

COLONY BANKCORP INC  
Form 10-Q  
October 31, 2017  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2017 COMMISSION FILE NUMBER 0-12436

COLONY BANKCORP, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

GEORGIA 58-1492391  
(STATE OR OTHER JURISDICTION OF (I.R.S. EMPLOYER  
INCORPORATION OR ORGANIZATION) IDENTIFICATION NUMBER)

115 SOUTH GRANT STREET, FITZGERALD, GEORGIA 31750

ADDRESS OF PRINCIPAL EXECUTIVE OFFICES

229/426-6000

REGISTRANT'S TELEPHONE NUMBER INCLUDING AREA CODE

INDICATE BY CHECK MARK WHETHER THE REGISTRANT (1) HAS FILED REPORTS REQUIRED TO BE  
FILED BY SECTIONS 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934 DURING THE

PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO FILE SUCH REPORTS), AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS.

YES  NO

INDICATE BY CHECK MARK WHETHER THE REGISTRANT HAS SUBMITTED ELECTRONICALLY AND POSTED ON ITS CORPORATE WEB SITE, IF ANY, EVERY INTERACTIVE DATA FILE REQUIRED TO BE SUBMITTED AND POSTED PURSUANT TO RULE 405 OF REGULATION S-T (§232.405 OF THIS CHAPTER) DURING THE PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO SUBMIT AND POST SUCH FILES).

YES  NO

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A LARGE ACCELERATED FILER, AN ACCELERATED FILER, A NON-ACCELERATED FILER, SMALLER REPORTING COMPANY, OR AN EMERGING GROWTH COMPANY. SEE THE DEFINITIONS OF "LARGE ACCELERATED FILER," "ACCELERATED FILER," "SMALLER REPORTING COMPANY," AND "EMERGING GROWTH COMPANY" IN RULE 12b-2 OF THE EXCHANGE ACT.

LARGE ACCELERATED FILER  
ACCELERATED FILER  
NON-ACCELERATED FILER (DO NOT CHECK IF A SMALLER REPORTING COMPANY)  
SMALLER REPORTING COMPANY  
EMERGING GROWTH COMPANY

IF AN EMERGING GROWTH COMPANY, INDICATE BY CHECK MARK IF THE REGISTRANT HAS ELECTED NOT TO USE THE EXTENDED TRANSITION PERIOD FOR COMPLYING WITH ANY NEW OR REVISED FINANCIAL ACCOUNTING STANDARDS PROVIDED PURSUANT TO SECITON 13(A) OF THE EXCHANGE ACT.

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A SHELL COMPANY (AS DEFINED IN RULE 12B-2 OF THE EXCHANGE ACT).

YES      NO

INDICATE THE NUMBER OF SHARES OUTSTANDING OF EACH OF THE ISSUER'S CLASSES OF COMMON STOCK, AS OF THE LATEST PRACTICABLE DATE.

<u>CLASS</u>	<u>OUTSTANDING AT OCTOBER 31, 2017</u>
COMMON STOCK, \$1 PAR VALUE	8,439,258

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## Forward Looking Statement Disclosure

Certain statements contained in this Quarterly Report that are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the Act), notwithstanding that such statements are not specifically identified. In addition, certain statements may be contained in the Company's future filings with the SEC, in press releases, and in oral and written statements made by or with the approval of the Company that are not statements of historical fact and constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other financial items; (ii) statements of plans and objectives of Colony Bankcorp, Inc. or its management or Board of Directors, including those relating to products or services; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as "believes," "anticipates," "expects," "intends," "targeted" and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:

Local and regional economic conditions and the impact they may have on the Company and its customers and the Company's assessment of that impact.

Changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements.

The effects of and changes in trade, monetary and fiscal policies and laws, including interest rate policies of the Federal Reserve Board.

Inflation, interest rate, market and monetary fluctuations.

Political instability.

Acts of war, terrorism or cyberterrorism.

The timely development and acceptance of new products and services and perceived overall value of these products and services by users.

Changes in consumer spending, borrowings and savings habits.

Technological changes.

Acquisitions and integration of acquired businesses.

The ability to increase market share and control expenses.

The effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which the Company and its subsidiary must comply.

The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Financial Accounting Standards Board and other accounting standard setters.

Changes in the Company's organization, compensation and benefit plans.

The costs and effects of litigation and of unexpected or adverse outcomes in such litigation.

Greater than expected costs or difficulties related to the integration of new lines of business.

The Company's success at managing the risks involved in the foregoing items.

Forward-looking statements speak only as of the date on which such statements are made. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made, or to reflect the occurrence of unanticipated events.

Readers should carefully review all disclosures we file from time to time with the Securities and Exchange Commission (SEC).

**PART 1. FINANCIAL INFORMATION**

ITEM 1

**FINANCIAL STATEMENTS**

THE FOLLOWING FINANCIAL STATEMENTS ARE PROVIDED FOR COLONY BANKCORP, INC. AND ITS WHOLLY-OWNED SUBSIDIARY BANK, COLONY BANK

- A. CONSOLIDATED BALANCE SHEETS – SEPTEMBER 30, 2017 (UNAUDITED) AND DECEMBER 31, 2016 (AUDITED).
- B. CONSOLIDATED STATEMENTS OF INCOME – FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016 AND FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016 (UNAUDITED).
- C. CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME – FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016 AND FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016 (UNAUDITED).
- D. CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2017 AND 2016 (UNAUDITED).

THE CONSOLIDATED FINANCIAL STATEMENTS FURNISHED HAVE NOT BEEN AUDITED BY INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS, BUT REFLECT, IN THE OPINION OF MANAGEMENT, ALL ADJUSTMENTS (CONSISTING SOLELY OF NORMAL RECURRING ADJUSTMENTS) NECESSARY FOR A FAIR PRESENTATION OF THE RESULTS OF OPERATIONS FOR THE PERIODS PRESENTED.

THE RESULTS OF OPERATIONS FOR THE NINE MONTH PERIOD ENDED SEPTEMBER 30, 2017 ARE NOT NECESSARILY INDICATIVE OF THE RESULTS TO BE EXPECTED FOR THE FULL YEAR.



**PART I (Continued)**

## Item 1 (Continued)

**COLONY  
BANKCORP,  
INC. AND  
SUBSIDIARY  
CONSOLIDATED  
BALANCE  
SHEETS  
SEPTEMBER 30,  
2017 AND  
DECEMBER 31,  
2016  
(DOLLARS IN  
THOUSANDS)**

	<b>September 30, 2017 (Unaudited)</b>	December 31, 2016 (Audited)
<b>ASSETS</b>		
<b>Cash and Cash Equivalents</b>		
Cash and Due from Banks	<b>\$ 18,848</b>	\$28,822
<b>Interest-Bearing Deposits</b>	<b>12,752</b>	46,345
<b>Investment Securities</b>		
Available for Sale, at Fair Value	<b>338,249</b>	323,658
<b>Federal Home Loan Bank Stock, at Cost</b>	<b>3,255</b>	3,010
<b>Loans</b>	<b>770,046</b>	754,283
Allowance for Loan Losses	<b>(7,977)</b>	(8,923)
Unearned Interest and Fees	<b>(430)</b>	(361)
	<b>761,639</b>	744,999
<b>Premises and Equipment</b>	<b>27,616</b>	27,969
<b>Other Real Estate (Net of Allowance of \$1,373 and \$1,878 as of September 30, 2017 and December 31, 2016, Respectively)</b>	<b>4,520</b>	6,439
<b>Other Intangible Assets</b>	<b>54</b>	81
<b>Other Assets</b>	<b>28,460</b>	29,119
<b>Total Assets</b>	<b>\$ 1,195,393</b>	\$1,210,442
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Deposits</b>		
Noninterest-Bearing	<b>\$ 162,706</b>	\$159,059
Interest-Bearing	<b>857,557</b>	885,298

	<b>1,020,263</b>	1,044,357
<b>Borrowed Money</b>		
Subordinated Debentures	<b>24,229</b>	24,229
Other Borrowed Money	<b>56,000</b>	46,000
	<b>80,229</b>	70,229
<b>Other Liabilities</b>	<b>3,299</b>	2,468
<b>Stockholders' Equity</b>		
Preferred Stock, Stated Value \$1,000 a Share; Authorized 10,000,000 Shares, Issued Shares of 0 and 9,360 as of September 30, 2017 and December 31, 2016, Respectively	-	9,360
Common Stock, Par Value \$1 a Share; Authorized 20,000,000 Shares, Issued 8,439,258 Shares as of September 30, 2017 and December 31, 2016	<b>8,439</b>	8,439
Paid-In Capital	<b>29,145</b>	29,145
Retained Earnings	<b>57,794</b>	51,466
Accumulated Other Comprehensive (Loss), Net of Tax Benefits	<b>(3,776)</b>	(5,022)
	<b>91,602</b>	93,388
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 1,195,393</b>	\$ 1,210,442

The accompanying notes are an integral part of these statements.

**PART I (Continued)**

## Item 1 (Continued)

**COLONY  
BANKCORP,  
INC. AND  
SUBSIDIARY  
CONSOLIDATED  
STATEMENTS  
OF INCOME  
THREE  
MONTHS  
ENDED  
SEPTEMBER 30,  
2017 AND 2016  
AND NINE  
MONTHS  
ENDED  
SEPTEMBER 30,  
2017 AND 2016  
(UNAUDITED)  
(DOLLARS IN  
THOUSANDS)**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September</b>	<b>September</b>	<b>September</b>	<b>September</b>
	<b>30, 2017</b>	<b>30, 2016</b>	<b>30, 2017</b>	<b>30, 2016</b>
<b>Interest Income</b>				
Loans, Including Fees	<b>\$9,754</b>	\$9,810	<b>\$28,884</b>	\$29,135
Deposits with Other Banks	<b>52</b>	18	<b>166</b>	79
Investment Securities				
U.S. Government Agencies	<b>1,684</b>	1,266	<b>4,932</b>	3,978
State, County and Municipal	<b>27</b>	30	<b>87</b>	97
Corporate Debt	<b>23</b>	-	<b>59</b>	-
Dividends on Other Investments	<b>38</b>	32	<b>109</b>	97
	<b>11,578</b>	11,156	<b>34,237</b>	33,386
<b>Interest Expense</b>				
Deposits	<b>1,191</b>	1,187	<b>3,559</b>	3,580
Federal Funds Purchased	<b>-</b>	-	<b>3</b>	-
Borrowed Money	<b>544</b>	413	<b>1,554</b>	1,269
	<b>1,735</b>	1,600	<b>5,116</b>	4,849
<b>Net Interest Income</b>	<b>9,843</b>	9,556	<b>29,121</b>	28,537
Provision for Loan Losses	<b>-</b>	354	<b>335</b>	1,062

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<b>Net Interest Income After Provision for Loan Losses</b>	<b>9,843</b>	9,202	<b>28,786</b>	27,475
<b>Noninterest Income</b>				
Service Charges on Deposits	<b>1,169</b>	1,128	<b>3,315</b>	3,185
Other Service Charges, Commissions and Fees	<b>741</b>	686	<b>2,300</b>	2,104
Mortgage Fee Income	<b>241</b>	254	<b>629</b>	507
Securities Gains (Losses)	-	256	-	385
Other	<b>273</b>	313	<b>974</b>	980
	<b>2,424</b>	2,637	<b>7,218</b>	7,161
<b>Noninterest Expenses</b>				
Salaries and Employee Benefits	<b>4,802</b>	4,726	<b>14,467</b>	13,825
Occupancy and Equipment	<b>1,014</b>	1,025	<b>2,965</b>	2,967
Other	<b>2,564</b>	2,903	<b>7,976</b>	8,451
	<b>8,380</b>	8,654	<b>25,408</b>	25,243
<b>Income Before Income Taxes</b>	<b>3,887</b>	3,185	<b>10,596</b>	9,393
<b>Income Taxes</b>	<b>1,265</b>	927	<b>3,424</b>	2,907
<b>Net Income</b>	<b>2,622</b>	2,258	<b>7,172</b>	6,486
<b>Preferred Stock Dividends</b>	-	378	<b>211</b>	1,189
<b>Net Income Available to Common Stockholders</b>	<b>\$2,622</b>	\$1,880	<b>\$6,961</b>	\$5,297
<b>Net Income Per Share of Common Stock</b>				
Basic	<b>\$0.31</b>	\$0.22	<b>\$0.82</b>	\$0.63
Diluted	<b>\$0.30</b>	\$0.22	<b>\$0.81</b>	\$0.62
<b>Cash Dividends Declared Per Share of Common Stock</b>	<b>\$0.025</b>	\$-	<b>\$0.075</b>	\$-
<b>Weighted Average Basic Shares Outstanding</b>	<b>8,439,258</b>	8,439,258	<b>8,439,258</b>	8,439,258
<b>Weighted Average Diluted Shares Outstanding</b>	<b>8,629,523</b>	8,506,268	<b>8,631,566</b>	8,495,752

The accompanying notes are an integral part of these statements.

**PART I (Continued)**

## Item 1 (Continued)

**COLONY  
BANKCORP, INC.  
AND SUBSIDIARY  
CONSOLIDATED  
STATEMENTS OF  
COMPREHENSIVE  
INCOME  
THREE MONTHS  
ENDED  
SEPTEMBER 30,  
2017 AND 2016  
NINE MONTHS  
ENDED  
SEPTEMBER 30,  
2017 AND 2016  
(UNAUDITED)  
(DOLLARS IN  
THOUSANDS)**

	<b>Three Months Ended September 30, 2017</b>		<b>Nine Months Ended September 30, 2017</b>	
	September 30, 2016		September 30, 2016	
<b>Net Income</b>	<b>\$2,622</b>	\$ 2,258	<b>\$7,172</b>	\$ 6,486
<b>Other Comprehensive Income:</b>				
Gains (Losses) on Securities Arising During the Year	<b>300</b>	(1,182 )	<b>1,888</b>	5,905
Tax Effect	<b>(102 )</b>	402	<b>(642 )</b>	(2,008 )
Realized Gains on Sale of AFS Securities	-	(256 )	-	(385 )
Tax Effect	-	87	-	131
Change in Unrealized Gains (Losses) on Securities Available for Sale, Net of Reclassification Adjustment and Tax Effects	<b>198</b>	(949 )	<b>1,246</b>	3,643
<b>Comprehensive Income</b>	<b>\$2,820</b>	\$ 1,309	<b>\$8,418</b>	\$ 10,129

The accompanying notes are an integral part of these statements.

**PART I (Continued)**

## Item 1 (Continued)

**COLONY  
BANKCORP,  
INC. AND  
SUBSIDIARY  
CONSOLIDATED  
STATEMENTS  
OF CASH  
FLOWS  
NINE MONTHS  
ENDED  
SEPTEMBER 30,  
2017 AND 2016  
(UNAUDITED)  
(DOLLARS IN  
THOUSANDS)**

	<b>Nine Months Ended</b>	
	<b>September</b>	<b>September</b>
	<b>30, 2017</b>	<b>30, 2016</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Income	<b>\$7,172</b>	\$ 6,486
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation	<b>1,240</b>	1,178
Provision for Loan Losses	<b>335</b>	1,062
Securities (Gains)	<b>-</b>	(385 )
Amortization and Accretion	<b>1,077</b>	1,142
(Gain) on Sale of Other Real Estate and Repossessions	<b>(111 )</b>	(17 )
Provision for Losses on Other Real Estate	<b>256</b>	126
Increase in Cash Surrender Value of Life Insurance	<b>(404 )</b>	(416 )
(Gain) Loss on Sale of Premises & Equipment	<b>(11 )</b>	80
Other Prepaids, Deferrals and Accruals, Net	<b>1,344</b>	340
	<b>10,898</b>	9,596
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of Investment Securities Available for Sale	<b>(54,448)</b>	(49,355 )
Proceeds from Maturities, Calls, and Paydowns of Investment Securities:		
Available for Sale	<b>40,698</b>	39,022
Proceeds from Sale of Investment Securities Available for Sale	<b>-</b>	25,210
Interest-Bearing Deposits in Other Banks	<b>33,593</b>	24,743
Net Loans to Customers	<b>(18,360)</b>	(21,968 )
Purchase of Premises and Equipment	<b>(913 )</b>	(2,635 )

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Proceeds from Sale of Other Real Estate and Repossessions	<b>3,168</b>	2,981
Federal Home Loan Bank Stock	<b>(245 )</b>	(279 )
Proceeds from Sale of Premises and Equipment	<b>38</b>	86
	<b>3,531</b>	17,805
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Noninterest-Bearing Customer Deposits	<b>3,647</b>	5,055
Interest-Bearing Customer Deposits	<b>(27,741)</b>	(38,019 )
Dividends Paid for Preferred Stock	<b>(316 )</b>	(1,230 )
Dividends Paid for Common Stock	<b>(633 )</b>	-
Redemption of Preferred Stock	<b>(9,360 )</b>	(3,661 )
Payments on Other Borrowed Money	<b>(16 )</b>	(4,000 )
Proceeds from Federal Home Loan Bank Advances	<b>5,000</b>	10,000
Proceeds from Other Borrowed Money	<b>5,016</b>	-
	<b>(24,403)</b>	(31,855 )
Net Decrease in Cash and Cash Equivalents	<b>(9,974 )</b>	(4,454 )
Cash and Cash Equivalents at Beginning of Period	<b>28,822</b>	22,257
Cash and Cash Equivalents at End of Period	<b>\$18,848</b>	\$ 17,803

The accompanying notes are an integral part of these statements.



**PART I (Continued)**

Item 1 (Continued)

**COLONY BANKCORP, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(1) Summary of Significant Accounting Policies**

**Presentation**

Colony Bankcorp, Inc. (the Company) is a bank holding company located in Fitzgerald, Georgia. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Colony Bank, Fitzgerald, Georgia (the Bank). All significant intercompany accounts have been eliminated in consolidation. The accounting and reporting policies of the Company conform to generally accepted accounting principles and practices utilized in the commercial banking industry.

All dollars in notes to consolidated financial statements are rounded to the nearest thousand, except for per share amounts.

The consolidated financial statements in this report are unaudited, except for the December 31, 2016 consolidated balance sheet. All adjustments consisting of normal recurring accruals which are, in the opinion of management, necessary for fair presentation of the interim consolidated financial statements, have been included and fairly and accurately present the financial position, results of operations and cash flows of the Company. The results of operations for the nine months ended September 30, 2017 are not necessarily indicative of the results which may be expected for the entire year.

**Nature of Operations**

The Bank provides a full range of retail and commercial banking services for consumers and small- to medium-size businesses located primarily in central, south and coastal Georgia. The Bank is headquartered in Fitzgerald, Georgia

with banking offices in Albany, Ashburn, Broxton, Centerville, Columbus, Cordele, Douglas, Eastman, Fitzgerald, Leesburg, Moultrie, Quitman, Rochelle, Savannah, Soperton, Sylvester, Statesboro, Thomaston, Tifton, Valdosta and Warner Robins. Lending and investing activities are funded primarily by deposits gathered through its retail banking office network.

### **Use of Estimates**

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the balance sheet date and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans.

### **Reclassifications**

In certain instances, amounts reported in prior years' consolidated financial statements have been reclassified to conform to statement presentations selected for 2017. Such reclassifications have not affected previously reported stockholders' equity or net income.

### **Concentrations of Credit Risk**

Concentrations of credit risk can exist in relation to individual borrowers or groups of borrowers, certain types of collateral, certain types of industries, or certain geographic regions. The Company has a concentration in real estate loans as well as a geographic concentration that could pose an adverse credit risk. At September 30, 2017, approximately 86 percent of the Company's loan portfolio was concentrated in loans secured by real estate. A substantial portion of borrowers' ability to honor their contractual obligations is dependent upon the viability of the real estate economic sector. Collateral real estate values that secure land development, construction and speculative real estate loans in the Company's larger Metropolitan Statistical Area (MSA) markets have resulted in high loan loss provisions in recent years. In addition, a large portion of the Company's foreclosed assets are also located in these same geographic markets, making the recovery of the carrying amount of foreclosed assets susceptible to changes in market conditions. Management continues to monitor these concentrations and has considered these concentrations in its allowance for loan loss analysis.

**PART I (Continued)**

Item 1 (Continued)

**(1) Summary of Significant Accounting Policies (Continued)**

**Concentrations of Credit Risk (Continued)**

The success of the Company is dependent, to a certain extent, upon the economic conditions in the geographic markets it serves. Adverse changes in the economic conditions in these geographic markets would likely have a material adverse effect on the Company's results of operations and financial condition. The operating results of the Company depend primarily on its net interest income. Accordingly, operations are subject to risks and uncertainties surrounding the exposure to changes in the interest rate environment.

At times, the Company may have cash and cash equivalents at financial institutions in excess of federal deposit insurance limits. The Company places its cash and cash equivalents with high credit quality financial institutions whose credit ratings are monitored by management to minimize credit risk.

**Investment Securities**

The Company classifies its investment securities as trading, available for sale or held to maturity. Securities that are held principally for resale in the near term are classified as trading. Trading securities are carried at fair value, with realized and unrealized gains and losses included in noninterest income. Currently, no securities are classified as trading. Securities acquired with both the intent and ability to be held to maturity are classified as held to maturity and reported at amortized cost. All securities not classified as trading or held to maturity are considered available for sale. Securities available for sale are reported at estimated fair value. Unrealized gains and losses on securities available for sale are excluded from earnings and are reported, net of deferred taxes, in accumulated other comprehensive income (loss), a component of stockholders' equity. Gains and losses from sales of securities available for sale are computed using the specific identification method. Securities available for sale includes securities which may be sold to meet liquidity needs arising from unanticipated deposit and loan fluctuations, changes in regulatory capital requirements, or unforeseen changes in market conditions.

The Company evaluates each held to maturity and available for sale security in a loss position for other-than-temporary impairment (OTTI). In estimating other-than-temporary impairment losses, management

considers such factors as the length of time and the extent to which the market value has been below cost, the financial condition of the issuer and the Company's intent to sell and whether it is more likely than not that the Company will be required to sell the security before anticipated recovery of the amortized cost basis. If the Company intends to sell or if it is more likely than not that the Company will be required to sell the security before recovery, the OTTI write-down is recognized in earnings. If the Company does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the OTTI write-down is separated into an amount representing credit loss, which is recognized in earnings and an amount related to all other factors, which is recognized in other comprehensive income (loss).

### **Federal Home Loan Bank Stock**

Investment in stock of a Federal Home Loan Bank (FHLB) is required for every federally insured institution that utilizes its services. FHLB stock is considered restricted, as defined in the accounting standards. The FHLB stock is reported in the consolidated financial statements at cost. Dividend income is recognized when earned.

### **Loans**

Loans that the Company has the ability and intent to hold for the foreseeable future or until maturity are recorded at their principal amount outstanding, net of unearned interest and fees. Loan origination fees, net of certain direct origination costs, are deferred and amortized over the estimated terms of the loans using the straight-line method. Interest income on loans is recognized using the effective interest method.

A loan is considered to be delinquent when payments have not been made according to contractual terms, typically evidenced by nonpayment of a monthly installment by the due date.

When management believes there is sufficient doubt as to the collectability of principal or interest on any loan or generally when loans are 90 days or more past due, the accrual of applicable interest is discontinued and the loan is designated as nonaccrual, unless the loan is well secured and in the process of collection. Interest payments received on nonaccrual loans are either applied against principal or reported as income, according to management's judgment as to the collectability of principal. Loans are returned to an accrual status when factors indicating doubtful collectability on a timely basis no longer exist.

**PART I (Continued)**

Item 1 (Continued)

**(1) Summary of Significant Accounting Policies (Continued)**

**Loans Modified in a Troubled Debt Restructuring (TDR)**

Loans are considered to have been modified in a TDR when, due to a borrower's financial difficulty, the Company makes certain concessions to the borrower that it would not otherwise consider for new debt with similar risk characteristics. Modifications may include interest rate reductions, principal or interest forgiveness, forbearance, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of the collateral. Generally, a non-accrual loan that has been modified in a TDR remains on non-accrual status for a period of 6 months to demonstrate that the borrower is able to meet the terms of the modified loan. However, performance prior to the modification, or significant events that coincide with the modification, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of loan modification or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains on non-accrual status. Once a loan is modified in a troubled debt restructuring it is accounted for as an impaired loan, regardless of its accrual status, until the loan is paid in full, sold or charged off. A TDR may cease being classified as impaired if the loan is subsequently modified at market terms and, has performed according to the modified terms for at least six months, and there has not been any prior principal forgiveness on a cumulative basis.

**Allowance for Loan Losses**

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the inability to collect a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

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

The allowance consists of specific, historical and general components. The specific component relates to loans that are classified as either doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan are lower than the carrying value of that loan. The historical component covers nonclassified loans and is based on historical loss experience adjusted for qualitative factors. A general component is maintained to cover uncertainties that could affect management's estimate of probable losses. The general component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and historical losses in the portfolio. General valuation allowances are based on internal and external qualitative risk factors such as (1) changes in lending policies and procedures, including changes in underwriting standards and collections, charge offs, and recovery practices, (2) changes in international, national, regional, and local conditions, (3) changes in the nature and volume of the portfolio and terms of loans, (4) changes in the experience, depth, and ability of lending management, (5) changes in the volume and severity of past due loans and other similar conditions, (6) changes in the quality of the organization's loan review system, (7) changes in the value of underlying collateral for collateral dependent loans, (8) the existence and effect of any concentrations of credit and changes in the levels of such concentrations, and (9) the effect of other external factors (i.e. competition, legal and regulatory requirements) on the level of estimated credit losses.

Loans identified as losses by management, internal loan review and/or regulatory agencies are charged off.

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

## **PART I (Continued)**

### Item 1 (Continued)

#### **(1) Summary of Significant Accounting Policies (Continued)**

##### **Allowance for Loan Losses (Continued)**

A significant portion of the Company's impaired loans are deemed to be collateral dependent. Management therefore measures impairment on these loans based on the fair value of the collateral. Collateral values are determined based on appraisals performed by qualified licensed appraisers hired by the Company or by senior members of the Company's credit administration staff. The decision whether or not to obtain an external third-party appraisal usually depends on the type of property being evaluated. External appraisals are usually obtained on more complex, income producing properties such as hotels, shopping centers and businesses. Less complex properties such as residential lots, farm land and single family houses may be evaluated internally by senior credit administration staff. When the Company does obtain appraisals from external third-parties, the values utilized in the impairment calculation are "as is" or current market values. The appraisals, whether prepared internally or externally, may utilize a single valuation approach or a combination of approaches including the comparable sales, income and cost approach. Appraised amounts used in the impairment calculation are typically discounted 10 percent to account for selling and marketing costs, if the repayment of the loan is to come from the sale of the collateral. Although appraisals are not obtained each year on all impaired loans, the collateral values used in the impairment calculations are evaluated quarterly by management. Based on management's knowledge of the collateral and the current real estate market conditions, appraised values may be further discounted to reflect facts and circumstances known to management since the most recent appraisal was performed.

Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a level 3 classification of the inputs for determining fair value. Because of the high degree of judgment required in estimating the fair value of collateral underlying impaired loans and because of the relationship between fair value and general economic conditions, we consider the fair value of impaired loans to be highly sensitive to changes in market conditions.

##### **Premises and Equipment**

Premises and equipment are recorded at acquisition cost net of accumulated depreciation.

Depreciation is charged to operations over the estimated useful lives of the assets. The estimated useful lives and methods of depreciation are as follows:

Description	Life in Years	Method
Banking Premises	15-40	Straight-Line and Accelerated
Furniture and Equipment	5 - 10	Straight-Line and Accelerated

Expenditures for major renewals and betterments are capitalized. Maintenance and repairs are charged to operations as incurred. When property and equipment are retired or sold, the cost and accumulated depreciation are removed from the respective accounts and any gain or loss is reflected in other income or expense.

### **Intangible Assets**

Intangible assets consist of core deposit intangibles acquired in connection with a business combination. The core deposit intangible is initially recognized based on a valuation performed as of the consummation date. The core deposit intangible is amortized by the straight-line method over the average remaining life of the acquired customer deposits.

### **Transfers of Financial Assets**

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.



**PART I (Continued)**

Item 1 (Continued)

**(1) Summary of Significant Accounting Policies (Continued)**

**Statement of Cash Flows**

For reporting cash flows, cash and cash equivalents include cash on hand, noninterest-bearing amounts due from banks and federal funds sold. Cash flows from demand deposits, interest-bearing checking accounts, savings accounts, loans and certificates of deposit are reported net.

**Advertising Costs**

The Company expenses the cost of advertising in the periods in which those costs are incurred.

**Income Taxes**

The provision for income taxes is based upon income for financial statement purposes, adjusted for nontaxable income and nondeductible expenses. Deferred income taxes have been provided when different accounting methods have been used in determining income for income tax purposes and for financial reporting purposes.

Deferred tax assets and liabilities are recognized based on future tax consequences attributable to differences arising from the financial statement carrying values of assets and liabilities and their tax bases. The differences relate primarily to depreciable assets (use of different depreciation methods for financial statement and income tax purposes) and allowance for loan losses (use of the allowance method for financial statement purposes and the direct write-off method for tax purposes). In the event of changes in the tax laws, deferred tax assets and liabilities are adjusted in the period of the enactment of those changes, with effects included in the income tax provision. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Company and its subsidiary file a consolidated federal income tax return. The subsidiary pays its proportional share of federal income taxes to the Company based on its taxable income.

Positions taken in the Company's tax returns may be subject to challenge by the taxing authorities upon examination. Uncertain tax positions are initially recognized in the consolidated financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions are both initially and subsequently measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon settlement with the tax authority, assuming full knowledge of the position and all relevant facts. The Company provides for interest and, in some cases, penalties on tax positions that may be challenged by the taxing authorities. Interest expense is recognized beginning in the first period that such interest would begin accruing. Penalties are recognized in the period that the Company claims the position in the tax return. Interest and penalties on income tax uncertainties are classified within income tax expense in the consolidated statement of income.

### **Other Real Estate**

Other real estate generally represents real estate acquired through foreclosure and is initially recorded at estimated fair value at the date of acquisition less the cost of disposal. Losses from the acquisition of property in full or partial satisfaction of debt are recorded as loan losses. Properties are evaluated regularly to ensure the recorded amounts are supported by current fair values, and valuation allowances are recorded as necessary to reduce the carrying amount to fair value less estimated cost of disposal. Routine holding costs and gains or losses upon disposition are included in other noninterest expense.

### **Bank-Owned Life Insurance**

The Company has purchased life insurance on the lives of certain key members of management and directors. The life insurance policies are recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or amounts due that are probable at settlement, if applicable. Increases in the cash surrender value are recorded as other income in the consolidated statements of income. The cash surrender value of the insurance contracts is recorded in other assets on the consolidated balance sheets in the amount of \$15,823 and \$15,419 as of September 30, 2017 and December 31, 2016, respectively.

## **PART I (Continued)**

### Item 1 (Continued)

#### **(1) Summary of Significant Accounting Policies (Continued)**

##### **Comprehensive Income**

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on securities available for sale, represent equity changes from economic events of the period other than transactions with owners and are not reported in the consolidated statements of operations but as a separate component of the equity section of the consolidated balance sheets. Such items are considered components of other comprehensive income (loss). Accounting standards codification requires the presentation in the consolidated financial statements of net income and all items of other comprehensive income (loss) as total comprehensive income (loss).

##### **Off-Balance Sheet Credit Related Financial Instruments**

In the ordinary course of business, the Company has entered into commitments to extend credit, commercial letters of credit and standby letters of credit. Such financial instruments are recorded when they are funded.

##### **Changes in Accounting Principles and Effects of New Accounting Pronouncements**

ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity is expected to be entitled for those goods or services. ASU 2014-09 defines a five-step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP, including 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 performance obligation. ASU 2014-09, as deferred one year by ASU 2015-14, is effective for the Company in the first quarter of fiscal year 2018. The Company is currently evaluating the impact of the pending adoption of ASU 2014-09 on the consolidated financial statements.

ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. ASU 2016-01 will be effective for the Company on January 1, 2018. The Company is currently evaluating the impact of the pending adoption of ASU 2016-01 on the consolidated financial statements.

ASU 2016-02, *Leases (Topic 842)*. This ASU requires lessees to put most leases on their balance sheets but recognize expenses in the income statement in a manner similar to current accounting treatment. This ASU changes the guidance on sale-leaseback transactions, initial direct costs and lease execution costs, and, for lessors, modifies the classification criteria and the accounting for sales-type and direct financing leases. For public business entities, this ASU is effective for annual periods beginning after December 15, 2018, and interim periods therein. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. The Company is evaluating the impact of this ASU on its financial statements and disclosures.

ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326)*. This ASU sets forth a “current expected credit loss” (CECL) model which requires the Company to measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions and reasonable supported forecasts. This replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost and applies to some off-balance sheet credit exposures. This ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is currently assessing the impact of the adoption of this ASU on its consolidated financial statements.

**PART I (Continued)**

Item 1 (Continued)

**(1) Summary of Significant Accounting Policies (Continued)**

**Changes in Accounting Principles and Effects of New Accounting Pronouncements (Continued)**

ASU 2016-15, *Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments*. ASU 2016-15 provides guidance related to certain cash flow issues in order to reduce the current and potential future diversity in practice. ASU 2016-15 will be effective for us on January 1, 2018 and is not expected to have a significant impact on our financial statements.

ASU 2016-18, *Statement of Cash Flows (Topic 230) - Restricted Cash*. ASU 2016-18 requires restricted cash and restricted cash equivalents to 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 adoption of this guidance will only affect the Consolidated Statements of Cash Flows. ASU 2016-18 is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, and is not expected to have a significant impact on the Company's consolidated financial statements.

ASU 2017-08, *Premium Amortization on Purchased Callable Debt Securities*. This ASU shortens the amortization period for the premium on certain purchased callable debt securities to the earliest call date. Today, entities generally amortize the premium over the contractual life of the security. The new guidance does not change the accounting for purchased callable debt securities held at a discount; the discount continues to be amortized to maturity. ASU No. 2017-08 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. The guidance calls for a modified retrospective transition approach under which a cumulative-effect adjustment will be made to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Company is currently evaluating the provisions of ASU No. 2017-08 to determine the potential impact the new standard will have on the Company's Consolidated Financial Statements.

**(2) Investment Securities**

Investment securities as of September 30, 2017 and December 31, 2016 are summarized as follows:

September 30, 2017	Amortized Cost	Gross	Gross	Fair Value
		Unrealized Gains	Unrealized Losses	
<b>Securities Available for Sale:</b>				
U. S. Government Agencies				
Mortgage-Backed	\$ 336,376	\$ 368	\$ (6,086 )	\$ 330,658
State, County & Municipal	4,527	37	(25 )	4,539
Corporate Bonds	2,052	8	-	2,060
Asset Backed	1,016	-	(24 )	992
	\$ 343,971	\$ 413	\$ (6,135 )	\$ 338,249

December 31, 2016	Amortized Cost	Gross	Gross	Fair Value
		Unrealized Gains	Unrealized Losses	
<b>Securities Available for Sale:</b>				
U. S. Government Agencies				
Mortgage-Backed	\$ 326,694	\$ 76	\$ (7,673 )	\$ 319,097
State, County & Municipal	4,573	18	(30 )	4,561
	\$ 331,267	\$ 94	\$ (7,703 )	\$ 323,658

**PART I (Continued)**

## Item 1 (Continued)

**(2) Investment Securities (Continued)**

The amortized cost and fair value of investment securities as of September 30, 2017, by contractual maturity, are shown hereafter. Expected maturities may differ from contractual maturities for certain investments because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. This is often the case with mortgage-backed securities, which are disclosed separately in the table below.

	<b>Securities</b>	
	<b>Available for Sale</b>	
	<b>Amortized</b>	<b>Fair</b>
	<b>Cost</b>	<b>Value</b>
Due In One Year or Less	<b>\$318</b>	<b>\$320</b>
Due After One Year Through Five Years	<b>4,690</b>	<b>4,682</b>
Due After Five Years Through Ten Years	<b>878</b>	<b>899</b>
Due After Ten Years	<b>1,709</b>	<b>1,690</b>
	<b>\$7,595</b>	<b>\$7,591</b>
 Mortgage-Backed Securities	 <b>336,376</b>	 <b>330,658</b>
	<b>\$343,971</b>	<b>\$338,249</b>

The Bank did not sell any investments during the first nine months of 2017. Therefore the Bank did not have any proceeds, gains or losses during the first nine months of 2017. Proceeds from the sale of investments available for sale totaled \$25,210 for the first nine months of 2016. The sale of investments available for sale during the first six months of 2016 resulted in gross realized gains of \$392 and losses of \$7.

Investment securities having a carrying value approximating \$153,050 and \$144,854 as of September 30, 2017 and December 31, 2016, respectively, were pledged to secure public deposits and for other purposes.

Information pertaining to securities with gross unrealized losses at September 30, 2017 and December 31, 2016 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

**Less Than 12 Months    12 Months or Greater    Total**

	<b>Fair</b>	<b>Gross</b>		<b>Fair</b>	<b>Gross</b>		<b>Fair</b>	<b>Gross</b>
	<b>Value</b>	<b>Unrealized</b>		<b>Value</b>	<b>Unrealized</b>		<b>Value</b>	<b>Unrealized</b>
		<b>Losses</b>			<b>Losses</b>			<b>Losses</b>
<b>September 30, 2017</b>								
U. S. Government Agencies								
Mortgage-Backed	<b>\$136,825</b>	<b>\$ (1,973)</b>	)	<b>\$126,175</b>	<b>\$ (4,113)</b>	)	<b>\$263,000</b>	<b>\$ (6,086)</b>
State, County and Municipal	<b>1,423</b>	<b>(25)</b>	)	-	-	)	<b>1,423</b>	<b>(25)</b>
Asset Backed	<b>992</b>	<b>(24)</b>	)	-	-	)	<b>992</b>	<b>(24)</b>
	<b>\$139,240</b>	<b>\$ (2,022)</b>	)	<b>\$126,175</b>	<b>\$ (4,113)</b>	)	<b>\$265,415</b>	<b>\$ (6,135)</b>
<b>December 31, 2016</b>								
U.S. Government Agencies								
Mortgage-Backed	\$174,201	\$ (3,460)	)	\$107,482	\$ (4,213)	)	\$281,683	\$ (7,673)
State, County and Municipal	3,488	(30)	)	-	-	)	3,488	(30)
	\$177,689	\$ (3,490)	)	\$107,482	\$ (4,213)	)	\$285,171	\$ (7,703)



**PART I (Continued)**

## Item 1 (Continued)

**(2) Investment Securities (Continued)**

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At September 30, 2017, 106 securities have unrealized losses which have depreciated 2.26 percent from the Company's amortized cost basis. These securities are guaranteed by either the U.S. Government, other governments or U.S. corporations. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred and the results of reviews of the issuer's financial condition. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other than temporary.

**(3) Loans**

The following table presents the composition of loans segregated by class of loans, as of September 30, 2017 and December 31, 2016.

	<b>September 30, 2017</b>	December 31, 2016
<b>Commercial and Agricultural</b>		
Commercial	<b>\$ 45,363</b>	\$47,025
Agricultural	<b>25,246</b>	17,080
<b>Real Estate</b>		
Commercial Construction	<b>36,533</b>	30,358
Residential Construction	<b>8,905</b>	11,830
Commercial	<b>346,251</b>	349,090

Residential	<b>196,332</b>	195,580
Farmland	<b>71,903</b>	66,877
<b>Consumer and Other</b>		
Consumer	<b>18,677</b>	19,695
Other	<b>20,836</b>	16,748
<b>Total Loans</b>	<b>\$ 770,046</b>	\$754,283

Commercial and industrial loans are extended to a diverse group of businesses within the Company's market area. These loans are often underwritten based on the borrower's ability to service the debt from income from the business. Real estate construction loans often require loan funds to be advanced prior to completion of the project. Due to uncertainties inherent in estimating construction costs, changes in interest rates and other economic conditions, these loans often pose a higher risk than other types of loans. Consumer loans are originated at the Bank level. These loans are generally smaller loan amounts spread across many individual borrowers to help minimize risk.

*Credit Quality Indicators.* As part of the ongoing monitoring of the credit quality of the loan portfolio, management tracks certain credit quality indicators including trends related to (i) the risk grade assigned to commercial and consumer loans, (ii) the level of classified commercial loans, (iii) net charge-offs, (iv) nonperforming loans, and (v) the general economic conditions in the Company's geographic markets.

**PART I (Continued)**

Item 1 (Continued)

**(3) Loans (Continued)**

The Company uses a risk grading matrix to assign a risk grade to each of its loans. Loans are graded on a scale of 1 to 8. A description of the general characteristics of the grades is as follows:

Grades 1 and 2 – Borrowers with these assigned grades range in risk from virtual absence of risk to minimal risk. Such loans may be secured by Company-issued and controlled certificates of deposit or properly margined equity securities or bonds. Other loans comprising these grades are made to companies that have been in existence for a long period of time with many years of consecutive profits and strong equity, good liquidity, excellent debt service ability and unblemished past performance, or to exceptionally strong individuals with collateral of unquestioned value that fully secures the loans. Loans in this category fall into the “pass” classification.

Grades 3 and 4 – Loans assigned these “pass” risk grades are made to borrowers with acceptable credit quality and risk. The risk ranges from loans with no significant weaknesses in repayment capacity and collateral protection to acceptable loans with one or more risk factors considered to be more than average.

Grade 5 – This grade includes “special mention” loans on management’s watch list and is intended to be used on a temporary basis for pass grade loans where risk-modifying action is intended in the short-term.

Grade 6 – This grade includes “substandard” loans in accordance with regulatory guidelines. This category includes borrowers with well-defined weaknesses that jeopardize the payment of the debt in accordance with the agreed terms. Loans considered to be impaired are assigned this grade, and these loans often have assigned loss allocations as part of the allowance for loan and lease losses. Generally, loans on which interest accrual has been stopped would be included in this grade.

Grades 7 and 8 – These grades correspond to regulatory classification definitions of “doubtful” and “loss,” respectively. In practice, any loan with these grades would be for a very short period of time, and generally the Company has no loans with these assigned grades. Management manages the Company’s problem loans in such a way that uncollectible loans or uncollectible portions of loans are charged off immediately with any residual, collectible amounts assigned a risk grade of 6.

The following table presents the loan portfolio by credit quality indicator (risk grade) as of September 30, 2017 and December 31, 2016. Those loans with a risk grade of 1, 2, 3 or 4 have been combined in the pass column for

presentation purposes. For the period ending September 30, 2017, the Company did not have any loans classified as “doubtful” or a “loss”.

**September 30, 2017**

	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>Total Loans</b>
<b>Commercial and Agricultural</b>				
Commercial	\$43,641	\$ 838	\$ 884	\$45,363
Agricultural	24,759	164	323	25,246
<b>Real Estate</b>				
Commercial Construction	32,100	1,206	3,227	36,533
Residential Construction	8,707	-	198	8,905
Commercial	332,075	4,744	9,432	346,251
Residential	180,695	4,921	10,716	196,332
Farmland	70,111	923	869	71,903
<b>Consumer and Other</b>				
Consumer	18,206	102	369	18,677
Other	20,827	9	-	20,836
<b>Total Loans</b>	<b>\$731,121</b>	<b>\$ 12,907</b>	<b>\$ 26,018</b>	<b>\$770,046</b>

**PART I (Continued)**

## Item 1 (Continued)

**(3) Loans (Continued)**

December 31, 2016

	<b>Pass</b>	<b>Special Mention</b>	<b>Substandard</b>	<b>Total Loans</b>
<b>Commercial and Agricultural</b>				
Commercial	\$44,250	\$ 1,862	\$ 913	\$47,025
Agricultural	16,586	192	302	17,080
<b>Real Estate</b>				
Commercial Construction	28,425	1,349	584	30,358
Residential Construction	11,630	-	200	11,830
Commercial	327,561	9,403	12,126	349,090
Residential	178,618	5,659	11,303	195,580
Farmland	65,075	839	963	66,877
<b>Consumer and Other</b>				
Consumer	19,072	226	397	19,695
Other	16,748	-	-	16,748
<b>Total Loans</b>	<b>\$707,965</b>	<b>\$ 19,530</b>	<b>\$ 26,788</b>	<b>\$754,283</b>

A loan's risk grade is assigned at the inception of the loan and is based on the financial strength of the borrower and the type of collateral. Loan risk grades are subject to reassessment at various times throughout the year as part of the Company's ongoing loan review process. Loans with an assigned risk grade of 6 or below and an outstanding balance of \$250,000 or more are reassessed on a quarterly basis. During this reassessment process individual reserves may be identified and placed against certain loans which are not considered impaired.

In assessing the overall economic condition of the markets in which it operates, the Company monitors the unemployment rates for its major service areas. The unemployment rates are reviewed on a quarterly basis as part of the allowance for loan loss determination.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Generally, loans are placed on nonaccrual status if principal or interest payments become 90 days past due or when, in management's opinion, the borrower may be unable to meet payment obligations as they

become due, as well as when required by regulatory provision. Loans may be placed on nonaccrual status regardless of whether or not such loans are considered past due.

**PART I (Continued)**

## Item 1 (Continued)

**(3) Loans (Continued)**

The following table represents an age analysis of past due loans and nonaccrual loans, segregated by class of loans, as of September 30, 2017 and December 31, 2016:

**September 30, 2017**

	Accruing Loans 90 Days			Nonaccrual Loans	Current Loans	Total Loans
	30-89 Days Past Due	or More Past Due	Total Accruing Loans Past Due			
<b>Commercial and Agricultural</b>						
Commercial	\$301	\$ -	\$ 301	\$ 653	\$44,409	\$45,363
Agricultural	75	-	75	321	24,850	25,246
<b>Real Estate</b>						
Commercial Construction	56	-	56	602	35,875	36,533
Residential Construction	-	-	-	198	8,707	8,905
Commercial	1,501	-	1,501	3,146	341,604	346,251
Residential	2,917	-	2,917	2,868	190,547	196,332
Farmland	158	-	158	839	70,906	71,903
<b>Consumer and Other</b>						
Consumer	242	-	242	180	18,255	18,677
Other	-	-	-	-	20,836	20,836
<b>Total Loans</b>	<b>\$5,250</b>	<b>\$ -</b>	<b>\$ 5,250</b>	<b>\$ 8,807</b>	<b>\$755,989</b>	<b>\$770,046</b>

## December 31, 2016

	Accruing Loans 90 Days			Nonaccrual Loans
	30-89 Days	or More	Total Accruing	

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	<b>Past Due</b>	<b>Past Due</b>	<b>Loans Past Due</b>		<b>Current Loans</b>	<b>Total Loans</b>
<b>Commercial and Agricultural</b>						
Commercial	\$420	\$ -	\$ 420	\$ 635	\$45,970	\$47,025
Agricultural	33	-	33	209	16,838	17,080
<b>Real Estate</b>						
Commercial Construction	54	-	54	190	30,114	30,358
Residential Construction	-	-	-	-	11,830	11,830
Commercial	492	-	492	6,360	342,238	349,090
Residential	3,179	-	3,179	3,944	188,457	195,580
Farmland	95	-	95	800	65,982	66,877
<b>Consumer and Other</b>						
Consumer	196	-	196	212	19,287	19,695
Other	-	-	-	-	16,748	16,748
<b>Total Loans</b>	<b>\$4,469</b>	<b>\$ -</b>	<b>\$ 4,469</b>	<b>\$ 12,350</b>	<b>\$737,464</b>	<b>\$754,283</b>



**PART I (Continued)**

## Item 1 (Continued)

**(3) Loans (Continued)**

The following table details impaired loan data as of September 30, 2017:

**September 30, 2017**

	<b>Unpaid Contractual Principal Balance</b>	<b>Impaired Balance</b>	<b>Related Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>	<b>Interest Income Collected</b>
<b>With No Related Allowance Recorded</b>						
Commercial	\$ 653	\$ 653	\$ -	\$ 642	\$ 28	\$ 28
Agricultural	342	322	-	271	5	12
Commercial Construction	176	176	-	163	4	5
Residential Construction	198	198	-	99	5	5
Commercial Real Estate	10,775	10,775	-	12,851	368	356
Residential Real Estate	5,506	4,718	-	4,563	156	176
Farmland	841	839	-	779	54	58
Consumer	180	179	-	186	5	5
Other	-	-	-	-	-	-
	<b>18,671</b>	<b>17,860</b>	<b>-</b>	<b>19,554</b>	<b>625</b>	<b>645</b>
<b>With An Allowance Recorded</b>						
Commercial	-	-	-	-	-	-
Agricultural	-	-	-	-	-	-
Commercial Construction	497	497	69	178	22	32
Residential Construction	-	-	-	-	-	-
Commercial Real Estate	7,124	7,124	1,471	6,817	201	202
Residential Real Estate	37	37	21	575	(1)	2
Farmland	373	373	24	377	17	16
Consumer	-	-	-	-	-	-
Other	-	-	-	-	-	-
	<b>8,031</b>	<b>8,031</b>	<b>1,585</b>	<b>7,947</b>	<b>239</b>	<b>252</b>
<b>Total</b>						

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Commercial	<b>653</b>	<b>653</b>	-	<b>642</b>	<b>28</b>	<b>28</b>
Agricultural	<b>342</b>	<b>322</b>	-	<b>271</b>	<b>5</b>	<b>12</b>
Commercial Construction	<b>673</b>	<b>673</b>	<b>69</b>	<b>341</b>	<b>26</b>	<b>37</b>
Residential Construction	<b>198</b>	<b>198</b>	-	<b>99</b>	<b>5</b>	<b>5</b>
Commercial Real Estate	<b>17,899</b>	<b>17,899</b>	<b>1,471</b>	<b>19,668</b>	<b>569</b>	<b>558</b>
Residential Real Estate	<b>5,543</b>	<b>4,755</b>	<b>21</b>	<b>5,138</b>	<b>155</b>	<b>178</b>
Farmland	<b>1,214</b>	<b>1,212</b>	<b>24</b>	<b>1,156</b>	<b>71</b>	<b>74</b>
Consumer	<b>180</b>	<b>179</b>	-	<b>186</b>	<b>5</b>	<b>5</b>
Other	-	-	-	-	-	-
	<b>\$ 26,702</b>	<b>\$ 25,891</b>	<b>\$ 1,585</b>	<b>\$ 27,501</b>	<b>\$ 864</b>	<b>\$ 897</b>

**PART I (Continued)**

## Item 1 (Continued)

The following table details impaired loan data as of December 31, 2016:

December 31, 2016

	<b>Unpaid Contractual Principal Balance</b>	<b>Impaired Balance</b>	<b>Related Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>	<b>Interest Income Collected</b>
<b>With No Related Allowance Recorded</b>						
Commercial	\$ 635	\$ 635	\$ -	\$ 539	\$ 24	\$ 27
Agricultural	229	209	-	210	9	12
Commercial Construction	191	191	-	698	7	7
Residential Construction	-	-	-	-	-	-
Commercial Real Estate	14,358	14,276	-	14,275	567	560
Residential Real Estate	4,261	3,952	-	4,553	73	191
Farmland	921	799	-	1,016	22	26
Consumer	212	212	-	213	10	12
	20,807	20,274	-	21,504	712	835
<b>With An Allowance Recorded</b>						
Commercial	-	-	-	30	-	-
Agricultural	-	-	-	-	-	-
Commercial Construction	72	72	21	74	1	2
Residential Construction	-	-	-	-	-	-
Commercial Real Estate	8,557	8,467	3,022	8,340	239	236
Residential Real Estate	1,476	1,468	363	1,043	28	32
Farmland	380	380	29	384	21	21
Consumer	-	-	-	-	-	-
	10,485	10,387	3,435	9,871	289	291
<b>Total</b>						
Commercial	635	635	-	569	24	27
Agricultural	229	209	-	210	9	12
Commercial Construction	263	263	21	772	8	9
Residential Construction	-	-	-	-	-	-
Commercial Real Estate	22,915	22,743	3,022	22,615	806	796
Residential Real Estate	5,737	5,420	363	5,596	101	223
Farmland	1,301	1,179	29	1,400	43	47

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Consumer	212	212	-	213	10	12
	\$ 31,292	\$ 30,661	\$ 3,435	\$ 31,375	\$ 1,001	\$ 1,126

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**PART I (Continued)**

## Item 1 (Continued)

**(3) Loans (Continued)**

The following table details impaired loan data as of September 30, 2016:

September 30, 2016

	<b>Unpaid Contractual Principal Balance</b>	<b>Impaired Balance</b>	<b>Related Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>	<b>Interest Income Collected</b>
<b>With No Related Allowance Recorded</b>						
Commercial	\$ 646	\$ 646	\$ -	\$ 515	\$ 15	\$ 18
Agricultural	301	280	-	211	5	13
Commercial Construction	508	508	-	825	16	15
Residential Construction	-	-	-	-	-	-
Commercial Real Estate	16,457	16,367	-	14,274	490	480
Residential Real Estate	5,321	4,995	-	4,704	56	178
Farmland	921	919	-	1,071	(4 )	1
Consumer	241	241	-	214	7	9
Other	-	-	-	-	-	-
	24,395	23,956	-	21,814	585	714
<b>With An Allowance Recorded</b>						
Commercial	-	-	-	38	-	-
Agricultural	-	-	-	-	-	-
Commercial Construction	73	73	22	74	-	-
Residential Construction	-	-	-	-	-	-
Commercial Real Estate	8,316	8,316	2,470	8,308	177	173
Residential Real Estate	858	851	435	936	4	6
Farmland	382	382	33	385	16	14
Consumer	-	-	-	-	-	-
Other	-	-	-	-	-	-
	9,629	9,622	2,960	9,741	197	193
<b>Total</b>						

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Commercial	646	646	-	553	15	18
Agricultural	301	280	-	211	5	13
Commercial Construction	581	581	22	899	16	15
Residential Construction	-	-	-	-	-	-
Commercial Real Estate	24,773	24,683	2,470	22,582	667	653
Residential Real Estate	6,179	5,846	435	5,640	60	184
Farmland	1,303	1,301	33	1,456	12	15
Consumer	241	241	-	214	7	9
Other	-	-	-	-	-	-
	\$ 34,024	\$ 33,578	\$ 2,960	\$ 31,555	\$ 782	\$ 907

**PART I (Continued)**

Item 1 (Continued)

**(3) Loans (Continued)**

TDRs are troubled loans on which the original terms of the loan have been modified in favor of the borrower due to deterioration in the borrower's financial condition. Each potential loan modification is reviewed individually and the terms of the loan are modified to meet the borrower's specific circumstances at a point in time. Not all loan modifications are TDRs. Loan modifications are reviewed and approved by the Company's senior lending staff, who then determine whether the loan meets the criteria for a TDR. Generally, the types of concessions granted to borrowers that are evaluated in determining whether a loan is classified as a TDR include:

Interest rate reductions – Occur when the stated interest rate is reduced to a nonmarket rate or a rate the borrower would not be able to obtain elsewhere under similar circumstances.

Amortization or maturity date changes – Result when the amortization period of the loan is extended beyond what is considered a normal amortization period for loans of similar type with similar collateral.

Principal reductions – These are often the result of commercial real estate loan workouts where two new notes are created. The primary note is underwritten based upon our normal underwriting standards and is structured so that the projected cash flows are sufficient to repay the contractual principal and interest of the newly restructured note. The terms of the secondary note vary by situation and often involve that note being charged-off, or the principal and interest payments being deferred until after the primary note has been repaid. In situations where a portion of the note is charged-off during modification there is often no specific reserve allocated to those loans. This is due to the fact that the amount of the charge-off usually represents the excess of the original loan balance over the collateral value and the Company has determined there is no additional exposure on those loans.

As discussed in Note 1, Summary of Significant Accounting Policies, once a loan is identified as a TDR, it is accounted for as an impaired loan. The Company had no unfunded commitments to lend to a customer that has a troubled debt restructured loan as of September 30, 2017. The following tables present the number of loan contracts restructured during the three month and nine month period ended September 30, 2017 and 2016. It shows the pre- and post-modification recorded investment as well as the number of contracts and the recorded investment for those TDRs modified during the previous twelve months which subsequently defaulted during the period. Loans modified in a troubled debt restructuring are considered to be in default once the loan becomes 90 days past due. A TDR may cease being classified as impaired if the loan is subsequently modified at market terms and, has performed according to the modified terms for at least six months, and there has not been any prior principal forgiveness on a cumulative basis.

<b>Troubled Debt Restructurings</b>	<b>Three Months Ended September 30, 2017</b>				<b>Nine Months Ended September 30, 2017</b>			
	#				#			
	of	Pre-Modification	Post-Modification		of	Pre-Modification	Post-Modification	
	Contracts		Contracts		Contracts		Contracts	
Residential Real Estate	-	\$ -	\$ -	-	-	\$ -	\$ -	-
Total Loans	-	\$ -	\$ -	-	-	\$ -	\$ -	-

<b>Troubled Debt Restructurings</b>	<b>Three Months Ended September 30, 2016</b>				<b>Nine Months Ended September 30, 2016</b>			
	#				#			
	of	Pre-Modification	Post-Modification		of	Pre-Modification	Post-Modification	
	Contracts		Contracts		Contracts		Contracts	
Residential Real Estate	-	\$ -	\$ -	-	1	\$ 91	\$ 91	
Total Loans	-	\$ -	\$ -	-	1	\$ 91	\$ 91	

The company did not have any TDRs that subsequently defaulted for the three months and nine months ended September 30, 2017.



**PART I (Continued)**

## Item 1 (Continued)

**(4) Allowance for Loan Losses**

The following tables detail activity in the allowance for loan losses, segregated by class of loan, for the nine month period ended September 30, 2017 and September 30, 2016. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other loan categories and periodically may result in reallocation within the provision categories.

**September 30, 2017**

	<b>Beginning Balance</b>	<b>Charge-Offs</b>	<b>Recoveries</b>	<b>Provision</b>	<b>Ending Balance</b>
<b>Commercial and Agricultural</b>					
Commercial	\$ 456	\$ (215 )	\$ 124	\$ 71	\$ 436
Agricultural	168	(160 )	3	238	249
<b>Real Estate</b>					
Commercial Construction	323	(49 )	241	473	988
Residential Construction	13	-	-	(7 )	6
Commercial	5,751	(966 )	523	(1,085 )	4,223
Residential	1,396	(648 )	47	334	1,129
Farmland	722	(61 )	2	209	872
<b>Consumer and Other</b>					
Consumer	80	(184 )	60	100	56
Other	14	-	2	2	18
	<b>\$ 8,923</b>	<b>\$ (2,283 )</b>	<b>\$ 1,002</b>	<b>\$ 335</b>	<b>\$ 7,977</b>

**PART I (Continued)**

## Item 1 (Continued)

**(4) Allowance for Loan Losses (Continued)**

September 30, 2016

	<b>Beginning Balance</b>	<b>Charge-Offs</b>	<b>Recoveries</b>	<b>Provision</b>	<b>Ending Balance</b>
<b>Commercial and Agricultural</b>					
Commercial	\$ 855	\$ (291 )	\$ 54	\$ (127 )	\$ 491
Agricultural	203	(18 )	3	93	281
<b>Real Estate</b>					
Commercial Construction	691	(25 )	813	(1,021 )	458
Residential Construction	20	-	-	2	22
Commercial	3,851	(992 )	197	2,231	5,287
Residential	1,990	(243 )	32	(114 )	1,665
Farmland	912	-	137	(187 )	862
<b>Consumer and Other</b>					
Consumer	63	(180 )	44	176	103
Other	19	-	6	9	34
	<b>\$ 8,604</b>	<b>\$ (1,749 )</b>	<b>\$ 1,286</b>	<b>\$ 1,062</b>	<b>\$ 9,203</b>

During the first quarter of 2017 Company management completed the transition to a change to its allowance for loan loss methodology by expanding the historical loss period from a rolling 8 quarters to 16 quarters. Management believes the longer historical loss period better reflects the current and expected loss behavior of the loan portfolio within the current credit cycle. As of September 30, 2017, this change in the historical loss period resulted in an increase to the allowance for loan losses of \$191.

Management continually evaluates the allowance for loan losses methodology seeking to refine and enhance this process as appropriate, and it is likely that the methodology will continue to evolve over time.

The Company determines its individual reserves during its quarterly review of substandard loans. This process involves reviewing all loans with a risk grade of 6 or greater and an outstanding balance of \$250,000 or more, regardless of the loans impairment classification. At September 30, 2017, there were 155 impaired loans totaling \$4.5

million below the \$250,000 review threshold which were not individually reviewed for impairment. Those loans were subject to the bank's general loan loss reserve methodology and are included in the "Collectively Evaluated for Impairment" column of the following tables. Likewise, at September 30, 2016, there were 160 impaired loans totaling \$4.6 million which were below the \$250,000 review threshold and were subject to the bank's general loan loss reserve methodology and are included in the "Collectively Evaluated for Impairment" column of the following tables.

Since not all loans in the substandard category are considered impaired, this quarterly review process may result in the identification of specific reserves on unimpaired loans. Management considers those loans graded substandard, but not classified as impaired, to be higher risk loans and, therefore, makes specific allocations to the allowance for those loans if warranted. The total of such loans is \$12.68 million and \$12.45 million as of September 30, 2017 and 2016, respectively. Specific allowance allocations were made for these loans totaling \$1.49 million and \$742 thousand as of September 30, 2017 and 2016, respectively. Since these loans are not considered impaired, both the loan balance and related specific allocation are included in the "Collectively Evaluated for Impairment" column of the following tables.

**PART I (Continued)**

## Item 1 (Continued)

**(4) Allowance for Loan Losses (Continued)**

The following tables present breakdowns of the allowance for loan losses, segregated by impairment methodology for September 30, 2017 and 2016:

**September 30, 2017**

	Ending Allowance Balance			Ending Loan Balance		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
<b>Commercial and Agricultural</b>						
Commercial	\$-	\$ 436	\$436	\$77	\$ 45,286	\$45,363
Agricultural	-	249	249	5	25,241	25,246
<b>Real Estate</b>						
Commercial Construction	69	919	988	497	36,036	36,533
Residential Construction	-	6	6	-	8,905	8,905
Commercial	1,471	2,752	4,223	17,605	328,646	346,251
Residential	21	1,108	1,129	2,204	194,128	196,332
Farmland	24	848	872	1,038	70,865	71,903
<b>Consumer and Other</b>						
Consumer	-	56	56	-	18,677	18,677
Other	-	18	18	-	20,836	20,836
<b>Total End of Period Balance</b>	<b>\$1,585</b>	<b>\$ 6,392</b>	<b>\$7,977</b>	<b>\$21,426</b>	<b>\$ 748,620</b>	<b>\$770,046</b>

**September 30, 2016**

	Ending Allowance Balance			Ending Loan Balance		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
<b>Commercial and Agricultural</b>						

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Commercial	\$-	\$ 491	\$491	\$8	\$ 45,765	\$45,773
Agricultural	-	281	281	-	26,547	26,547
<b>Real Estate</b>						
Commercial Construction	22	436	458	380	33,344	33,724
Residential Construction	-	22	22	-	10,325	10,325
Commercial	2,470	2,817	5,287	24,363	325,029	349,392
Residential	435	1,230	1,665	3,200	191,845	195,045
Farmland	33	829	862	1,047	72,754	73,801
<b>Consumer and Other</b>						
Consumer	-	103	103	-	20,378	20,378
Other	-	34	34	-	21,132	21,132
<b>Total End of Period Balance</b>	<b>\$2,960</b>	<b>\$ 6,243</b>	<b>\$9,203</b>	<b>\$28,998</b>	<b>\$ 747,119</b>	<b>\$776,117</b>

**PART I (Continued)**

## Item 1 (Continued)

**(5) Other Real Estate Owned**

The aggregate carrying amount of Other Real Estate Owned (OREO) at September 30, 2017 and December 31, 2016 was \$4,520 and \$6,439, respectively. All of the Company's other real estate owned represents properties acquired through foreclosure or deed in lieu of foreclosure. The following table details the change in OREO for the nine months ended September 30, 2017 and the year ended December 31, 2016.

	<b>Nine Months Ended September 30, 2017</b>	Twelve Months Ended December 31, 2016
<b>Balance, Beginning</b>	<b>\$ 6,439</b>	\$ 8,839
Additions	<b>1,345</b>	5,664
Sales of OREO	<b>(3,121 )</b>	(7,416 )
Gains (Losses) on Sale	<b>113</b>	(146 )
Provision for Losses	<b>(256 )</b>	(502 )
<b>Balance, Ending</b>	<b>\$ 4,520</b>	\$ 6,439

At September 30, 2017, the Company held \$674 thousand of residential real estate property as foreclosed property compared to \$431 thousand as of December 31, 2016. Also at September 30, 2017, \$93 thousand of consumer mortgage loans collateralized by residential real estate property were in the process of foreclosure according to local requirements of the applicable jurisdictions. At December 31, 2016, only \$204 thousand of consumer mortgage loans collateralized by residential real estate property were in the process of foreclosure according to local requirements of the applicable jurisdictions.

**(6) Deposits**

The aggregate amount of overdrawn deposit accounts reclassified as loan balances totaled \$435 and \$414 as of September 30, 2017 and December 31, 2016.

Components of interest-bearing deposits as of September 30, 2017 and December 31, 2016 are as follows:

	<b>Nine Months Ended September 30, 2017</b>	Twelve Months Ended December 31, 2016
Interest-Bearing Demand	<b>\$ 433,210</b>	\$ 448,004
Savings	<b>77,551</b>	70,066
Time, \$250,000 and Over	<b>34,236</b>	32,168
Other Time	<b>312,560</b>	335,060
	<b>\$ 857,557</b>	\$ 885,298

At September 30, 2017 and December 31, 2016, the Company had brokered deposits of \$49,632 and \$49,303, respectively. All of these brokered deposits represent Certificate of Deposits Account Registry Service (CDARS) reciprocal deposits. The CDARS deposits are ones in which customers placed core deposits into the CDARS program for FDIC insurance coverage and the Company receives reciprocal brokered deposits in a like amount. The aggregate amount of short-term jumbo certificates of deposit, each with a minimum denomination of \$250,000 was approximately \$29,163 and \$25,446 as of September 30, 2017 and December 31, 2016, respectively. The aggregate amount of certificates of deposit, each with a minimum deposit of \$250,000 was \$34,236 and \$32,168 as of September 30, 2017 and December 31, 2016.

**PART I (Continued)**

## Item 1 (Continued)

**(6) Deposits (Continued)**

As of September 30, 2017 and December 31, 2016, the scheduled maturities of certificates of deposits are as follows:

<u>Maturity</u>	<b>September 30, 2017</b>	December 31, 2016
One Year and Under	<b>\$ 255,989</b>	\$256,886
One to Three Years	<b>69,454</b>	85,794
Three Years and Over	<b>21,353</b>	24,548
	<b>\$ 346,796</b>	\$367,228

**(7) Other Borrowed Money**

Other borrowed money at September 30, 2017 and December 31, 2016 is summarized as follows:

	<b>September 30, 2017</b>	December 31, 2016
Federal Home Loan Bank Advances	<b>\$ 51,000</b>	\$ 46,000
Other Borrowings	<b>5,000</b>	-
	<b>\$ 56,000</b>	\$ 46,000

Advances from the Federal Home Loan Bank (FHLB) have maturities ranging from 2017 to 2026 and interest rates ranging from 0.98 percent to 3.51 percent. As collateral on the outstanding FHLB advances, the Company has provided a blanket lien on its portfolio of qualifying residential first mortgage loans and commercial loans. At September 30, 2017 the book value of those loans pledged is \$112,553. At September 30, 2017 the Company had remaining credit availability from the FHLB of \$248,160. The Company may be required to pledge additional qualifying collateral in order to utilize the full amount of the remaining credit line.

The Company borrowed \$5,000 during the first quarter of 2017 as a short term loan to be paid off within one year with an interest rate of prime plus 0.75 percent, currently 5.00 percent.



The aggregate stated maturities of other borrowed money at September 30, 2017 are as follows:

Year	Amount
2017	\$10,000
2018	2,500
2019	5,000
2020	2,500
After 2020	36,000
	\$56,000

The Company also has available federal funds lines of credit with various financial institutions totaling \$43,500, none of which were outstanding at September 30, 2017.

The Company has the ability to borrow funds from the Federal Reserve Bank (FRB) of Atlanta utilizing the discount window. The discount window is an instrument of monetary policy that allows eligible institutions to borrow money from the FRB on a short-term basis to meet temporary liquidity shortages caused by internal or external disruptions. At September 30, 2017, the Company had borrowing capacity available under this arrangement, with no outstanding balances. The Company would be required to pledge certain available-for-sale investment securities as collateral under this agreement.

#### **(8) Preferred Stock and Warrants**

The Company redeemed 9,360 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the Preferred Stock) outstanding with private investors on March 31, 2017. As a result, there is no outstanding Preferred Stock as of September 30, 2017. The Company redeemed 8,661 shares of Preferred Stock at \$1,000 per share in 2016. The Company redeemed 9,979 shares of Preferred Stock at \$1,000 per share during 2015. The Company also had a warrant (the Warrant) to purchase up to 500,000 shares of the Company's common stock outstanding with private investors. Both the Preferred Stock and the Warrant originated in 2009 through transactions with the United States Department of the Treasury and were subsequently sold to the public through an auction process in 2013.

**PART I (Continued)**

## Item 1 (Continued)

**(8) Preferred Stock and Warrants (Continued)**

The Preferred Stock qualified as Tier 1 capital and was nonvoting, other than class voting rights on certain matters that could adversely affect the Preferred Stock. The Preferred Stock was redeemable by the Company at the liquidation preference of \$1,000 per share, plus any accrued and unpaid dividends. The Warrant could be exercised on or before January 9, 2019 at an exercise price of \$8.40 per share. No voting rights may be exercised with respect to the shares of the Warrant until the Warrant was exercised.

**(9) Subordinated Debentures (Trust Preferred Securities)**

<b>Description</b>	<b>Date</b>	<b>Amount</b>	<b>3 Month Libor Rate</b>	<b>Added Points</b>	<b>Total Rate</b>	<b>Maturity</b>	<b>5 Year Call Option</b>
Colony Bankcorp Statutory Trust III	6/17/2004	\$ 4,640	1.32111	2.68	4.00111	6/14/2034	6/17/2009
Colony Bankcorp Capital Trust I	4/13/2006	5,155	1.33500	1.50	2.83500	4/13/2036	4/13/2011
Colony Bankcorp Capital Trust II	3/12/2007	9,279	1.33500	1.65	2.98500	3/12/2037	3/12/2012
Colony Bankcorp Capital Trust III	9/14/2007	5,155	1.31111	1.40	2.71111	9/14/2037	9/14/2012

The Trust Preferred Securities are recorded as subordinated debentures on the consolidated balance sheets, but subject to certain limitations, qualify as Tier 1 Capital for regulatory capital purposes. The proceeds from the offerings were used to fund certain acquisitions, pay off holding company debt and inject capital into the bank subsidiary.

The Trust Preferred Securities pay interest quarterly.

**(10) Commitments and Contingencies**

*Credit-Related Financial Instruments.* The Company is a party to credit related financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. Such commitments

involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance sheet instruments. We evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies, but may include cash or cash equivalents, negotiable instruments, real estate, accounts receivable, inventory, oil, gas and mineral interests, property, plant, and equipment.

At September 30, 2017 and December 31, 2016 the following financial instruments were outstanding whose contract amounts represent credit risk:

	<b>Contract Amount</b>	
	<b>September 30, 2017</b>	<b>December 31, 2016</b>
Loan Commitments	<b>\$91,744</b>	\$ 71,359
Letters of Credit	<b>1,566</b>	1,551

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Company, is based on management's credit evaluation of the customer.

Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are uncollateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Company is committed.

Standby and performance letters of credit are conditional lending commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements.



**PART I (Continued)**

Item 1 (Continued)

**(10) Commitments and Contingencies (Continued)**

Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

*Legal Contingencies.* In the ordinary course of business, there are various legal proceedings pending against the Company and the Bank. The aggregate liabilities, if any, arising from such proceedings would not, in the opinion of management, have a material adverse effect on the Company's consolidated financial position.

**(11) Fair Value of Financial Instruments and Fair Value Measurements**

Generally accepted accounting standards in the U.S. require disclosure of fair value information about financial instruments, whether or not recognized on the face of the balance sheet, for which it is practicable to estimate that value. The assumptions used in the estimation of the fair value of the Company and the Bank's financial instruments are detailed hereafter. Where quoted prices are not available, fair values are based on estimates using discounted cash flows and other valuation techniques. The use of discounted cash flows can be significantly affected by the assumptions used, including the discount rate and estimates of future cash flows.

Generally accepted accounting principles related to Fair Value Measurements define fair value, establish a framework for measuring fair value, establish a three-level valuation hierarchy for disclosure of fair value measurement and enhance disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level inputs to the valuation methodology are unobservable and represent the Company's own assumptions about the  
3 assumptions that market participants would use in pricing the assets or liabilities.

The following disclosures should not be considered a surrogate of the liquidation value of the Company, but rather a good-faith estimate of the increase or decrease in value of financial instruments held by the Company since purchase, origination or issuance.

**Cash and Short-Term Investments** – For cash, due from banks, bank-owned deposits and federal funds sold, the carrying amount is a reasonable estimate of fair value and is classified as Level 1.

**Investment Securities** – Fair values for investment securities are based on quoted market prices where available and classified as Level 1. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable instruments and classified as Level 2. If a comparable is not available, the investment securities are classified as Level 3.

**Federal Home Loan Bank Stock** – The fair value of Federal Home Loan Bank stock approximates carrying value and is classified as Level 1.

**Loans** – The fair value of fixed rate loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings. For variable rate loans, the carrying amount is a reasonable estimate of fair value. Most loans are classified as Level 2, but impaired loans with a related allowance are classified as Level 3.

**Bank-Owned Life Insurance** – The carrying value of bank-owned life insurance policies approximates fair value and is classified as Level 1.

**Deposit Liabilities** – The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date and is classified as Level 1. The fair value of fixed maturity certificates of deposit is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities and is classified as Level 2.

**PART I (Continued)**

## Item 1 (Continued)

**(11) Fair Value of Financial Instruments and Fair Value Measurements (Continued)**

**Subordinated Debentures** – The fair value of subordinated debentures is estimated by discounting the future cash flows using the current rates at which similar advances would be obtained. Subordinate Debentures are classified as Level 2.

**Other Borrowed Money** – The fair value of other borrowed money is calculated by discounting contractual cash flows using an estimated interest rate based on current rates available to the Company for debt of similar remaining maturities and collateral terms. Other borrowed money is classified as Level 2 due to their expected maturities.

Disclosures of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or non-recurring basis, are required in the financial statements.

The carrying amount, estimated fair values, and placement in the fair value hierarchy of the Company's financial instruments as of September 30, 2017 and December 31, 2016 are as follows:

	<b>Fair Value Measurements at September 30, 2017</b>				
	<b>Carrying Value</b>	<b>Estimated Fair Value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets</b>					
Cash and Short-Term Investments	<b>\$31,600</b>	<b>\$31,600</b>	<b>\$31,600</b>	<b>\$-</b>	<b>\$-</b>
Investment Securities Available for Sale	<b>338,249</b>	<b>338,249</b>	<b>-</b>	<b>338,019</b>	<b>230</b>
Federal Home Loan Bank Stock	<b>3,255</b>	<b>3,255</b>	<b>3,255</b>	<b>-</b>	<b>-</b>
Loans, Net	<b>761,639</b>	<b>761,831</b>	<b>-</b>	<b>755,385</b>	<b>6,446</b>
Bank-Owned Life Insurance	<b>15,823</b>	<b>15,823</b>	<b>15,823</b>	<b>-</b>	<b>-</b>
<b>Liabilities</b>					
Deposits	<b>1,020,263</b>	<b>1,020,647</b>	<b>673,468</b>	<b>347,179</b>	<b>-</b>
Subordinated Debentures	<b>24,229</b>	<b>24,229</b>	<b>-</b>	<b>24,229</b>	<b>-</b>

Other Borrowed Money	<b>56,000</b>	<b>56,251</b>	-	<b>56,251</b>	-
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Fair Value Measurements at  
December 31, 2016

	<b>Carrying Value</b>	<b>Estimated Fair Value</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets</b>					
Cash and Short-Term Investments	\$75,167	\$75,167	\$75,167	\$-	\$-
Investment Securities Available for Sale	323,658	323,658	-	323,082	576
Federal Home Loan Bank Stock	3,010	3,010	3,010	-	-
Loans, Net	744,999	745,240	-	738,288	6,952
Bank-Owned Life Insurance	15,419	15,419	15,419	-	-
<b>Liabilities</b>					
Deposits	1,044,357	1,045,726	677,129	368,597	-
Subordinated Debentures	24,229	24,229	-	24,229	-
Other Borrowed Money	46,000	46,232	-	46,232	-

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on many judgments.



**PART I (Continued)**

Item 1 (Continued)

**(11) Fair Value of Financial Instruments and Fair Value Measurements (Continued)**

These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets and liabilities that are not considered financial instruments include deferred income taxes and premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring and nonrecurring basis, as well as the general classification of such instruments pursuant to the valuation hierarchy:

**Assets**

*Securities* – Where quoted prices are available in an active market, securities are classified within level 1 of the valuation hierarchy. Level 1 inputs include securities that have quoted prices in active markets for identical assets. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flow. Examples of such instruments, which would generally be classified within level 2 of the valuation hierarchy, include certain collateralized mortgage and debt obligations and certain high-yield debt securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within level 3 of the valuation hierarchy. When measuring fair value, the valuation techniques available under the market approach, income approach and/or cost approach are used. The Company's evaluations are based on market data and the Company employs combinations of these approaches for its valuation methods depending on the asset class.

*Impaired Loans* – Impaired loans are those loans which the Company has measured impairment 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, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair

values, based upon the lowest level of input that is significant to the fair value measurements.

*Other Real Estate* – Other real estate owned assets are adjusted to fair value less estimated selling costs upon transfer of the loans to other real estate owned. Typically, an external, third-party appraisal is performed on the collateral upon transfer into the other real estate owned account to determine the asset's fair value. Subsequent adjustments to the collateral's value may be based upon either updated third-party appraisals or management's knowledge of the collateral and the current real estate market conditions. Appraised amounts used in determining the asset's fair value, whether internally or externally prepared, are discounted 10 percent to account for selling and marketing costs. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a level 3 classification of the inputs for determining fair value. Because of the high degree of judgment required in estimating the fair value of other real estate owned assets and because of the relationship between fair value and general economic conditions, we consider the fair value of other real estate owned assets to be highly sensitive to changes in market conditions.

*Assets and Liabilities Measured at Fair Value on a Recurring and Nonrecurring Basis* – The following table presents the recorded amount of the Company's assets measured at fair value on a recurring and nonrecurring basis as of September 30, 2017 and December 31, 2016, aggregated by the level in the fair value hierarchy within which those measurements fall. The table below includes only impaired loans with a specific reserve and only other real estate properties with a valuation allowance at September 30, 2017. Those impaired loans and other real estate properties are shown net of the related specific reserves and valuation allowances.

**PART I (Continued)**

Item 1 (Continued)

**(11) Fair Value of Financial Instruments and Fair Value Measurements (Continued)**

		Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>September 30, 2017</b>	<b>Total Fair Value</b>			
<b>Recurring Securities Available for Sale</b>				
U.S. Government Agencies				
Mortgage-Backed State, County and Municipal	\$330,658	\$-	\$ 330,658	\$ -
Corporate Bonds	4,539	-	4,309	230
Asset Backed	2,060	-	2,060	-
	992	-	992	-
	\$338,249	\$-	\$ 338,019	\$ 230
<b>Nonrecurring</b>				
Impaired Loans	\$6,446	\$-	\$ -	\$ 6,446
Other Real Estate	\$1,625	\$-	\$ -	\$ 1,625

		Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>December 31, 2016</b>	<b>Total Fair Value</b>			

**(Level 1)  
1) (Level 2)**

**Recurring Securities Available for Sale**

U.S. Government Agencies				
Mortgage-Backed	\$319,097	\$-	\$ 319,097	\$ -
State, County and Municipal	4,561	-	3,985	576
	\$323,658	\$-	\$ 323,082	\$ 576
<b>Nonrecurring</b>				
Impaired Loans	\$6,952	\$-	\$ -	\$ 6,952
Other Real Estate	\$2,505	\$-	\$ -	\$ 2,505

**Liabilities**

The Company did not identify any liabilities that are required to be presented at fair value.

**PART I (Continued)**

## Item 1 (Continued)

**(11) Fair Value of Financial Instruments and Fair Value Measurements (Continued)***Fair Value Measurements Using Significant Unobservable Inputs (Level 3)*

The following table presents quantitative information about the significant unobservable inputs used in the fair value measurements for assets in level 3 of the fair value hierarchy measured on a nonrecurring basis at September 30, 2017 and December 31, 2016. This table is comprised primarily of collateral dependent impaired loans and other real estate owned:

	September 30, 2017	Valuation Techniques	Unobservable Inputs	Range Weighted Avg
Real Estate Commercial Construction	\$ 428	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(16.00)% - 1975.00% 979.50%
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	0.00% - 10.00% 5.00%
Residential Real Estate	16	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(43.30)% - 83.30% 20.00%
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	10.00% - 25.00% 17.50%
Commercial Real Estate	5,653	Sales Comparison	Management Adjustments for Age of Appraisals and/or Current Market Conditions	0.00% - 10.00% 5.00%
		Income Approach	Capitalization Rate	10.67%

Farmland	<b>349</b>	<b>Sales Comparison</b>	<b>Adjustment for Differences Between the Comparable Sales</b>	<b>(71.00)% -88.70%</b> <b>8.85%</b>
			<b>Management Adjustments for Age of Appraisals and/or Current Market Conditions</b>	<b>10.00% -75.00%</b> <b>42.50%</b>
Other Real Estate Owned	<b>1,625</b>	<b>Sales Comparison</b>	<b>Adjustment for Differences Between the Comparable Sales</b>	<b>(34.01)% -35.00%</b> <b>0.50%</b>
			<b>Management Adjustments for Age of Appraisals and/or Current Market Conditions</b>	<b>1.60% -81.32%</b> <b>29.15%</b>

**PART I (Continued)**

## Item 1 (Continued)

**(11) Fair Value of Financial Instruments and Fair Value Measurements (Continued)**

	December 31, 2016	Valuation Techniques	Unobservable Inputs	Range Weighted Avg
Real Estate				
Commercial Construction	\$ 51	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(5.00)% - 99.00% 47.00%
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	0.00% - 10.00% 5.00%
Residential Real Estate	1,105	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(22.00)% - 0.00% (11.00)%
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	0.00% - 40.00% 20.00%
Commercial Real Estate	5,445	Sales Comparison	Adjustment for differences Between the comparable Sales	(14.08)% - 24.62% 5.27%

			Management Adjustments for Age of Appraisals and/or Current Market Conditions	0.00%	- 100.00%
		Income Approach	Capitalization Rate	10.67%	
Farmland	351	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(27.00)%	- 15.00%
				(6.00)%	
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	10.00%	- 75.00%
				42.50%	
Other Real Estate Owned	2,505	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(50.80)%	- 316.00%
				132.60%	
			Management Adjustment for Age of Appraisals and/or Current Market Conditions	6.25%	- 76.92%
				36.31%	
		Income Approach	Discount Rate	12.50%	



**PART I (Continued)**

## Item 1 (Continued)

**(11) Fair Value of Financial Instruments and Fair Value Measurements (Continued)**

The table below presents a reconciliation and statement of income classification of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (level 3) for the nine months ended September 30, 2017 and the twelve months ended December 31, 2016.

	<b>Available for Sale Securities September 30, 2017</b>	<b>December 31, 2016</b>
<b>Balance, Beginning</b>	<b>\$576</b>	<b>\$ 930</b>
Transfers out of Level 3	-	-
Maturities	<b>(345)</b>	<b>(330 )</b>
Loss on OTTI Impairment Included in Noninterest Income	-	-
Unrealized Gains included in Other Comprehensive Income (Loss)	<b>(1 )</b>	<b>(24 )</b>
<b>Balance, Ending</b>	<b>\$230</b>	<b>\$ 576</b>

The Company's policy is to recognize transfers in and transfers out of levels 1, 2 and 3 as of the end of a reporting period. There were no transfers of securities between levels for the nine months ended September 30, 2017 and the twelve months ended December 31, 2016.

The following table presents quantitative information about recurring level 3 fair value measurements as of September 30, 2017.

	<b>Fair Value</b>	<b>Valuation Techniques</b>	<b>Unobservable Inputs</b>	<b>Range Weighted Avg</b>
State, County and Municipal	<b>\$ 230</b>	Discounted Cash Flow	Discount Rate	N/A*

\* The Company relies on a third-party pricing service to value its municipal securities. The details of the unobservable inputs and other adjustments used by the third-party pricing service were not readily available to the Company.

## **(12) Regulatory Capital Matters**

The amount of dividends payable to the parent company from the subsidiary bank is limited by various banking regulatory agencies. Upon approval by regulatory authorities, the Bank may pay cash dividends to the parent company in excess of regulatory limitations.

The Company is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and, possibly, additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Company's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. As of September 30, 2017, the interim final Basel III rules (Basel III) require the Company to also maintain minimum amounts and ratios of common equity Tier 1 capital to risk-weighted assets. These amounts and ratios as defined in regulations are presented hereafter. Management believes, as of September 30, 2017, the Company meets all capital adequacy requirements to which it is subject under the regulatory framework for prompt corrective action. In the opinion of management, there are no events or conditions since prior notification of capital adequacy from the regulators that have changed the institution's category.

**PART I (Continued)**

## Item 1 (Continued)

**(12) Regulatory Capital Matters (Continued)**

The Basel III rules also require the implementation of a new capital conservation buffer comprised of common equity Tier 1 capital. The capital conservation buffer will be phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and increase each subsequent year by 0.625% until reaching its final level of 2.5% on January 1, 2019.

The following table summarizes regulatory capital information as of September 30, 2017 and December 31, 2016 on a consolidated basis and for the subsidiary, as defined. Regulatory capital ratios for September 30, 2017 and December 31, 2016 were calculated in accordance with the Basel III rules.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of September 30, 2017</b>						
Total Capital to Risk-Weighted Assets						
Consolidated	\$126,812	15.75 %	\$64,398	8.00 %	N/A	N/A
Colony Bank	129,973	16.17	64,312	8.00	\$80,390	10.00 %
Tier I Capital to Risk-Weighted Assets						
Consolidated	118,835	14.76	48,299	6.00	N/A	N/A
Colony Bank	121,996	15.18	48,234	6.00	64,312	8.00
Common Equity Tier I Capital to Risk-Weighted Assets						
Consolidated	95,335	11.84	36,224	4.50	N/A	N/A
Colony Bank	121,996	15.18	36,175	4.50	52,253	6.50
Tier I Capital to Average Assets						
Consolidated	118,835	9.91	47,978	4.00	N/A	N/A

Colony Bank	<b>121,996</b>	<b>10.19</b>	<b>47,906</b>	<b>4.00</b>	<b>59,882</b>	<b>5.00</b>
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**PART I (Continued)**

## Item 1 (Continued)

**(12) Regulatory Capital Matters (Continued)**

	<b>Actual</b>		<b>For Capital Adequacy Purposes</b>		<b>To Be Well Capitalized Under Prompt Corrective Action Provisions</b>	
	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>	<b>Amount</b>	<b>Ratio</b>
As of December 31, 2016						
<b>Total Capital to Risk-Weighted Assets</b>						
Consolidated	\$130,785	16.64%	\$62,880	8.00%	N/A	N/A
Colony Bank	127,646	16.26	62,796	8.00	\$78,495	10.00%
<b>Tier I Capital to Risk-Weighted Assets</b>						
Consolidated	121,862	15.50	47,160	6.00	N/A	N/A
Colony Bank	118,723	15.12	47,097	6.00	62,796	8.00
<b>Common Equity Tier I Capital to Risk-Weighted Assets</b>						
Consolidated	89,002	11.32	35,370	4.50	N/A	N/A
Colony Bank	118,723	15.12	35,323	4.50	51,022	6.50
<b>Tier I Capital to Average Assets</b>						
Consolidated	121,862	10.29	47,368	4.00	N/A	N/A
Colony Bank	118,723	10.04	47,290	4.00	59,113	5.00

**PART I (Continued)**

## Item 1 (Continued)

**(13) Earnings Per Share**

Basic earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during each period. Diluted earnings per share reflects the potential dilution of restricted stock and common stock warrants. Net income available to common stockholders represents net income after preferred stock dividends. The following table presents earnings per share for the three month and nine month period ended September 30, 2017 and 2016.

	<b>Three Months Ended September 30 2017</b>		<b>Nine Months Ended September 30 2016</b>	
<b>Numerator</b>				
Net Income Available to Common Stockholders	<b>\$2,622</b>	\$1,880	<b>\$6,961</b>	\$5,297
<b>Denominator</b>				
Weighted Average Number of Common Shares Outstanding for Basic Earnings Per Common Share	<b>8,439</b>	8,439	<b>8,439</b>	8,439
Dilutive Effect of Potential Common Stock				
Restricted Stock	-	-	-	-
Stock Warrants	<b>191</b>	67	<b>193</b>	57
Weighted-Average Number of Shares Outstanding for Diluted Earnings Per Common Share	<b>8,630</b>	8,506	<b>8,632</b>	8,496
Earnings Per Share - Basic	<b>\$0.31</b>	\$0.22	<b>\$0.82</b>	\$0.63
Earnings Per Share - Diluted	<b>\$0.30</b>	\$0.22	<b>\$0.81</b>	\$0.62

**(14) Accumulated Other Comprehensive Income (Loss)**

Changes in accumulated other comprehensive income (loss) for unrealized gains and losses securities available for sale for the period ended September 30, 2017 and the year ended December 31, 2016 are as follows:

	<b>September 30, 2017</b>	December 31, 2016
<b>Beginning Balance</b>	<b>\$ (5,022 )</b>	\$ (4,434 )
Other Comprehensive Income Before Reclassification	<b>1,246</b>	(334 )
Amounts Reclassified from Accumulated Other Comprehensive Income	-	(254 )
Net Current Period Other Comprehensive Income	<b>1,246</b>	(588 )
<b>Ending Balance</b>	<b>\$ (3,776 )</b>	\$ (5,022 )

**PART I (Continued)**

Item 2

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Future Outlook**

During the recent financial crisis, the financial industry experienced tremendous adversities as a result of the collapse of the real estate markets across the country. The Company, like most banking companies, has been affected by these economic challenges that started with a rapid stall of real estate sales and developments throughout the country. While much has been accomplished in addressing problem assets the past several years, there is still work to be done in bringing our problem assets to an acceptable level. Our focus in 2017 has been and will continue to be directed toward further reduction of problem assets.

In 2017 we have committed to improving earnings, reducing problem assets and redeeming TARP preferred stock. In the first quarter of 2017 we received approval from the Federal Reserve and the Department of Banking and Finance to completely eliminate the Preferred Stock. Given the improved condition of the Company, we are also considering product and market expansion. In 2016, we opened new offices in Tifton and Statesboro, while closing four offices in smaller rural markets. In January 2017, the Company opened its third office in Savannah. Currently, the Company is performing due diligence on a property for a new office in Statesboro.

In addition to improving earnings, reducing problem assets and maintaining strong capital levels, we reinstated quarterly dividend payments beginning first quarter 2017. The Company's board of directors suspended the payment of dividends in the third quarter of 2009.

We continue to explore opportunities to improve core non-interest income. Revenue enhancement initiatives to accomplish this include new product lines and services. The Company will also invest in new technology with the implementation of a new loan platform which will offer much efficiency with our "back-office" operations.

In addition, we continue to make efforts to attract and retain top talent to improve business operations. To that end, the Company entered into Retention Agreements with members of management in the first quarter of 2015. The Company expects that these agreements will facilitate the retention of key individuals responsible for maintaining current



operations and spearheading future product and market expansion.

## Major Trends/Significant Considerations

The following discussion sets forth management's discussion and analysis of our consolidated financial condition as of September 30, 2017, and the consolidated results of operations for the nine months ended September 30, 2017. This discussion should be read in conjunction with the Company's annual report on Form 10-K filed with the Securities and Exchange Commission on March 10, 2017. Readers should also carefully review all other disclosures we file from time to time with the SEC.

## Non-GAAP Financial Measures

Our accounting and reporting policies conform to generally accepted accounting principles (GAAP) in the United States and prevailing practices in the banking industry. However, management uses certain non-GAAP measures to supplement the evaluation of our performance. These include the fully-taxable equivalent measures: tax-equivalent net interest income, tax-equivalent net interest margin, and tax-equivalent net interest spread, which include the effects of taxable-equivalent adjustments using a federal income tax rate of 34% to increase tax-exempt interest income to a tax-equivalent basis. Tax-equivalent adjustments are reported in Notes 1 and 2 to the Average Balances with Average Yields and Rates table under Rate/Volume Analysis. Tangible book value per common share is also a non-GAAP measure used in the selected Financial Data Section.

*Tax-equivalent net interest income, net interest margin and net interest spread.* Net interest income on a tax-equivalent basis is a non-GAAP measure that adjusts for the tax-favored status of net interest income from loans and investments. We believe this measure to be the preferred industry measurement of net interest income and it enhances comparability of net interest income arising from taxable and tax-exempt sources. The most directly comparable financial measure calculated in accordance with GAAP is our net interest income. Net interest margin on a tax-equivalent basis is net interest income on a tax-equivalent basis divided by average interest-earning assets on a tax-equivalent basis. The most directly comparable financial measure calculated in accordance with GAAP is our net interest margin. Net interest spread on a tax-equivalent basis is the difference in the average yield on average interest-earning assets on a tax equivalent basis and the average rate paid on average interest-bearing liabilities. The most directly comparable financial measure calculated in accordance with GAAP is our net interest spread.

**PART I (Continued)**

## Item 2 (continued)

These non-GAAP financial measures should not be considered alternatives to GAAP-basis financial statements, and other bank holding companies may define or calculate these non-GAAP measures or similar measures differently.

A reconciliation of these performance measures to GAAP performance measures is included in the tables below.

**Non-GAAP Performance Measures Reconciliation**

	<b>Three months ended September 30, 2017</b>		<b>Nine months ended September 30, 2017</b>	
	2016		2016	
<b>Interest Income Reconciliation</b>				
Interest Income – Taxable Equivalent	\$11,622	\$11,202	\$34,355	\$33,518
Tax Equivalent Adjustment	44	46	118	132
Interest Income (GAAP)	\$11,578	\$11,156	\$34,237	\$33,386

**Net Interest Income Reconciliation**

Net Interest Income – Taxable Equivalent	\$9,887	\$9,602	\$29,239	\$28,669
Tax Equivalent Adjustment	44	46	118	132
Net Interest Income (GAAP)	\$9,843	\$9,556	\$29,121	\$28,537

	<b>Three Months Ended September 30, 2017</b>		<b>Nine Months Ended September 30, 2017</b>	
	2016		2016	
<b>Net Interest Margin Reconciliation</b>				
Net Interest Margin – Taxable Equivalent	3.50 %	3.56 %	3.45 %	3.52 %
Tax Equivalent Adjustment	0.01	0.02	0.02	0.02
Net Interest Margin (GAAP)	3.49 %	3.54 %	3.43 %	3.50 %

**Interest Rate Spread Reconciliation**

Net Interest Margin – Taxable Equivalent	3.50 %	3.56 %	3.45 %	3.52 %
Tax Equivalent Adjustment	0.01	0.02	0.02	0.02
Net Interest Margin (GAAP)	3.49 %	3.54 %	3.43 %	3.50 %

**Interest Rate Spread Reconciliation**

Interest Rate Spread – Taxable Equivalent	<b>3.38 %</b>	3.45 %	<b>3.33 %</b>	3.40 %
Tax Equivalent Adjustment	<b>0.01</b>	0.02	<b>0.01</b>	0.01
Interest Rate Spread (GAAP)	<b>3.37 %</b>	3.43 %	<b>3.32 %</b>	3.39 %

## The Company

Colony Bankcorp, Inc. (the Company) is a bank holding company headquartered in Fitzgerald, Georgia that provides, through Colony Bank, its wholly owned subsidiary (collectively referred to as the Company), a broad array of products and services throughout 19 Georgia markets. The Company offers commercial, consumer and mortgage banking services.

## Application of Critical Accounting Policies and Accounting Estimates

The accounting and reporting policies of the Company are in accordance with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. The Company's financial position and results of operations are affected by management's application of accounting policies, including judgments made to arrive at the carrying value of assets and liabilities and amounts reported for revenues, expenses and related disclosures. Different assumptions in the application of these policies could result in material changes in the Company's financial position and/or results of operations. Critical accounting policies are those policies that management believes are the most important to the portrayal of the Company's financial condition and results of operations, and they require management to make estimates that are difficult and subjective.

## Overview

The following discussion and analysis presents the more significant factors affecting the Company's financial condition as of September 30, 2017 and December 31, 2016, and results of operations for each of the nine months in the periods ended September 30, 2017 and 2016. This discussion and analysis should be read in conjunction with the Company's consolidated financial statements, notes thereto and other financial information appearing elsewhere in this report.

**PART I (Continued)**

## Item 2 (continued)

Taxable-equivalent adjustments are the result of increasing income from tax-free loans and investments by an amount equal to the taxes that would be paid if the income were fully taxable based on a 34 percent federal tax rate, thus making tax-exempt yields comparable to taxable asset yields.

Dollar amounts in tables are stated in thousands, except for per share amounts.

**Results of Operations**

The Company's results of operations are determined by its ability to effectively manage interest income and expense, to minimize loan and investment losses, to generate noninterest income and to control noninterest expense. Since market forces and economic conditions beyond the control of the Company determine interest rates, the ability to generate net interest income is dependent upon the Company's ability to obtain an adequate spread between the rate earned on interest-earning assets and the rate paid on interest-bearing liabilities. Thus, the key performance for net interest income is the interest margin or net yield, which is taxable-equivalent net interest income divided by average interest-earning assets. Net income available to common shareholders totaled \$2.62 million, or \$0.30 diluted per common share, in the three months ended September 30, 2017 compared to net income available to common shareholders of 1.88 million, or \$0.22 diluted per common share, in the three months ended September 30, 2016. Net income available to common shareholders totaled \$6.96 million, or \$0.81 diluted per common share, in nine months ended September 30, 2017 compared to net income available to common shareholders of \$5.30 million, or \$0.62 diluted per common share, in nine months ended September 30, 2016. The Company did not have any material changes to its results of operations in the third quarter of 2017.

Selected income statement data, returns on average assets and average common equity and dividends per share for the comparable periods were as follows:

	Three Months Ended September 30				Nine Months Ended September 30			
	2017	2016	\$ Variance	% Variance	2017	2016	\$ Variance	% Variance
Taxable-equivalent net interest income	\$9,887	\$9,602	\$ 285	2.97 %	\$29,239	\$28,669	\$ 570	1.99 %
	44	46	(2 )	(4.35 )	118	132	(14 )	(10.61 )

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Taxable-equivalent  
adjustment

Net interest income	<b>9,843</b>	9,556	<b>287</b>	<b>3.00</b>	<b>29,121</b>	28,537	<b>584</b>	<b>2.05</b>
Provision for loan losses	-	354	<b>(354 )</b>	<b>(100.00 )</b>	<b>335</b>	1,062	<b>(727 )</b>	<b>(68.46 )</b>
Noninterest income	<b>2,424</b>	2,637	<b>(213 )</b>	<b>(8.08 )</b>	<b>7,218</b>	7,161	<b>57</b>	<b>0.80</b>
Noninterest expense	<b>8,380</b>	8,654	<b>(274 )</b>	<b>(3.17 )</b>	<b>25,408</b>	25,243	<b>165</b>	<b>0.65</b>
Income before income taxes	<b>3,887</b>	3,185	<b>702</b>	<b>22.04</b>	<b>10,596</b>	9,393	<b>1,203</b>	<b>12.81</b>
Income taxes	<b>1,265</b>	927	<b>338</b>	<b>36.46</b>	<b>3,424</b>	2,907	<b>517</b>	<b>17.78</b>
Net income	<b>2,622</b>	2,258	<b>364</b>	<b>16.12</b>	<b>7,172</b>	6,486	<b>686</b>	<b>10.58</b>
Preferred stock dividends	-	378	<b>(378 )</b>	<b>(100.00 )</b>	<b>211</b>	1,189	<b>(978 )</b>	<b>(82.85 )</b>
Net income available to common shareholders	<b>\$2,622</b>	\$1,880	<b>\$ 742</b>	<b>39.47 %</b>	<b>\$6,961</b>	\$5,297	<b>\$ 1,664</b>	<b>31.41 %</b>
Net income available to common shareholders:								
Basic	<b>\$0.31</b>	\$0.22	<b>\$ 0.09</b>	<b>40.91 %</b>	<b>\$0.82</b>	\$0.63	<b>\$ 0.19</b>	<b>30.16 %</b>
Diluted	<b>\$0.30</b>	\$0.22	<b>\$ 0.08</b>	<b>36.36 %</b>	<b>\$0.81</b>	\$0.62	<b>\$ 0.19</b>	<b>30.65 %</b>
Return on average assets	<b>0.88 %</b>	0.65 %	<b>0.23</b>	<b>35.38 %</b>	<b>0.78 %</b>	0.61 %	<b>0.17</b>	<b>27.87 %</b>
Return on average total equity	<b>11.57 %</b>	7.35 %	<b>4.22</b>	<b>57.41 %</b>	<b>10.23 %</b>	7.03 %	<b>3.20</b>	<b>45.52 %</b>

Details of the changes in the various components of net income are further discussed below.

**PART I (Continued)**

Item 2 (continued)

**Net Interest Income**

Net interest income is the difference between interest income on earning assets, such as loans and securities, and interest expense on liabilities, such as deposits and borrowings, which are used to fund those assets. Net interest income is the Company's largest source of revenue, representing 80.14 percent of total revenue for nine months ended September 30, 2017 and 79.94 percent for the same period a year ago.

Net interest margin is the taxable-equivalent net interest income as a percentage of average interest-earning assets for the period. The level of interest rates and the volume and mix of interest-earning assets and interest-bearing liabilities impact net interest income and net interest margin.

The Federal Reserve Board influences the general market rates of interest, including the deposit and loan rates offered by many financial institutions. The Company's loan portfolio is significantly affected by changes in the prime interest rate. The prime interest rate, which is the rate offered on loans to borrowers with strong credit, is currently 4.25 percent. The rate increased 25 basis points in the first and second quarter of 2017. The federal funds rate moved similarly to the prime rate with interest rates currently at 1.25 percent. We expect another additional rate increase in 2017.

The following table presents the changes in taxable-equivalent net interest income and identifies the changes due to differences in the average volume of interest-earning assets and interest-bearing liabilities and the changes due to changes in the average interest rate on those assets and liabilities. The changes in net interest income due to changes in both average volume and average interest rate have been allocated to the average volume change or the average interest rate change in proportion to the absolute amounts of the change in each. The Company's consolidated average balance sheets along with an analysis of taxable-equivalent net interest earnings are presented in the Quantitative and Qualitative Disclosures About Market Risk included elsewhere in this report.

**PART I (Continued)**

Item 2 (continued)

**Rate/Volume Analysis**

The rate/volume analysis presented hereafter illustrates the change from September 30, 2016 to September 30, 2017 for each component of the taxable equivalent net interest income separated into the amount generated through volume changes and the amount generated by changes in the yields/rates.

(\$ in thousands)	Changes from September 30, 2016 to September 30, 2017		
	Volume	Rate	Total
Interest Income			
Loans, Net-taxable	\$83	\$(344)	\$(261)
Investment Securities			
Taxable	532	478	1,010
Tax-exempt	(6)	(5)	(11)
Total Investment Securities	526	473	999
Interest-Bearing Deposits in other Banks	7	80	87
Other Interest - Earning Assets	11	1	12
Total Interest Income	627	210	837
Interest Expense			
Interest-Bearing Demand and Savings Deposits	141	23	164
Time Deposits	(186)	1	(185)
Subordinated Debentures	-	227	227
Other Borrowed Money	133	(75)	58
Federal Funds Purchased	3	-	3
Total Interest Expense	91	176	267
Net Interest Income	\$536	\$34	\$570

(1) Changes in net interest income for the periods, based on either changes in average balances or changes in average rates for interest-earning assets and interest-bearing liabilities, are shown on this table. During each year, there are numerous and simultaneous balance and rate changes; therefore, it is not possible to precisely allocate the changes

between balances and rates. For the purpose of this table, changes that are not exclusively due to balance changes or rate changes have been attributed to rates.

The Company maintains about 21 percent of its loan portfolio in adjustable rate loans that reprice with prime rate changes, while the bulk of its other loans mature within 3 years. The liabilities to fund assets are primarily in short term certificate of deposits that mature within one year. The net interest margin decreased to 3.45 percent for the nine months ended September 30, 2017 compared to 3.52 percent for the same period a year ago. We anticipate the net interest margin remaining relatively flat for 2017.

Taxable-equivalent net interest income for the nine months ended September 30, 2017 increased by \$570 thousand, or 1.99 percent compared to the same period a year ago. The average volume of earning assets during nine months ended September 30, 2017 increased \$44.11 million compared to the same period a year ago. Growth in average earning assets during 2017 was primarily in investments and loans.

The average volume of loans increased \$2.16 million for the nine months ended September 30, 2017 compared to the same period a year ago. The average yield on loans decreased 6 basis points for the nine months ended September 30, 2017 compared to the same period a year ago. The average volume of investment securities increased \$39.89 million for the nine months ended September 30, 2017 compared to the same year ago period, while the average yield on investment securities increased 18 basis points for the same period comparison. The average volume of deposits increased \$38.73 million for the nine months ended September 30, 2017 compared to the same period a year ago, with interest-bearing deposits increasing \$21.24 million for the nine months ended September 30, 2017.



**PART I (Continued)**

Item 2 (continued)

Accordingly, the ratio of average interest-bearing deposits to total average deposits was 84.94 percent for the nine months ended September 30, 2017 compared to 86.12 percent in the same period a year ago. This deposit mix had the effect of decreasing the average cost of total deposits by 2 basis points in nine months ended September 30, 2017 compared to the same period a year ago.

The Company's net interest spread, which represents the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities, was 3.33 percent in nine months ended September 30, 2017 compared to 3.40 percent in the same period a year ago. The net interest spread, as well as the net interest margin, will be impacted by future changes in short-term and long-term interest rate levels, as well as the impact from the competitive environment.

**PART I (Continued)**

Item 2 (continued)

<b>AVERAGE BALANCE SHEETS</b>	<b>Nine Months Ended</b>			<b>Nine Months Ended</b>		
	<b>September 30, 2017</b>			<b>September 30, 2016</b>		
<b>(\$ in thousands)</b>	<b>Average</b>	<b>Income/</b>	<b>Yields/</b>	<b>Average</b>	<b>Income/</b>	<b>Yields/</b>
	<b>Balances</b>	<b>Expense</b>	<b>Rates</b>	<b>Balances</b>	<b>Expense</b>	<b>Rates</b>
Assets						
Interest-Earning Assets						
Loans, Net of Unearned Interest and fees						
Taxable (1)	<b>\$760,540</b>	<b>\$28,981</b>	<b>5.08 %</b>	\$758,377	\$29,242	5.14 %
Investment Securities						
Taxable	<b>343,183</b>	<b>5,037</b>	<b>1.96 %</b>	303,100	4,027	1.77 %
Tax-Exempt (2)	<b>2,307</b>	<b>62</b>	<b>3.58 %</b>	2,503	73	3.89 %
Total Investment Securities	<b>345,490</b>	<b>5,099</b>	<b>1.97 %</b>	305,603	4,100	1.79 %
Interest-Bearing Deposits	<b>21,611</b>	<b>166</b>	<b>1.02 %</b>	19,867	79	0.53 %
Interest-Bearing Other Assets	<b>3,114</b>	<b>109</b>	<b>4.67 %</b>	2,802	97	4.62 %
Total Interest-Earning Assets	<b>\$1,130,755</b>	<b>\$34,355</b>	<b>4.05 %</b>	\$1,086,649	\$33,518	4.11 %
Non-interest-Earning Assets						
Cash and Cash Equivalents	<b>19,942</b>			14,904		
Allowance for Loan Losses	<b>(8,691)</b>			(9,418)		
Other Assets	<b>54,991</b>			65,681		
Total Noninterest-Earning Assets	<b>66,242</b>			71,167		
Total Assets	<b>\$1,196,997</b>			\$1,157,816		
Liabilities and Stockholders' Equity						
Interest-Bearing Liabilities						
Interest-Bearing Deposits						
Interest-Bearing Demand and Savings	<b>\$515,412</b>	<b>\$1,405</b>	<b>0.36 %</b>	\$463,115	\$1,241	0.36 %
Other Time	<b>357,075</b>	<b>2,154</b>	<b>0.80 %</b>	388,137	2,339	0.80 %
Total Interest-Bearing Deposits	<b>872,487</b>	<b>3,559</b>	<b>0.54 %</b>	851,252	3,580	0.56 %
Other Interest-Bearing Liabilities						
Other Borrowed Money	<b>47,923</b>	<b>887</b>	<b>2.47 %</b>	41,285	829	2.68 %
Subordinated Debentures	<b>24,229</b>	<b>667</b>	<b>3.67 %</b>	24,229	440	2.42 %
Federal Funds Purchased	<b>233</b>	<b>3</b>	<b>1.72 %</b>	-	-	- %
Total Other Interest-Bearing Liabilities	<b>72,385</b>	<b>1,557</b>	<b>2.87 %</b>	65,514	1,269	2.58 %
Total Interest-Bearing Liabilities	<b>\$944,872</b>	<b>\$5,116</b>	<b>0.72 %</b>	\$916,766	\$4,849	0.71 %
Noninterest-Bearing Liabilities and						
Stockholders' Equity						
Demand Deposits	<b>154,723</b>			137,230		
Other Liabilities	<b>6,640</b>			3,389		
Stockholders' Equity	<b>90,762</b>			100,431		
Total Noninterest-Bearing Liabilities and	<b>252,125</b>			241,050		
Stockholders' Equity						
Total Liabilities and Stockholders' Equity	<b>\$1,196,997</b>			\$1,157,816		

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Interest Rate Spread		3.33 %		3.40 %
Net Interest Income	\$29,239		\$28,669	
Net Interest Margin		3.45 %		3.52 %

The average balance of loans includes the average balance of nonaccrual loans. Income on such loans is recognized (1) and recorded on the cash basis. Taxable equivalent adjustments totaling \$97 and \$107 for nine month periods ended September 30, 2017 and 2016, respectively, are included in tax-exempt interest on loans.

Taxable-equivalent adjustments totaling \$21 and \$25 for nine month periods ended September 30, 2017 and 2016, (2) respectively, are included in tax-exempt interest on investment securities. The adjustments are based on a federal tax rate of 34 percent with appropriate reductions for the effect of disallowed interest expense incurred in carrying tax-exempt obligations.

**PART I (Continued)**

## Item 2 (continued)

**Provision for Loan Losses**

The provision for loan losses is determined by management as the amount to be added to the allowance for loan losses after net charge-offs have been deducted to bring the allowance to a level which, in management's best estimate, is necessary to absorb probable losses within the existing loan portfolio. The provision for loan losses totaled \$335 thousand in the nine months ended September 30, 2017 compared to \$1.06 million in the same period a year ago. See the section captioned "Allowance for Loan Losses" elsewhere in this discussion for further analysis of the provision for loan losses.

**Noninterest Income**

The components of noninterest income were as follows:

	Three Months Ended September 30				Nine Months Ended September 30			
	2017	2016	\$ Variance	% Variance	2017	2016	\$ Variance	% Variance
Service Charges on Deposit Accounts	\$1,169	\$1,128	\$ 41	3.63 %	\$3,315	\$3,185	\$ 130	4.08 %
Other Charges, Commissions and Fees	741	686	55	8.02	2,300	2,104	196	9.32
Mortgage Fee Income	241	254	(13 )	(5.12 )	629	507	122	24.06
Securities Gains (Losses)	-	256	(256 )	(100.00 )	-	385	(385 )	(100.00 )
Other	273	313	(40 )	(12.78 )	974	980	(6 )	(0.61 )
Total	\$2,424	\$2,637	\$ (213 )	(8.08 )%	\$7,218	\$7,161	\$ 57	0.80 %

*Other Charges, Commissions and Fees.* Debit card interchange fees and foreign fees increased \$171 thousand in 2017 compared to the same period in 2016. The Company also received a refund on credit life insurance in 2017 of \$27 thousand.

*Mortgage Fee Income.* The volume of mortgage loans has shown an increase in 2017 compared to the same period in 2016 which contributed to the increase in mortgage fee income.

*Securities Gains (Losses).* The Bank did not sale any securities in 2017; therefore the decrease is attributable to the gain on sale of securities in the prior year.

### Noninterest Expense

	Three Months Ended September 30				Nine Months Ended September 30			
	2017	2016	\$ Variance	% Variance	2017	2016	\$ Variance	% Variance
Salaries and Employee Benefits	\$4,802	\$4,726	\$ 76	1.61 %	\$14,467	\$13,825	\$ 642	4.64 %
Occupancy and Equipment	1,014	1,025	(11 )	(1.07 )	2,965	2,967	(2 )	(0.07 )
Other	2,564	2,903	(339 )	(11.68 )	7,976	8,451	(475 )	(5.62 )
Total	\$8,380	\$8,654	\$ (274 )	(3.17 )%	\$25,408	\$25,243	\$ 165	0.65 %

The components of noninterest expense were as follows:

*Salaries and Employee Benefits.* The increase in 2017 is primarily attributable to merit pay increases.

*Occupancy and Equipment.* The change in 2017 is relatively flat for occupancy and equipment.

*Other.* The decrease in 2017 as compared to 2016 is primarily attributable to the decrease in FDIC assessments by \$336 thousand in 2017, a decrease in advertising by \$206 thousand in 2017, and a decrease in foreclosed property by \$129 thousand in 2017. The decrease was offset by \$248 thousand increase in ATM expense, \$85 thousand increase in software expense and \$117 thousand increase in legal & professional fees.

**PART I (Continued)**

Item 2 (continued)

**Loans**

The following table presents the composition of the Company's loan portfolio as of September 30, 2017 and December 31, 2016:

	<b>September 30, 2017</b>	December 31, 2016	<b>\$ Variance</b>	<b>% Variance</b>
<b>Commercial and Agricultural</b>				
Commercial	<b>\$ 45,363</b>	\$47,025	<b>\$ (1,662 )</b>	<b>(3.53 )%</b>
Agricultural	<b>25,246</b>	17,080	<b>8,166</b>	<b>47.81</b>
<b>Real Estate</b>				
Commercial Construction	<b>36,533</b>	30,358	<b>6,175</b>	<b>20.34</b>
Residential Construction	<b>8,905</b>	11,830	<b>(2,925 )</b>	<b>(24.73 )</b>
Commercial	<b>346,251</b>	349,090	<b>(2,839 )</b>	<b>(0.81 )</b>
Residential	<b>196,332</b>	195,580	<b>752</b>	<b>0.38</b>
Farmland	<b>71,903</b>	66,877	<b>5,026</b>	<b>7.52</b>
<b>Consumer and Other</b>				
Consumer	<b>18,677</b>	19,695	<b>(1,018 )</b>	<b>(5.17 )</b>
Other	<b>20,836</b>	16,748	<b>4,088</b>	<b>24.41</b>
<b>Gross Loans</b>	<b>770,046</b>	754,283	<b>15,763</b>	<b>2.09</b>
Unearned Interest and Fees	<b>(430 )</b>	(361 )	<b>(69 )</b>	<b>(19.11 )</b>
Allowance for Loan Losses	<b>(7,977 )</b>	(8,923 )	<b>946</b>	<b>10.60</b>
<b>Net Loans</b>	<b>\$ 761,639</b>	\$ 744,999	<b>\$ 16,640</b>	<b>2.23 %</b>

*Loan Origination/Risk Management.* In accordance with the Company's decentralized banking model, loan decisions are made at the Bank level. The Company utilizes both an Executive Loan Committee and a Director Loan Committee to assist lenders with the decision making and underwriting process of larger loan requests. Due to the diverse economic markets served by the Company, evaluation and underwriting criteria may vary slightly by market. Overall, loans are extended after a review of the borrower's repayment ability, collateral adequacy, and overall credit worthiness.

Commercial purpose, commercial real estate, and agricultural loans are underwritten similarly to how other loans are underwritten throughout the Company. The properties securing the Company's commercial real estate portfolio are diverse in terms of type and geographic location. In addition, the Company restricts total loans to \$10 million per

borrower, subject to exception and approval by the Director Loan Committee. This diversity helps reduce the Company's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans monthly based on collateral, geography, and risk grade criteria. The Company also utilizes information provided by third-party agencies to provide additional insight and guidance about economic conditions and trends affecting the markets it serves.

The Company extends loans to builders and developers that are secured by non-owner occupied properties. In such cases, the Company reviews the overall economic conditions and trends for each market to determine the desirability of loans to be extended for residential construction and development. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim mini-perm loan commitment from the Company until permanent financing is obtained. In some cases, loans are extended for residential loan construction for speculative purposes and are based on the perceived present and future demand for housing in a particular market served by the Company. These loans are monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, general economic conditions and trends, the demand for the properties, and the availability of long-term financing.

The Company originates consumer loans at the Bank level. Due to the diverse economic markets served by the Company, underwriting criteria may vary slightly by market. The Company is committed to serving the borrowing needs of all markets served and, in some cases, adjusts certain evaluation methods to meet the overall credit demographics of each market. Consumer loans represent relatively small loan amounts that are spread across many individual borrowers to help minimize risk. Additionally, consumer trends and outlook reports are reviewed by management on a regular basis.

The Company utilizes an independent third party company for loan review and validation of the credit risk program on an ongoing quarterly basis. Results of these reviews are presented to management and the audit committee. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

**PART I (Continued)**

Item 2 (continued)

*Commercial and Agricultural.* Commercial and agricultural loans at September 30, 2017 increased 10.15 percent to \$70.61 million from December 31, 2016 at \$64.1 million. The Company's commercial and agricultural loans are a diverse group of loans to small, medium and large businesses. The purpose of these loans varies from supporting seasonal working capital needs to term financing of equipment. While some short-term loans may be made on an unsecured basis, most are secured by the assets being financed with collateral margins that are consistent with the Company's loan policy guidelines.

*Real Estate.* Commercial and residential construction loans increased by \$3.25 million, or 7.70 percent, at September 30, 2017 to \$45.44 million from \$42.2 million at December 31, 2016. Commercial real estate decreased \$2.84 million, or 0.81 percent, at September 30, 2017 to \$346.25 million from \$349.09 million at December 31, 2016.

*Other.* Other loans at September 30, 2017 increased 24.41 percent to \$20.84 million from \$16.75 million at December 31, 2016.

*Collateral Concentrations.* Concentrations of credit risk can exist in relation to individual borrowers or groups of borrowers, certain types of collateral, certain types of industries, or certain geographic regions. The Company has a concentration in real estate loans as well as a geographic concentration that could pose an adverse credit risk, particularly with the current economic downturn in the real estate market. At September 30, 2017, approximately 86 percent of the Company's loan portfolio was concentrated in loans secured by real estate. A substantial portion of borrowers' ability to honor their contractual obligations is dependent upon the viability of the real estate economic sector. In addition, a large portion of the Company's foreclosed assets are also located in these same geographic markets, making the recovery of the carrying amount of foreclosed assets susceptible to changes in market conditions. Management continues to monitor these concentrations and has considered these concentrations in its allowance for loan loss analysis. Though the real estate market remains somewhat sluggish, we have seen real estate values stabilize. The stabilization of rates has resulted in a decrease in the number of loans being classified as impaired over the past several years.



**PART I (Continued)**

Item 2 (continued)

**Nonperforming Assets and Potential Problem Loans**

Nonperforming assets and accruing past due loans as of September 30, 2017, December 31, 2016 and September 30, 2016 were as follows:

	<b>September 30, 2017</b>	December 31, 2016	September 30, 2016		
Loans Accounted for on Nonaccrual	<b>\$ 8,807</b>	\$ 12,350	\$ 13,986		
Loans Accruing Past Due 90 Days or More	-	-	1		
Other Real Estate Foreclosed	<b>4,520</b>	6,439	9,812		
Total Nonperforming Assets	<b>\$ 13,327</b>	\$ 18,789	\$ 23,799		
Nonperforming Assets by Segment					
Construction and Land Development	<b>\$ 2,907</b>	\$ 3,376	\$ 4,352		
1-4 Family Residential	<b>3,542</b>	4,375	4,442		
Nonfarm Residential	<b>4,885</b>	9,182	12,917		
Farmland	<b>839</b>	800	919		
Commercial and Consumer	<b>1,154</b>	1,056	1,169		
Total Nonperforming Assets	<b>\$ 13,327</b>	\$ 18,789	\$ 23,799		
Nonperforming Assets as a Percentage of:					
Total Loans and Foreclosed Assets	<b>1.72</b>	%	2.47	%	3.03
Total Assets	<b>1.11</b>	%	1.55	%	2.06
Nonperforming Loans as a Percentage of:					
Total Loans	<b>1.14</b>	%	1.64	%	1.80
Supplemental Data:					
Trouble Debt Restructured Loans In Compliance with Modified Terms	<b>\$ 16,952</b>	\$ 17,992	\$ 19,269		
Trouble Debt Restructured Loans Past Due 30-89 Days	<b>132</b>	319	324		
Accruing Past Due Loans:					
30-89 Days Past Due	<b>\$ 5,250</b>	\$ 4,469	\$ 4,175		
90 or More Days Past Due	-	-	1		
Total Accruing Past Due Loans	<b>\$ 5,250</b>	\$ 4,469	\$ 4,176		
Allowance for Loan Losses	<b>\$ 7,977</b>	\$ 8,923	\$ 9,203		
ALLL as a Percentage of:					
Total Loans	<b>1.04</b>	%	1.18	%	1.19

Nonperforming Loans	<b>90.58</b>	%	72.25	%	65.80	%
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Nonperforming assets include nonaccrual loans, loans past due 90 days or more and foreclosed real estate. Nonperforming assets at September 30, 2017 decreased 29.07 percent from December 31, 2016.

Generally, loans are placed on non-accrual status if principal or interest payments become 90 days past due and/or management deems the collectability of the principal and/or interest to be in question, as well as when required by regulatory requirements. Loans to a customer whose financial condition has deteriorated are considered for non-accrual status whether or not the loan is 90 days or more past due. For consumer loans, collectability and loss are generally determined before the loan reaches 90 days past due. Accordingly, losses on consumer loans are recorded at the time they are determined. Consumer loans that are 90 days or more past due are generally either in liquidation/payment status or bankruptcy awaiting confirmation of a plan. Once interest accruals are discontinued, accrued but uncollected interest is charged to current year operations. Subsequent receipts on nonaccrual loans are recorded as a reduction of principal, and interest income is recorded only after principal recovery is reasonably assured. Classification of a loan as nonaccrual does not preclude the ultimate collection of loan principal or interest.

Troubled debt restructured loans are loans on which, due to deterioration in the borrower's financial condition, the original terms have been modified in favor of the borrower or either principal or interest has been forgiven.

## **PART I (Continued)**

### Item 2 (continued)

Foreclosed assets represent property acquired as the result of borrower defaults on loans. Foreclosed assets are recorded at estimated fair value less estimated selling costs, at the time of foreclosure. Write-downs occurring at foreclosure are charged against the allowance for loan losses. On an ongoing basis, properties are appraised as required by market indications and applicable regulations. Write-downs are provided for subsequent declines in value and are included in other non-interest expense along with other expenses related to maintaining the properties.

### **Allowance for Loan Losses**

The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The allowance for loan losses includes allowance allocations calculated in accordance with current U.S. accounting standards. The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Company's allowance for loan losses consists of specific valuation allowances established for probable losses on specific loans and historical valuation allowances for other loans with similar risk characteristics. The allowances established for probable losses on specific loans are the result of management's quarterly review of substandard loans with an outstanding balance of \$250,000 or more. This review process usually involves regional credit officers along with local lending officers reviewing the loans for impairment. Specific valuation allowances are determined after considering the borrower's financial condition, collateral deficiencies, and economic conditions affecting the borrower's industry, among other things. In the case of collateral dependent loans, collateral shortfall is most often based upon local market real estate value estimates. This review process is performed at the subsidiary bank level and is reviewed at the parent Company level.

Once the loan becomes impaired, it is removed from the pool of loans covered by the general reserve and reviewed individually for exposure as described above. In cases where the individual review reveals no exposure, no reserve is recorded for that loan, either through an individual reserve or through a general reserve. If, however, the individual

review of the loan does indicate some exposure, management often charges off this exposure, rather than recording a specific reserve. In these instances, a loan which becomes nonperforming could actually reduce the allowance for loan losses. Those loans deemed uncollectible are transferred to our problem loan department for workout, foreclosure and/or liquidation. The problem loan department obtains a current appraisal on the property in order to record the fair market value (less selling expenses) when the property is foreclosed on and moved into other real estate.

The allowances established for the remainder of the loan portfolio are based on historical loss factors, adjusted for certain qualitative factors, which are applied to groups of loans with similar risk characteristics. Loans are segregated into fifteen separate groups based on call codes. Most of the Company's charge-offs during the past two years have been real estate dependent loans. The historical loss ratios applied to these groups of loans are updated quarterly based on actual charge-off experience. The historical loss ratios are further adjusted by qualitative factors.

Management evaluates the adequacy of the allowance for each of these components on a quarterly basis. Peer comparisons, industry comparisons, and regulatory guidelines are also used in the determination of the general valuation allowance. Loans identified as losses by management, internal loan review, and/or bank examiners are charged off. Additional information about the Company's allowance for loan losses is provided in the Notes to the Consolidated Financial Statements for Allowance for Loan Losses.

**PART I (Continued)**

Item 2 (continued)

**Deposits**

The following table presents the average amount outstanding and the average rate paid on deposits by the Company for the nine month periods ended September 30, 2017 and September 30, 2016.

	<b>September 30, 2017</b>		September 30, 2016		
	<b>Average Amount</b>	<b>Average Rate (1)</b>	Average Amount	Average Rate (1)	
Noninterest-Bearing Demand Deposits	<b>\$154,723</b>		\$137,230		
Interest-Bearing Demand and Savings Deposits	<b>515,412</b>	<b>0.36 %</b>	463,115	0.36 %	
Time Deposits	<b>357,075</b>	<b>0.80 %</b>	388,137	0.80 %	
<b>Total Deposits</b>	<b>\$1,027,210</b>	<b>0.46 %</b>	\$988,482	0.48 %	

(1) Average rate is an annualized rate.

Average deposits increased \$38.73 million to \$1.03 billion at September 30, 2017 from \$988.48 million at September 30, 2016. The increase included an increase of \$17.49 million, or 12.75 percent in noninterest-bearing demand deposits while, at the same time, interest-bearing demand and savings deposits increased \$52.30 million, or 11.29 percent and time deposits decreased \$31.06 million, or 8.00 percent. Accordingly the ratio of average noninterest-bearing deposits to total average deposits was 15.06 percent for nine months ended September 30, 2017 compared to 13.88 percent for nine months ended September 30, 2016. This deposit mix had the effect of decreasing the average cost of total deposits by 2 basis points in nine months ended September 30, 2017 compared to the same period a year ago.

**Off-Balance-Sheet Arrangements, Commitments, Guarantees**

In the ordinary course of business, the Company enters into off-balance sheet financial instruments which are not reflected in the consolidated financial statements. These instruments include commitments to extend credit, standby letters of credit, performance letters of credit, guarantees and liability for assets held in trust. Such financial instruments are recorded in the financial statements when funds are disbursed or the instruments become payable and the contract or notional amounts of these instruments reflect the extent of involvement and exposure to credit loss that

we have in these particular classes of financial instruments.

Commitments to extend credit are agreements to lend to a customer provided that the terms established in the contract are met. Commitments generally have fixed expiration dates and may require the payment of fees. Since some commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan commitments to customers and similarly do not necessarily represent future cash obligations.

As of September 30, 2017 and December 31, 2016, financial instruments with off-balance sheet risk were as follows:

	<b>Contract Amount</b>	
	<b>September</b>	December
	<b>30,</b>	31, 2016
	<b>2017</b>	
Loan Commitments	<b>\$91,744</b>	\$ 71,359
Letters of Credit	<b>1,566</b>	1,551

The Company uses the same credit policies for these off-balance sheet financial instruments as they do for instruments that are recorded in the consolidated financial statements. We evaluate each customer's creditworthiness at a local bank level on a case-by-case basis. The amount of collateral obtained, if deemed necessary, upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies but may include cash or cash equivalents, negotiable instruments, real estate, accounts receivable, inventory, oil, gas and mineral interests, property, plant, and equipment.

**PART I (Continued)**

Item 2 (continued)

*Loan Commitments.* The Company enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the Company's commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. The Company minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for loan losses. Loan commitments outstanding at September 30, 2017 are included in the table in Footnote 10 of the Consolidated Financial Statements.

**Capital and Liquidity**

At September 30, 2017, stockholders' equity totaled \$91.60 million compared to \$93.39 million at December 31, 2016. In addition to net income of \$7.17 million, other significant changes in stockholders' equity during nine months ended September 30, 2017 included \$211 thousand of preferred stock dividends paid and \$9.36 million redemption of preferred stock. The Company also had \$633 thousand of common stock dividends paid during the nine months ended September 30, 2017. The accumulated other comprehensive income (loss) component of stockholders' equity totaled \$(3.78) thousand at September 30, 2017 compared to \$(5.02) million at December 31, 2016. This fluctuation was mostly related to the after-tax effect of changes in the fair value of securities available for sale. Regulatory agencies for banks and bank holding companies utilize capital guidelines designed to measure Tier 1 and total capital and take into consideration the risk inherent in both on-balance sheet and off-balance sheet items.

Tier 1 capital consists of common stock and qualifying preferred stockholders' equity and trust preferred securities less goodwill. Tier 2 capital consists of tier 1 capital and the allowance for loan losses up to 1.25 percent of risk-weighted assets. The Company has no Tier 2 capital other than the allowance for loan losses.

Using the capital requirements presently in effect, the Tier 1 ratio as of September 30, 2017 was 14.76 percent and total Tier 1 and 2 risk-based capital was 15.75 percent. Both of these measures compare favorably with the regulatory minimum to be adequately capitalized of 6 percent for Tier 1 and 8 percent for total risk-based capital. The Company's common equity Tier 1 ratio as of September 30, 2017 was 11.84, which exceeds the regulatory minimum of 4.50 percent. The Company's Tier 1 leverage ratio as of September 30, 2017 was 9.91 percent, which exceeds the required ratio standard of 4 percent.

As of September 30, 2017, average capital was \$90.76 million, representing 7.58 percent of average assets for the year. This compares to 8.67 percent for September 2016.

After suspending common stock dividend payments beginning in the third quarter of 2009 for capital retention purposes, the Company reinstated common stock dividends in the first quarter of 2017. The Company paid \$0.025 per share of common stock in each of the first three quarters of 2017.

The Company declared dividends of \$211 thousand and \$1.19 million on preferred stock on September 30, 2017 and 2016, respectively. Additional information is provided in the Notes to the Consolidated Financial Statements for Preferred Stock and Warrants.

The Company, primarily through the actions of the Bank, engages in liquidity management to ensure adequate cash flow for deposit withdrawals, credit commitments and repayments of borrowed funds. Needs are met through loan repayments, net interest and fee income and the sale or maturity of existing assets. In addition, liquidity is continuously provided through the acquisition of new deposits, the renewal of maturing deposits and external borrowings.

Management monitors deposit flow and evaluates alternate pricing structures to retain and grow deposits. To the extent needed to fund loan demand, traditional local deposit funding sources are supplemented by the use of FHLB borrowings, brokered deposits and other wholesale deposit sources outside the immediate market area. Internal policies have been updated to monitor the use of various core and non-core funding sources, and to balance ready access with risk and cost. Through various asset/liability management strategies, a balance is maintained among goals of liquidity, safety and earnings potential. Internal policies that are consistent with regulatory liquidity guidelines are monitored and enforced by the Bank.

The investment portfolio provides a ready means to raise cash if liquidity needs arise. As of September 30, 2017, the available for sale bond portfolio totaled \$338.2 million. At December 31, 2016, the available for sale bond portfolio totaled \$323.7 million. Only marketable investment grade bonds are purchased. Although a good portion of the banks' bond portfolios are encumbered as pledges to secure various public funds deposits, repurchase agreements, and for other purposes, management can restructure and free up investment securities for a sale if required to meet liquidity needs.



**PART I (Continued)**

Item 2 (continued)

Management continually monitors the relationship of loans to deposits as it primarily determines the Company's liquidity posture. The Company had ratios of loans to deposits of 75.5 percent as of September 30, 2017 and 72.2 percent at December 31, 2016. Management employs alternative funding sources when deposit balances will not meet loan demands. The ratios of loans to all funding sources (excluding Subordinated Debentures) at September 30, 2017 and December 31, 2016 were 71.5 percent and 69.2 percent, respectively.

Management continues to emphasize programs to generate local core deposits as our Company's primary funding sources. The stability of the banks' core deposit base is an important factor in Colony's liquidity position. A heavy percentage of the deposit base is comprised of accounts of individuals and small businesses with comprehensive banking relationships and limited volatility. At September 30, 2017 and December 31, 2016, the Company had \$34.2 million and \$32.2 million in certificates of deposit of \$250 or more. These larger deposits represented 3.4 percent and 3.1 percent of respective total deposits. Management seeks to monitor and control the use of these larger certificates, which tend to be more volatile in nature, to ensure an adequate supply of funds as needed. Relative interest costs to attract local core relationships are compared to market rates of interest on various external deposit sources to help minimize the Company's overall cost of funds.

The Company supplemented deposit sources with brokered deposits. As of September 30, 2017, the Company had \$49.6 million, or 4.86 percent of total deposits, in CDARS. Additional information is provided in the Notes to the Consolidated Financial Statements regarding these brokered deposits. Additionally, the Company uses external deposit listing services to obtain out-of-market certificates of deposit at competitive interest rates when funding is needed. These deposits obtained from listing services are often referred to as wholesale or internet CDs. As of September 30, 2017, the Company had \$13.65 million, or 1.34 percent of total deposits, in internet certificates of deposit obtained through deposit listing services.

To plan for contingent sources of funding not satisfied by both local and out-of-market deposit balances, the Company and the Bank have established multiple borrowing sources to augment their funds management. The Company has borrowing capacity through membership in the Federal Home Loan Bank program. The Bank has also established overnight borrowing for Federal Funds purchased through various correspondent banks. Management believes the various funding sources discussed above are adequate to meet the Company's liquidity needs in the future without any material adverse impact on operating results.

Liquidity measures the ability to meet current and future cash flow needs as they become due. The liquidity of a financial institution reflects its ability to meet loan requests, to accommodate possible outflows in deposits and to take advantage of interest rate market opportunities. The ability of a financial institution to meet its current financial

obligations is a function of balance sheet structure, the ability to liquidate assets, and the availability of alternative sources of funds. The Company seeks to ensure its funding needs are met by maintaining a level of liquid funds through asset/liability management.

Asset liquidity is provided by liquid assets which are readily marketable or pledgeable or which will mature in the near future. Liquid assets include cash, interest-bearing deposits in banks, securities available for sale, federal funds sold and securities purchased under resale agreements.

Liability liquidity is provided by access to funding sources which include core deposits. Should the need arise, the Company also maintains relationships with the Federal Home Loan Bank, Federal Reserve Bank and three correspondent banks.

Since the Company is a bank holding company and does not conduct operations, its primary sources of liquidity are dividends up streamed from the Bank and borrowings from outside sources.

The liquidity position of the Company is continuously monitored and adjustments are made to the balance between sources and uses of funds as deemed appropriate. Management is not aware of any events that are reasonably likely to have a material adverse effect on the Company's liquidity, capital resources or operations. In addition, management is not aware of any regulatory recommendations regarding liquidity, which if implemented, would have a material adverse effect on the Company.

**PART I (Continued)**

Item 2 (continued)

**Return on Assets and Stockholders' Equity**

The following table presents selected financial ratios for each of the periods indicated.

	<b>Three Months Ended September 30 2017</b>		<b>Nine Months Ended September 30 2016</b>	
Return on Average Assets (1)	<b>0.88 %</b>	0.65 %	<b>0.78 %</b>	0.61 %
Return on Average Total Equity (1)	<b>11.57 %</b>	7.35 %	<b>10.23 %</b>	7.03 %
Average Total Equity to Average Assets	<b>7.58 %</b>	8.89 %	<b>7.58 %</b>	8.67 %

(1) Computed using annualized net income available to common shareholders.

**PART I (Continued)**

Item 3

**ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Interest rate risk is the change in value due to changes in interest rates. The Company is exposed only to U. S. dollar interest rate changes and, accordingly, the Company manages exposure by considering the possible changes in the net interest margin. In order to reduce the exposure to interest rate fluctuations, we have implemented strategies to more closely match our balance sheet composition. There have been no material changes in market risk from the information provided in the Company’s annual report on Form 10-K for the year ended December 31, 2016.

**ITEM 4 – CONTROLS AND PROCEDURES**

The Company’s Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of the Company’s “disclosure controls and procedures,” as such term is defined in Rule 13a-15(e) or 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Based upon their evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, the Company’s disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (the “SEC”) (1) is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and (2) is accumulated and communicated to the Company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. In addition, no change in the Company’s internal control over financial reporting occurred during the quarter ended September 30, 2017 that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

**PART II**

Item 6

ITEM 6 – EXHIBITS

**3.1 Articles of Incorporation, As Amended** -filed as Exhibit 99.1 to the Registrant’s 10-Q for the period ended June 30, 2014 (File No. 0-12436), filed with the Commission on August 4, 2014 and incorporated herein by reference.

**3.2 Bylaws, as Amended** -filed as Exhibit 3(b) to the Registrant’s Registration Statement on Form 10 (File No. 0-18486), filed with the Commission on April 25, 1990 and incorporated herein by reference.

**3.3 Article of Amendment to the Company’s Articles of Incorporation Authorizing Additional Capital Stock in the Form of Ten Million Shares of Preferred Stock** -filed as Exhibit 3.1 to the Registrant’s Current Report on Form 8-K (File No. 000-12436) filed with the Commission on January 13, 2009 and incorporated herein by reference.

**3.4 Articles of Amendment to the Company’s Articles of Incorporation Establishing the Terms of the Series A Preferred Stock** -filed as Exhibit 3.2 to the Registrant’s Current Report on Form 8-K (File No. 000-12436) filed with the Commission on January 13, 2009 and incorporated herein by reference.

**3.5 Amendment to the Company’s Bylaws** -filed as Exhibit 99.1 to the Registrant’s 8-K (File No.000-12436) , filed with the Commission on May 29, 2015 and incorporated herein by reference.

**4.1 Warrant to Purchase up to 500,000 shares of Common Stock** -filed as Exhibit 4.1 to the Registrant’s Current Report on Form 8-K (File No. 000-12436), filed with the Commission on January 13, 2009 and incorporated herein by reference.

**4.2 Form of Series A Preferred Stock Certificate** -filed as Exhibit 4.2 to the Registrant’s Current Report on Form 8-K (File No. 000-12436), filed with the Commission on January 13, 2009 and incorporated herein by reference.

**10.1 Deferred Compensation Plan and Sample Director Agreement** -filed as Exhibit 10(a) to the Registrant's Registration Statement on Form 10 (File No. 0-18486), filed with the Commission on April 25, 1990 and incorporated herein by reference.

**10.2 Profit-Sharing Plan Dated January 1, 1979** -filed as Exhibit 10(b) to the Registrant's Registration Statement on Form 10 (File No. 0-18486), filed with the Commission on April 25, 1990 and incorporated herein by reference.

**PART II (continued)**

Item 6 (continued)

**10.3 1999 Restricted Stock Grant Plan and Restricted Stock Grant Agreement** - filed as Exhibit 10(c) the Registrant's Annual Report on Form 10-K (File No. 000-12436), filed with the Commission on March 30, 2001 and incorporated herein by reference.

**10.4 2004 Restricted Stock Grant Plan and Restricted Stock Grant Agreement** - filed as Exhibit C to the Registrant's Definitive Proxy Statement for Annual Meeting of Shareholders held on April 27, 2004, filed with the Securities and Exchange Commission on March 3, 2004 (File No. 000-12436) and incorporated herein by reference.

**10.5 Lease Agreement – Mobile Home Tracts, LLC c/o Stafford Properties, Inc. and Colony Bank Worth** - filed as Exhibit 10.5 to the Registrant's Quarterly Report on Form 10Q (File No. 000-12436), filed with Securities and Exchange Commission on November 5, 2004 and incorporated herein by reference.

**10.6 Letter Agreement, Dated January 9, 2009, Including Securities Purchase Agreement – Standard Terms Incorporated by Reference Therein, Between the Company and the United States Department of the Treasury** - filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 000-12436), filed with the Commission on January 13, 2009 and incorporated herein by reference.

**10.7 Form of Waiver, Executed by Al D. Ross** - filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K (File No. 000-12436), filed with the Commission on January 13, 2009 and incorporated herein by reference.

**10.8 Form of Waiver, Executed by Terry L. Hester** - filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K (File No. 000-12436), filed with the Commission on January 13, 2009 and incorporated herein by reference.

**10.9 Form of Waiver, Executed by Henry F. Brown, Jr.** - filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K (File No. 000-12436), filed with the Commission on January 13, 2009 and incorporated herein by reference.

**10.10 Form of Waiver, Executed by Walter F. Patten** - filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K (File No. 000-12436), filed with the Commission on January 13, 2009 and incorporated herein by reference.

**10.11 Form of Waiver, Executed by Larry E. Stevenson - filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K (File No. 000-12436), filed with the Commission on January 13, 2009 and incorporated herein by reference.**

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**PART II (continued)**

Item 6 (continued)

**10.12 Employment Agreement, Dated April 27, 2012 Between Edward P. Loomis, Jr. and Colony Bankcorp, Inc.** -filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 000-12436), filed with the Commission on May 3, 2012 and incorporated herein by reference.

**99.1 Retention Agreement** -filed as Exhibit 99.1 to the Registrant's 10-Q for the period ended March 31, 2015 (File No. 000-12436), filed with the Commission on May 4, 2015 and incorporated herein by reference.

**99.2 Retention Agreement** -filed as Exhibit 99.2 to the Registrant's 10-Q for the period ended June 30, 2016 (File No. 000-12436), filed with the Commission on August 2, 2016 and incorporated herein by reference.

**31.1 Certificate of Chief Executive Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002**

**31.2 Certificate of Chief Financial Officer Pursuant to Section 302 of Sarbanes – Oxley Act of 2002**

**32.1 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

**101.INS XBRL Instance Document**

**101.SCH XBRL Schema Document**

**101.CAL XBRL Calculation Linkbase Document**

**101.DEF XBRL Definition Linkbase Document**

**101.LAB XBRL Label Linkbase Document**

**101.PRE XBRL Presentation Linkbase Document**

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**SIGNATURES**

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

Colony Bankcorp, Inc.

Date: October 31, 2017

/s/ Edward P. Loomis, Jr.  
Edward P. Loomis, Jr.  
President/Director/Chief Executive  
Officer

Date: October 31, 2017

/s/ Terry L. Hester  
Terry L. Hester  
Executive Vice-President/Director/Chief  
Financial Officer