjustments are considered to be unobservable inputs. Income and expenses from operations and further declines in the fair value of the collateral subsequent to foreclosure are included in net expenses from OREO.

The following tables present additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Company uses Level III inputs to determine fair value:

(Dollar amounts in thousands)	Quantitative Information about Level III Fair Value Measurements			
	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)
June 30, 2018				
Impaired loans	$ *1,134*	Appraisal of collateral (1)	Appraisal adjustments (2)	*0% to 100% (47.49%)*

(Dollar amounts in thousands)	Quantitative Information about Level III Fair Value Measurements			
	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)
December 31, 2017				
Impaired loans	$ *3,072*	Appraisal of collateral (1)	Appraisal adjustments (2)	*0% to 86.1% (13.8%)*
Other real estate owned	$ *32*	Appraisal of collateral (1)	Appraisal adjustments (2)	*0% to 10.0%*

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various level III inputs which are *not* identifiable, less any associated allowance.

(2) Appraisals *may* be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

The estimated fair value of the Company's financial instruments *not* recorded at fair value on a recurring basis is as follows:

	June 30, 2018				
	Carrying Value	Level I	Level II	Level III	Total Fair Value
	(Dollar amounts in thousands)				
Financial assets:					

Cash and cash equivalents [1]	$*71,246*	$*71,246*	$-	$-	$*71,246*
Loans held for sale	*1,132*	-	*1,132*	-	*1,132*
Net loans	*936,172*	-	-	*925,076*	*925,076*
Bank-owned life insurance [1]	*15,862*	*15,862*	-	-	*15,862*
Federal Home Loan Bank stock [1]	*3,679*	*3,679*	-	-	*3,679*
Accrued interest receivable [1]	*3,295*	*3,295*	-	-	*3,295*
Financial liabilities:					
Deposits	$*932,246*	$*641,887*	$-	$*287,358*	$*929,245*
Short-term borrowings [1]	*87,833*	*87,833*	-	-	*87,833*
Other borrowings	*18,996*	-	-	*18,990*	*18,990*
Accrued interest payable [1]	*661*	*661*	-	-	*661*

(*1*) This financial instrument is carried at cost at *June 30, 2018,* which approximates the fair value of the instrument.

	December 31, 2017				
	Carrying Value	Level I	Level II	Level III	Total Fair Value
	(Dollar amounts in thousands)				
Financial assets:					
Cash and cash equivalents	$*39,886*	$*39,886*	$-	$-	$*39,886*
Loans held for sale	*463*	-	*463*	-	*463*
Net loans	*916,023*	-	-	*913,323*	*913,323*
Bank-owned life insurance	*15,652*	*15,652*	-	-	*15,652*
Federal Home Loan Bank stock	*3,589*	*3,589*	-	-	*3,589*
Accrued interest receivable	*3,288*	*3,288*	-	-	*3,288*
Financial liabilities:					
Deposits	$*878,194*	$*635,207*	$-	$*242,020*	$*877,227*
Short-term borrowings	*74,707*	*74,707*	-	-	*74,707*
Other borrowings	*29,065*	-	-	*29,069*	*29,069*
Accrued interest payable	*578*	*578*	-	-	*578*

NOTE *6* – ACCUMULATED OTHER COMPREHENSIVE INCOME

The following tables present the changes in accumulated other comprehensive income ("AOCI") by component net of tax for the *three* and *six* months ended *June 30, 2018* and *2017,* respectively:

(Dollars in thousands)	Unrealized gains on available-for-sale securities (a)
Balance as of March 31, 2018	$ *(373*)
Other comprehensive loss before reclassification	*(58*)
Balance at June 30, 2018	$ *(431*)
Balance as of December 31, 2017	$ *1,091*
Other comprehensive loss before reclassification	*(1,568*)
Change in accounting principle, ASC 2016-01 (b)	*(141*)
Change in accounting principle, ASC 2018-02 (b)	*187*

Period change		*(1,522*)
Balance at June 30, 2018	$	*(431*)

(Dollars in thousands)	Unrealized gains on available-for-sale securities (a)
Balance as of March 31, 2017	$ *1,032*
Other comprehensive income before reclassification	*783*
Amount reclassified from accumulated other comprehensive income	-
Period change	*783*
Balance at June 30, 2017	$ *1,815*
Balance as of December 31, 2016	$ *1,201*
Other comprehensive income before reclassification	*936*
Amount reclassified from accumulated other comprehensive income	*(322*)
Period change	*614*
Balance at June 30, 2017	$ *1,815*

(a) All amounts are net of tax. Amounts in parentheses indicate debits to AOCI.

(b) Reclassifications are the result of the adoption of ASUs *2016-01* and *2018-02* effective for the Company beginning *January 1, 2018.* The reclassifications are presented within the Consolidated Statement of Changes in Stockholders' Equity for the affected transitional periods.

The following tables present significant amounts reclassified from or to each component of AOCI:

(Dollars in thousands)	Amount Reclassified from Accumulated Other Comprehensive Income *For the Six Months Ended*		Affected Line Item in the Statement Where *Net Income is*
Details about other comprehensive income	June 30, 2018	June 30, 2017	Presented
Unrealized gains on available-for-sale securities (a)	$ -	$ *488*	Investment securities gains on sale, net Income taxes
	-	*(166*)	
	$ -	$ *322*	

(a) For unrealized gains on available-for-sale securities, amounts in parentheses indicate expenses and other amounts indicate income.

There were *no* amounts reclassified to or from AOCI for the *three* months ended *June 30, 2018* and *June 30, 2017.*

NOTE 7 – INVESTMENT AND EQUITY SECURITIES

The amortized cost and fair values of investment securities are as follows:

	June 30, 2018			
(Dollar amounts in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	$8,052	$ 43	$ (107)	$7,988
Obligations of states and political subdivisions:				
Taxable	503	11	-	514
Tax-exempt	74,767	786	(670)	74,883
Mortgage-backed securities in government-sponsored entities	17,249	44	(650)	16,643
Total	$100,571	$ 884	$ (1,427)	$100,028

	December 31, 2017			
(Dollar amounts in thousands)	Amortized Cost	Gross Unrealized	Gross Unrealized	Fair