HASBRO INC
Form 4
July 03, 2007

FORM 4

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

OMB APPROVAL

OMB Number:	3235-0287
Expires:	January 31, 2005
Estimated average burden hours per response...	0.5

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
PHILIP EDWARD M

(Last) (First) (Middle)

C/O HASBRO, INC., 1011 NEWPORT AVENUE

(Street)

PAWTUCKET, RI 02862

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
HASBRO INC [HAS]

3. Date of Earliest Transaction (Month/Day/Year)
06/29/2007

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director _____ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security	2. Conversion or Exercise	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any	4. Transaction Code	5. Number of Derivative	6. Date Exercisable and Expiration Date (Month/Day/Year)	7. Title and Amount of Underlying Securities (Instr. 3 and 4)	8. Price of Derivative Security

(Instr. 3)	Price of Derivative Security	(Month/Day/Year)		(Instr. 8)		Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)						(Instr. 5)
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares	
Phantom Stock Units (1)	$ 0 (2)	06/29/2007		A		780		(3)(4)	(3)(4)	Common Stock	780	$ 31.4

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
PHILIP EDWARD M C/O HASBRO, INC. 1011 NEWPORT AVENUE PAWTUCKET, RI 02862	X			

Signatures

Tarrant Sibley, p/o/a for Edward M. Philip	07/03/2007
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) All of the phantom stock units were acquired pursuant to the Hasbro, Inc. Deferred Compensation Plan for Non-Employee Directors in accordance with Section 16b-3.

(2) Units correspond 1-for-1 with common stock.

(3) Units are settled only in cash and are payable after the reporting person ceases to be a director.

(4) Vesting of 16 units will occur on the earlier of 12/31/07 (provided the reporting person is still a director as of such date) and the death, disability or retirement (after age 72) of the reporting person. Vesting of 16 units will occur on the earlier of 12/31/08 (provided the reporting person is still a director as of such date) and the death, disability or retirement (after age 72) of the reporting person. The remainder of the units are immediately vested.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. New Roman", Times, serif; font-size: 10pt; padding-bottom: 3px; margin-left: 0pt;">

Income per common share:

Basic

$*0.12* $*0.13*

Diluted

$*0.12* $*0.13*

For the *three* months ended *March 31, 2018* and *2017,* common stock equivalents reflected in the table above were related entirely to the incremental shares of unvested restricted stock. Stock options of *19,200* and *37,700* for the *three* months ended *March 31, 2018* and *2017,* respectively, were excluded from common stock equivalents. The exercise prices of stock options exceeded the average market price of FNCB's common shares during the periods presented; therefore, inclusion of these common stock equivalents would be anti-dilutive to the diluted earnings per common share calculation.

Note *13.* Other Comprehensive Income

There were *no* reclassifications out of accumulated other comprehensive income (loss) for the *three* months ended *March 31, 2018.* The following table summarizes the reclassifications out of accumulated other comprehensive income (loss) for the *three* months ended *March 31, 2017,* comprised entirely of unrealized gains and losses on available-for-sale debt securities:

	Three Months Ended March 31, 2017	
(in thousands)	**Amount Reclassifed from Accumulated Other Comprehensive Income (Loss)**	**Affected Line Item in the Consolidated Statements of Income**
Available-for-sale securities:		
Reclassification adjustment for net gains reclassified into net income	$*(278)*	Net gain on sale of securities
Taxes	*95*	Income taxes
Net of tax amount	$*(183)*	

The following table summarizes the changes in accumulated other comprehensive (loss) income, net of tax for the *three* months ended *March 31, 2018* and *2017:*

	Three Months Ended March 31,	
(in thousands)	**2018**	**2017**
Balance, beginning of period	$*(1,745)*	$*(1,560)*
Other comprehensive (loss) income before reclassifications	*(3,932)*	*1,211*
Amounts reclassified from accumulated other comprehensive (loss) income	-	*(183*)
Net other comprehensive (loss) income during the period	*(3,932)*	*1,028*
Reclassification of net loss on equity securities upon adoption of ASU 2016-1	*65*	-
Balance, end of period	$*(5,612)*	$*(532*)

Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A")

This Quarterly Report should be read in conjunction with the more detailed and comprehensive disclosures included in the Annual Report on Form 10-K for the year ended December 31, 2017 for FNCB Bancorp, Inc. and subsidiaries ("FNCB"). In addition, please read this section in conjunction with the consolidated financial statements and notes to consolidated financial statements contained elsewhere herein.

FNCB is in the business of providing customary retail and commercial banking services to individuals, businesses and local governments and municipalities through its wholly-owned subsidiary, FNCB Bank's 18 full-service branch offices within its primary market area, Northeastern Pennsylvania, and a LPO based in Allentown, Lehigh County, Pennsylvania.

FORWARD-LOOKING STATEMENTS

FNCB may from time to time make written or oral "forward-looking statements," including statements contained in our filings with the Securities and Exchange Commission ("SEC"), in reports to shareholders, and in our other communications, which are made in good faith by us pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements include statements with respect to FNCB's beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions, that are subject to significant risks and uncertainties, and are subject to change based on various factors (some of which are beyond our control). The words "may," "could," "should," "would," "believe," "anticipate," "estimate," "expect," "intend," "plan" and similar expressions are intended to identify forward-looking statements. The following factors, among others, could cause FNCB's financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements: the strength of the United States economy in general and the strength of the local economies in our markets; the effects of, and changes in trade, monetary, corporate tax and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System; inflation, interest rate, market and monetary fluctuations; the timely development of and acceptance of new products and services; the ability of FNCB to compete with other institutions for business; the composition and concentrations of FNCB's lending risk and the adequacy of our reserves to manage those risks; the valuation of FNCB's investment securities; the ability of FNCB to pay dividends or repurchase common shares; the ability of FNCB to retain key personnel; the impact of any pending or threatened litigation against FNCB; the marketability of shares of FNCB stock and fluctuations in the value of FNCB's share price; the effectiveness of FNCB's system of internal controls; the ability of FNCB to attract additional capital investment; the impact of changes in financial services' laws and regulations (including laws concerning capital adequacy, taxes, banking, securities and insurance); the impact of technological changes and security risks upon our information technology systems; changes in consumer spending and saving habits; the nature, extent, and timing of governmental actions and reforms, and the success of FNCB at managing the risks involved in the foregoing and other risks and uncertainties, including those detailed in FNCB's filings with the SEC.

31

FNCB cautions that the foregoing list of important factors is not all inclusive. Readers are also cautioned not to place undue reliance on any forward-looking statements, which reflect management's analysis only as of the date of this report, even if subsequently made available by FNCB on its website or otherwise. FNCB does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of FNCB to reflect events or circumstances occurring after the date of this report.

Readers should carefully review the risk factors described in the Annual Report and other documents that FNCB periodically files with the SEC, including its Form 10-K for the year ended December 31, 2017.

CRITICAL ACCOUNTING POLICIES

In preparing the consolidated financial statements, management has made estimates, judgments and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated statements of condition and results of operations for the periods indicated. Actual results could differ significantly from those estimates.

FNCB's accounting policies are fundamental to understanding management's discussion and analysis of its financial condition and results of operations. Management has identified the policies on the determination of the allowance for loan and lease losses ("ALLL"), securities' valuation and impairment evaluation, the valuation of other real estate owned ("OREO") and income taxes to be critical, as management is required to make subjective and/or complex judgments about matters that are inherently uncertain and could be most subject to revision as new information becomes available.

The judgments used by management in applying the critical accounting policies discussed below may be affected by changes and/or deterioration in the economic environment, which may impact future financial results. Specifically, subsequent evaluations of the loan portfolio, in light of the factors then prevailing, may result in significant changes in the ALLL in future periods, and the inability to collect on outstanding loans could result in increased loan losses. In addition, the valuation of certain securities in FNCB's investment portfolio could be negatively impacted by illiquidity or dislocation in marketplaces resulting in significantly depressed market prices thus leading to impairment losses.

Allowance for Loan and Lease Losses

Management evaluates the credit quality of FNCB's loan portfolio on an ongoing basis, and performs a formal review of the adequacy of the ALLL on a quarterly basis. The ALLL is established through a provision for loan losses charged to earnings and is maintained at a level management considers adequate to absorb estimated probable losses inherent in the loan portfolio as of the evaluation date. Loans, or portions of loans, determined by management to be uncollectible are charged off against the ALLL, while recoveries of amounts previously charged off are credited to the ALLL.

Determining the amount of the ALLL is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, qualitative factors, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. Banking regulators, as an integral part of their examination of FNCB, also review the ALLL, and may require, based on their judgments about information available to them at the time of their examination, that certain loan balances be charged off or require that adjustments be made to the ALLL. Additionally, the ALLL is determined, in part, by the composition and size of the loan portfolio.

The ALLL consists of two components, a specific component and a general component. The specific component relates to loans that are classified as impaired. For such loans, an allowance is established when the discounted cash flows, collateral value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers all other loans and is based on historical loss experience adjusted by qualitative factors. The general reserve component of the ALLL is based on pools of unimpaired loans segregated by loan segment and risk rating categories of “Pass”, “Special Mention” or “Substandard and Accruing.” Historical loss factors and various qualitative factors are applied based on the risk profile in each risk rating category to determine the appropriate reserve related to those loans. Substandard loans on nonaccrual status above the $100 thousand loan relationship threshold and all loans considered troubled debt restructurings (“TDRs”) are classified as impaired.

See Note 4, “Loans” of the notes to consolidated financial statements included in Item 1 hereof for additional information about the ALLL.

Securities Valuation and Evaluation for Impairment

Management utilizes various inputs to determine the fair value of its investment portfolio. To the extent they exist, unadjusted quoted market prices in active markets (Level 1) or quoted prices for similar assets or models using inputs that are observable, either directly or indirectly (Level 2) are utilized to determine the fair value of each investment in the portfolio. In the absence of observable inputs or if markets are illiquid, valuation techniques are used to determine fair value of any investments that require inputs that are both unobservable and significant to the fair value measurement (Level 3). For Level 3 inputs, valuation techniques are based on various assumptions, including, but not limited to, cash flows, discount rates, adjustments for nonperformance and liquidity, and liquidation values. A significant degree of judgment is involved in valuing investments using Level 3 inputs. The use of different assumptions could have a positive or negative effect on FNCB’s financial condition or results of operations. See Note 3, “Securities” and Note 11, “Fair Value Measurements” of the notes to consolidated financial statements included in Item 1 hereof for additional information about FNCB’s securities valuation techniques.

On a quarterly basis, management evaluates individual investment securities in an unrealized loss position for other than temporary impairment (“OTTI”). The analysis of OTTI requires the use of various assumptions, including but not limited to, the length of time an investment’s fair value is less than book value, the severity of the investment’s decline, any credit deterioration of the issuer, whether management intends to sell the security, and whether it is more-likely-than-not that FNCB will be required to sell the security prior to recovery of its amortized cost basis. Debt investment securities deemed to have OTTI are written down by the impairment related to the estimated credit loss, and the non-credit related impairment loss is recognized in other comprehensive income. FNCB did not recognize any OTTI charges on investment securities for the three months ended March 31, 2018 and 2017 within the consolidated statements of income.

Refer to Note 3, “Securities,” of the notes to consolidated financial statements included in Item 1 hereof for additional information about valuation of securities.

Other Real Estate Owned

OREO consists of property acquired by foreclosure, abandonment or conveyance of deed in-lieu of foreclosure of a loan, and bank premises that are no longer used for operation or for future expansion. OREO is held for sale and is initially recorded at fair value less costs to sell at the date of acquisition or transfer, which establishes a new cost basis. Upon acquisition of the property through foreclosure or deed-in-lieu of foreclosure, any adjustment to fair value less estimated selling costs is recorded to the ALLL. The determination is made on an individual asset basis. Bank premises no longer used for operations or future expansion are transferred to OREO at fair value less estimated selling costs with any related write-down included in non-interest expense. Subsequent to acquisition, valuations are periodically performed and the assets are carried at the lower of cost or fair value less cost to sell. Fair value is determined through external appraisals, current letters of intent, broker price opinions or executed agreements of sale, unless management determines that conditions exist that warrant an adjustment to the value. Costs relating to the development and improvement of the OREO properties may be capitalized; holding period costs and any subsequent changes to the valuation allowance are charged to expense as incurred.

Income Taxes

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in FNCB's consolidated financial statements or tax returns. Fluctuations in the actual outcome of these future tax consequences could impact our consolidated financial condition or results of operations.

FNCB records an income tax provision or benefit based on the amount of tax currently payable or receivable and the change in deferred tax assets and liabilities. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial and tax reporting purposes. Management conducts quarterly assessments of all available positive and negative evidence to determine the amount of deferred tax assets that will more likely than not be realized. FNCB establishes a valuation allowance for deferred tax assets and records a charge to income if management determines, based on available evidence at the time the determination is made, that it is more likely than not that some portion or all of the deferred tax assets will not be realized. In evaluating the need for a valuation allowance, management considers past operating results, estimates of future taxable income based on approved business plans, future capital requirements and ongoing tax planning strategies. This evaluation process involves significant management judgment about assumptions that are subject to change from period to period depending on the related circumstances. The recognition of deferred tax assets requires management to make significant assumptions and judgments about future earnings, the periods in which items will impact taxable income, future corporate tax rates, and the application of inherently complex tax laws. The use of different estimates can result in changes in the amounts of deferred tax items recognized, which may result in equity and earnings volatility because such changes are reported in current period earnings.

In connection with determining the income tax provision or benefit, management considers maintaining liabilities for uncertain tax positions and tax strategies that it believes contain an element of uncertainty. Periodically, management evaluates each of FNCB's tax positions and strategies to determine whether a liability for uncertain tax benefits is required. As of March 31, 2018 and December 31, 2017, management determined that FNCB did not have any uncertain tax positions or tax strategies and that no liability was required to be recorded.

Refer to Note 6, "Income Taxes," of the notes to consolidated financial statements included in Item 1 hereof for additional information about income taxes.

New Authoritative Accounting Guidance and Accounting Guidance to be Adopted in Future Periods

Refer to Note 2, "New Authoritative Accounting Guidance," of the notes to consolidated financial statements included in Item 1 hereof for information about new authoritative accounting guidance adopted by FNCB during the three months ended March 31, 2018, as well as new accounting guidance issued, but not previously reported, that will be adopted by FNCB in future periods.

Executive Summary

The following overview should be read in conjunction with this MD&A in its entirety.

FNCB recorded consolidated net income of $2.0 million, or $0.12 per diluted common share, for the three months ended March 31, 2018, a decrease of $0.2 million, or 8.1%, compared to $2.2 million, or $0.13 per diluted common share, for the three months ended March 31, 2017. Annualized return on average assets and return on average equity were 0.70% and 9.44%, respectively, for the three months ended March 31, 2018, compared to 0.78% and 9.77%, respectively, for three months ended March 31, 2017. FNCB paid a dividend of $0.04 per share to holders of our common stock in the first quarter of 2018, an increase of $0.01 per share, or 33.3%, compared to a dividend of $0.03 per share paid to holders of common stock in the first quarter of 2017.

The decline in first quarter earnings primarily reflected a provision for loan and lease losses of $0.7 million in 2018 compared to a credit for loan and lease losses of $0.5 million in 2017, coupled with an increase of $0.3 million, or 4.4%, in non-interest expenses. Partially offsetting the negative factors was an increase of $1.0 million, or 12.6%, in net interest income and a decrease in income tax expense of $0.4 million comparing the three-month periods ended March 31, 2018 and 2017.

Total assets increased $27.0 million, or 2.3%, to $1.189 billion at March 31, 2018 from $1.162 billion at December 31, 2017. The change in total assets reflected strong growth in interest-earning assets, including a $37.0 million, or 4.9%, increase in net loans to $798.6 million at March 31, 2018 from $761.6 million at December 31, 2017 and an $8.9 million, or 3.1%, increase in available-for-sale securities to $298.3 million at the end of the first quarter of 2018 from $289.4 million at year-end 2017. Total deposits decreased by $47.2 million, or 4.7%, to $955.3 million at March 31, 2018 from $1.0 billion at December 31, 2017. The deposits decline was primarily attributable to cyclical net outflows of public funds. These cash outflows led to a $76.5 million increase in Federal Home Loan Bank of Pittsburgh advances from $45.0 million at the end of 2017 to $121.5 million at March 31, 2018, coupled with a $23.6 million decrease in cash and cash equivalents from $37.7 million at December 31, 2017 to $14.2 million at March 31, 2018.

Total shareholders' equity decreased $2.5 million, or 2.8%, to $86.7 million at March 31, 2018 from $89.2 million at December 31, 2017. The reduction in capital resulted primarily from a $3.9 million increase in accumulated other comprehensive loss to $5.6 million at March 31, 2018 from $1.7 million at December 31, 2017, which was related entirely to a decline in the fair value of FNCB's available-for-sale securities, net of income taxes. Partially offsetting this reduction, was net income of $2.0 million for the three months ended March 31, 2018. FNCB declared and paid dividends for the first quarter of 2018 of $0.7 million.

Throughout 2018, management is focused on developing strategies aimed at improving long-term financial performance by improving efficiency, increasing net interest income through commercial and retail loan growth initiatives, growing core deposits, developing additional sources of non-interest income and enhancing the marketability and liquidity of FNCB's stock. To facilitate loan and deposit growth initiatives, enhance efficiency, and improve the customer experience, during the second quarter of 2018, FNCB anticipates opening a new, state-of-the-art branch office located in Plains Township, Luzerne County, Pennsylvania. The new branch will feature the "personal banker" model in order to provide customers with an enhanced, more personalized banking experience. The new facility is part of the comprehensive branch network improvement program announced during 2017, and will consolidate three branches located in Luzerne County, Pennsylvania to this new location. The three branches that will be relocated include: 1) a branch located at 734 San Souci Parkway, Hanover Township, Pennsylvania; 2) a branch located at 27 North River Street, Plains, Pennsylvania; and 3) a branch located at 3 Old Boston Road, Pittston, Pennsylvania.

In addition, during 2018, management plans to evaluate the development of new state-of-the-art facilities on properties already owned by FNCB located in Dunmore, Lackawanna County, Pennsylvania and in Taylor Borough, Lackawanna County, Pennsylvania. In conjunction with management's ongoing monitoring of FNCB's delivery channels as part of FNCB's branch network improvement plan, on April 11, 2018, FNCB announced that the Bank has entered into an agreement to purchase real property, improvements and fixtures located at 196 North Main Street, Shavertown, Luzerne County, Pennsylvania. FNCB intends to relocate its existing branch, located at 1919 Memorial Highway, Shavertown, Luzerne County, Pennsylvania, to the new location in late 2018, pending approval from all required regulatory authorities.

Focusing on commercial and retail loan growth initiatives, during the third quarter of 2018, management also plans to implement a bank-wide customer relationship management ("CRM") system to improve customer service, enhance market share and create cross-sales opportunities between retail and commercial business units. Management expanded operations related to the limited production office located in Allentown, Lehigh County, Pennsylvania to include retail lending products by adding a full-time mortgage loan originator during the first quarter of 2018.

Over the past year, management has invested in staff additions to provide improved customer experiences, increase loan growth and enhance revenue streams. Recent specialized lending staff additions include an indirect auto lending relationship manager and a government banking sales officer. Similarly, FNCB recently enhanced its third-party Wealth Management services, now offered by LPL Financial, LLC, and hired a full-time financial consultant as an employee of FNCB Bank. Management expects that these investments in employees will provide positive returns throughout 2018 and forward.

Aligned with enhancing the marketability and liquidity of FNCB's stock, on December 29, 2017, FNCB filed a listing application with The Nasdaq Stock Market LLC ("Nasdaq"). FNCB subsequently received approval from Nasdaq on February 26, 2018 to list its common shares for trading on The Nasdaq Capital Market®. FNCB's shares of common stock began trading on Nasdaq effective with the market opening on Monday, March 5, 2018.

Summary of Performance

Net Interest Income

Net interest income is the difference between (i) interest income, interest and fees on interest-earning assets, and (ii) interest expense, interest paid on deposits and borrowed funds. Net interest income represents the largest component of FNCB's operating income and, as such, is the primary determinant of profitability. Net interest income is impacted by variations in the volume, rate and composition of earning assets and interest-bearing liabilities, changes in general market rates and the level of non-performing assets. Interest income is shown on a fully tax-equivalent basis and is calculated by adjusting tax-free interest using the effective corporate tax rate of 21.0% for the three months ended March 31, 2018 and FNCB's historic federal marginal tax rate of 34.0% for the three months ended March 31, 2017, in order to equate the yield to that of taxable interest rates.

Net interest income on a tax-equivalent basis increased $908 thousand, or 11.3%, to $9.0 million for the three months ended March 31, 2018 from $8.1 million for the same three months of 2017. Tax-equivalent net interest income was positively impacted by growth in average earning assets, coupled with improvements in rates earned on loans, investments, and interest-bearing deposits in other banks. The tax-equivalent yield on interest-earning assets improved by 36 basis points to 3.83% for the three months ended March 31, 2018 from 3.47% for the same three months of 2017. Average interest-earning assets increased by $48.8 million, to $1.10 billion at March 31, 2018 from $1.05 billion at March 31, 2017. The average balance of interest-bearing liabilities and the rate paid on those liabilities increased to a lesser extent, including a $22.9 million increase in total interest-bearing liabilities and a 21-basis point increase in the rate paid on those liabilities comparing the three-month periods ending March 31, 2018 and 2017. Tax-equivalent net interest margin, a key measurement used in the banking industry to measure income from earning assets relative to the cost to fund those assets, is calculated by dividing tax-equivalent net interest income by average interest-earning assets. FNCB's tax-equivalent net interest margin increased by 19 basis points due to the factors detailed above, to 3.26% during the three months ended March 31, 2018 from 3.07% for the same three months of 2017. Rate spread, the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities shown on a fully tax-equivalent basis, was 3.14% for the three months ended March 31, 2018, an improvement of 15 basis points compared to 2.99% for the same period of 2017.

Interest income on a tax-equivalent basis increased $1.4 million, or 15.5%, to $10.5 million for the three-month period ended March 31, 2018, compared to $9.1 million in 2017. The increase was attributed to both an increase in average earning assets of $48.8 million, or 4.6%, as well as increases in the yields earned on the loan and investment portfolios, and interest-bearing deposits in other banks. The largest increase was concentrated in the loan portfolio, as the average balance of loans increased by $68.5 million, or 9.4%, to $792.8 million at March 31, 2018 compared to $724.3 million at March 31, 2017. The increase in the average balance of loans contributed $699 thousand to the increase in interest income for the three months ended March 31, 2018. In addition, the average balance of total investment securities increased $16.1 million, or 5.6%, to $303.4 million for the three months ended March 31, 2018 compared to $287.3 million for the same three months of 2017, contributing $106 thousand to the increase in interest income. Partially offsetting these increases in average balance was a reduction in interest-bearing deposits in other banks of $35.7 million, which resulted in a reduction in interest income of $129 thousand. The tax-equivalent yield on earning assets increased by 36 basis points to 3.83% for the three months ended March 31, 2018 compared to 3.47% for the same period of 2017, driven by increases in the federal funds target rate and corresponding increases in the national prime lending rate and general market interest rates. Changes in the yields of earnings assets resulted in a $738 thousand increase in tax-equivalent interest income. Specifically, the tax-equivalent yield on the loan portfolio improved 28 basis points to 4.23% in the first quarter of 2018 from 3.95% for the same quarter of 2017, contributing $529 thousand to the increase in tax-equivalent interest income. Similarly, the tax-equivalent yield on the investment portfolio increased 19 basis points to 2.81% for the first quarter of 2018 from 2.62% for the same period of 2017, which contributed $147 thousand to the increase in tax-equivalent interest income. The yield earned on average interest-bearing deposits in other banks also increased by 150 basis points comparing the three months ended March 31, 2018 and 2017, which resulted in an increase in tax-equivalent interest income of $62 thousand.

Increases in the federal funds target rate also contributed to an increase in interest expense paid on interest-bearing liabilities. FNCB’s net interest income levels were negatively impacted by a $506 thousand, or 47.9%, increase in interest expense, attributable to an increase in interest expense due to rates of $388 thousand, combined with an increase in interest expense due to volumes of $118 thousand. FNCB’s cost of funds for the first quarter of 2018 increased by 21 basis points to 0.69% compared to 0.48% for the same quarter of 2017. Higher average rates paid on interest-bearing deposits led to an increase in interest expense of $314 thousand, concentrated in interest-bearing demand and time deposits. Specifically, the rate paid on interest-bearing demand deposits increased 15 basis points from 0.29% to 0.44% comparing the three months ended March 31, 2018 and 2017, which contributed $198 thousand to the increase in interest expense paid on deposits. The rate paid on time deposits similarly increased by 23 basis points to 0.94% for the first quarter of 2018 compared to 0.71% for the same period of 2017, and contributed $115 thousand to the increase in interest expense paid on deposits. The average balance of interest-bearing deposits remained steady, declining by only $1.5 million, or 0.2%; however, the shift in the composition of the deposit portfolio resulted in a $9 thousand increase in interest expense due to volumes. Interest expense paid on borrowed funds increased by $183 thousand comparing the first quarters of 2018 and 2017, as FHLB borrowings were utilized to provide additional funding for growth in interest-earning assets. The average balance of borrowed funds and the rate paid on those funds increased $24.4 million and 34 basis points, respectively, which resulted in respective increases in interest expense of $109 thousand and $74 thousand.

Net interest income depends upon the relative amount of interest-earning assets and interest-bearing liabilities and the interest rate earned or paid on them. The following table presents certain information about FNCB's consolidated statements of financial condition and consolidated statements of income for the three-month periods ended March 31, 2018 and 2017, and reflects the average yield on assets and average cost of liabilities for the periods indicated. Such yields and costs are calculated by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods shown. Average balances are derived from average daily balances. The yields include amortization of fees which are considered adjustments to yields.

	Three Months Ended					
	March 31, 2018			**March 31, 2017**		
(dollars in thousands)	**Average Balance**	**Interest**	**Yield/ Cost**	**Average Balance**	**Interest**	**Yield/ Cost**
Assets						
Earning assets (2)(3)						
Loans-taxable (4)	$748,375	$7,934	4.24 %	$680,518	$6,643	3.90 %
Loans-tax free (4)	44,383	448	4.04 %	43,822	511	4.66 %
Total loans (1)(2)	792,758	8,382	4.23 %	724,340	7,154	3.95 %
Securities-taxable	301,032	2,109	2.80 %	284,712	1,846	2.59 %
Securities-tax free	2,325	25	4.30 %	2,571	35	5.42 %
Total securities (1)(5)	303,357	2,134	2.81 %	287,283	1,881	2.62 %
Interest-bearing deposits in other banks	3,825	23	2.41 %	39,520	90	0.91 %
Total earning assets	1,099,940	10,539	3.83 %	1,051,143	9,125	3.47 %
Non-earning assets	85,217			100,966		
Allowance for loan and lease losses	(9,103)			(8,598)		
Total assets	$1,176,054			$1,143,511		
Liabilities and Shareholders' Equity						
Interest-bearing liabilities						
Interest-bearing demand deposits	$496,240	552	0.44 %	$509,079	363	0.29 %
Savings deposits	104,702	34	0.13 %	102,531	32	0.12 %
Time deposits	205,552	481	0.94 %	196,371	349	0.71 %
Total interest-bearing deposits	806,494	1,067	0.53 %	807,981	744	0.37 %
Borrowed funds and other interest-bearing liabilities	102,676	495	1.93 %	78,306	312	1.59 %
Total interest-bearing liabilities	909,170	1,562	0.69 %	886,287	1,056	0.48 %
Demand deposits	169,450			155,010		
Other liabilities	10,663			11,045		
Shareholders' equity	86,771			91,169		
Total liabilities and shareholder's equity	$1,176,054			$1,143,511		
Net interest income/interest rate spread (6)		8,977	3.14 %		8,069	2.99 %
Tax equivalent adjustment		(99)			(186)	
Net interest income as reported		$8,878			$7,883	
Net interest margin (7)			3.26 %			3.07 %

(1) Interest income is presented on a tax equivalent basis using a 21% rate for 2018 and a 34% rate for 2017.
(2) Loans are stated net of unearned income.
(3) Nonaccrual loans are included in loans within earning assets
(4) Loan fees included in interest income are not significant
(5) The yields for securities that are classified as available for sale is based on the average historical amortized cost.
(6) Interest rate spread represents the difference between the average yield on interest earning assets and the cost of interest bearing liabilities and is presented on a tax equivalent basis.
(7) Net interest income as a percentage of total average interest earning assets.

37

Rate Volume Analysis

The most significant impact on net income between periods is derived from the interaction of changes in the volume and rates earned or paid on interest-earning assets and interest-bearing liabilities. The volume of earning assets, specifically loans and investments, compared to the volume of interest-bearing liabilities represented by deposits and borrowings, combined with the spread, produces the changes in net interest income between periods. Components of interest income and interest expense are presented on a tax-equivalent basis using the corporate federal income tax rate of 21% for the three months ended March 31, 2018 and FNCB's historic statutory federal income tax rate of 34% for the three months ended March 31, 2017.

The following table summarizes the effect that changes in volumes of earning assets and interest-bearing liabilities and the interest rates earned and paid on these assets and liabilities have on net interest income. The net change or mix component attributable to the combined impact of rate and volume changes has been allocated proportionately to the change due to volume and the change due to rate.

	Quarter Ended March 31, 2018 vs. 2017 Increase (Decrease)		
(dollars in thousands)	**Due to Volume**	**Due to Rate**	**Total Change**
Interest Income:			
Loans - taxable	$693	$598	$ 1,291
Loans - tax free	6	(69)	(63)
Total loans	699	529	1,228
Securities - taxable	109	154	263
Securities - tax free	(3)	(7)	(10)
Total securities	106	147	253
Interest-bearing deposits in other banks	(129)	62	(67)
Total interest income	676	738	1,414
Interest Expense:			
Interest-bearing demand deposits	(9)	198	189
Savings deposits	1	1	2
Time deposits	17	115	132
Total interest-bearing deposits	9	314	323
Borrowed funds and other interest-bearing liabilities	109	74	183
Total interest expense	118	388	506
Net Interest Income	$558	$350	$ 908

Provision for Loan and Lease Losses

Management closely monitors the loan portfolio and the adequacy of the ALLL by considering the underlying financial performance of the borrower, collateral values and associated credit risks. Future material adjustments may be necessary to the provision for loan and lease losses and the ALLL if economic conditions or loan performance differ substantially from the assumptions management considered in its evaluation of the ALLL. The provision for loan and lease losses is an expense charged against net interest income to provide for probable losses attributable to uncollectible loans and is based on management's analysis of the adequacy of the ALLL. A credit to loan and lease losses reflects the reversal of amounts previously charged to the ALLL.

FNCB recorded a provision for loan and lease losses of $0.7 million for the three-month period ended March 31, 2018, compared to a credit of $0.5 million for the three months ended March 31, 2017. The provision in the first quarter of 2018 primarily reflected an increase in the balance of the net loans of $37.0 million, coupled with net charge-offs for the period of $192 thousand. The credit for loan and lease losses recorded during the three months ended March 31, 2017 represented a reduction in total loans outstanding, improvements in historical loss factors and net recoveries of $0.4 million, which were partially offset by an increase in specific reserves established for loans individually evaluated for impairment of $0.3 million.

Non-interest Income

For the three months ended March 31, 2018, non-interest income totaled $1.5 million, a decrease of $0.1 million, or 3.2%, compared to $1.6 million for the same three months of 2017. The change resulted primarily from decreases in net gains on the sale of securities, other repossessed assets and other real estate owned of $278 thousand, $57 thousand and $14 thousand, respectively, coupled with a $19 thousand loss on equity securities. Partially mitigating these decreases were net gains on the sale of SBA guaranteed loans of $251 thousand, and increases in net gains on the sale of mortgage loans held for sale and other income of $24 thousand and 39 thousand, respectively. Service charges on deposits increased by $11 thousand, or 1.6%, comparing the first quarter of 2018 and 2017, while loan-related fees and income from bank-owned life insurance remained steady, decreasing by $7 thousand and $1 thousand, respectively.

Non-interest Expense

Non-interest expense increased $304 thousand, or 4.4%, to $7.2 million for the three months ended March 31, 2018 from $6.9 million for the same three months of 2017. The change primarily reflected an increase of $142 thousand, or 4.0%, in salaries and employee benefits expense, coupled with an increase in other operating expenses of $157 thousand, or 21.0%. The increases in other operating expenses included increases in telecommunications expenses related to network enhancements, directors' fees related to the addition of three new members to the Board of Directors in September 2017, and a one-time application fee related to FNCB's transition to the Nasdaq Capital Market for listing its shares of common stock. Partially offsetting these increases were decreases in equipment expenses and other losses of $146 thousand and $97 thousand, respectively.

Provision for Income Taxes

FNCB recorded income tax expense of $426 thousand for the first quarter of 2018, a decrease of $380 thousand, or 47.1%, compared to income tax expense of $426 thousand for the same quarter of 2017. The decrease in income tax expense primarily reflected the reduction in the statutory corporate tax rate from a maximum federal corporate income tax rate of 35% to 21%, effective January 1, 2018.

Management evaluates the carrying amount of its deferred tax assets on a quarterly basis, or more frequently, if necessary, in accordance with guidance set forth in ASC Topic 740 "Income Taxes," and applies the criteria in the guidance to determine whether it is more likely than not that some portion, or all, of the deferred tax asset will not be realized within its life cycle, based on the weight of available evidence. If management determines based on available evidence, both positive and negative, that it is more likely than not that some portion or all of the deferred tax asset will not be realized in future periods, a valuation allowance is calculated and recorded. These determinations are inherently subjective and depend upon management’s estimates and judgments used in their evaluation of both positive and negative evidence.

In evaluating available evidence, management considers, among other factors, historical financial performance, expectation of future earnings, the ability to carry back losses to recoup taxes previously paid, length of statutory carry forward periods, experience with operating loss and tax credit carry forwards not expiring unused, tax planning strategies and timing of reversals of temporary differences. In assessing the need for a valuation allowance, management carefully weighs both positive and negative evidence currently available.

Management performed an evaluation of FNCB’s deferred tax assets at March 31, 2018 taking into consideration both positive and negative evidence that existed as of that date. Based on this evaluation, management believes that FNCB’s future taxable income will be sufficient to utilize deferred tax assets. Accordingly, management concluded that no valuation allowance for deferred tax assets was required at March 31, 2018.

FINANCIAL CONDITION

Assets

Total assets increased $27.0 million, or 2.3%, to $1.189 billion at March 31, 2018 from $1.162 billion at December 31, 2017. The change in total assets reflected strong growth in interest-earning assets, including a $37.0 million, or 4.9%, increase in net loans and an $8.9 million increase in available-for-sale securities. The growth in net loans was concentrated in the consumer lending segment, as the addition of a full-time relationship manager for FNCB’s indirect automobile lending portfolio resulted in the onboarding of new dealerships and related growth in automobile lending. Total deposits decreased by $47.2 million, or 4.7%, primarily attributable to cyclical net outflows of municipal deposits, as well as a reduction in commercial deposits concentrated with one large local business relationship. Borrowed funds increased by $76.5 million, or 126.9%, to $136.8 million at March 31, 2018 as compared to $60.3 million at December 31, 2017. The increase in borrowed funds was concentrated in overnight advances from the FHLB of Pittsburgh used to supplement the strong growth in interest-earning assets.

Cash and Cash Equivalents

Cash and cash equivalents declined $23.6 million, or 62.4%, to $14.2 million at March 31, 2018 from $37.7 million at December 31, 2017. The reduction was due primarily to cash outflows to fund asset growth, coupled with cyclical reductions in deposits. FNCB paid a dividend of $0.04 per share to holders of our common stock during the first quarter of 2018, an increase of 33.3% from $0.03 per share during the first quarter of 2017.

Securities

FNCB’s investment securities portfolio provides a source of liquidity needed to meet expected loan demand and interest income to increase profitability. Additionally, the investment securities portfolio is used to meet pledging requirements to secure public deposits and for other purposes. Management classifies investment debt securities as either held-to-maturity or available-for-sale at the time of purchase based on its intent. Held-to-maturity securities are carried at amortized cost, while available-for-sale securities are carried at fair value, with unrealized holding gains and losses reported as a component of shareholders’ equity in accumulated other comprehensive income (loss), net of tax. At March 31, 2018 and December 31, 2017, all debt securities were classified as available-for-sale. Equity securities with readily determinable fair values are carried at fair value, with gains and losses due to fluctuations in market value included in the consolidated statement of income. Securities with limited marketability and/or restrictions, such as FHLB of Pittsburgh stock, are carried at cost. Decisions to purchase or sell investment securities are based upon management’s current assessment of long- and short-term economic and financial conditions, including the interest rate environment and asset/liability management, liquidity and tax-planning strategies.

At March 31, 2018, the investment portfolio was comprised principally of fixed-rate securities issued by U.S. government or U.S. government-sponsored agencies, which include mortgage-backed securities and residential and commercial collateralized mortgage obligations (“CMOs”), fixed-rate taxable obligations of state and political subdivisions, asset-backed securities and corporate debt securities. Except for U.S. government and government-sponsored agencies, there were no securities of any individual issuer that exceeded 10.0% of shareholders’ equity at March 31, 2018.

The following table presents the carrying value of debt securities, all of which were classified as available-for-sale and carried at fair value at March 31, 2018 and December 31, 2017:

Composition of the Investment Portfolio

(in thousands)	March 31, 2018	December 31, 2017
Available-for-sale debt securities		
Obligations of state and political subdivisions	$151,436	$145,999
U.S. government/ government-sponsored agencies:		
Collateralized mortgage obligations - residential	34,235	35,657
Collateralized mortgage obligations - commerical	73,658	75,418
Mortgage-backed securities	24,880	22,311
Corporate debt securities	4,005	4,058
Asset-backed securities	7,189	3,086
Negotiable certificates of deposit	2,911	2,930
Total available-for-sale debt securities	$298,314	$289,459

Management monitors the investment portfolio regularly and adjusts the investment strategy to reflect changes in liquidity needs, asset/liability strategy and tax planning requirements. FNCB currently has $40.5 million in net operating loss carryovers, which it uses to offset any taxable income. Because of this tax position, there is no benefit from holding tax-exempt obligations of state and political subdivisions. Accordingly, management actions during recent periods have reflected current tax planning initiatives focused on generating sustained taxable income to be able to reduce NOL carryovers.

40

Securities purchased during the first quarter of 2018 totaled $15.4 million and were comprised of obligations of state and political subdivisions, collateralized mortgage obligations and asset-backed securities. There were no sales of securities during the three-month period ended March 31, 2018.

The following table presents the maturities of available-for-sale debt securities, based on carrying value at March 31, 2018 and the weighted average yields of such securities calculated on the basis of the amortized cost and effective yields weighted for the scheduled maturity of each security. The yields on tax-exempt obligations of state and political subdivisions are presented on a tax-equivalent basis using the federal corporate income tax rate of 21.0%. Because residential and commercial collateralized mortgage obligations, mortgage-backed securities and asset-backed securities are not due at a single maturity date, they are not included in the maturity categories in the following summary.

Maturity Distribution of the Investment Portfolio

	March 31, 2018					
(dollars in thousands)	**Within One Year**	**>1 - 5 Years**	**6 - 10 Years**	**Over 10 Years**	**Collateralized Mortgage Obligations, Mortgage-Backed and Asset-Backed Securities**	**Total**
Available-for-sale debt securities						
Obligations of state and political subdivisions	$-	$39,532	$107,965	$3,939	$ -	$151,436
Yield		2.51 %	2.84 %	3.73 %		2.78 %
U.S. government/government-sponsored agencies:						
Collateralized mortgage obligations - residential	-	-	-	-	34,235	34,235
Yield					2.77 %	2.77 %
Collateralized mortgage obligations - commercial	-	-	-	-	73,658	73,658
Yield					2.50 %	2.50 %
Mortgage-backed securities	-	-	-	-	24,880	24,880
Yield					2.92 %	2.92 %
Corporate debt securities	-	-	4,005	-	-	4,005
Yield			6.63 %			6.63 %

Asset-back securities	-	-	-	-	7,189	7,189
Yield					3.62 %	3.62 %
Negotiable certificates of deposit	496	2,415	-	-	-	2,911
Yield	1.85 %	2.14 %				2.09 %
Total available-for-sale debt securities	$496	$41,947	$111,970	$3,939	$ 139,962	$298,314
Weighted average yield	1.85 %	2.48 %	2.98 %	3.73 %	2.70 %	2.79 %

OTTI Evaluation

There was no OTTI recognized during the three months ended March 31, 2018 or 2017. For additional information regarding management's evaluation of securities for OTTI, see Note 3, "Securities" of the notes to consolidated financial statements included in Item 1 hereof.

The following table presents the investment in FNCB's restricted securities, which have limited marketability and are carried at cost:

(in thousands)	**March 31, 2018**	**December 31, 2017**
Stock in Federal Home Loan Bank of Pittsburgh	$5,693	$ 2,753
Stock in Atlantic Community Banker's Bank	10	10
Total restricted securities, at cost	$5,703	$ 2,763

Management noted no indicators of impairment for the Federal Home Loan Bank of Pittsburgh or Atlantic Community Banker's Bank stock at March 31, 2018 and December 31, 2017.

41

FNCB owns $1.7 million, representing a 4.9% interest, in the common stock of a privately-held bank holding company. The common stock was purchased as part of a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933 for offerings not involving any public offering. The common stock is not currently traded on any established market, and is not expected to be traded in the near future on any securities exchange or established over-the-counter market. FNCB has elected to account for this transaction as an investment in an equity security without a readily determinable fair value. An equity security without a readily determinable fair value shall be written down to its fair value if a qualitative assessment indicates that the investment is impaired and the fair value of the investment is less than its carrying value. The $1.7 million investment is included in other assets in the consolidated statements of financial condition at March 31, 2018 and December 31, 2017. Management evaluates this investment for impairment quarterly. As part of its evaluation at March 31, 2018, management engaged an independent third party to provide a valuation of this investment, and conducted a qualitative analysis to determine whether or not this investment was impaired. The evaluation indicated that the investment was not impaired and accordingly, no adjustment for impairment was required at March 31, 2018.

Loans

During the first three months of 2018, FNCB experienced strong demand for its lending products. Total loans increased $36.8 million, or 4.8%, to $804.9 million at March 31, 2018 from $768.1 million at December 31, 2017. FNCB experienced strong growth in its consumer lending portfolio which resulted from the addition of a full-time relationship manager for its indirect lending product, as well as strong growth within the commercial and industrial and construction, land acquisition and development segments resulting from additions to commercial lending staff during 2017.

Historically, commercial lending activities have represented a significant portion of FNCB’s loan portfolio. Commercial lending includes commercial and industrial loans, commercial real estate loans and construction, land acquisition and development loans, and represented 54.4% and 56.4% of total loans at March 31, 2018 and December 31, 2017.

From a collateral standpoint, a majority of FNCB’s loan portfolio consists of loans secured by real estate. Real estate secured loans, which include commercial real estate, construction, land acquisition and development, residential real estate loans and home equity lines of credit (“HELOCs”), decreased $2.5 million, or 0.6%, to $427.6 million at March 31, 2018 from $430.1 million at December 31, 2017. The decrease was concentrated in commercial and residential real estate loans, and was partially mitigated by an increase in construction, land acquisition and development loans. Real estate secured loans represented 59.7% and 58.8% of total loans at March 31, 2018 and December 31, 2017, respectively.

Commercial and industrial loans increased $12.3 million during the first quarter to $162.4 million at March 31, 2018 from $150.1 million at December 31, 2017. Commercial and industrial loans consist primarily of equipment loans, working capital financing, revolving lines of credit and loans secured by cash and marketable securities. Loans secured by commercial real estate decreased $12.8 million, or 4.9%, to $249.0 million at March 31, 2018 from $261.8 million at December 31, 2017. The decrease was largely due to the sale of the guaranteed principal balance of several SBA-guaranteed loans during the first quarter of 2018. Commercial real estate loans include long-term commercial mortgage financing and are primarily secured by first or second lien mortgages. Offsetting this decrease was an increase in construction, land acquisition and development loans of $5.3 million, or 25.2%, to $26.3 million at March 31, 2018 from $21.0 million at December 31, 2017.

Residential real estate loans totaled $164.7 million at March 31, 2018, an increase of $6.7 million, or 4.3%, from $158.0 million at December 31, 2017. The components of residential real estate loans include fixed-rate and variable-rate mortgage loans. HELOCs are not included in this category but are included in consumer loans. FNCB primarily underwrites fixed-rate purchase and refinance of residential mortgage loans for sale in the secondary market to reduce interest rate risk and provide funding for additional loans. Additionally, FNCB offers a “WOW” mortgage product, which is a non-saleable mortgage with maturity terms of 7.5 to 14.5 years and offers customers an attractive fixed interest rate, low closing costs and a guaranteed 30-day close.

Consumer loans increased by $22.0 million, or 16.4%, during the first three months of 2018 to $156.7 million at March 31, 2018 from $134.7 million at December 31, 2017, concentrated within the indirect auto loan portfolio. Loans to state and municipal governments increased $3.3 million, or 7.7%, to $45.8 million at March 31, 2018 from $42.5 million at December 31, 2017.

The following table presents loans receivable, net by major category at March 31, 2018 and December 31, 2017:

Loan Portfolio Detail

(in thousands)	**March 31, 2018**	**December 31, 2017**
Residential real estate	$164,747	$158,020
Commercial real estate	248,984	261,783
Construction, land acquisition and development	26,260	20,981
Commercial and industrial	162,381	150,103
Consumer	156,684	134,653
State and political subdivisions	45,801	42,529
Total loans, gross	804,857	768,069
Unearned income	(78)	(80)
Net deferred loan costs	3,423	2,654
Allowance for loan and lease losses	(9,562)	(9,034)
Loans, net	$798,640	$761,609

Under industry regulations, a concentration is considered to exist when there are amounts loaned to a multiple number of borrowers engaged in similar activities which would cause them to be similarly impacted by economic or other conditions. Typically, industry guidelines require disclosure of concentrations of loans exceeding 10.0% of total loans outstanding. FNCB had no such concentrations at March 31, 2018 or December 31, 2017. In addition to industry guidelines, FNCB's internal policy considers a concentration to exist in its loan portfolio if an aggregate loan balance outstanding to borrowers within a specific industry exceeds 25.0% of capital. However, management regularly reviews loans by all industry categories to determine if a potential concentration exists.

The following table presents industry concentrations within FNCB's loan portfolio at March 31, 2018 and December 31, 2017:

Loan Concentrations

	March 31, 2018	**December 31, 2017**
(dollars in thousands)	**Amount**	**Amount**

		% of Gross Loans		% of Gross Loans
Retail space/shopping centers	$43,630	5.42 %	$44,184	5.75 %
1-4 family residential investment properties	39,197	4.87 %	33,275	4.33 %
Automobile dealers	21,028	2.61 %	22,792	2.97 %

Asset Quality

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at the amount of unpaid principal, net of unearned interest, deferred loan fees and costs, and reduced by the ALLL. The ALLL is established through a provision for loan and lease losses charged to earnings.

FNCB has established and consistently applies loan policies and procedures designed to foster sound underwriting and credit monitoring practices. Credit risk is managed through the efforts of loan officers, the loan review function, and the Credit Risk Management and the ALLL committees, as well as oversight from the Board of Directors. Management continually evaluates its credit risk management practices to ensure it is reacting to problems in the loan portfolio in a timely manner, although, as is the case with any financial institution, a certain degree of credit risk is dependent in part on local and general economic conditions that are beyond management's control.

Under FNCB's risk rating system, loans that are rated pass, special mention, substandard, doubtful, or loss are reviewed regularly as part of the risk management practices. The Credit Risk Management Committee, which consists of key members of management, finance, legal, retail lending and credit administration, meets monthly or more often as necessary to review individual problem credits and workout strategies and provides monthly reports to the Board of Directors.

A loan is considered impaired when it is probable that FNCB will be unable to collect all amounts due (including principal and interest) according to the contractual terms of the note and loan agreement. For purposes of the analysis, all TDRs, loan relationships with an aggregate outstanding balance greater than $100 thousand rated substandard and non-accrual, and loans that are identified as doubtful or loss are considered impaired. Impaired loans are analyzed individually to determine the amount of impairment. For collateral-dependent loans, impairment is measured based on the fair value of the collateral supporting the loans. A loan is determined to be collateral dependent when repayment of the loan is expected to be provided through the liquidation of the collateral held. For impaired loans that are secured by real estate, external appraisals are obtained annually, or more frequently as warranted, to ascertain a fair value so that the impairment analysis can be updated. Should a current appraisal not be available at the time of impairment analysis, other sources of valuation may be used, including current letters of intent, broker price opinions or executed agreements of sale. For non-collateral-dependent loans, impairment is measured based on the present value of expected future cash flows, net of any deferred fees and costs, discounted at the loan’s original effective interest rate.

Loans to borrowers that are experiencing financial difficulty that are modified and result in the granting of concessions to the borrowers are classified as TDRs and are considered to be impaired. Such concessions generally involve an extension of a loan’s stated maturity date, a reduction of the stated interest rate, payment modifications, capitalization of property taxes with respect to mortgage loans or a combination of these modifications. Non-accrual TDRs are returned to accrual status if principal and interest payments, under the modified terms, are brought current, are performing under the modified terms for six consecutive months, and management believes that collection of the remaining interest and principal is probable.

Non-performing loans are monitored on an ongoing basis as part of FNCB’s loan review process. Additionally, work-out efforts for non-performing loans and OREO are actively monitored through the Credit Risk Management Committee. A potential loss on a non-performing asset is generally determined by comparing the outstanding loan balance to the fair market value of the pledged collateral, less cost to sell.

Loans are placed on non-accrual when a loan is specifically determined to be impaired or when management believes that the collection of interest or principal is doubtful. This generally occurs when a default of interest or principal has existed for 90 days or more, unless the loan is well secured and in the process of collection, or when management becomes aware of facts or circumstances that the loan would default before 90 days. FNCB determines delinquency status based on the number of days since the date of the borrower’s last required contractual loan payment. When the interest accrual is discontinued, all unpaid interest income is reversed and charged back against current earnings. Any subsequent cash payments received are applied, first to the outstanding loan amounts, then to the recovery of any charged-off loan amounts, with any excess treated as a recovery of lost interest. A non-accrual loan is returned to accrual status when the loan is current as to principal and interest payments, is performing according to contractual terms for six consecutive months and future payments are reasonably assured.

Management actively manages impaired loans in an effort to mitigate loss to FNCB by working with customers to develop strategies to resolve borrower difficulties, through sale or liquidation of collateral, foreclosure, and other appropriate means. In addition, management monitors employment conditions within FNCB’s market area, as weakening of conditions could result in real estate devaluations and an increase in loan delinquencies, which could negatively impact asset quality and cause an increase in the provision for loan and lease losses.

Under the fair value of collateral method, the impaired amount of the loan is deemed to be the difference between the loan amount and the fair value of the collateral, less the estimated costs to sell. For real estate secured loans, management generally estimates selling costs using a factor of 10%, which is based on typical cost factors, such as a 6% broker commission, 1% transfer taxes, and 3% various other miscellaneous costs associated with the sales process. If the valuation indicates that the fair value has deteriorated below the carrying value of the loan, the difference between the fair value and the principal balance is charged off. For impaired loans for which the value of the collateral less costs to sell exceeds the loan value, the impairment is determined to be zero.

44

The following table presents information about non-performing assets and accruing TDRs at March 31, 2018 and December 31, 2017:

Non-performing Assets and Accruing TDRs

(dollars in thousands)	March 31, 2018	December 31, 2017
Non-accrual loans	$2,403	$ 2,578
Loans past due 90 days or more and still accruing	-	-
Total non-performing loans	2,403	2,578
Other real estate owned	579	1,023
Other non-performing assets	1,900	1,900
Total non-performing assets	$4,882	$ 5,501
Accruing TDRs	$8,797	$ 9,299
Non-performing loans as a percentage of gross loans	0.30 %	0.34 %

Work-out efforts focused on the effective management and resolution of problem credits and the continued disposition of foreclosed properties led to improvement in FNCB's asset quality throughout the first quarter of 2018. Total non-performing assets decreased $0.6 million, or 11.3%, to $4.9 million at March 31, 2018 from $5.5 million at December 31, 2017. The improvement was largely due to a $0.4 million reduction in other real estate owned to $0.6 million at March 31, 2018 from $1.0 million at year-end 2017. FNCB's ratio of non-performing loans to total gross loans improved to 0.30% at March 31, 2018 from 0.34% at December 31, 2017. FNCB's ratio of non-performing assets as a percentage of shareholders' equity decreased to 5.6% at March 31, 2018 from 6.2% at December 31, 2017. Management continues to monitor non-accrual loans, delinquency trends and economic conditions within FNCB's market area on an on-going basis in order to proactively address any collection-related issues and mitigate any potential loss.

Other non-performing assets at March 31, 2018 and December 31, 2017 are comprised solely of a classified account receivable secured by an evergreen letter of credit in the amount of $1.9 million, received in 2011 as part of a settlement agreement for a large construction, land acquisition and development loan for a residential development project in the Pocono region of Monroe County. The project was stalled due to a decline in real estate values in this area following the financial crisis of 2008. The agreement provides for payment to FNCB as real estate building lots are sold. In 2016, management classified this receivable as substandard due to the length of holding time and continues to monitor this project closely. To date, no lots have been sold; however, economic development in this market area has recently improved and construction activity related to this project by the developer has increased.

TDRs at March 31, 2018 and December 31, 2017 were $9.7 million and $10.2 million, respectively. Accruing and non-accruing TDRs were $8.8 million and $0.9 million, respectively at March 31, 2018 and $9.3 million and $0.9 million, respectively at December 31, 2017. FNCB was not committed to lend additional funds to any loan classified as a TDR at March 31, 2018.

The average balance of impaired loans was $11.0 million and $6.9 million for the three months ended March 31, 2018 and 2017, respectively. FNCB recognized $103 thousand and $70 thousand of interest income on impaired loans for the three months ended March 31, 2018 and 2017, respectively.

The following table presents the changes in non-performing loans for the three months ended March 31, 2018 and 2017. Loan foreclosures represent recorded investment at time of foreclosure not including the effect of any guarantees:

Changes in Non-Performing Loans

	March 31,	
(in thousands)	**2018**	**2017**
Balance at January 1,	$2,578	$2,234
Loans newly placed on non-accrual	384	296
Changes in loans past due 90 days or more and still accruing	-	-
Loans transferred to OREO	-	-
Loans returned to performing status	-	-
Loans charged-off	(389)	(284)
Loan payments received	(170)	(324)
Balance at March 31,	$2,403	$1,922

The additional interest income that would have been earned on non-accrual and restructured loans had the loans been performing in accordance with their original terms for the quarter ended on March 31, 2018 and 2017 approximated $40 thousand and $27 thousand, respectively.

The following table presents accruing loan delinquencies and non-accrual loans as a percentage of gross loans at March 31, 2018 and December 31, 2017:

Loan Delinquencies and Non-Accrual Loans

	March 31, 2018		**December 31, 2017**	
Accruing:				
30-59 days	0.34	%	0.27	%
60-89 days	0.09	%	0.11	%
90+ days	0.00	%	0.00	%
Non-accrual	0.30	%	0.34	%
Total delinquencies	0.73	%	0.72	%

The slight increase in total delinquencies as a percentage of gross loans was due to an increase in loans 30-59 days past due within the commercial and industrial and commercial real estate segments, partially mitigated by slight decreases in loans 60-89 days past due and non-accrual loans.

Allowance for Loan and Lease Losses

The ALLL represents management’s estimate of probable loan losses inherent in the loan portfolio. The ALLL is analyzed in accordance with GAAP and is maintained at a level that is based on management’s evaluation of the adequacy of the ALLL in relation to the risks inherent in the loan portfolio.

As part of its evaluation, management considers qualitative and environmental factors, including, but not limited to:

- changes in national, local, and business economic conditions and developments, including the condition of various market segments;
- changes in the nature and volume of the loan portfolio;
- changes in lending policies and procedures, including underwriting standards, collection, charge-off and recovery practices and results;
- changes in the experience, ability and depth of lending management and staff;
- changes in the quality of the loan review system and the degree of oversight by the Board of Directors;
- changes in the trend of the volume and severity of past due and classified loans, including trends in the volume of non-accrual loans, TDRs and other loan modifications;
- the existence and effect of any concentrations of credit and changes in the level of such concentrations;
- the effect of external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the current loan portfolio; and
- analysis of customers' credit quality, including knowledge of their operating environment and financial condition.

Evaluations are intrinsically subjective, as the results are estimated based on management knowledge and experience and are subject to interpretation and modification as information becomes available or as future events occur. Management monitors the loan portfolio on an ongoing basis with emphasis on weakness in both the real estate market and the economy in general and its effect on repayment. Adjustments to the ALLL are made based on management's assessment of the factors noted above.

For purposes of management's analysis of the ALLL, all loan relationships with an aggregate balance greater than $100 thousand that are rated substandard and non-accrual, identified as doubtful or loss, and all TDRs are considered impaired and are analyzed individually to determine the amount of impairment. Circumstances such as construction delays, declining real estate values, and the inability of the borrowers to make scheduled payments have resulted in these loan relationships being classified as impaired. FNCB utilizes the fair value of collateral method for collateral-dependent loans and TDRs for which repayment depends on the sale of collateral. For non-collateral-dependent loans and TDRs, FNCB measures impairment based on the present value of expected future cash flows discounted at the loan's original effective interest rate. With regard to collateral-dependent loans, appraisals are received at least annually to ensure that impairment measurements reflect current market conditions. Should a current appraisal not be available at the time of impairment analysis, other valuation sources including current letters of intent, broker price opinions or executed agreements of sale may be used. Only downward adjustments are made based on these supporting values. Included in all impairment calculations is a cost to sell adjustment of approximately 10%, which is based on typical cost factors, including a 6% broker commission, 1% transfer taxes and 3% various other miscellaneous costs associated with the sales process. Sales costs are periodically reviewed and revised based on actual experience. The ALLL analysis is adjusted for subsequent events that may arise after the end of the reporting period but before the financial reports are filed.

The ALLL equaled $9.6 million at March 31, 2018, an increase of $0.6 million from $9.0 million at December 31, 2017. The increase resulted from a provision for loan and lease losses of $0.7 million, partially offset by net charge-offs of $0.2 million for the first three months of 2018.

The ALLL consists of both specific and general components. The component of the ALLL that is related to impaired loans that are individually evaluated for impairment, the guidance for which is provided by ASC 310 "*Impairment of a Loan*" ("ASC 310"), was $0.7 million, or 7.5%, of the total ALLL at March 31, 2018, compared to $0.8 million, or 8.6%, of the total ALLL at December 31, 2017. A general allocation of $8.8 million was calculated for loans analyzed collectively under ASC 450 "*Contingencies*" ("ASC 450"), which represented 92.5% of the total ALLL of $9.6 million. Comparatively, at December 31, 2017, the general allocation for loans collectively analyzed for impairment amounted to $8.2 million, or 91.4%, of the total ALLL. The ratio of the ALLL to total loans at March 31, 2018 and December 31, 2017 was 1.18% and 1.17%, respectively, based on loans, net of net deferred loan costs and unearned income of $808.2 million and $770.6 million, respectively.

The following table presents an allocation of the ALLL by major loan category and percent of loans in each category to total loans at March 31, 2018 and December 31, 2017:

Allocation of the ALLL

	March 31, 2018		December 31, 2017	
		Percentage		Percentage

(dollars in thousands)	Allowance Amount	of Loans in Each Category to Total Loans		Allowance Amount	of Loans in Each Category to Total Loans	
Residential real estate	$1,249	20.47	%	$1,236	20.58	%
Commercial real estate	3,342	30.93	%	3,499	34.08	%
Construction, land acquisition and development	256	3.26	%	209	2.73	%
Commercial and industrial	2,505	20.18	%	2,340	19.54	%
Consumer	1,822	19.47	%	1,395	17.53	%
State and political subdivision	388	5.69	%	355	5.54	%
Total	$9,562	100.00	%	$9,034	100.00	%

The following table presents an analysis of the ALLL by loan category for the three months ended March 31, 2018 and 2017:

Reconciliation of the ALLL

(dollars in thousands)	**For the three months ended March 31, 2018**	**2017**
Balance at beginning of period	$9,034	$8,419
Charge-offs:		
Residential real estate	63	49
Commercial real estate	-	-
Construction, land acquisition and development	-	-
Commercial and industrial	77	30
Consumer	260	218
State and political subdivisions	-	-
Total charge-offs	400	297
Recoveries of charged-off loans:		
Residential real estate	6	1
Commercial real estate	1	4
Construction, land acquisition and development	30	421
Commercial and industrial	72	69
Consumer	99	167
State and political subdivisions	-	-
Total recoveries	208	662
Net charge-offs (recoveries)	192	(365)
Provision (credit) for loan and lease losses	720	(478)
Balance at end of period	$9,562	$8,306
Net charge-offs (recoveries) as a percentage of average loans	0.02 %	(0.05)%
Allowance for loan and lease losses as a percentage of gross loans outstanding at period end	1.18 %	1.16 %

Other Real Estate Owned

At March 31, 2018, OREO consisted of four properties with an aggregate carrying value of $0.6 million, a decrease of $0.4 million from $1.0 million at December 31, 2017. There were no properties foreclosed upon during the three months ended March 31, 2018. There was one sale of a property with an aggregate carrying value of $428 thousand during the three months ended March 31, 2018, which resulted in a net gain of $37 thousand. During the three months ended March 31, 2017, one investor-owned property with a carrying value of $45 thousand was foreclosed upon. In addition, during the first quarter of 2017, there was one sale and one partial sale of properties with an aggregate carrying value of $741 thousand, which resulted in net gains of $51 thousand. The expenses related to maintaining OREO, not including adjustments to property values subsequent to foreclosure, and net of any income from operation of the properties amounted to $28 thousand and $40 thousand for the three months ended March 31, 2018 and 2017, respectively.

FNCB actively markets OREO properties for sale through a variety of channels including internal marketing and the use of outside brokers/realtors. The carrying value of OREO is generally calculated at an amount not greater than 90% of the most recent fair market appraised value unless specific conditions warrant an exception. A 10% factor is generally used to estimate costs to sell, which is based on typical cost factors, such as 6% broker commission, 1% transfer taxes, and 3% various other miscellaneous costs associated with the sales process. The fair value is updated on an annual basis or more frequently if new valuation information is available. Deterioration in the real estate market could result in additional losses on these properties. FNCB incurred valuation adjustments of $17 thousand related to OREO properties for the three months ended March 31, 2018. There were no valuation adjustments related to OREO properties for the three months ended March 31, 2017.

The following table presents the activity in OREO for the three months ended March 31, 2018 and 2017:

Activity in OREO

	Three Months Ended March 31,	
(in thousands)	**2018**	**2017**
Balance, beginning of period	$1,023	$2,048
Real estate foreclosures	-	45
Valuation adjustments	(17)	-
Carrying value of OREO sold	(427)	(741)
Balance, end of period	$579	$1,352

The following table presents a distribution of OREO at March 31, 2018 and December 31, 2017:

Distribution of OREO

(in thousands)	**March 31, 2018**	**December 31, 2017**
Land / lots	$ 516	$ 516
Commercial real estate	-	427
Residential real estate	63	80
Total other real estate owned	$ 579	$ 1,023

Liabilities

Total liabilities were $1.103 billion at March 31, 2018, an increase of $29.4 million, or 2.7%, from $1.073 billion at December 31, 2017. The increase was primarily attributable to a $76.5 million increase in borrowed funds, specifically advances from the FHLB of Pittsburgh, partially offset by an outflow of deposits of $47.2 million, or 4.8%. The increase in borrowed funds was used to fund growth in interest-earning assets, while the decrease in total deposits reflected a decrease in municipal deposit accounts primarily attributable to cyclical net outflows of municipal deposits, as well as a reduction in commercial deposits concentrated with one large local business relationship. Interest-bearing deposits decreased $43.8 million, or 5.3%, to $782.4 million at March 31, 2018 compared to $826.1 million at December 31, 2017, while non-interest-bearing demand deposits decreased $3.4 million, or 1.9%, comparing the same time period.

Equity

Total shareholders’ equity decreased $2.5 million, or 2.8%, to $86.7 million at March 31, 2018 from $89.2 million at December 31, 2017. The reduction in capital resulted primarily from a $3.9 million increase in accumulated other comprehensive loss coupled with dividends declared and paid of $0.7 million, partially offset by net income for the first quarter of 2018 of $2.0 million. Book value per common share was $5.17 at March 31, 2018, a decrease of $0.15, or 2.8%, compared to $5.32 at December 31, 2017.

Liquidity

The term liquidity refers to the ability to generate sufficient amounts of cash to meet cash flow needs. Liquidity is required to fulfill the borrowing needs of FNCB’s credit customers and the withdrawal and maturity requirements of its deposit customers, as well as to meet other financial commitments. FNCB’s liquidity position is impacted by several factors, which include, among others, loan origination volumes, loan and investment maturity structure and cash flows, deposit demand and certificate of deposit maturity structure and retention. FNCB has liquidity and contingent funding policies in place that are designed with controls in place to provide advanced detection of potentially significant funding shortfalls, establish methods for assessing and monitoring risk levels, and institute prompt responses that may alleviate a potential liquidity crisis. Management monitors FNCB’s liquidity position and fluctuations daily, forecasts future liquidity needs, performs periodic stress tests on its liquidity levels and develops strategies to ensure adequate liquidity at all times.

The statements of cash flows present the change in cash and cash equivalents from operating, investing and financing activities. Cash and due from banks and interest-bearing deposits in other banks are FNCB's most liquid assets. At March 31, 2018, cash and cash equivalents totaled $14.2 million, a decrease of $23.5 million compared to $37.7 million at December 31, 2017. Net funds used in investing activities were $57.1 million for the first quarter of 2018, largely representing an increase in loans to customers of $43.0 million, coupled with purchases of securities available for sale of $15.4 million. Investing activities provided $28.7 million in net cash for the three months ended March 31, 2018, which resulted primarily from net proceeds from FHLB advances of $76.5 million, partially offset by a decrease in deposits of $47.2 million. Operating activities for the first three months of 2018 provided net cash of $4.9 million.

Interest Rate Risk

Interest Rate Sensitivity

Market risk is the risk to earnings and/or financial position resulting from adverse changes in market rates or prices, such as interest rates, foreign exchange rates or equity prices. FNCB's exposure to market risk is primarily interest rate risk associated with our lending, investing and deposit gathering activities, all of which are other than trading. Changes in interest rates affect earnings by changing net interest income and the level of other interest-sensitive income and operating expenses. In addition, variations in interest rates affect the underlying economic value of our assets, liabilities and off-balance sheet items.

Asset and Liability Management

FNCB manages these objectives through its Asset and Liability Management Committee ("ALCO") and its Rate and Liquidity and Investment Committees, which consist of certain members of management and certain members of the finance unit. Members of the committees meet regularly to develop balance sheet strategies affecting the future level of net interest income, liquidity and capital. The major objectives of ALCO are to:

- manage exposure to changes in the interest rate environment by limiting the changes in net interest margin to an acceptable level within a reasonable range of interest rates;
- ensure adequate liquidity and funding;
- maintain a strong capital base; and
- maximize net interest income opportunities.

ALCO monitors FNCB's exposure to changes in net interest income over both a one-year planning horizon and a longer-term strategic horizon. ALCO uses net interest income simulations and economic value of equity ("EVE") simulations as the primary tools in measuring and managing FNCB's position and considers balance sheet forecasts, our liquidity position, the economic environment, anticipated direction of interest rates and FNCB's earnings sensitivity to changes in these rates in its modeling. In addition, ALCO has established policy tolerance limits for acceptable negative changes in net interest income. Furthermore, as part of its ongoing monitoring, ALCO has been enhanced to require quarterly back testing of modeling results, which involves after-the-fact comparisons of projections with FNCB's actual performance to measure the validity of assumptions used in the modeling techniques.

Earnings at Risk and Economic Value at Risk Simulations

Earnings at Risk

Earnings-at-risk simulation measures the change in net interest income and net income under various interest rate scenarios. Specifically, given the current market rates, ALCO looks at "earnings at risk" to determine anticipated changes in net interest income from a base case scenario with scenarios of +200, +400, and -100 basis points for simulation purposes. The simulation takes into consideration that not all assets and liabilities re-price equally and simultaneously with market rates (i.e., savings rate).

Economic Value at Risk

While earnings-at-risk simulation measures the short-term risk in the balance sheet, economic value (or portfolio equity) at risk measures the long-term risk by finding the net present value of the future cash flows from FNCB's existing assets and liabilities. ALCO examines this ratio regularly, and given the current rate environment, has utilized rate shocks of +200, +400, and -100 basis points for simulation purposes. Management recognizes that, in some instances, this ratio may contradict the "earnings at risk" ratio.

While ALCO regularly performs a wide variety of simulations under various strategic balance sheet and treasury yield curve scenarios, the following results reflect FNCB's sensitivity over the subsequent twelve months based on the following assumptions:

- asset and liability levels using March 31, 2018 as a starting point;
- cash flows are based on contractual maturity and amortization schedules with applicable prepayments derived from internal historical data and external sources; and
- cash flows are reinvested into similar instruments so as to keep interest-earning asset and interest-bearing liability levels constant.

Explanation of Responses:

The following table illustrates the simulated impact of parallel and instantaneous interest rate shocks of +400 basis points, +200 basis points, and -100 basis points on net interest income and the change in economic value over a one-year time horizon from the March 31, 2018 levels:

	Rates +200		**Rates +400**		**Rates -100**	
	Simulation Results	**Policy Limit**	**Simulation Results**	**Policy Limit**	**Simulation Results**	**Policy Limit**
Earnings at risk:						
Percent change in net interest income	(4.6%)	(10.0 %)	(9.5 %)	(20.0 %)	(1.8%)	(5.0 %)
Economic value at risk:						
Percent change in economic value of equity	(7.8%)	(20.0 %)	(16.5%)	(35.0 %)	(2.6%)	(10.0 %)

Under the model, FNCB’s net interest income and economic value of equity are expected to decrease 4.6% and 7.8%, respectively, under a +200-basis point interest rate shock. Model results at December 31, 2017 were comparable and indicated net interest income and economic value of equity were expected to decrease 2.9% and 5.0%, respectively, given a +200-basis point rate shock.

This analysis does not represent a forecast for FNCB and should not be relied upon as being indicative of expected operating results. These simulations are based on numerous assumptions: the nature and timing of interest rate levels, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, reinvestment/replacements of asset and liability cash flows, and other factors. While assumptions reflect current economic and local market conditions, FNCB cannot make any assurances as to the predictive nature of these assumptions, including changes in interest rates, customer preferences, competition and liquidity needs, or what actions ALCO might take in responding to these changes.

As previously mentioned, as part of its ongoing monitoring, ALCO requires periodic back testing of modeling results, which involves after-the-fact comparisons of projections with FNCB’s actual performance to measure the validity of assumptions used in the modeling techniques. As part of its quarterly review, management compared tax-equivalent net interest income recorded for the three months ended March 31, 2018 with tax-equivalent net interest income that was projected for the same three-month period. The variance between actual and projected tax-equivalent net interest income for the three-month period ended March 31, 2018 was $289 thousand, or 3.1%. The variance for the first quarter of 2018 was largely attributable to higher than anticipated loan growth. ALCO performs a detailed rate/volume analysis between actual and projected results in order to continue to improve the accuracy of it simulation models.

Off-Balance Sheet Arrangements

In the normal course of operations, FNCB engages in a variety of financial transactions that, in accordance with GAAP, are not recorded in our consolidated financial statements or are recorded in amounts that differ from the notional amounts. These transactions involve, to varying degrees, elements of credit, interest rate, and liquidity risk. Such transactions may be used for general corporate purposes or for customer needs. Corporate purpose transactions would be used to help manage credit, interest rate, and liquidity risk or to optimize capital. Customer transactions are used to manage customers' requests for funding.

For the three months ended March 31, 2018, FNCB did not engage in any off-balance sheet transactions that would have or would be reasonably likely to have a material effect on its consolidated financial condition.

Item 3 — Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes in FNCB's exposure to market risk during the first three months of 2018. For discussion of FNCB's exposure to market risk, refer to Item 7A, Quantitative and Qualitative Disclosures about Market Risk, contained in FNCB's Form 10-K for the year ended December 31, 2017.

Item 4 — Controls and Procedures

FNCB's management, with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of FNCB's disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based on that evaluation, FNCB's Chief Executive Officer and Chief Financial Officer concluded FNCB's disclosure controls and procedures were effective as of March 31, 2018.

There were no changes made to FNCB's internal control over financial reporting that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, FNCB's internal control over financial reporting.

PART II Other Information

Item 1 — Legal Proceedings.

On May 24, 2012, a putative shareholder filed a complaint in the Court of Common Pleas for Lackawanna County ("Shareholder Derivative Suit") against certain present and former directors and officers of FNCB (the "Individual Defendants") alleging, inter alia, breach of fiduciary duty, abuse of control, corporate waste, and unjust enrichment. FNCB was named as a nominal defendant. On February 4, 2014, the Court issued a Final Order and Judgment for the matter granting approval of a Stipulation of Settlement (the "Settlement") and dismissing all claims against FNCB and the Individual Defendants. As part of the Settlement, without admitting any fault, wrongdoing or liability, the Individual Defendants agreed to settle the derivative litigation for $5.0 million. The $5.0 million Settlement payment was made to FNCB on March 28, 2014. The Individual Defendants reserved their rights to indemnification under FNCB's Articles of Incorporation and Bylaws, resolutions adopted by the Board, the Pennsylvania Business Corporation Law and any and all rights they have against FNCB's and the Bank's insurance carriers. In addition, in conjunction with the Settlement, FNCB accrued $2.5 million related to fees and costs of the plaintiff's attorneys, which was included in non-interest expense in the consolidated statements of income for the year ended December 31, 2013. On April 1, 2014, FNCB paid the $2.5 million related to fees and costs of the plaintiff's attorneys and partial indemnification of the Individual Defendants in the amount of $2.5 million. Commencing on July 1, 2017, FNCB made partial indemnifications to the Individual Defendants through monthly principal payments, made on behalf of the Individual Defendants, of $25,000 plus accrued interest to First Northern Bank and Trust Co. As of March 31, 2018, $2.5 million plus accrued interest was accrued in other liabilities related to the potential indemnification of the Individual Defendants. On April 11, 2018, FNCB indemnified the Individual Defendants by paying in full the $2.5 million, plus accrued interest to First Northern Bank & Trust Co, which satisfied that liability outstanding at March 31, 2018.

On September 5, 2012, Fidelity and Deposit Company of Maryland ("F&D") filed an action against FNCB and the Bank, as well as several current and former officers and directors of FNCB, in the United States District Court for the Middle District of Pennsylvania. F&D has asserted a claim for the rescission of a directors' and officers' insurance policy and a bond that it had issued to FNCB. On November 9, 2012, FNCB and the Bank answered the claim and asserted counterclaims for the losses and expenses already incurred by FNCB and the Bank. FNCB and the other defendants are defending the claims and have opposed F&D's requested relief by way of counterclaims, breaches of contract and bad faith claims against F&D for its failure to fulfill its obligations to FNCB and the Bank under the insurance policy. Discovery is complete and the parties have exchanged expert reports. Dispositive motions have been submitted by the parties and the Court heard oral arguments on the motions on August 9, 2017. FNCB is awaiting the Court's rulings on the dispositive motions. At this time, FNCB cannot reasonably determine the outcome of potential range of loss, if any, in connection with this matter.

FNCB has been subject to tax audits, and is also a party to routine litigation involving various aspects of its business, such as employment practice claims, workers compensation claims, claims to enforce liens, condemnation proceedings on properties in which FNCB holds security interests, claims involving the making and servicing of real property loans and other issues incident to its business, none of which has or is expected to have a material adverse impact on the consolidated financial condition, results of operations or liquidity of FNCB.

There have been no changes in the status of the other litigation disclosed in FNCB's Annual Report on Form 10-K for the year ended December 31, 2017.

Item 1A — Risk Factors.

Management of FNCB does not believe there have been any material changes in the risk factors that were previously disclosed in FNCB's Form 10-K for the year ending December 31, 2017.

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

None.

Item 3 - Defaults upon Senior Securities.

None.

52

Item 4 — Mine Safety Disclosures.

Not applicable.

Item 5 - Other Information.

None.

Item 6 — Exhibits.

The following exhibits are filed herewith or incorporated by reference.

EXHIBIT 3.1	Amended and Restated Articles of Incorporation dated October 4, 2016 — filed as Exhibit 3.1 to FNCB's Current Report on Form 8-K on October 11, 2016, and incorporated herein by this reference.
EXHIBIT 3.2	Amended and Restated Bylaws — filed as Exhibit 3.2 to FNCB's Current Report on Form 8-K on October 11, 2016, and incorporated herein by this reference.
EXHIBIT 4.1	Form of Common Stock Certificate — filed as Exhibit 4.1 to FNCB's Form 10-Q for the quarter ended September 30, 2016, as filed on November 4, 2016, and incorporated herein by this reference.
EXHIBIT 4.2	Form of Amended and Restated Subordinated Note — filed as Exhibit 4.2 to FNCB's Quarterly Report on Form 10-Q for the quarter ended June 30, 2015, as filed on August 7, 2015, and incorporated herein by this reference.
EXHIBIT 31.1*	Certification of Chief Executive Officer
EXHIBIT 31.2*	Certification of Chief Financial Officer
EXHIBIT 32.1**	Section 1350 Certification —Chief Executive Officer and Chief Financial Officer
EXHIBIT 101.INS	XBRL INSTANCE DOCUMENT
EXHIBIT 101.SCH	XBRL TAXONOMY EXTENSION SCHEMA

EXHIBIT 101.CAL	XBRL TAXONOMY EXTENSION CALCULATION LINKBASE
EXHIBIT 101.DEF	XBRL TAXONOMY EXTENSION DEFINITION LINKBASE
EXHIBIT 101.LAB	XBRL TAXONOMY EXTENSION LABEL LINKBASE
EXHIBIT 101.PRE	XBRL TAXONOMY EXTENSION PRESENTATION LINKBASE

*Filed herewith
**Furnished herewith

SIGNATURES

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

Registrant: FNCB BANCORP, INC.

Date: May 4, 2018 By: /s/ Gerard A. Champi
Gerard A. Champi
President and Chief Executive Officer

Date: May 4, 2018 By: /s/ James M. Bone, Jr.
James M. Bone, Jr., CPA
Executive Vice President and Chief Financial Officer
Principal Financial Officer

Date: May 4, 2018 By: /s/ Stephanie A. Westington
Stephanie A. Westington, CPA
Senior Vice President and Controller
Principal Accounting Officer