

AMES NATIONAL CORP  
Form 10-Q  
November 06, 2018

Table of Contents

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

FORM 10-Q

[Mark One]

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

For the quarterly period ended September 30, 2018

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-32637

**AMES NATIONAL CORPORATION**

(Exact Name of Registrant as Specified in Its Charter)

**IOWA** **42-1039071**  
(State or Other Jurisdiction of (I. R. S. Employer

Incorporation or Organization) Identification Number)

**405 FIFTH STREET**

**AMES, IOWA 50010**

(Address of Principal Executive Offices)

Registrant's Telephone Number, Including Area Code: **(515) 232-6251**

**Not Applicable**

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this Chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, a smaller reporting company or an emerging growth company. See definition of "accelerated filer", "large accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(1) of the Exchange Act.

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

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

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

**COMMON STOCK, \$2.00 PAR VALUE 9,310,913**

(Class)

(Shares Outstanding at October 31, 2018)

---

Table of Contents

AMES NATIONAL CORPORATION

INDEX

|  | Page |
|--|------|
| Part I. <u>Financial Information</u>   |      |
| Item 1. <u>Consolidated Financial Statements (Unaudited)</u>   | 3    |
| <u>Consolidated Balance Sheets at September 30, 2018 and December 31, 2017</u>   | 3    |
| <u>Consolidated Statements of Income for the three and nine months ended September 30, 2018 and 2017</u>               | 4    |
| <u>Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2018 and 2017</u> | 5    |
| <u>Consolidated Statements of Stockholders' Equity for the three and nine months ended September 30, 2018 and 2017</u> | 6    |
| <u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017</u>                     | 7    |
| <u>Notes to Consolidated Financial Statements</u>  | 9    |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                   | 32   |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | 52   |
| Item 4. <u>Controls and Procedures</u>   | 52   |
| Part II. <u>Other Information</u>  |      |
| Item 1. <u>Legal Proceedings</u>   | 53   |
| Item 1.A. <u>Risk Factors</u>  | 53   |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>   | 53   |
| Item 3. <u>Defaults Upon Senior Securities</u>   | 53   |
| Item 4. <u>Mine Safety Disclosures</u>   | 53   |

|                                  |    |
|----------------------------------|----|
| Item 5. <u>Other Information</u> | 54 |
| Item 6. <u>Exhibits</u>          | 54 |
| <u>Signatures</u>                | 55 |

Table of Contents**AMES NATIONAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS***(unaudited)*

|   | <b>September 30,<br/>2018</b> | <b>December 31,<br/>2017</b> |
|---|-------------------------------|------------------------------|
| <b>ASSETS</b>   |                               |                              |
| Cash and due from banks   | \$25,318,944                  | \$26,397,550                 |
| Interest bearing deposits in financial institutions                         | 38,048,525                    | 43,021,953                   |
| Securities available-for-sale   | 474,442,299                   | 495,321,664                  |
| Federal Home Loan Bank (FHLB) and Federal Reserve Bank (FRB) stock, at cost | 2,946,100                     | 3,021,200                    |
| Loans receivable, net   | 859,830,015                   | 771,549,655                  |
| Loans held for sale   | 279,940                       | -                            |
| Bank premises and equipment, net  | 16,071,119                    | 15,399,146                   |
| Accrued income receivable   | 9,485,035                     | 8,382,391                    |
| Other real estate owned   | 729,795                       | 385,509                      |
| Bank-owned life insurance   | 2,757,310                     | -                            |
| Deferred income taxes, net  | 4,803,300                     | 2,542,533                    |
| Intangible assets, net  | 2,842,085                     | 1,091,462                    |
| Goodwill  | 9,618,621                     | 6,732,216                    |
| Other assets  | 1,079,179                     | 1,214,371                    |
| <b>Total assets</b>   | <b>\$1,448,252,267</b>        | <b>\$1,375,059,650</b>       |

**LIABILITIES AND STOCKHOLDERS' EQUITY****LIABILITIES**

|  |                      |                      |
|--|----------------------|----------------------|
| <b>Deposits</b>                                |                      |                      |
| Demand, noninterest bearing                    | \$220,806,001        | \$227,332,347        |
| NOW accounts                                   | 369,779,264          | 322,392,945          |
| Savings and money market                       | 414,057,574          | 389,630,180          |
| Time, \$250,000 and over                       | 42,849,563           | 38,838,782           |
| Other time                                     | 168,268,111          | 156,196,433          |
| <b>Total deposits</b>                          | <b>1,215,760,513</b> | <b>1,134,390,687</b> |
| Securities sold under agreements to repurchase | 48,858,900           | 37,424,619           |
| Federal Home Loan Bank (FHLB) advances         | 8,400,000            | 13,500,000           |
| Other borrowings                               | -                    | 13,000,000           |
| Dividends payable                              | 2,141,510            | 2,048,401            |
| Accrued expenses and other liabilities         | 4,461,535            | 3,942,801            |
| <b>Total liabilities</b>                       | <b>1,279,622,458</b> | <b>1,204,306,508</b> |

**STOCKHOLDERS' EQUITY**

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

|   |                        |                        |
|---|------------------------|------------------------|
| Common stock, \$2 par value, authorized 18,000,000 shares; issued and outstanding 9,310,913 shares as of September 30, 2018 and December 31, 2017 | 18,621,826             | 18,621,826             |
| Additional paid-in capital  | 20,878,728             | 20,878,728             |
| Retained earnings   | 135,828,253            | 131,684,961            |
| Accumulated other comprehensive (loss) - net unrealized (loss) on securities available-for-sale   | (6,698,998 )           | (432,373 )             |
| <b>Total stockholders' equity</b>   | <b>168,629,809</b>     | <b>170,753,142</b>     |
| <b>Total liabilities and stockholders' equity</b>   | <b>\$1,448,252,267</b> | <b>\$1,375,059,650</b> |

See Notes to Consolidated Financial Statements.

Table of Contents

## AMES NATIONAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

*(unaudited)*

|  | Three Months Ended<br>September 30, |                   | Nine Months Ended<br>September 30, |                   |
|--|-------------------------------------|-------------------|------------------------------------|-------------------|
|  | 2018                                | 2017              | 2018                               | 2017              |
| Interest income:   |                                     |                   |                                    |                   |
| Loans, including fees                                      | \$9,557,527                         | \$8,729,702       | \$27,442,604                       | \$25,345,116      |
| Securities:  |                                     |                   |                                    |                   |
| Taxable  | 1,545,541                           | 1,557,872         | 4,638,503                          | 4,637,498         |
| Tax-exempt   | 1,085,131                           | 1,210,510         | 3,451,084                          | 3,819,380         |
| Interest bearing deposits and federal funds sold           | 272,358                             | 114,820           | 721,417                            | 365,346           |
| <b>Total interest income</b>                               | <b>12,460,557</b>                   | <b>11,612,904</b> | <b>36,253,608</b>                  | <b>34,167,340</b> |
| Interest expense:  |                                     |                   |                                    |                   |
| Deposits   | 1,740,579                           | 1,169,296         | 4,736,455                          | 3,204,115         |
| Other borrowed funds                                       | 134,017                             | 292,054           | 533,870                            | 862,798           |
| <b>Total interest expense</b>                              | <b>1,874,596</b>                    | <b>1,461,350</b>  | <b>5,270,325</b>                   | <b>4,066,913</b>  |
| <b>Net interest income</b>                                 | <b>10,585,961</b>                   | <b>10,151,554</b> | <b>30,983,283</b>                  | <b>30,100,427</b> |
| Provision for loan losses                                  | 100,000                             | 57,277            | 192,978                            | 1,221,620         |
| <b>Net interest income after provision for loan losses</b> | <b>10,485,961</b>                   | <b>10,094,277</b> | <b>30,790,305</b>                  | <b>28,878,807</b> |
| Noninterest income:  |                                     |                   |                                    |                   |
| Wealth management income                                   | 877,146                             | 747,634           | 2,534,510                          | 2,180,941         |
| Service fees   | 363,993                             | 401,237           | 1,036,841                          | 1,126,122         |
| Securities gains, net                                      | -                                   | 37,881            | -                                  | 498,560           |
| Gain on sale of loans held for sale                        | 207,856                             | 179,553           | 576,441                            | 544,095           |
| Merchant and card fees                                     | 358,816                             | 348,847           | 1,035,338                          | 1,017,362         |
| Gain on foreclosure of other real estate owned             | 162,862                             | -                 | 162,862                            | -                 |
| Other noninterest income                                   | 191,130                             | 144,953           | 570,685                            | 598,791           |
| <b>Total noninterest income</b>                            | <b>2,161,803</b>                    | <b>1,860,105</b>  | <b>5,916,677</b>                   | <b>5,965,871</b>  |
| Noninterest expense:                                       |                                     |                   |                                    |                   |
| Salaries and employee benefits                             | 4,331,976                           | 4,026,932         | 13,216,844                         | 12,058,903        |
| Data processing  | 838,414                             | 807,419           | 2,506,804                          | 2,481,331         |
| Occupancy expenses, net                                    | 536,004                             | 527,071           | 1,490,395                          | 1,546,657         |
| FDIC insurance assessments                                 | 99,934                              | 111,987           | 308,002                            | 326,958           |
| Professional fees  | 423,172                             | 307,484           | 1,123,577                          | 919,157           |
| Business development                                       | 327,985                             | 262,408           | 821,344                            | 722,869           |
| Intangible asset amortization                              | 94,883                              | 89,861            | 266,337                            | 280,837           |



Edgar Filing: AMES NATIONAL CORP - Form 10-Q

|                                      |                    |                    |                     |                     |
|--------------------------------------|--------------------|--------------------|---------------------|---------------------|
| Data conversion costs                | 167,815            | -                  | 167,815             | -                   |
| Other operating expenses, net        | 167,649            | 162,826            | 664,914             | 835,414             |
| <b>Total noninterest expense</b>     | <b>6,987,832</b>   | <b>6,295,988</b>   | <b>20,566,032</b>   | <b>19,172,126</b>   |
| <b>Income before income taxes</b>    | <b>5,659,932</b>   | <b>5,658,394</b>   | <b>16,140,950</b>   | <b>15,672,552</b>   |
| Provision for income taxes           | 1,201,100          | 1,729,987          | 3,328,100           | 4,661,687           |
| <b>Net income</b>                    | <b>\$4,458,832</b> | <b>\$3,928,407</b> | <b>\$12,812,850</b> | <b>\$11,010,865</b> |
| Basic and diluted earnings per share | \$0.48             | \$0.42             | \$1.38              | \$1.18              |
| Dividends declared per share         | \$0.23             | \$0.22             | \$0.94              | \$0.66              |

See Notes to Consolidated Financial Statements.

Table of Contents**AMES NATIONAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME***(unaudited)*

|  | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |              |
|--|---------------------------|-------------|--------------------------|--------------|
|  | <b>September 30,</b>      |             | <b>September 30,</b>     |              |
|  | <b>2018</b>               | <b>2017</b> | <b>2018</b>              | <b>2017</b>  |
| Net income   | \$4,458,832               | \$3,928,407 | \$12,812,850             | \$11,010,865 |
| Other comprehensive income (loss), before tax:                     |                           |             |                          |              |
| Unrealized gains (losses) on securities before tax:                |                           |             |                          |              |
| Unrealized holding gains (losses) arising during the period        | (2,171,391)               | (270,853 )  | (8,245,692 )             | 5,828,684    |
| Less: reclassification adjustment for gains realized in net income | -                         | 37,881      | -                        | 498,560      |
| Other comprehensive income (loss), before tax                      | (2,171,391)               | (308,734 )  | (8,245,692 )             | 5,330,124    |
| Tax effect related to other comprehensive income (loss)            | 542,848                   | 114,233     | 2,061,767                | (1,972,145 ) |
| Other comprehensive income (loss), net of tax                      | (1,628,543)               | (194,501 )  | (6,183,925 )             | 3,357,979    |
| Comprehensive income   | \$2,830,289               | \$3,733,906 | \$6,628,925              | \$14,368,844 |

See Notes to Consolidated Financial Statements.

Table of Contents

## AMES NATIONAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

*(unaudited)*

## Three Months Ended September 30, 2018 and 2017

|   | Common<br>Stock | Additional<br>Paid-<br>in Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss),<br>Net of Taxes | Total<br>Stockholders'<br>Equity |
|---|-----------------|-----------------------------------|----------------------|---|----------------------------------|
| <b>Balance, June 30, 2017</b>             | \$18,621,826    | \$20,878,728                      | \$129,167,032        | \$2,975,793   | \$171,643,379                    |
| Net income                                | -               | -                                 | 3,928,407            | -   | 3,928,407                        |
| Other comprehensive income                | -               | -                                 | -                    | (194,501 )  | (194,501 )                       |
| Cash dividends declared, \$0.22 per share | -               | -                                 | (2,048,401 )         | -   | (2,048,401 )                     |
| <b>Balance, September 30, 2017</b>        | \$18,621,826    | \$20,878,728                      | \$131,047,038        | \$2,781,292   | \$173,328,884                    |
| <b>Balance, June 30, 2018</b>             | \$18,621,826    | \$20,878,728                      | \$133,510,931        | \$(5,070,455 )  | \$167,941,030                    |
| Net income                                | -               | -                                 | 4,458,832            | -   | 4,458,832                        |
| Other comprehensive (loss)                | -               | -                                 | -                    | (1,628,543 )  | (1,628,543 )                     |
| Cash dividends declared, \$0.23 per share | -               | -                                 | (2,141,510 )         | -   | (2,141,510 )                     |
| <b>Balance, September 30, 2018</b>        | \$18,621,826    | \$20,878,728                      | \$135,828,253        | \$(6,698,998 )  | \$168,629,809                    |

## Nine Months Ended September 30, 2018 and 2017

|                                   | Common<br>Stock | Additional<br>Paid-<br>in Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income (Loss),<br>Net of Taxes | Total<br>Stockholders'<br>Equity |
|-----------------------------------|-----------------|-----------------------------------|----------------------|---|----------------------------------|
| <b>Balance, December 31, 2016</b> | \$18,621,826    | \$20,878,728                      | \$126,181,376        | \$(576,687 )  | \$165,105,243                    |

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

|  |               |               |                |                 |                |
|--|---------------|---------------|----------------|-----------------|----------------|
| Net income   | -             | -             | 11,010,865     | -               | 11,010,865     |
| Other comprehensive income                                 | -             | -             | -              | 3,357,979       | 3,357,979      |
| Cash dividends declared, \$0.66 per share                  | -             | -             | (6,145,203 )   | -               | (6,145,203 )   |
| <b>Balance, September 30, 2017</b>                         | \$ 18,621,826 | \$ 20,878,728 | \$ 131,047,038 | \$ 2,781,292    | \$ 173,328,884 |
| <b>Balance, December 31, 2017</b>                          | \$ 18,621,826 | \$ 20,878,728 | \$ 131,684,961 | \$ (432,373 )   | \$ 170,753,142 |
| Net income   | -             | -             | 12,812,850     | -               | 12,812,850     |
| Other comprehensive (loss)                                 | -             | -             | -              | (6,183,925 )    | (6,183,925 )   |
| The cumulative effect from change in accounting policy (1) | -             | -             | 82,700         | (82,700 )       | -              |
| Cash dividends declared, \$0.94 per share                  | -             | -             | (8,752,258 )   | -               | (8,752,258 )   |
| <b>Balance, September 30, 2018</b>                         | \$ 18,621,826 | \$ 20,878,728 | \$ 135,828,253 | \$ (6,698,998 ) | \$ 168,629,809 |

(1) The cumulative effect for the nine months ended September 30, 2018, reflects adoption in first quarter 2018 of ASU 2018-02.

See Notes to Consolidated Financial Statements.

Table of Contents**AMES NATIONAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS***(unaudited)***Nine Months Ended September 30, 2018 and 2017**

|   | <b>2018</b>       | <b>2017</b>         |
|---|-------------------|---------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                       |                   |                     |
| Net income  | \$ 12,812,850     | \$ 11,010,865       |
| Adjustments to reconcile net income to net cash provided by operating activities: |                   |                     |
| Provision for loan losses   | 192,978           | 1,221,620           |
| Provision for off-balance sheet commitments                                       | 9,000             | 4,000               |
| Amortization, net   | 1,583,534         | 2,129,648           |
| Amortization of intangible asset  | 266,337           | 280,837             |
| Depreciation  | 845,163           | 861,700             |
| Deferred income taxes   | (24,000 )         | (303,999 )          |
| Securities gains, net   | -                 | (498,560 )          |
| (Gain) on sales of loans held for sale  | (576,441 )        | (544,095 )          |
| Proceeds from loans held for sale   | 23,480,924        | 22,668,307          |
| Originations of loans held for sale   | (23,184,423 )     | (22,161,394 )       |
| Loss on sale of premises and equipment, net                                       | 11,479            | 56,168              |
| (Gain) on sale and foreclosure of other real estate owned, net                    | (226,054 )        | (14,648 )           |
| Change in assets and liabilities:   |                   |                     |
| (Increase) in accrued income receivable   | (239,749 )        | (654,349 )          |
| (Increase) decrease in other assets   | 133,639           | (377,095 )          |
| Increase (decrease) in accrued expenses and other liabilities                     | 385,983           | (126,404 )          |
| <b>Net cash provided by operating activities</b>                                  | <b>15,471,220</b> | <b>13,552,601</b>   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                       |                   |                     |
| Purchase of securities available-for-sale   | (24,209,779 )     | (46,766,543 )       |
| Proceeds from sale of securities available-for-sale                               | -                 | 11,756,963          |
| Proceeds from maturities and calls of securities available-for-sale               | 52,143,244        | 48,326,502          |
| Purchase of FHLB stock  | (3,070,400 )      | (4,505,400 )        |
| Proceeds from the redemption of FHLB stock  | 3,275,100         | 4,261,600           |
| Net (increase) decrease in interest bearing deposits in financial institutions    | 6,448,428         | (3,749,025 )        |
| Net (increase) in loans   | (12,239,005 )     | (13,190,423 )       |
| Net proceeds from the sale of other real estate owned                             | 117,905           | 191,564             |
| Purchase of bank premises and equipment, net                                      | (591,165 )        | (447,039 )          |
| Cash paid, net of cash acquired, for bank acquired                                | (13,443,219 )     | -                   |
| Other   | 1,139,029         | (61,761 )           |
| <b>Net cash provided by (used in) investing activities</b>                        | <b>9,570,138</b>  | <b>(4,183,562 )</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                       |                   |                     |
| Increase (decrease) in deposits   | (1,795,096 )      | 5,129,194           |
| Increase (decrease) in securities sold under agreements to repurchase             | 2,434,281         | (19,336,317 )       |

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

|  |                     |                     |
|--|---------------------|---------------------|
| Payments on FHLB borrowings and other borrowings         | (24,500,000)        | (1,000,000 )        |
| Proceeds from short-term borrowings and other borrowings | 6,400,000           | 5,500,000           |
| Dividends paid   | (8,659,149 )        | (6,052,094 )        |
| <b>Net cash (used in) financing activities</b>           | <b>(26,119,964)</b> | <b>(15,759,217)</b> |
| <br>   |                     |                     |
| <b>Net (decrease) in cash and due from banks</b>         | <b>(1,078,606 )</b> | <b>(6,390,178 )</b> |
| <br>   |                     |                     |
| <b>CASH AND DUE FROM BANKS</b>                           |                     |                     |
| Beginning  | 26,397,550          | 29,478,068          |
| Ending   | \$25,318,944        | \$23,087,890        |

7

---

Table of Contents**AMES NATIONAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)***(unaudited)***Nine Months Ended September 30, 2018 and 2017**

|  | <b>2018</b> | <b>2017</b> |
|--|-------------|-------------|
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>                    |             |             |
| Cash payments for:   |             |             |
| Interest   | \$5,039,767 | \$4,027,782 |
| Income taxes   | 3,484,746   | 5,050,220   |
| <b>SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES</b>             |             |             |
| Transfer of loans receivable to other real estate owned                    | \$116,137   | \$16,668    |
| Business Combination:  |             |             |
| Fair value of interest bearing deposits in financial institutions acquired | \$1,475,000 | \$-         |
| Fair value of federal funds sold acquired                                  | 1,154,000   | -           |
| Fair value of securities available-for-sale acquired                       | 17,196,715  | -           |
| Fair value of loans receivable acquired                                    | 76,041,470  | -           |
| Fair value of bank premises and equipment acquired                         | 924,400     | -           |
| Fair value of accrued interest receivable acquired                         | 862,895     | -           |
| Fair value of other real estate owned acquired                             | 120,000     | -           |
| Fair value of other tangible assets acquired                               | 318,596     | -           |
| Fair value of bank owned life insurance                                    | 2,754,798   | -           |
| Goodwill   | 2,886,405   | -           |
| Core deposit intangible  | 2,002,000   | -           |
| Deposits assumed   | 83,169,311  | -           |
| Federal funds purchased assumed  | 9,000,000   | -           |
| Other liabilities assumed  | 123,749     | -           |

See Notes to Consolidated Financial Statements.

Table of Contents

**AMES NATIONAL CORPORATION AND SUBSIDIARIES**

Notes to Consolidated Financial Statements (*unaudited*)

1. Significant Accounting Policies

The consolidated financial statements for the three and nine months ended September 30, 2018 and 2017 are unaudited. In the opinion of the management of Ames National Corporation (the "Company"), these financial statements reflect all adjustments, consisting only of normal recurring accruals, necessary to present fairly these consolidated financial statements. The results of operations for the interim periods are not necessarily indicative of results which may be expected for an entire year. Certain information and footnote disclosures normally included in complete financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted in accordance with the requirements for interim financial statements. The interim financial statements and notes thereto should be read in conjunction with the year-end audited financial statements contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 (the "Annual Report"). The consolidated financial statements include the accounts of the Company and its wholly-owned banking subsidiaries (the "Banks"). All significant intercompany balances and transactions have been eliminated in consolidation.

**Goodwill:** Goodwill represents the excess of cost over the fair value of net assets acquired. Goodwill resulting from acquisitions is not amortized, but is tested for impairment annually or whenever events change and circumstances indicate that it is more likely than not that an impairment loss has occurred. Goodwill is tested for impairment using a two-step process that begins with an estimation of the fair value of a reporting unit. The second step, if necessary, measures the amount of impairment, if any.

Significant judgment is applied when goodwill is assessed for impairment. This judgment includes developing cash flow projections, selecting appropriate discount rates, identifying relevant market comparables, incorporating general economic and market conditions and selecting an appropriate control premium. At September 30, 2018, Company management has performed a goodwill impairment assessment and determined goodwill was not impaired.

New and Pending Accounting Pronouncements: In January 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") No. 2016-01, Financial Instruments—Overall (Subtopic 825-10): *Recognition and Measurement of Financial Assets and Financial Liabilities*. The update enhances the reporting model for financial instruments to provide users of financial statements with more decision-useful information by updating certain aspects of recognition, measurement, presentation and disclosure of financial instruments. Among other



changes, the update includes requiring changes in fair value of equity securities with readily determinable fair value to be recognized in net income and clarifies that entities should evaluate the need for a valuation allowance on a deferred tax asset related to available for sale securities in combination with the entities' other deferred tax assets. Among other items the ASC requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. The Company adopted this guidance effective January 1, 2018 and is to be applied on a modified retrospective basis. The fair value of the Company's loan portfolio is presented using an exit price method. Also, the Company is no longer required to disclose the methodologies used for estimating fair value of financial instruments measured at amortized cost on a recurring or nonrecurring basis. The remaining requirements of this update did not have a material impact on the Company's consolidated financial statements.

Table of Contents

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The ASU requires a lessee to recognize on the balance sheet assets and liabilities for leases with lease terms of more than 12 months. Consistent with current GAAP, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. Unlike current GAAP, which requires that only capital leases be recognized on the balance sheet, the ASC requires that both types of leases be recognized on the balance sheet. In July 2018, the FASB issued ASU No. 2018-11, Targeted Improvements, which amends ASC 842, Leases. This update provides for an adoption option that will not require earlier periods to be restated at the adoption date. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2018. Early application is permitted. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The ASU requires an organization to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2019. The Company is currently planning for the implementation of this accounting standard. It is too early to assess the impact that the guidance will have on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606): *Summary and Amendments that Create Revenue from Contracts with Customers (Topic 606) and Other Assets and Deferred Costs—Contracts with Customers (Subtopic 340-40)*. The guidance in this update supersedes the revenue recognition requirements in ASC Topic 605, Revenue Recognition, and most industry-specific guidance throughout the industry topics of the Codification. The Company adopted this guidance effective January 1, 2018. The guidance does not apply to revenues associated with financial instruments, including loans and securities that are accounted for under U.S. GAAP. The requirements of this update did not have a material impact on the Company's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles—Goodwill and Other (Topic 350): *Simplifying the Test for Goodwill Impairment*. The guidance in this update eliminates the Step 2 from the goodwill impairment test. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2019, with early adoption permitted for interim and annual goodwill impairment test with a measurement date after January 1, 2017. The Company does not expect the guidance to have a material impact on the Company's consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, Income Statement-Reporting Comprehensive Income (Topic 220): *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. The amendments in this ASU would require a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the newly enacted federal corporate income tax rate. The amount of the reclassification would be the difference between the historical corporate income tax rate and the newly enacted 21 percent corporate income tax rate. The amendments in this update will be effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption of the amendments in this update is permitted. The Company adopted this ASU in the first quarter of 2018. The Company made an election to reclassify the income tax effects of the Tax Cuts and Jobs Act from accumulated comprehensive income to retained earnings. This update did not have a material impact on the Company's financial statements.

Table of Contents

In August 2018, the FASB issued ASU No. 2018-13, Fair Value Measurement (Topic 820): *Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. The amendments in this update modify the disclosure requirements for fair value measurements by removing, modifying, or adding certain disclosures. The update is effective for interim and annual periods in fiscal years beginning after December 15, 2019, with early adoption permitted for the removed disclosures and delayed adoption until fiscal year 2020 permitted for the new disclosures. The removed and modified disclosures will be adopted on a retrospective basis, and the new disclosures will be adopted on a prospective basis. The adoption will not have a material effect on the Company’s consolidated financial statements.

Reclassifications: Certain amounts in prior year financial statements have been reclassified, with no effect on net income, comprehensive income or stockholder’s equity, to conform with current period presentation.

2. Bank Acquisition

On September 14, 2018, First National Bank (FNB) completed the purchase and merger of Clarke County State Bank (CCSB) located in Osceola and Murray, Iowa (the “Acquisition”). The Acquisition was consistent with the Bank’s strategy to strengthen and expand its Iowa market share. The acquired assets and liabilities are recorded at fair value at the date of acquisition and were reflected in the September 30, 2018 financial statements as such. 100% of the stock of CCSB was purchased for cash consideration of \$14.8 million. As a result of this acquisition, the Company recorded a core deposit intangible asset of \$2.0 million and goodwill of \$2.9 million. The results of operations for this acquisition have been included since the transaction date of September 14, 2018. The fair value of purchased credit deteriorated loans related to the Acquisition is \$386,000. These purchased loans are included in the impaired loan category in the financial statements. Non-routine expenses associated with this transaction were approximately \$340,000 for the nine months ended September 30, 2018.

Table of Contents

The following table summarizes the fair value of the total consideration transferred as a part of the Acquisition as well as the fair value of identifiable assets acquired and liabilities assumed as of the effective date of the transaction.

|   |              |
|---|--------------|
| Cash consideration transferred  | \$14,806,981 |
| Recognized amounts of identifiable assets acquired and liabilities assumed: |              |
| Cash and due from banks   | \$1,363,762  |
| Federal funds sold  | 1,154,000    |
| Interest bearing deposits in financial institutions                         | 1,475,000    |
| Securities available-for-sale   | 17,196,715   |
| Federal Home Loan Bank stock  | 129,600      |
| Loans receivable  | 76,041,470   |
| Accrued interest receivable   | 862,895      |
| Bank premises and equipment   | 924,400      |
| Other real estate owned   | 120,000      |
| Deferred income taxes   | 175,000      |
| Bank owned life insurance   | 2,754,798    |
| Core deposit intangible asset   | 2,002,000    |
| Other assets  | 13,996       |
| Deposits  | (83,169,311) |
| Federal funds purchased   | (9,000,000 ) |
| Accrued interest payable and other liabilities                              | (123,749 )   |
| Total identifiable net assets   | 11,920,576   |
| Goodwill  | \$2,886,405  |

On September 14, 2018, the contractual balance of loans receivable acquired was \$77.2 million and the contractual balance of deposits assumed was \$83.1 million. Loans receivable acquired include commercial real estate, 1-4 family real estate agricultural real estate, commercial operating, agricultural operating and consumer loans.

The acquired loans at contractual values as of September 14, 2018 were determined to be risk rated as follows:

|                                    |              |
|------------------------------------|--------------|
| Pass                               | \$63,220,130 |
| Watch                              | 9,430,540    |
| Special Mention                    | 2,733,940    |
| Substandard                        | 1,426,137    |
| Deteriorated credit                | 385,884      |
| Total loans acquired at book value | \$77,196,631 |

Loans acquired as deteriorated credit loans will be included with impaired loans.

The core deposit intangible asset is amortized to expense on a declining basis over a period of ten years. The loan market valuation is accreted to income on the effective yield method over a ten year period. The time deposits market valuation is amortized to expense on a declining basis over a two year period.

Table of Contents

3.Dividends

On August 8, 2018, the Company declared a cash dividend on its common stock, payable on November 15, 2018 to stockholders of record as of November 1, 2018, equal to \$0.23 per share

4.Earnings Per Share

Earnings per share amounts were calculated using the weighted average shares outstanding during the periods presented. The weighted average outstanding shares for the three and nine months ended September 30, 2018 and 2017 were 9,310,913. The Company had no potentially dilutive securities outstanding during the periods presented.

5.Off-Balance Sheet Arrangements

The Company is party to financial instruments with off-balance sheet risk in the normal course of business. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. No material changes in the Company's off-balance sheet arrangements have occurred since December 31, 2017.

6.Fair Value Measurements

Assets and liabilities carried at fair value are required to be classified and disclosed according to the process for determining fair value. There are three levels of determining fair value.

Level 1: Inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

Level 2: Inputs to the valuation methodology include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatility, prepayment speeds, credit risk); or inputs

derived principally from or can be corroborated by observable market data by correlation or other means.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement. Level 3 assets and liabilities include financial instruments whose value is determined using discounted cash flow methodologies, as well as instruments for which the determination of fair value requires significant management judgment or estimation.



Table of Contents

The following table presents the balances of assets measured at fair value on a recurring basis by level as of September 30, 2018 and December 31, 2017. *(in thousands)*

| Description                                | Total     | Level<br>1 | Level 2   | Level<br>3 |
|--|-----------|------------|-----------|------------|
| <b>2018</b>                                |           |            |           |            |
| U.S. government treasuries                 | \$8,209   | \$8,209    | \$-       | \$ -       |
| U.S. government agencies                   | 117,011   | -          | 117,011   | -          |
| U.S. government mortgage-backed securities | 73,277    | -          | 73,277    | -          |
| State and political subdivisions           | 221,930   | -          | 221,930   | -          |
| Corporate bonds                            | 54,015    | -          | 54,015    | -          |
|  | \$474,442 | \$8,209    | \$466,233 | \$ -       |
| <b>2017</b>                                |           |            |           |            |
| U.S. government treasuries                 | \$6,367   | \$6,367    | \$-       | \$ -       |
| U.S. government agencies                   | 111,263   | -          | 111,263   | -          |
| U.S. government mortgage-backed securities | 81,780    | -          | 81,780    | -          |
| State and political subdivisions           | 237,413   | -          | 237,413   | -          |
| Corporate bonds                            | 58,464    | -          | 58,464    | -          |
| Equity securities, other                   | 35        | 35         | -         | -          |
|  | \$495,322 | \$6,402    | \$488,920 | \$ -       |

Level 1 securities include U.S. Treasury securities and other equity securities that are traded by dealers or brokers in active over-the-counter markets. U.S government agencies, mortgage-backed securities, state and political subdivisions, and most corporate bonds are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the security's terms and conditions, among other things.

The Company's policy is to recognize transfers between levels at the end of each reporting period, if applicable. There were no transfers between levels of the fair value hierarchy during the three and nine months ended September 30, 2018.

Table of Contents

Certain assets are measured at fair value on a nonrecurring basis; that is, they are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets carried on the balance sheet (after specific reserves) by caption and by level within the valuation hierarchy as of September 30, 2018 and December 31, 2017. (*in thousands*)

| Description             | Total   | Level<br>1 | Level<br>2 | Level<br>3 |
|-------------------------|---------|------------|------------|------------|
| <b>2018</b>             |         |            |            |            |
| Loans receivable        | \$2,338 | \$ -       | \$ -       | \$2,338    |
| Other real estate owned | 730     | -          | -          | 730        |
| Total                   | \$3,068 | \$ -       | \$ -       | \$3,068    |
| <b>2017</b>             |         |            |            |            |
| Loans receivable        | \$2,606 | \$ -       | \$ -       | \$2,606    |
| Other real estate owned | 386     | -          | -          | 386        |
| Total                   | \$2,992 | \$ -       | \$ -       | \$2,992    |

**Loans Receivable:** Loans in the tables above consist of impaired credits held for investment. In accordance with the loan impairment guidance, impairment was measured based on the fair value of collateral less estimated selling costs for collateral dependent loans. Fair value for impaired loans is based upon appraised values of collateral adjusted for trends observed in the market. A valuation allowance was recorded for the excess of the loan's recorded investment over the amounts determined by the collateral value method. This valuation allowance is a component of the allowance for loan losses. The Company considers these fair value measurements as level 3.

**Other Real Estate Owned:** Other real estate owned in the table above consists of real estate obtained through foreclosure. Other real estate owned is recorded at fair value less estimated selling costs, at the date of transfer, with any impairment amount charged to the allowance for loan losses. Subsequent to the transfer, other real estate owned is carried at the lower of cost or fair value, less estimated selling costs, with any impairment amount recorded as a noninterest expense. The carrying value of other real estate owned is not re-measured to fair value on a recurring basis but is subject to fair value adjustments when the carrying value exceeds the fair value less estimated selling costs. Management uses appraised values and adjusts for trends observed in the market and for disposition costs in determining the value of other real estate owned. A valuation allowance was recorded for the excess of the asset's recorded investment over the amount determined by the fair value, less estimated selling costs. This valuation allowance is a component of the allowance for other real estate owned. The valuation allowance was \$239,000 and \$287,000 as of September 30, 2018 and December 31, 2017, respectively. The Company considers these fair value measurements as level 3.



Table of Contents

The significant inputs used in the fair value measurements for Level 3 assets measured at fair value on a nonrecurring basis as of September 30, 2018 and December 31, 2017 are as follows: *(in thousands)*

|                         |                      | <b>2018</b>              |                      |                 |         |
|-------------------------|----------------------|--------------------------|----------------------|-----------------|---------|
|                         | Estimated Fair Value | Valuation Techniques     | Unobservable Inputs  | Range (Average) |         |
| Impaired Loans          | \$2,338              | Evaluation of collateral | Estimation of value  | NM*             |         |
| Other real estate owned | \$730                | Appraisal                | Appraisal adjustment | 6%-             | 8% (7%) |
|                         |                      | <b>2017</b>              |                      |                 |         |
|                         | Estimated Fair Value | Valuation Techniques     | Unobservable Inputs  | Range (Average) |         |
| Impaired Loans          | \$2,606              | Evaluation of collateral | Estimation of value  | NM*             |         |
| Other real estate owned | \$386                | Appraisal                | Appraisal adjustment | 6%-             | 8% (7%) |

\* Not Meaningful. Evaluations of the underlying assets are completed for each impaired loan with a specific reserve. The types of collateral vary widely and could include accounts receivables, inventory, a variety of equipment and real estate. Collateral evaluations are reviewed and discounted as appropriate based on knowledge of the specific type of collateral. In the case of real estate, an independent appraisal may be obtained. Types of discounts considered included aging of receivables, condition of the collateral, potential market for the collateral and estimated disposal costs. These discounts will vary from loan to loan, thus providing a range would not be meaningful.

GAAP requires disclosure of the fair value of financial assets and financial liabilities, including those that are not measured and reported at fair value on a recurring basis or nonrecurring basis. The methodologies for estimating the fair value of financial assets and financial liabilities that are measured at fair value on a recurring or nonrecurring basis are discussed above. The methodologies for other financial assets and financial liabilities are discussed below.

**Fair value of financial instruments:**

Disclosure of fair value information about financial instruments, for which it is practicable to estimate that value, is required whether or not recognized in the consolidated balance sheets. In cases in which quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are

significantly affected by the assumptions used, including the discount rate and estimate of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases could not be realized in immediate settlement of the instruments. Certain financial instruments with a fair value that is not practicable to estimate and all non-financial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value amounts presented do not necessarily represent the underlying value of the Company.

The following disclosures represent financial instruments in which the ending balances at September 30, 2018 and December 31, 2017 are not carried at fair value in their entirety on the consolidated balance sheets.

Table of Contents

Securities available-for-sale: Fair value measurement for Level 1 securities is based upon quoted prices. Fair value measurement for Level 2 securities are based upon quoted prices, if available. If quoted prices are not available, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the security's terms and conditions, among other things. Level 1 securities include U.S. Treasury and other equity securities that are traded by dealers or brokers in active over-the-counter markets. U.S government mortgage-backed securities, state and political subdivisions, and some corporate bonds are reported at fair value utilizing Level 2 inputs.

Loans held for sale: The fair value of loans held for sale is based on prevailing market prices.

Limitations: Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The estimated fair values of the Company's financial instruments as described above as of September 30, 2018 and December 31, 2017 are as follows: *(in thousands)*

|  |                            | <b>2018</b>     |                      | <b>2017</b>     |                      |
|--|----------------------------|-----------------|----------------------|-----------------|----------------------|
|  | Fair Value Hierarchy Level | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial assets:                              |                            |                 |                      |                 |                      |
| Cash and due from banks                        | Level 1                    | \$25,319        | \$25,319             | \$26,398        | \$26,398             |
| Interest bearing deposits                      | Level 1                    | 38,049          | 38,049               | 43,022          | 43,022               |
| Securities available-for-sale                  | See previous table         | 474,442         | 474,442              | 495,322         | 495,322              |
| FHLB and FRB stock                             | Level 2                    | 2,946           | 2,946                | 3,021           | 3,021                |
| Loans receivable, net                          | Level 2                    | 859,830         | 836,630              | 771,550         | 768,444              |
| Loans held for sale                            | Level 2                    | 280             | 280                  | -               | -                    |
| Accrued income receivable                      | Level 1                    | 9,485           | 9,485                | 8,382           | 8,382                |
| Financial liabilities:                         |                            |                 |                      |                 |                      |
| Deposits                                       | Level 2                    | \$1,215,761     | \$1,214,578          | \$1,134,391     | \$1,134,468          |
| Securities sold under agreements to repurchase | Level 1                    | 48,859          | 48,859               | 37,425          | 37,425               |
| FHLB advances                                  | Level 2                    | 8,400           | 8,346                | 13,500          | 13,482               |
| Other borrowings                               | Level 2                    | -               | -                    | 13,000          | 13,079               |

|                          |         |     |     |     |     |
|--------------------------|---------|-----|-----|-----|-----|
| Accrued interest payable | Level 1 | 643 | 643 | 477 | 477 |
|--------------------------|---------|-----|-----|-----|-----|

The methodologies used to determine fair value as of September 30, 2018 did not change from the methodologies described in the December 31, 2017 Annual Financial Statements, except for loans receivables which are now presented using an exit price method.

Table of Contents

## 7. Debt and Equity Securities

The amortized cost of securities available-for-sale and their fair values as of September 30, 2018 and December 31, 2017 are summarized below: *(in thousands)*

| <b>2018:</b>                               | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
|--|-------------------|------------------------------|-------------------------------|----------------------------|
| U.S. government treasuries                 | \$ 8,415          | \$ -                         | \$ (206 )                     | \$ 8,209                   |
| U.S. government agencies                   | 119,886           | 1                            | (2,876 )                      | 117,011                    |
| U.S. government mortgage-backed securities | 75,111            | 75                           | (1,909 )                      | 73,277                     |
| State and political subdivisions           | 224,514           | 334                          | (2,918 )                      | 221,930                    |
| Corporate bonds                            | 55,448            | 3                            | (1,436 )                      | 54,015                     |
|  | \$ 483,374        | \$ 413                       | \$ (9,345 )                   | \$ 474,442                 |

| <b>2017:</b>                               | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
|--|-------------------|------------------------------|-------------------------------|----------------------------|
| U.S. government treasuries                 | \$ 6,413          | \$ 2                         | \$ (48 )                      | \$ 6,367                   |
| U.S. government agencies                   | 111,900           | 136                          | (773 )                        | 111,263                    |
| U.S. government mortgage-backed securities | 81,685            | 422                          | (327 )                        | 81,780                     |
| State and political subdivisions           | 237,349           | 1,233                        | (1,169 )                      | 237,413                    |
| Corporate bonds                            | 58,647            | 206                          | (389 )                        | 58,464                     |
| Equity securities, other                   | 15                | 20                           | -                             | 35                         |
|  | \$ 496,009        | \$ 2,019                     | \$ (2,706 )                   | \$ 495,322                 |

The proceeds, gains and losses from securities available-for-sale are summarized as follows: *(in thousands)*

|  | Three<br>Months<br>Ended<br>September<br>30,<br><b>2018</b> | Nine<br>Months<br>Ended<br>September<br>30,<br><b>2017</b> |
|--|---|--|
| Proceeds from sales of securities available-for-sale | \$- \$ 933  | \$- \$ 11,757  |



Edgar Filing: AMES NATIONAL CORP - Form 10-Q

|   |   |    |   |      |
|---|---|----|---|------|
| Gross realized gains on securities available-for-sale                           | - | 38 | - | 501  |
| Gross realized losses on securities available-for-sale                          | - | -  | - | (2 ) |
| Tax provision applicable to net realized gains on securities available-for-sale | - | 14 | - | 175  |

18

---

Table of Contents

Unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position are summarized as of September 30, 2018 and December 31, 2017 are as follows: *(in thousands)*

|  | Less than 12 Months |             | 12 Months or More |             | Total      |             |
|--|---------------------|-------------|-------------------|-------------|------------|-------------|
|  | Estimated           | Unrealized  | Estimated         | Unrealized  | Estimated  | Unrealized  |
|  | Fair Value          | Losses      | Fair Value        | Losses      | Fair Value | Losses      |
| <b>2018:</b>                               |                     |             |                   |             |            |             |
| Securities available-for-sale:             |                     |             |                   |             |            |             |
| U.S. government treasuries                 | \$4,876             | \$ (85 )    | \$2,833           | \$ (121 )   | \$7,709    | \$ (206 )   |
| U.S. government agencies                   | 72,358              | (1,270 )    | 44,156            | (1,606 )    | 116,514    | (2,876 )    |
| U.S. government mortgage-backed securities | 54,391              | (1,371 )    | 13,993            | (538 )      | 68,384     | (1,909 )    |
| State and political subdivisions           | 132,856             | (1,475 )    | 35,338            | (1,443 )    | 168,194    | (2,918 )    |
| Corporate bonds                            | 36,003              | (796 )      | 16,999            | (640 )      | 53,002     | (1,436 )    |
|  | \$300,484           | \$ (4,997 ) | \$113,319         | \$ (4,348 ) | \$413,803  | \$ (9,345 ) |

|  | Less than 12 Months |                   | 12 Months or More |                   | Total      |                   |
|--|---------------------|-------------------|-------------------|-------------------|------------|-------------------|
|  | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value | Unrealized Losses |
|  | <b>2017:</b>        |                   |                   |                   |            |                   |
| Securities available-for-sale:             |                     |                   |                   |                   |            |                   |
| U.S. government treasuries                 | \$4,894             | \$ (48 )          | \$-               | \$ -              | \$4,894    | \$ (48 )          |
| U.S. government agencies                   | 73,953              | (549 )            | 10,168            | (224 )            | 84,121     | (773 )            |
| U.S. government mortgage-backed securities | 39,565              | (245 )            | 5,344             | (82 )             | 44,909     | (327 )            |
| State and political subdivisions           | 89,904              | (703 )            | 16,631            | (466 )            | 106,535    | (1,169 )          |
| Corporate bonds                            | 29,808              | (198 )            | 6,709             | (191 )            | 36,517     | (389 )            |
|  | \$238,124           | \$ (1,743 )       | \$38,852          | \$ (963 )         | \$276,976  | \$ (2,706 )       |

Gross unrealized losses on debt securities totaled \$9,345,000 as of September 30, 2018. These unrealized losses are generally due to changes in interest rates or general market conditions. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, state or political subdivision, or corporations. Management then determines whether downgrades by bond rating agencies have occurred, and reviews industry analysts' reports. The Company's procedures for evaluating investments in states, municipalities and political subdivisions include but are not limited to reviewing the offering statement and the most current available financial information, comparing yields to yields of bonds of similar credit quality, confirming capacity to repay, assessing operating and financial performance, evaluating the stability of tax revenues, considering debt profiles and local demographics, and for revenue bonds, assessing the source and strength of revenue structures for municipal authorities. These procedures, as applicable, are utilized for all municipal purchases and are utilized in whole or in part for monitoring the portfolio of municipal holdings. The Company does not utilize third party credit rating agencies as a primary component of determining if the municipal issuer has an adequate capacity to meet the financial commitments under the security for the projected life of the investment, and, therefore, does not compare

internal assessments to those of the credit rating agencies. Credit rating downgrades are utilized as an additional indicator of credit weakness and as a reference point for historical default rates. Management concluded that the gross unrealized losses on debt securities were temporary. Due to potential changes in conditions, it is at least reasonably possible that changes in fair values and management's assessments will occur in the near term and that such changes could materially affect the amounts reported in the Company's financial statements.

Table of Contents

## 8. Loans Receivable and Credit Disclosures

Activity in the allowance for loan losses, on a disaggregated basis, for the three and nine months ended September 30, 2018 and 2017 is as follows: *(in thousands)*

**Three Months Ended September 30, 2018**

|                                    | 1-4<br>Family<br>Residential   |                | Commercial     | Agricultural   | Commercial | Agricultural | Consumer<br>and<br>Other | Total    |
|------------------------------------|--------------------------------|----------------|----------------|----------------|------------|--------------|--------------------------|----------|
|                                    | Construction<br>Real<br>Estate | Real<br>Estate | Real<br>Estate | Real<br>Estate | Commercial | Agricultural | Consumer<br>and<br>Other | Total    |
| Balance, June 30, 2018             | \$846                          | \$ 1,732       | \$ 4,842       | \$ 977         | \$ 1,688   | \$ 1,178     | \$ 120                   | \$11,383 |
| Provision (credit) for loan losses | (209)                          | 131            | (372 )         | 218            | 92         | 168          | 72                       | 100      |
| Recoveries of loans charged-off    | -                              | 2              | -              | -              | 1          | -            | 5                        | 8        |
| Loans charged-off                  | -                              | (23 )          | (107 )         | -              | (10 )      | (58 )        | (5 )                     | (203 )   |
| Balance, September 30, 2018        | \$637                          | \$ 1,842       | \$ 4,363       | \$ 1,195       | \$ 1,771   | \$ 1,288     | \$ 192                   | \$11,288 |

**Nine Months Ended September 30, 2018**

|                                    | 1-4<br>Family<br>Residential   |                | Commercial     | Agricultural   | Commercial | Agricultural | Consumer<br>and<br>Other | Total    |
|------------------------------------|--------------------------------|----------------|----------------|----------------|------------|--------------|--------------------------|----------|
|                                    | Construction<br>Real<br>Estate | Real<br>Estate | Real<br>Estate | Real<br>Estate | Commercial | Agricultural | Consumer<br>and<br>Other | Total    |
| Balance, December 31, 2017         | \$796                          | \$ 1,716       | \$ 4,734       | \$ 997         | \$ 1,739   | \$ 1,171     | \$ 168                   | \$11,321 |
| Provision (credit) for loan losses | (159)                          | 144            | (264 )         | 198            | 33         | 175          | 66                       | 193      |
| Recoveries of loans charged-off    | -                              | 5              | -              | -              | 22         | -            | 19                       | 46       |
| Loans charged-off                  | -                              | (23 )          | (107 )         | -              | (23 )      | (58 )        | (61 )                    | (272 )   |
| Balance, September 30, 2018        | \$637                          | \$ 1,842       | \$ 4,363       | \$ 1,195       | \$ 1,771   | \$ 1,288     | \$ 192                   | \$11,288 |

**Three Months Ended September 30, 2017**

|  | 1-4<br>Family<br>Residential   |                | Commercial     | Agricultural   | Commercial | Agricultural | Consumer<br>and<br>Other | Total |
|--|--------------------------------|----------------|----------------|----------------|------------|--------------|--------------------------|-------|
|  | Construction<br>Real<br>Estate | Real<br>Estate | Real<br>Estate | Real<br>Estate | Commercial | Agricultural | Consumer<br>and<br>Other | Total |

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

|                                    |       |          |          |        |          |          |        |          |
|------------------------------------|-------|----------|----------|--------|----------|----------|--------|----------|
| Balance, June 30, 2017             | \$780 | \$ 1,713 | \$ 4,437 | \$ 907 | \$ 2,071 | \$ 1,154 | \$ 126 | \$11,188 |
| Provision (credit) for loan losses | (74 ) | 15       | 155      | 36     | (80 )    | (34 )    | 39     | 57       |
| Recoveries of loans charged-off    | -     | 4        | -        | -      | 2        | -        | 4      | 10       |
| Loans charged-off                  | -     | -        | -        | -      | (109 )   | -        | (6 )   | (115 )   |
| Balance, September 30, 2017        | \$706 | \$ 1,732 | \$ 4,592 | \$ 943 | \$ 1,884 | \$ 1,120 | \$ 163 | \$11,140 |

**Nine Months Ended September 30, 2017**

|                                    | 1-4<br>Family |             |             |              |            |              |           |          |
|------------------------------------|---------------|-------------|-------------|--------------|------------|--------------|-----------|----------|
|                                    | Construction  | Residential | Commercial  | Agricultural |            |              | Consumer  |          |
|                                    | Real Estate   | Real Estate | Real Estate | Real Estate  | Commercial | Agricultural | and Other | Total    |
| Balance, December 31, 2016         | \$908         | \$ 1,711    | \$ 3,960    | \$ 861       | \$ 1,728   | \$ 1,216     | \$ 123    | \$10,507 |
| Provision (credit) for loan losses | (202)         | 12          | 632         | 82           | 735        | (96 )        | 59        | 1,222    |
| Recoveries of loans charged-off    | -             | 9           | -           | -            | 30         | -            | 8         | 47       |
| Loans charged-off                  | -             | -           | -           | -            | (609 )     | -            | (27 )     | (636 )   |
| Balance, September 30, 2017        | \$706         | \$ 1,732    | \$ 4,592    | \$ 943       | \$ 1,884   | \$ 1,120     | \$ 163    | \$11,140 |

Table of Contents

Allowance for loan losses disaggregated on the basis of impairment analysis method as of September 30, 2018 and December 31, 2017 is as follows: *(in thousands)*

|                                       | 1-4<br>Family                  |                               |                              |                                |            |              |        | Consumer<br>and<br>Other | Total |
|---------------------------------------|--------------------------------|-------------------------------|------------------------------|--------------------------------|------------|--------------|--------|--------------------------|-------|
|                                       | Construction<br>Real<br>Estate | Residential<br>Real<br>Estate | Commercial<br>Real<br>Estate | Agricultural<br>Real<br>Estate | Commercial | Agricultural |        |                          |       |
| Individually evaluated for impairment | \$ -                           | \$ 53                         | \$ 13                        | \$ -                           | \$ 510     | \$ -         | \$ 22  | \$ 598                   |       |
| Collectively evaluated for impairment | 637                            | 1,789                         | 4,350                        | 1,195                          | 1,261      | 1,288        | 170    | 10,690                   |       |
| Balance September 30, 2018            | \$ 637                         | \$ 1,842                      | \$ 4,363                     | \$ 1,195                       | \$ 1,771   | \$ 1,288     | \$ 192 | \$ 11,288                |       |

|                                       | 1-4<br>Family                  |                               |                              |                                |            |              |        | Consumer<br>and<br>Other | Total |
|---------------------------------------|--------------------------------|-------------------------------|------------------------------|--------------------------------|------------|--------------|--------|--------------------------|-------|
|                                       | Construction<br>Real<br>Estate | Residential<br>Real<br>Estate | Commercial<br>Real<br>Estate | Agricultural<br>Real<br>Estate | Commercial | Agricultural |        |                          |       |
| Individually evaluated for impairment | \$ -                           | \$ 42                         | \$ 115                       | \$ -                           | \$ 607     | \$ -         | \$ 47  | \$ 811                   |       |
| Collectively evaluated for impairment | 796                            | 1,674                         | 4,619                        | 997                            | 1,132      | 1,171        | 121    | 10,510                   |       |
| Balance December 31, 2017             | \$ 796                         | \$ 1,716                      | \$ 4,734                     | \$ 997                         | \$ 1,739   | \$ 1,171     | \$ 168 | \$ 11,321                |       |

Loans receivable disaggregated on the basis of impairment analysis method as of September 30, 2018 and December 31, 2017 is as follows: *(in thousands)*:

|                                       | 1-4<br>Family                  |                               |                              |                                |            |              |        | Consumer<br>and<br>Other | Total |
|---------------------------------------|--------------------------------|-------------------------------|------------------------------|--------------------------------|------------|--------------|--------|--------------------------|-------|
|                                       | Construction<br>Real<br>Estate | Residential<br>Real<br>Estate | Commercial<br>Real<br>Estate | Agricultural<br>Real<br>Estate | Commercial | Agricultural |        |                          |       |
| Individually evaluated for impairment | \$ -                           | \$ 367                        | \$ 135                       | \$ 76                          | \$ 3,039   | \$ -         | \$ 22  | \$ 3,639                 |       |
| Collectively evaluated for impairment | 44,810                         | 171,368                       | 373,779                      | 103,507                        | 79,343     | 78,429       | 16,329 | 867,565                  |       |

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

| Balance September 30, 2018            | \$ 44,810                | \$ 171,735             | \$ 373,914             | \$ 103,583               | \$ 82,382  | \$ 78,429    | \$ 16,351          | \$ 871,204 |
|---------------------------------------|--------------------------|------------------------|------------------------|--------------------------|------------|--------------|--------------------|------------|
| <b>2017</b>                           |                          |                        |                        |                          |            |              |                    |            |
|                                       | Construction Real Estate | 1-4 Family Real Estate | Commercial Real Estate | Agricultural Real Estate | Commercial | Agricultural | Consumer and Other | Total      |
| Individually evaluated for impairment | \$ -                     | \$ 689                 | \$ 901                 | \$ -                     | \$ 3,140   | \$ -         | \$ 80              | \$ 4,810   |
| Collectively evaluated for impairment | 50,309                   | 145,569                | 349,725                | 81,790                   | 70,676     | 69,806       | 10,265             | 778,140    |
| Balance December 31, 2017             | \$ 50,309                | \$ 146,258             | \$ 350,626             | \$ 81,790                | \$ 73,816  | \$ 69,806    | \$ 10,345          | \$ 782,950 |

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payment of principal and interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. The Company will apply its normal loan review procedures to identify loans that should be evaluated for impairment.

Table of Contents

Impaired loans, on a disaggregated basis, as of September 30, 2018 and December 31, 2017: *(in thousands)*

|   | 2018                   |                                |                      | 2017                   |                                |                      |
|---|------------------------|--------------------------------|----------------------|------------------------|--------------------------------|----------------------|
|   | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance |
| With no specific reserve recorded:      |                        |                                |                      |                        |                                |                      |
| Real estate - construction              | \$-                    | \$ -                           | \$ -                 | \$-                    | \$ -                           | \$ -                 |
| Real estate - 1 to 4 family residential | 250                    | 275                            | -                    | 572                    | 677                            | -                    |
| Real estate - commercial                | 122                    | 617                            | -                    | 671                    | 1,353                          | -                    |
| Real estate - agricultural              | 76                     | 89                             | -                    | -                      | -                              | -                    |
| Commercial                              | 255                    | 262                            | -                    | 125                    | 148                            | -                    |
| Agricultural                            | -                      | -                              | -                    | -                      | -                              | -                    |
| Consumer and other                      | -                      | 1                              | -                    | 25                     | 44                             | -                    |
| Total loans with no specific reserve:   | 703                    | 1,244                          | -                    | 1,393                  | 2,222                          | -                    |
| With an allowance recorded:             |                        |                                |                      |                        |                                |                      |
| Real estate - construction              | -                      | -                              | -                    | -                      | -                              | -                    |
| Real estate - 1 to 4 family residential | 117                    | 141                            | 53                   | 117                    | 180                            | 42                   |
| Real estate - commercial                | 13                     | 130                            | 13                   | 230                    | 230                            | 115                  |
| Real estate - agricultural              | -                      | -                              | -                    | -                      | -                              | -                    |
| Commercial                              | 2,784                  | 3,127                          | 510                  | 3,015                  | 3,336                          | 607                  |
| Agricultural                            | -                      | -                              | -                    | -                      | -                              | -                    |
| Consumer and other                      | 22                     | 26                             | 22                   | 55                     | 43                             | 47                   |
| Total loans with specific reserve:      | 2,936                  | 3,424                          | 598                  | 3,417                  | 3,789                          | 811                  |
| Total                                   |                        |                                |                      |                        |                                |                      |
| Real estate - construction              | -                      | -                              | -                    | -                      | -                              | -                    |
| Real estate - 1 to 4 family residential | 367                    | 416                            | 53                   | 689                    | 857                            | 42                   |
| Real estate - commercial                | 135                    | 747                            | 13                   | 901                    | 1,583                          | 115                  |
| Real estate - agricultural              | 76                     | 89                             | -                    | -                      | -                              | -                    |
| Commercial                              | 3,039                  | 3,389                          | 510                  | 3,140                  | 3,484                          | 607                  |
| Agricultural                            | -                      | -                              | -                    | -                      | -                              | -                    |
| Consumer and other                      | 22                     | 27                             | 22                   | 80                     | 87                             | 47                   |
|   | \$3,639                | \$ 4,668                       | \$ 598               | \$4,810                | \$ 6,011                       | \$ 811               |



Table of Contents

Average recorded investment and interest income recognized on impaired loans for the three and nine months ended September 30, 2018 and 2017: *(in thousands)*

|   | <b>Three Months Ended September 30,</b> |            |                                  |            |
|---|---|------------|----------------------------------|------------|
|   | <b>2018</b>                             |            | <b>2017</b>                      |            |
|   | Average Interest Recorded Income        |            | Average Interest Recorded Income |            |
|   | Investment                              | Recognized | Investment                       | Recognized |
| With no specific reserve recorded:      |   |            |                                  |            |
| Real estate - construction              | \$-                                     | \$ -       | \$-                              | \$ -       |
| Real estate - 1 to 4 family residential | 315                                     | 135        | 631                              | 18         |
| Real estate - commercial                | 123                                     | -          | 716                              | -          |
| Real estate - agricultural              | 38                                      | -          | -                                | -          |
| Commercial                              | 160                                     | -          | 139                              | 2          |
| Agricultural                            | -                                       | -          | -                                | -          |
| Consumer and other                      | -                                       | -          | 46                               | -          |
| Total loans with no specific reserve:   | 636                                     | 135        | 1,532                            | 20         |
| With an allowance recorded:             |   |            |                                  |            |
| Real estate - construction              | -                                       | -          | -                                | -          |
| Real estate - 1 to 4 family residential | 120                                     | 6          | 128                              | -          |
| Real estate - commercial                | 74                                      | -          | -                                | -          |
| Real estate - agricultural              | -                                       | -          | -                                | -          |
| Commercial                              | 2,838                                   | 2          | 3,263                            | -          |
| Agricultural                            | 29                                      | -          | -                                | -          |
| Consumer and other                      | 26                                      | -          | 29                               | -          |
| Total loans with specific reserve:      | 3,087                                   | 8          | 3,420                            | -          |
| Total                                   |   |            |                                  |            |
| Real estate - construction              | -                                       | -          | -                                | -          |
| Real estate - 1 to 4 family residential | 435                                     | 141        | 759                              | 18         |
| Real estate - commercial                | 197                                     | -          | 716                              | -          |
| Real estate - agricultural              | 38                                      | -          | -                                | -          |
| Commercial                              | 2,998                                   | 2          | 3,402                            | 2          |
| Agricultural                            | 29                                      | -          | -                                | -          |
| Consumer and other                      | 26                                      | -          | 75                               | -          |
|   | \$3,723                                 | \$ 143     | \$4,952                          | \$ 20      |

Table of Contents

|   | <b>Nine Months Ended September 30,</b> |                       |                       |                       |
|---|--|-----------------------|-----------------------|-----------------------|
|   | <b>2018</b>                            |                       | <b>2017</b>           |                       |
|   | Average Interest                       | Average Interest      | Average Interest      | Average Interest      |
|   | Recorded Income                        | Recorded Income       | Recorded Income       | Recorded Income       |
|   | Investment Recognized                  | Investment Recognized | Investment Recognized | Investment Recognized |
| With no specific reserve recorded:      |  |                       |                       |                       |
| Real estate - construction              | \$-                                    | \$ -                  | \$-                   | \$ -                  |
| Real estate - 1 to 4 family residential | 442                                    | 180                   | 535                   | 27                    |
| Real estate - commercial                | 266                                    | 258                   | 648                   | -                     |
| Real estate - agricultural              | 19                                     | -                     | -                     | -                     |
| Commercial                              | 127                                    | 5                     | 1,457                 | 3                     |
| Agricultural                            | -                                      | -                     | -                     | -                     |
| Consumer and other                      | 6                                      | -                     | 60                    | -                     |
| Total loans with no specific reserve:   | 860                                    | 443                   | 2,700                 | 30                    |
| With an allowance recorded:             |  |                       |                       |                       |
| Real estate - construction              | -                                      | -                     | 16                    | 2                     |
| Real estate - 1 to 4 family residential | 173                                    | 6                     | 162                   | -                     |
| Real estate - commercial                | 149                                    | -                     | -                     | -                     |
| Real estate - agricultural              | -                                      | -                     | -                     | -                     |
| Commercial                              | 2,901                                  | 2                     | 2,193                 | -                     |
| Agricultural                            | 15                                     | -                     | -                     | -                     |
| Consumer and other                      | 35                                     | 1                     | 15                    | 1                     |
| Total loans with specific reserve:      | 3,273                                  | 9                     | 2,386                 | 3                     |
| Total                                   |  |                       |                       |                       |
| Real estate - construction              | -                                      | -                     | 16                    | 2                     |
| Real estate - 1 to 4 family residential | 615                                    | 186                   | 697                   | 27                    |
| Real estate - commercial                | 415                                    | 258                   | 648                   | -                     |
| Real estate - agricultural              | 19                                     | -                     | -                     | -                     |
| Commercial                              | 3,028                                  | 7                     | 3,650                 | 3                     |
| Agricultural                            | 15                                     | -                     | -                     | -                     |
| Consumer and other                      | 41                                     | 1                     | 75                    | 1                     |
|   | \$4,133                                | \$ 452                | \$5,086               | \$ 33                 |

The interest foregone on nonaccrual loans for the three months ended September 30, 2018 and 2017 was approximately \$86,000 and \$88,000, respectively. The interest foregone on nonaccrual loans for the nine months ended September 30, 2018 and 2017 was approximately \$289,000.

Nonaccrual loans at September 30, 2018 and December 31, 2017 were \$3,639,000 and \$4,810,000 respectively.

The Company had loans meeting the definition of a troubled debt restructuring (TDR) of \$2,716,000 as of September 30, 2018, all of which were included in impaired and nonaccrual loans. The Company had TDRs of \$2,984,000 as of December 31, 2017, all of which were included in impaired and nonaccrual loans.

Table of Contents

The following table sets forth information on the Company's TDRs, on a disaggregated basis, occurring in the three and six months ended September 30, 2018 and 2017: *(dollars in thousands)*

|   | <b>Three Months Ended September 30,</b> |            |                               |            | <b>2017</b>                  |            |                               |            |
|---|---|------------|-------------------------------|------------|------------------------------|------------|-------------------------------|------------|
|   | <b>2018</b>                             |            |                               |            | <b>2017</b>                  |            |                               |            |
|   | Pre-Modification Outstanding            |            | Post-Modification Outstanding |            | Pre-Modification Outstanding |            | Post-Modification Outstanding |            |
|   | Number of Recorded                      |            | Recorded                      |            | Number of Recorded           |            | Recorded                      |            |
|   | Contract                                | Investment | Contract                      | Investment | Contract                     | Investment | Contract                      | Investment |
| Real estate - construction              | -                                       | \$ -       | \$ -                          | -          | \$ -                         | -          | \$ -                          |            |
| Real estate - 1 to 4 family residential | -                                       | -          | -                             | -          | -                            | -          | -                             |            |
| Real estate - commercial                | -                                       | -          | -                             | -          | -                            | -          | -                             |            |
| Real estate - agricultural              | -                                       | -          | -                             | -          | -                            | -          | -                             |            |
| Commercial                              | -                                       | -          | -                             | -          | -                            | -          | -                             |            |
| Agricultural                            | -                                       | -          | -                             | -          | -                            | -          | -                             |            |
| Consumer and other                      | -                                       | -          | -                             | -          | -                            | -          | -                             |            |
|   | -                                       | \$ -       | \$ -                          | -          | \$ -                         | -          | \$ -                          |            |
|   |   |            |                               |            |                              |            |                               |            |
|   | <b>Nine Months Ended September 30,</b>  |            |                               |            | <b>2017</b>                  |            |                               |            |
|   | <b>2018</b>                             |            |                               |            | <b>2017</b>                  |            |                               |            |
|   | Pre-Modification Outstanding            |            | Post-Modification Outstanding |            | Pre-Modification Outstanding |            | Post-Modification Outstanding |            |
|   | Number of Recorded                      |            | Recorded                      |            | Number of Recorded           |            | Recorded                      |            |
|   | Contract                                | Investment | Contract                      | Investment | Contract                     | Investment | Contract                      | Investment |
| Real estate - construction              | -                                       | \$ -       | \$ -                          | -          | \$ -                         | -          | \$ -                          |            |
| Real estate - 1 to 4 family residential | -                                       | -          | -                             | -          | -                            | -          | -                             |            |
| Real estate - commercial                | -                                       | -          | -                             | -          | -                            | -          | -                             |            |
| Real estate - agricultural              | -                                       | -          | -                             | -          | -                            | -          | -                             |            |
| Commercial                              | 3                                       | 80         | 80                            | 2          | 93                           | 99         | 99                            |            |
| Agricultural                            | -                                       | -          | -                             | -          | -                            | -          | -                             |            |
| Consumer and other                      | -                                       | -          | -                             | -          | -                            | -          | -                             |            |
|   | 3                                       | \$ 80      | \$ 80                         | 2          | \$ 93                        | 99         | \$ 99                         |            |

During the nine months ended September 30, 2018, the Company granted concessions to one borrower facing financial difficulties. During the nine months ended September 30, 2017, the Company granted concessions to two borrowers that were experiencing financial difficulties. The loans were extended beyond their normal terms and on one loan the interest was capitalized.

The Company considers TDR loans to have payment default when it is past due 60 days or more.

No TDR modified during the twelve months ended September 30, 2018 and 2017 had payment defaults. There were no charge-offs related to TDRs for the three and nine months ended September 30, 2018. An \$80,000 specific reserve was established in the nine months ended September 30, 2018. A \$530,000 specific reserve was established in the nine months ended September 30, 2017 on two TDR loans. There was \$12,000 and \$257,000 of net charge-offs related to TDRs for the nine months ended September 30, 2018 and 2017, respectively.

Table of Contents

An aging analysis of the recorded investments in loans, on a disaggregated basis, as of September 30, 2018 and December 31, 2017, is as follows: *(in thousands)*

| <b>2018</b>                             | 90 Days<br>or<br>Greater |             |                      | Current   | Total     | 90 Days<br>or<br>Greater |
|---|--------------------------|-------------|----------------------|-----------|-----------|--------------------------|
|   | 30-89<br>Past<br>Due     | Past<br>Due | Total<br>Past<br>Due |           |           | Accruing                 |
| Real estate - construction              | \$50                     | \$ -        | \$50                 | \$44,760  | \$44,810  | \$ -                     |
| Real estate - 1 to 4 family residential | 1,481                    | 134         | 1,615                | 170,120   | 171,735   | -                        |
| Real estate - commercial                | 26                       | 13          | 39                   | 373,875   | 373,914   | -                        |
| Real estate - agricultural              | 990                      | -           | 990                  | 102,593   | 103,583   | -                        |
| Commercial                              | 260                      | 664         | 924                  | 81,458    | 82,382    | -                        |
| Agricultural                            | 49                       | -           | 49                   | 78,380    | 78,429    | -                        |
| Consumer and other                      | 108                      | 2           | 110                  | 16,241    | 16,351    | -                        |
|   | \$2,964                  | \$ 813      | \$3,777              | \$867,427 | \$871,204 | \$ -                     |
| <br>                                    |                          |             |                      |           |           |                          |
| <b>2017</b>                             | 90 Days<br>or<br>Greater |             |                      | Current   | Total     | 90 Days<br>or<br>Greater |
|   | 30-89<br>Past<br>Due     | Past<br>Due | Total<br>Past<br>Due |           |           | Accruing                 |
| Real estate - construction              | \$159                    | \$-         | \$159                | \$50,150  | \$50,309  | \$ -                     |
| Real estate - 1 to 4 family residential | 940                      | 414         | 1,354                | 144,904   | 146,258   | 18                       |
| Real estate - commercial                | 363                      | 629         | 992                  | 349,634   | 350,626   | -                        |
| Real estate - agricultural              | 655                      | -           | 655                  | 81,135    | 81,790    | -                        |
| Commercial                              | 275                      | 418         | 693                  | 73,123    | 73,816    | -                        |
| Agricultural                            | 77                       | -           | 77                   | 69,729    | 69,806    | -                        |
| Consumer and other                      | 77                       | 38          | 115                  | 10,230    | 10,345    | -                        |
|   | \$2,546                  | \$ 1,499    | \$4,045              | \$778,905 | \$782,950 | \$ 18                    |

Table of Contents

The credit risk profile by internally assigned grade, on a disaggregated basis, as of September 30, 2018 and December 31, 2017 is as follows: (*in thousands*)

| <b>2018</b>          | Construction | Commercial  | Agricultural | Commercial | Agricultural | Total     |
|----------------------|--------------|-------------|--------------|------------|--------------|-----------|
|                      | Real Estate  | Real Estate | Real Estate  |            |              |           |
| Pass                 | \$ 39,158    | \$ 335,326  | \$ 74,334    | \$ 58,374  | \$ 53,563    | \$560,755 |
| Watch                | 5,444        | 20,279      | 20,086       | 16,997     | 21,794       | 84,600    |
| Special Mention      | 208          | 15,434      | 2,474        | 255        | -            | 18,371    |
| Substandard          | -            | 2,764       | 6,689        | 3,718      | 3,072        | 16,243    |
| Substandard-Impaired | -            | 111         | -            | 3,038      | -            | 3,149     |
|                      | \$ 44,810    | \$ 373,914  | \$ 103,583   | \$ 82,382  | \$ 78,429    | \$683,118 |

| <b>2017</b>          | Construction | Commercial  | Agricultural | Commercial | Agricultural | Total     |
|----------------------|--------------|-------------|--------------|------------|--------------|-----------|
|                      | Real Estate  | Real Estate | Real Estate  |            |              |           |
| Pass                 | \$ 47,726    | \$ 319,178  | \$ 60,301    | \$ 59,535  | \$ 45,816    | \$532,556 |
| Watch                | 2,583        | 27,528      | 20,114       | 9,628      | 22,640       | 82,493    |
| Special Mention      | -            | 184         | -            | -          | -            | 184       |
| Substandard          | -            | 2,835       | 1,375        | 1,513      | 1,350        | 7,073     |
| Substandard-Impaired | -            | 901         | -            | 3,140      | -            | 4,041     |
|                      | \$ 50,309    | \$ 350,626  | \$ 81,790    | \$ 73,816  | \$ 69,806    | \$626,347 |

The credit risk profile based on payment activity, on a disaggregated basis, as of September 30, 2018 and December 31, 2017 is as follows:

| <b>2018</b>    | 1-4 Family              | Consumer  | Total     |
|----------------|-------------------------|-----------|-----------|
|                | Residential Real Estate | and Other |           |
| Performing     | \$ 171,371              | \$ 16,328 | \$187,699 |
| Non-performing | 364                     | 23        | 387       |
|                | \$ 171,735              | \$ 16,351 | \$188,086 |

| <b>2017</b> | 1-4 Family              | Consumer  | Total |
|-------------|-------------------------|-----------|-------|
|             | Residential Real Estate | and Other |       |

|                |            |           |            |
|----------------|------------|-----------|------------|
| Performing     | \$ 145,551 | \$ 10,264 | \$ 155,815 |
| Non-performing | 707        | 81        | 788        |
|                | \$ 146,258 | \$ 10,345 | \$ 156,603 |

## 9. Goodwill

As of September 14, 2018, as a result of the acquisition of CCSB, FNB recognized \$2.9 million of goodwill. Goodwill recognized in the Acquisition was primarily attributable to an expanded market share and economies of scale expected from combining the operations of CCSB branches with FNB. Goodwill is not amortized but is evaluated for impairment at least annually. For income tax purposes, goodwill associated with CCSB is not amortized and goodwill associated with previous acquisition is amortized over fifteen years.



Table of Contents

## 10. Intangible assets

In conjunction with the acquisition of CCSB in 2018, the Company recorded \$2.0 million in core deposit intangible assets. The following sets forth the carrying amounts and accumulated amortization of the intangible assets at September 30, 2018 and December 31, 2017: *(in thousands)*

|                               | <b>2018</b>  |                          | <b>2017</b>  |                          |
|-------------------------------|--------------|--------------------------|--------------|--------------------------|
|                               | Gross Amount | Accumulated Amortization | Gross Amount | Accumulated Amortization |
| Core deposit intangible asset | \$4,520      | \$ 2,069                 | \$2,518      | \$ 1,861                 |
| Customer list                 | 535          | 144                      | 520          | 86                       |
| Total                         | \$5,055      | \$ 2,213                 | \$3,038      | \$ 1,947                 |

The weighted average life of the intangible assets is 3.9 years as of September 30, 2018 and 2.5 years as of December 31, 2017.

The following sets forth the activity related to the intangible assets for the three and nine months ended September 30, 2018 and 2017: *(in thousands)*

|                                 | <b>Three Months Ended September 30,</b> |             | <b>Nine Months Ended September 30,</b> |             |
|---------------------------------|---|-------------|--|-------------|
|                                 | <b>2018</b>                             | <b>2017</b> | <b>2018</b>                            | <b>2017</b> |
| Beginning intangible asset, net | \$935                                   | \$1,212     | \$1,091                                | \$1,353     |
| Purchase                        | 2,002                                   | -           | 2,002                                  | -           |
| Adjustment to intangible asset  | -                                       | 12          | 15                                     | 62          |
| Amortization                    | (95 )                                   | (90 )       | (266 )                                 | (281 )      |
| Ending intangible asset, net    | \$2,842                                 | \$1,134     | \$2,842                                | \$1,134     |

Table of Contents

Estimated remaining amortization expense on core deposit intangible for the years ending December 31 is as follows:  
(in thousands)

|                       |         |
|-----------------------|---------|
| 2018                  | \$166   |
| 2019                  | 540     |
| 2020                  | 440     |
| 2021                  | 402     |
| 2022                  | 363     |
| 2023                  | 318     |
| After                 | 613     |
| Intangible asset, net | \$2,842 |

## 11. Pledged Collateral Related to Securities Sold Under Repurchase Agreements

The following sets forth the pledged collateral at estimated fair value related to securities sold under repurchase agreements and term repurchase agreements as of September 30, 2018 and December 31, 2017: (in thousands)

|   | 2018                   |  |                          | 2017                   |  |                          |
|---|------------------------|--|--------------------------|------------------------|--|--------------------------|
|   | Remaining<br>Overnight | Contractual<br>Greater<br>than<br>90<br>days | Maturity of the<br>Total | Remaining<br>Overnight | Contractual<br>Greater<br>than<br>90<br>days | Maturity of the<br>Total |
| Securities sold under agreements to repurchase: |                        |  |                          |                        |  |                          |
| U.S. government treasuries                      | \$3,393                | \$ -   | \$3,393                  | \$1,474                | \$-  | \$1,474                  |
| U.S. government agencies                        | 46,610                 | -  | 46,610                   | 47,323                 | -  | 47,323                   |
| U.S. government mortgage-backed securities      | 18,676                 | -  | 18,676                   | 22,824                 | -  | 22,824                   |
| <b>Total</b>                                    | <b>\$68,679</b>        | <b>\$ -</b>                                  | <b>\$68,679</b>          | <b>\$71,621</b>        | <b>\$-</b>                                   | <b>\$71,621</b>          |
| Term repurchase agreements (Other borrowings):  |                        |  |                          |                        |  |                          |
| U.S. government agencies                        | \$-                    | \$ -   | \$-                      | \$-                    | \$14,986                                     | \$14,986                 |
| <b>Total pledged collateral</b>                 | <b>\$68,679</b>        | <b>\$ -</b>                                  | <b>\$68,679</b>          | <b>\$71,621</b>        | <b>\$14,986</b>                              | <b>\$86,607</b>          |

In the event the repurchase agreements exceed the estimated fair value of the pledged securities available-for-sale, the Company has unpledged securities available-for-sale that may be pledged on the repurchase agreements.



Table of Contents

## 12. Regulatory Matters

The Company and the Banks capital amounts and ratios are as follows: (*dollars in thousands*)

|   | Actual     |        | For Capital Adequacy Purposes * |         | To Be Well Capitalized Under Prompt Corrective Action Provisions |        |
|---|------------|--------|---------------------------------|---------|--|--------|
|   | Amount     | Ratio  | Amount                          | Ratio   | Amount   | Ratio  |
| As of September 30, 2018:                               |            |        |                                 |         |  |        |
| Total capital (to risk- weighted assets):               |            |        |                                 |         |  |        |
| Consolidated  | \$ 175,218 | 16.4 % | \$ 105,608                      | 9.875 % | N/A  | N/A    |
| Boone Bank & Trust                                      | 15,564     | 17.5   | 8,788                           | 9.875   | \$ 8,900   | 10.0 % |
| First National Bank                                     | 80,062     | 13.4   | 59,155                          | 9.875   | 59,904   | 10.0   |
| Reliance State Bank                                     | 27,631     | 15.6   | 17,506                          | 9.875   | 17,728   | 10.0   |
| State Bank & Trust                                      | 20,260     | 16.4   | 12,199                          | 9.875   | 12,353   | 10.0   |
| United Bank & Trust                                     | 14,955     | 19.6   | 7,546                           | 9.875   | 7,641  | 10.0   |
| Tier 1 capital (to risk- weighted assets):              |            |        |                                 |         |  |        |
| Consolidated  | \$ 163,388 | 15.3 % | \$ 84,219                       | 7.875 % | N/A  | N/A    |
| Boone Bank & Trust                                      | 14,654     | 16.5   | 7,008                           | 7.875   | \$ 7,120   | 8.0 %  |
| First National Bank                                     | 73,969     | 12.3   | 47,174                          | 7.875   | 47,923   | 8.0    |
| Reliance State Bank                                     | 25,487     | 14.4   | 13,961                          | 7.875   | 14,182   | 8.0    |
| State Bank & Trust                                      | 18,712     | 15.1   | 9,728                           | 7.875   | 9,883  | 8.0    |
| United Bank & Trust                                     | 14,140     | 18.5   | 6,017                           | 7.875   | 6,113  | 8.0    |
| Tier 1 capital (to average- weighted assets):           |            |        |                                 |         |  |        |
| Consolidated  | \$ 163,388 | 11.8 % | \$ 55,401                       | 4.000 % | N/A  | N/A    |
| Boone Bank & Trust                                      | 14,654     | 11.3   | 5,177                           | 4.000   | \$ 6,471   | 5.0 %  |
| First National Bank                                     | 73,969     | 9.8    | 30,217                          | 4.000   | 37,771   | 5.0    |
| Reliance State Bank                                     | 25,487     | 11.9   | 8,574                           | 4.000   | 10,718   | 5.0    |
| State Bank & Trust                                      | 18,712     | 11.5   | 6,485                           | 4.000   | 8,106  | 5.0    |
| United Bank & Trust                                     | 14,140     | 12.7   | 4,457                           | 4.000   | 5,572  | 5.0    |
| Common equity tier 1 capital (to risk-weighted assets): |            |        |                                 |         |  |        |
| Consolidated  | \$ 163,388 | 15.3 % | \$ 68,177                       | 6.375 % | N/A  | N/A    |
| Boone Bank & Trust                                      | 14,654     | 16.5   | 5,673                           | 6.375   | \$ 5,785   | 6.5 %  |
| First National Bank                                     | 73,969     | 12.3   | 38,189                          | 6.375   | 38,938   | 6.5    |
| Reliance State Bank                                     | 25,487     | 14.4   | 11,301                          | 6.375   | 11,523   | 6.5    |
| State Bank & Trust                                      | 18,712     | 15.1   | 7,875                           | 6.375   | 8,030  | 6.5    |

|                     |        |      |       |       |       |     |
|---------------------|--------|------|-------|-------|-------|-----|
| United Bank & Trust | 14,140 | 18.5 | 4,871 | 6.375 | 4,967 | 6.5 |
|---------------------|--------|------|-------|-------|-------|-----|

\* These ratios for September 30, 2018 include a capital conservation buffer of 1.875%, except for the Tier 1 capital to average weighted assets ratios.

Table of Contents

|   | Actual     |        | For Capital Adequacy Purposes * |        | To Be Well Capitalized Under Prompt Corrective Action Provisions |        |
|---|------------|--------|---------------------------------|--------|--|--------|
|   | Amount     | Ratio  | Amount                          | Ratio  | Amount   | Ratio  |
| As of December 31, 2017:                                |            |        |                                 |        |  |        |
| Total capital (to risk- weighted assets):               |            |        |                                 |        |  |        |
| Consolidated  | \$ 176,306 | 17.6 % | \$ 92,500                       | 9.25 % | N/A  | N/A    |
| Boone Bank & Trust                                      | 15,344     | 16.5   | 8,613                           | 9.25   | \$ 9,312   | 10.0 % |
| First National Bank                                     | 81,390     | 15.5   | 48,466                          | 9.25   | 52,396   | 10.0   |
| Reliance State Bank                                     | 26,982     | 15.3   | 16,324                          | 9.25   | 17,648   | 10.0   |
| State Bank & Trust                                      | 20,064     | 15.8   | 11,738                          | 9.25   | 12,690   | 10.0   |
| United Bank & Trust                                     | 14,833     | 19.9   | 6,878                           | 9.25   | 7,436  | 10.0   |
| Tier 1 capital (to risk- weighted assets):              |            |        |                                 |        |  |        |
| Consolidated  | \$ 164,467 | 16.4 % | \$ 72,500                       | 7.25 % | N/A  | N/A    |
| Boone Bank & Trust                                      | 14,453     | 15.5   | 6,751                           | 7.25   | \$ 7,449   | 8.0 %  |
| First National Bank                                     | 75,404     | 14.4   | 37,987                          | 7.25   | 41,917   | 8.0    |
| Reliance State Bank                                     | 24,775     | 14.0   | 12,795                          | 7.25   | 14,118   | 8.0    |
| State Bank & Trust                                      | 18,475     | 14.6   | 9,200                           | 7.25   | 10,152   | 8.0    |
| United Bank & Trust                                     | 14,012     | 18.8   | 5,391                           | 7.25   | 5,649  | 8.0    |
| Tier 1 capital (to average- weighted assets):           |            |        |                                 |        |  |        |
| Consolidated  | \$ 164,467 | 12.1 % | \$ 54,264                       | 4.00 % | N/A  | N/A    |
| Boone Bank & Trust                                      | 14,453     | 10.4   | 5,568                           | 4.00   | \$ 6,960   | 5.0 %  |
| First National Bank                                     | 75,404     | 10.1   | 29,910                          | 4.00   | 37,387   | 5.0    |
| Reliance State Bank                                     | 24,775     | 11.6   | 8,553                           | 4.00   | 10,691   | 5.0    |
| State Bank & Trust                                      | 18,475     | 11.8   | 6,284                           | 4.00   | 7,856  | 5.0    |
| United Bank & Trust                                     | 14,012     | 12.8   | 4,362                           | 4.00   | 5,453  | 5.0    |
| Common equity tier 1 capital (to risk-weighted assets): |            |        |                                 |        |  |        |
| Consolidated  | \$ 164,467 | 16.4 % | \$ 57,500                       | 5.75 % | N/A  | N/A    |
| Boone Bank & Trust                                      | 14,453     | 15.5   | 5,354                           | 5.75   | \$ 6,053   | 6.5 %  |
| First National Bank                                     | 75,404     | 14.4   | 30,128                          | 5.75   | 34,058   | 6.5    |
| Reliance State Bank                                     | 24,775     | 14.0   | 10,147                          | 5.75   | 11,471   | 6.5    |
| State Bank & Trust                                      | 18,475     | 14.6   | 7,297                           | 5.75   | 8,248  | 6.5    |
| United Bank & Trust                                     | 14,012     | 18.8   | 4,276                           | 5.75   | 4,833  | 6.5    |

\* These ratios for December 31, 2017 include a capital conservation buffer of 1.25%, except for the Tier 1 capital to average weighted assets ratios.

The Federal Reserve Board and the FDIC issued final rules implementing the Basel III regulatory capital framework and related Dodd-Frank Wall Street Reform and Consumer Protection Act changes in July 2013. The rules revise minimum capital requirements and adjust prompt corrective action thresholds. The final rules revise the regulatory capital elements, add a new common equity Tier I capital ratio, increase the minimum Tier 1 capital ratio requirements and implement a new capital conservation buffer. The rules also permit certain banking organizations to retain, through a one-time election, the existing treatment for accumulated other comprehensive income (loss). The Company and the Banks have made the election to retain the existing treatment for accumulated other comprehensive income (loss). The final rules took effect for the Company and the Banks on January 1, 2015, subject to a transition period for certain parts of the rules.

Table of Contents

Beginning in 2016, an additional capital conservation buffer was added to the minimum requirements for capital adequacy purposes, subject to a three year phase-in period. The capital conservation buffer will be fully phased-in on January 1, 2019 at 2.5 percent. A banking organization with a conservation buffer of less than 2.5 percent (or the required phase-in amount in years prior to 2019) will be subject to limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers. At the present time, the ratios for the Company and the Banks are sufficient to meet the fully phased-in conservation buffer.

13. Subsequent Events

Management evaluated subsequent events through the date the financial statements were issued. There were no significant events or transactions occurring after September 30, 2018, but prior to November 6, 2018, that provided additional evidence about conditions that existed at September 30, 2018. There were no other significant events or transactions that provided evidence about conditions that did not exist at September 30, 2018.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

**Overview**

Ames National Corporation (the "Company") is a bank holding company established in 1975 that owns and operates five bank subsidiaries in central Iowa (the "Banks"). The following discussion is provided for the consolidated operations of the Company and its Banks, First National Bank, Ames, Iowa (First National), State Bank & Trust Co. (State Bank), Boone Bank & Trust Co. (Boone Bank), Reliance State Bank (Reliance Bank), and United Bank & Trust NA (United Bank). The purpose of this discussion is to focus on significant factors affecting the Company's financial condition and results of operations.

The Company does not engage in any material business activities apart from its ownership of the Banks. Products and services offered by the Banks are for commercial and consumer purposes including loans, deposits and wealth management services. The Banks also offer investment services through a third-party broker-dealer. The Company employs thirteen individuals to assist with financial reporting, human resources, audit, compliance, marketing, technology systems, training and the coordination of management activities, in addition to 230 full-time equivalent individuals employed by the Banks, including employees from the Acquisition.



The Company's primary competitive strategy is to utilize seasoned and competent Bank management and local decision making authority to provide customers with faster response times and more flexibility in the products and services offered. This strategy is viewed as providing an opportunity to increase revenues through creating a competitive advantage over other financial institutions. The Company also strives to remain operationally efficient to provide better profitability while enabling the Company to offer more competitive loan and deposit rates.

The principal sources of Company revenues and cash flow are: (i) interest and fees earned on loans made by the Company and Banks; (ii) interest on fixed income investments held by the Banks; (iii) fees on wealth management services provided by those Banks exercising trust powers; (iv) service fees on deposit accounts maintained at the Banks and (v) Merchant and card fees. The Company's principal expenses are: (i) interest expense on deposit accounts and other borrowings; (ii) provision for loan losses; (iii) salaries and employee benefits; (iv) data processing costs associated with maintaining the Banks' loan and deposit functions; (v) occupancy expenses for maintaining the Bank's facilities; and (vi) professional fees. The largest component contributing to the Company's net income is net interest income, which is the difference between interest earned on earning assets (primarily loans and investments) and interest paid on interest bearing liabilities (primarily deposits and other borrowings). One of management's principal functions is to manage the spread between interest earned on earning assets and interest paid on interest bearing liabilities in an effort to maximize net interest income while maintaining an appropriate level of interest rate risk.

Table of Contents

On September 14, 2018, FNB purchased the stock of CCSB for approximately \$14.8 million. First National will operate all three bank offices previously owned by Clarke County as branches of First National.

The Company had net income of \$4,459,000, or \$0.48 per share, for the three months ended September 30, 2018, compared to net income of \$3,928,000, or \$0.42 per share, for the three months ended September 30, 2017.

The increase in quarterly earnings can be primarily attributed to an increase in loan interest income and lower federal income tax expense, offset in part by higher deposit interest expense, an increase in salaries and benefits and non-routine costs associated with the Acquisition.

Net loan charge-offs totaled \$195,000 and \$105,000 for the three months ended September 30, 2018 and 2017, respectively. The provision for loan losses totaled \$100,000 and \$57,000 for the three months ended September 30, 2018 and 2017, respectively.

The Company had net income of \$12,813,000, or \$1.38 per share, for the nine months ended September 30, 2018, compared to net income of \$11,011,000, or \$1.18 per share, for the nine months ended September 30, 2017.

The increase in nine month earnings can be primarily attributed to an increase in loan interest income, a reduction in the provision for loan losses and lower federal income tax expense, offset in part by higher deposit interest expense, an increase in salaries and benefits and a decrease in securities gains.

Net loan charge-offs totaled \$226,000 and \$589,000 for the nine months ended September 30, 2018 and 2017, respectively. The provision for loan losses totaled \$193,000 and \$1,222,000 for the nine months ended September 30, 2018 and 2017, respectively.

The following management discussion and analysis will provide a review of important items relating to:

Challenges  
Key Performance Indicators and Industry Results  
Critical Accounting Policies  
Income Statement Review  
Balance Sheet Review

Asset Quality Review and Credit Risk Management  
Liquidity and Capital Resources  
Forward-Looking Statements and Business Risks  
Non-GAAP Financial Measures

## **Challenges**

Management has identified certain events or circumstances that may negatively impact the Company's financial condition and results of operations in the future and is attempting to position the Company to best respond to those challenges. These challenges are addressed in the Company's most recent Annual Report on Form 10-K filed on March 12, 2018.

Table of Contents**Key Performance Indicators and Industry Results**

Certain key performance indicators for the Company and the industry are presented in the following chart. The industry figures are compiled by the Federal Deposit Insurance Corporation (the "FDIC") and are derived from 5,542 commercial banks and savings institutions insured by the FDIC. Management reviews these indicators on a quarterly basis for purposes of comparing the Company's performance from quarter-to-quarter against the industry as a whole.

## Selected Indicators for the Company and the Industry

|                     | <b>3 Months Ended September 30, 2018</b> |         | <b>9 Months Ended June 30, 2018</b> |         | <b>3 Months Ended June 30, 2018</b> |         |           |         | <b>Years Ended December 31, 2017</b> |  |           |  | <b>2016</b> |          |
|---------------------|--|---------|-------------------------------------|---------|-------------------------------------|---------|-----------|---------|--------------------------------------|--|-----------|--|-------------|----------|
|                     | Company                                  |         | Industry*                           |         | Company                             |         | Industry* |         | Company                              |  | Industry* |  | Company     | Industry |
| Return on assets    | 1.31 %                                   | 1.25 %  | 1.26 %                              | 1.33 %  | 1.00 %                              | 0.97 %  | 1.18 %    | 1.04 %  |                                      |  |           |  |             |          |
| Return on equity    | 10.54 %                                  | 10.15 % | 10.35 %                             | 11.83 % | 8.02 %                              | 8.64 %  | 9.38 %    | 9.32 %  |                                      |  |           |  |             |          |
| Net interest margin | 3.28 %                                   | 3.21 %  | 3.16 %                              | 3.36 %  | 3.25 %                              | 3.25 %  | 3.36 %    | 3.13 %  |                                      |  |           |  |             |          |
| Efficiency ratio    | 54.82 %                                  | 55.73 % | 55.02 %                             | 55.47 % | 52.70 %                             | 57.94 % | 51.95 %   | 58.28 % |                                      |  |           |  |             |          |
| Capital ratio       | 12.38 %                                  | 12.33 % | 12.18 %                             | 9.74 %  | 12.48 %                             | 9.62 %  | 12.60 %   | 9.48 %  |                                      |  |           |  |             |          |

\*Latest available data

Key performances indicators include:

## Return on Assets

This ratio is calculated by dividing net income by average assets. It is used to measure how effectively the assets of the Company are being utilized in generating income. The Company's annualized return on average assets was 1.31% and 1.15% for the three months ended September 30, 2018 and 2017, respectively. The increase in this ratio in 2018

from the previous period is primarily due to an increase in loan interest income, a decrease in income tax expense and a decrease in the provision for loan losses.

#### Return on Equity

This ratio is calculated by dividing net income by average equity. It is used to measure the net income or return the Company generated for the shareholders' equity investment in the Company. The Company's return on average equity was at 10.54% and 9.08% for the three months ended September 30, 2018 and 2017, respectively. The increase in this ratio in 2018 from the previous period is primarily due to an increase in loan interest income, a decrease in income tax expense and a decrease in the provision for loan losses.

#### Net Interest Margin

The net interest margin for the three months ended September 30, 2018 and 2017 was 3.28% and 3.29%, respectively. The ratio is calculated by dividing net interest income by average earning assets. Earning assets are primarily made up of loans and investments that earn interest. This ratio is used to measure how well the Company is able to maintain interest rates on earning assets above those of interest-bearing liabilities, which is the interest expense paid on deposits and other borrowings.

## Table of Contents

### Efficiency Ratio

This ratio is calculated by dividing noninterest expense by net interest income and noninterest income. The ratio is a measure of the Company's ability to manage noninterest expenses. The Company's efficiency ratio was 54.82% and 52.42% for the three months ended September 30, 2018 and 2017, respectively. The efficiency ratio increase for the three months ended September 30, 2018 primarily due to an increase in salaries and benefits.

### Capital Ratio

The average capital ratio is calculated by dividing average total equity capital by average total assets. It measures the level of average assets that are funded by shareholders' equity. Given an equal level of risk in the financial condition of two companies, the higher the capital ratio, generally the more financially sound the company. The Company's capital ratio of 12.38% as of September 30, 2018 is significantly higher than the industry average of 9.74% as of June 30, 2018.

### Industry Results

The FDIC Quarterly Banking Profile reported the following results for the second quarter of 2018:

#### Net Income Rises 25.1% Over Second Quarter 2017, Led by Higher Net Operating Revenue and a Lower Effective Tax Rate

The 5,542 FDIC-insured commercial banks and savings institutions reported net income of \$60.2 billion during the three months ended June 30, an increase of \$12.1 billion (25.1%) from a year earlier. Higher net operating revenue (the sum of net interest income and noninterest income) and a lower effective tax rate contributed to the increase in industry net income. Assuming the effective tax rate before the new tax law, net income would have totaled an estimated \$53.8 billion, an increase of \$5.6 billion (11.7%) from second quarter 2017. The average return on assets was 1.37%, up from 1.13% a year earlier. Only 3.8% of institutions were unprofitable during the quarter, down from 4.3% in second quarter 2017.

#### Margins Increase as Average Yields Outpace Growth in Funding Costs

Net interest income totaled \$134.1 billion, an increase of \$10.7 billion (8.7%) from 12 months earlier and the largest annual dollar increase ever reported by the industry. More than four out of five banks (85.1%) reported year-over-year increases. Net interest margin (NIM) rose to 3.38%, up 16 basis points from a year earlier, as average asset yields grew more rapidly than average funding costs. Institutions with assets of \$10 billion to \$250 billion reported the largest annual increase in average funding costs (up 30 basis points). The improvement in NIM was widespread, as more than two out of three banks (70.2%) reported increases from a year earlier.

#### Provisions Decline Modestly From Second Quarter 2017

Banks set aside \$11.7 billion in loan-loss provisions during the second quarter, a decline of \$293.5 million (2.4%) from the previous year. Almost one-third of all banks (31.3%) reported lower loan-loss provisions than in second quarter 2017. Loan-loss provisions as a percentage of net operating revenue declined to 5.8% for the current quarter, the lowest level since third quarter 2015.

Table of Contents

Noninterest Income Expands 2% From a Year Earlier

Noninterest income totaled \$68.1 billion, an increase of \$1.3 billion (2%) from the previous year. The 12-month increase in noninterest income was attributable to servicing fees (up \$638.2 million, or 29.5%), fiduciary activity (up \$558.4 million, or 6.3%), and net gains on sales of other assets (up \$388.3 million). Slightly more than half of all institutions (55.6%) reported increases in noninterest income from a year earlier.

Noninterest Expense Grows 4.6% Year-Over-Year

Noninterest expenses rose by \$5 billion (4.6%) from a year earlier, as salary and employee benefits grew by \$2.7 billion (5.2%) and other noninterest expense increased by \$1.8 billion (4.2%). Average assets per employee totaled \$8.4 million for the current quarter, up from \$8.2 million in second quarter 2017. The efficiency ratio (noninterest expense as a% of net operating revenue) improved to 55.5% in the second quarter, the lowest level since first quarter 2010.

Net Charge-Off Rate Remains Stable

For the past eleven quarters in a row, net charge-offs increased compared with a year earlier but at a slower rate. During the second quarter, banks charged-off \$11.7 billion in uncollectable loans, an increase of \$446.4 billion (4%) over the past 12 months. The annual increase in net charge-offs was led by credit card balances (up \$918.9 million, or 12.8%). The average net charge-off rate remained stable from a year earlier at 0.48%.

Noncurrent Loan Rate Declines to 1.06%

Noncurrent loan balances (90 days or more past due or in nonaccrual status) declined by \$7.7 billion (6.8%) from the first quarter, as more than half (52%) of all institutions reported quarterly declines. The improvement was led by residential mortgages (down \$5.2 billion, or 9.7%), commercial and industrial loans (down \$1.2 billion, or 6.8%), and credit cards (down \$848.6 million, or 7.4%). The average noncurrent rate fell from 1.15% in the first quarter to 1.06%.

Reserve Coverage of Noncurrent Loans Continues to Grow



Loan-loss reserves declined by \$330 million (0.3%) from the first quarter, as less than one-third (25.3%) of all institutions reported a quarterly decline. At banks that itemize their loan-loss reserves, which represent almost 91% of total industry loan-loss reserves, losses on credit cards increased by \$284.2 million (0.7%). Itemized reserves for residential real estate losses fell by \$522.3 million (3.7%). As noncurrent loan balances declined at a faster quarterly rate than loan-loss reserves, the coverage ratio (loan-loss reserves to noncurrent loan balances) grew from 110% in the first quarter to 117.7%.

#### Equity Capital Increases From the First Quarter

Equity capital of \$2 trillion rose by \$15.3 billion (0.8%) from the first quarter. Retained earnings contributed \$22.4 billion to equity growth but were partly offset by a \$7.8 billion reduction in accumulated other comprehensive income. With a decline in market value of available-for-sale securities, unrealized losses totaled \$40.2 billion for the current quarter, an increase of \$6 billion (17.4%) from the previous quarter. Declared dividends totaled \$37.8 billion, an increase of \$9.5 billion (33.4%) from the year before. At the end of the quarter, 99.6% of all insured institutions, which account for 99.97% of total industry assets, met or exceeded the requirements for the highest regulatory capital category, as defined for Prompt Corrective Action purposes.

## Table of Contents

### Balances at Federal Reserve Banks Decline Almost 12%

Total assets rose modestly (up \$1.3 billion) from the previous quarter, as cash and balances due from depository institutions declined by \$126.4 billion (6.5%), the largest quarterly dollar decline since second quarter 2015. Balances at Federal Reserve banks declined by \$139.7 billion (11.7%), and mortgage-backed securities rose by \$43.5 billion (2.1%).

### Loan Balances Expand 4.2% From Second Quarter 2017

Total loan and lease balances increased by \$104.3 billion (1.1%) from the first quarter, as more than three out of four banks (76.2%) reported quarterly increases. All major loan categories registered quarterly increases, led by commercial and industrial loans (up \$25.5 billion, or 1.2%); consumer loans, which include credit card balances (up \$23.7 billion, or 1.4%); nonfarm nonresidential loans (up \$18.9 billion, or 1.3%); and residential mortgage loans (up \$17.9 billion, or 0.9%). Over the past year, total loan and lease balances grew by \$398.5 billion (4.2%), a slight decline from last quarter's annual growth rate of 4.9%. Commercial and industrial loans rose by \$95.2 (4.8%); consumer loans, which include credit card balances, increased by \$84.4 billion (5.4%); residential mortgage loans grew by \$70.6 billion (3.5%); and nonfarm nonresidential loans expanded by \$56.4 billion (4.1%).

### Deposits Decline From the Previous Quarter

Total deposits fell by \$60.2 billion (0.4%) from the previous quarter, as deposits in both foreign offices (down \$38.8 billion, or 3%) and domestic offices (down \$21.5 billion, or 0.2%) declined. Domestic interest-bearing deposits rose by \$13.5 billion (0.1%), while noninterest-bearing deposits declined by \$34.9 billion (1.1%). Banks increased their nondeposit liabilities by \$46.3 billion (2.3%) from the first quarter, led by Federal Home Loan Banks advances (up \$30 billion, or 5.4%) and other liabilities (up \$11.7 billion, or 3.1%).

### Two New Charters Added in Second Quarter 2018

During the three months ended June 30, the number of FDIC-insured commercial banks and savings institutions declined by 65 to 5,542. Two new charters were added, 64 institutions were absorbed by mergers, and no banks failed. The number of institutions on the FDIC's "Problem Bank List" fell from 92 to 82, the lowest number since fourth quarter 2007. Assets of problem banks declined from \$56.4 billion to \$54.4 billion.

## **Critical Accounting Policies**

The discussion contained in this Item 2 and other disclosures included within this report are based, in part, on the Company's audited December 31, 2017 consolidated financial statements. These statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The financial information contained in these statements is, for the most part, based on the financial effects of transactions and events that have already occurred. However, the preparation of these statements requires management to make certain estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses.

The Company's significant accounting policies are described in the "Notes to Consolidated Financial Statements" accompanying the Company's audited financial statements. Based on its consideration of accounting policies that involve the most complex and subjective estimates and judgments, management has identified the allowance for loan losses, the assessment of other-than-temporary impairment for investment securities and the assessment of goodwill to be the Company's most critical accounting policies.

## Table of Contents

### Allowance for Loan Losses

The allowance for loan losses is established through a provision for loan losses that is treated as an expense and charged against earnings. Loans are charged against the allowance for loan losses when management believes that collectability of the principal is unlikely. The Company has policies and procedures for evaluating the overall credit quality of its loan portfolio, including timely identification of potential problem loans. On a quarterly basis, management reviews the appropriate level for the allowance for loan losses, incorporating a variety of risk considerations, both quantitative and qualitative. Quantitative factors include the Company's historical loss experience, delinquency and charge-off trends, collateral values, known information about individual loans and other factors. Qualitative factors include various considerations regarding the general economic environment in the Company's market area. To the extent actual results differ from forecasts and management's judgment, the allowance for loan losses may be greater or lesser than future charge-offs. Due to potential changes in conditions, it is at least reasonably possible that changes in estimates will occur in the near term and that such changes could be material to the amounts reported in the Company's financial statements.

For further discussion concerning the allowance for loan losses and the process of establishing specific reserves, see the section of the Annual Report on Form 10-K entitled "Asset Quality Review and Credit Risk Management" and "Analysis of the Allowance for Loan Losses".

### Fair Value and Other-Than-Temporary Impairment of Investment Securities

The Company's securities available-for-sale portfolio is carried at fair value with "fair value" being defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability is not adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact, and (iv) willing to transact.

Declines in the fair value of available-for-sale securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the intent to sell the investment securities and the more likely than not requirement that the Company will be required to sell the investment securities prior to recovery (2) the length of time and the extent to which the fair value has been less than cost and (3) the financial condition and near-term prospects of the issuer. Due to potential changes in conditions, it is at least reasonably possible that changes in management's assessment of

other-than-temporary impairment will occur in the near term and that such changes could be material to the amounts reported in the Company's financial statements.

## Goodwill

Goodwill arose in connection with three acquisitions consummated in the current and previous periods. Goodwill is tested annually for impairment or more often if conditions indicate a possible impairment. For the purposes of goodwill impairment testing, determination of the fair value of a reporting unit involves the use of significant estimates and assumptions. Impairment would arise if the fair value of a reporting unit is less than its carrying value. At September 30, 2018, Company's management has completed the goodwill impairment assessment and determined goodwill was not impaired. Actual future test results may differ from the present evaluation of impairment due to changes in the conditions used in the current evaluation.

Table of Contents**Non-GAAP Financial Measures**

This report contains references to financial measures that are not defined in GAAP. Such non-GAAP financial measures include the Company's presentation of net interest income and net interest margin on a fully taxable equivalent (FTE) basis. Management believes these non-GAAP financial measures provide useful information to both management and investors to analyze and evaluate the Company's financial performance. Limitations associated with non-GAAP financial measures include the risks that persons might disagree as to the appropriateness of items included in these measures and that different companies might calculate these measures differently. These non-GAAP disclosures should not be considered an alternative to the Company's GAAP results. The following table reconciles the non-GAAP financial measures of net interest income and net interest margin on an FTE basis to GAAP. (*dollars in thousands*)

|   | <b>Three Months Ended<br/>September 30,</b> |              | <b>Nine Months Ended<br/>September 30,</b> |              |
|---|---|--------------|--|--------------|
|   | <b>2018</b>                                 | <b>2017</b>  | <b>2018</b>                                | <b>2017</b>  |
| Reconciliation of net interest income and annualized net interest margin on an FTE basis to GAAP: |   |              |  |              |
| Net interest income (GAAP)  | \$ 10,586                                   | \$ 10,151    | \$ 30,983                                  | \$ 30,100    |
| Tax-equivalent adjustment <sup>(1)</sup>  | 288   | 653          | 917  | 2,057        |
| Net interest income on an FTE basis (non-GAAP)  | 10,874                                      | 10,804       | 31,900                                     | 32,157       |
| Average interest-earning assets   | \$ 1,324,697                                | \$ 1,312,397 | \$ 1,324,817                               | \$ 1,320,236 |
| Net interest margin on an FTE basis (non-GAAP)  | 3.28  | % 3.29       | % 3.21                                     | % 3.25       |

(1) Computed on a tax-equivalent basis using an incremental federal income tax rate of 21 percent for the three and nine months ended September 30, 2018 and 35 percent for the three and nine months ended September 30, 2017, adjusted to reflect the effect of the tax-exempt interest income associated with owning tax-exempt securities and loans.

Table of Contents**Income Statement Review for the Three Months ended September 30, 2018 and 2017**

The following highlights a comparative discussion of the major components of net income and their impact for the three months ended September 30, 2018 and 2017:

**AVERAGE BALANCES AND INTEREST RATES**

The following two tables are used to calculate the Company's net interest margin. The first table includes the Company's average assets and the related income to determine the average yield on earning assets. The second table includes the average liabilities and related expense to determine the average rate paid on interest bearing liabilities. The net interest margin is equal to the interest income less the interest expense divided by average earning assets.

**AVERAGE BALANCE SHEETS AND INTEREST RATES****Three Months Ended September 30,****2018****2017**

|                               | Average<br>balance | Revenue/<br>expense | Yield/<br>rate | Average<br>balance | Revenue/<br>expense | Yield/<br>rate |
|-------------------------------|--------------------|---------------------|----------------|--------------------|---------------------|----------------|
| <b>ASSETS</b>                 |                    |                     |                |                    |                     |                |
| <i>(dollars in thousands)</i> |                    |                     |                |                    |                     |                |
| Interest-earning assets       |                    |                     |                |                    |                     |                |
| Loans 1                       |                    |                     |                |                    |                     |                |
| Commercial                    | \$75,533           | \$972               | 5.15 %         | \$77,788           | \$920               | 4.73 %         |
| Agricultural                  | 70,925             | 1,075               | 6.06 %         | 67,951             | 922                 | 5.43 %         |
| Real estate                   | 648,628            | 7,375               | 4.55 %         | 623,214            | 6,756               | 4.34 %         |
| Consumer and other            | 10,206             | 136                 | 5.34 %         | 10,514             | 132                 | 5.03 %         |
| Total loans (including fees)  | 805,292            | 9,558               | 4.75 %         | 779,467            | 8,730               | 4.48 %         |
| Investment securities         |                    |                     |                |                    |                     |                |
| Taxable                       | 266,510            | 1,545               | 2.32 %         | 275,498            | 1,558               | 2.26 %         |
| Tax-exempt 2                  | 205,003            | 1,374               | 2.68 %         | 230,249            | 1,862               | 3.23 %         |
| Total investment securities   | 471,513            | 2,919               | 2.48 %         | 505,747            | 3,420               | 2.70 %         |
| Other interest-earning assets | 47,892             | 272                 | 2.27 %         | 27,183             | 115                 | 1.69 %         |
| Total interest-earning assets | 1,324,697          | \$12,749            | 3.85 %         | 1,312,397          | \$12,265            | 3.74 %         |

|                            |             |             |
|----------------------------|-------------|-------------|
| Noninterest-earning assets | 41,596      | 49,366      |
| TOTAL ASSETS               | \$1,366,293 | \$1,361,763 |

1 Average loan balance includes nonaccrual loans, if any. Interest income collected on nonaccrual loans has been included.

2 Tax-exempt income has been adjusted to a tax-equivalent basis using an incremental tax rate for the three months ended September 30, 2018 and 2017 of 21% and 35%, respectively.



Table of Contents**AVERAGE BALANCE SHEETS AND INTEREST RATES**

|   | <b>Three Months Ended September 30,</b> |                     |                |                    |                     |                |
|---|---|---------------------|----------------|--------------------|---------------------|----------------|
|   | <b>2018</b>                             |                     |                | <b>2017</b>        |                     |                |
|   | Average<br>balance                      | Revenue/<br>expense | Yield/<br>rate | Average<br>balance | Revenue/<br>expense | Yield/<br>rate |
| <b>LIABILITIES AND STOCKHOLDERS'<br/>EQUITY</b>       |   |                     |                |                    |                     |                |
| <i>(dollars in thousands)</i>                         |   |                     |                |                    |                     |                |
| Interest-bearing liabilities                          |   |                     |                |                    |                     |                |
| Deposits  |   |                     |                |                    |                     |                |
| NOW, savings accounts and money markets               | \$732,905                               | \$ 1,109            | 0.61 %         | \$712,550          | \$ 685              | 0.38 %         |
| Time deposits   | 196,664                                 | 632                 | 1.29 %         | 196,905            | 484                 | 0.98 %         |
| Total deposits  | 929,569                                 | 1,741               | 0.75 %         | 909,455            | 1,169               | 0.51 %         |
| Other borrowed funds                                  | 45,100                                  | 134                 | 1.19 %         | 71,266             | 292                 | 1.64 %         |
| Total Interest-bearing liabilities                    | 974,669                                 | 1,875               | 0.77 %         | 980,721            | 1,461               | 0.60 %         |
| Noninterest-bearing liabilities                       |   |                     |                |                    |                     |                |
| Demand deposits                                       | 214,956                                 |                     |                | 200,934            |                     |                |
| Other liabilities                                     | 7,523                                   |                     |                | 7,132              |                     |                |
| Stockholders' equity                                  | 169,145                                 |                     |                | 172,976            |                     |                |
| <b>TOTAL LIABILITIES AND<br/>STOCKHOLDERS' EQUITY</b> | <b>\$1,366,293</b>                      |                     |                | <b>\$1,361,763</b> |                     |                |
| Net interest income                                   |   | \$ 10,874           | 3.28 %         |                    | \$ 10,804           | 3.29 %         |
| Spread Analysis                                       |   |                     |                |                    |                     |                |
| Interest income/average assets                        | \$12,749                                | 3.73 %              |                | \$12,265           | 3.60 %              |                |
| Interest expense/average assets                       | \$1,875                                 | 0.55 %              |                | \$1,461            | 0.43 %              |                |
| Net interest income/average assets                    | \$10,874                                | 3.18 %              |                | \$10,804           | 3.17 %              |                |

**Net Interest Income**

For the three months ended September 30, 2018 and 2017, the Company's net interest margin adjusted for tax exempt income was 3.28% and 3.29%, respectively. Net interest income, prior to the adjustment for tax-exempt income, for the three months ended September 30, 2018 totaled \$10,586,000 compared to \$10,152,000 for the three months ended September 30, 2017.

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

For the three months ended September 30, 2018, interest income increased \$848,000, or 7%, when compared to the same period in 2017. The increase from 2017 was primarily attributable to increased loan volume and rates and recognition of nonaccrual interest income. Nonaccrual interest income recognized in the three months ended September 30, 2018 was \$143,000 as compared to \$20,000 for the same period in 2017. Loan interest rates increased in conjunction with general market interest rates, as the Federal Reserve Bank increased short term interest rate targets by 1.00% since September 30, 2017.

## Table of Contents

Interest expense increased \$413,000, or 28%, for the three months ended September 30, 2018 when compared to the same period in 2017. The higher interest expense for the period is primarily attributable to higher rates on deposits due to market interest rates and competitive pressures.

### Provision for Loan Losses

The Company's provision for loan losses was \$100,000 and \$57,000 for the three months ended September 30, 2018 and 2017, respectively. Net loan charge-offs were \$195,000 and \$105,000 for the three months ended September 30, 2018 and 2017, respectively. While the current provision for loan losses are not related to agricultural loans, the Iowa agricultural economy remains challenged as the result of the current low grain prices, potential tariff concerns on Iowa exports and excessive rainfall in most of our markets.

### Noninterest Income and Expense

Noninterest income increased \$302,000 for the three months ended September 30, 2018 compared to the same period in 2017. The increase in noninterest income is primarily due to higher wealth management income and a one-time gain on the foreclosure of other real estate owned. The higher wealth management income was primarily due to an increase in estate fees. Exclusive of realized securities gains, noninterest income was 19% higher in the third quarter of 2018 compared to the same period in 2017.

Noninterest expense increased \$692,000 or 11% for the three months ended September 30, 2018 compared to the same period in 2017 primarily as a result of non-routine costs associated with the Acquisition of \$340,000 and increases in salaries and employee benefits. This increase in salaries and benefits was primarily due to normal salary increases, additional personnel and changes in the Company's paid time off benefits. The efficiency ratio was 54.8% for the third quarter of 2018 as compared to 52.4% in 2017.

### Income Taxes

The provision for income taxes expense for the three months ended September 30, 2018 and 2017 was \$1,201,000 and \$1,730,000, respectively, representing an effective tax rate of 21% and 31%, respectively. The expected combined federal and state tax rate was 25% and 37% for the three months ended September 30, 2018 and 2017, respectively. The lower expected tax rate in 2018 is due to the enactment of the Tax Cut and Jobs Act Bill on December 22, 2017. The lower than expected effective tax rate for both periods is primarily due to tax-exempt interest income.



Table of Contents**Income Statement Review for the Nine Months ended September 30, 2018 and 2017**

The following highlights a comparative discussion of the major components of net income and their impact for the nine months ended September 30, 2018 and 2017:

**AVERAGE BALANCES AND INTEREST RATES**

The following two tables are used to calculate the Company's net interest margin. The first table includes the Company's average assets and the related income to determine the average yield on earning assets. The second table includes the average liabilities and related expense to determine the average rate paid on interest bearing liabilities. The net interest margin is equal to the interest income less the interest expense divided by average earning assets.

**AVERAGE BALANCE SHEETS AND INTEREST RATES**

|   | <b>Nine Months Ended September 30,</b> |                     |                |                    |                     |                |
|---|--|---------------------|----------------|--------------------|---------------------|----------------|
|   | <b>2018</b>                            |                     |                | <b>2017</b>        |                     |                |
|   | Average<br>balance                     | Revenue/<br>expense | Yield/<br>rate | Average<br>balance | Revenue/<br>expense | Yield/<br>rate |
| <b>ASSETS</b>   |  |                     |                |                    |                     |                |
| <i>(dollars in thousands)</i>                               |  |                     |                |                    |                     |                |
| Interest-earning assets                                     |  |                     |                |                    |                     |                |
| Loans 1   |  |                     |                |                    |                     |                |
| Commercial  | \$73,973                               | \$2,766             | 4.99 %         | \$77,471           | \$2,613             | 4.50 %         |
| Agricultural  | 69,500                                 | 3,023               | 5.80 %         | 69,093             | 2,703               | 5.22 %         |
| Real estate   | 639,563                                | 21,290              | 4.44 %         | 612,845            | 19,620              | 4.27 %         |
| Consumer and other  | 9,096                                  | 364                 | 5.33 %         | 11,121             | 411                 | 4.92 %         |
| Total loans (including fees)                                | 792,132                                | 27,443              | 4.62 %         | 770,530            | 25,347              | 4.39 %         |
| Investment securities                                       |  |                     |                |                    |                     |                |
| Taxable   | 268,284                                | 4,639               | 2.31 %         | 271,913            | 4,637               | 2.27 %         |
| Tax-exempt 2  | 218,392                                | 4,368               | 2.67 %         | 241,160            | 5,875               | 3.25 %         |
| Total investment securities                                 | 486,676                                | 9,007               | 2.47 %         | 513,073            | 10,512              | 2.73 %         |
| Interest bearing deposits with banks and federal funds sold | 46,009                                 | 721                 | 2.09 %         | 36,633             | 365                 | 1.33 %         |
| Total interest-earning assets                               | 1,324,817                              | \$37,171            | 3.74 %         | 1,320,236          | \$36,224            | 3.66 %         |

|                            |                    |                    |
|----------------------------|--------------------|--------------------|
| Noninterest-earning assets | 40,619             | 49,268             |
| <b>TOTAL ASSETS</b>        | <b>\$1,365,436</b> | <b>\$1,369,504</b> |

1 Average loan balance includes nonaccrual loans, if any. Interest income collected on nonaccrual loans has been included.

2 Tax-exempt income has been adjusted to a tax-equivalent basis using an incremental tax rate for the nine months ended September 30, 2018 and 2017 of 21% and 35%, respectively.

Table of Contents**AVERAGE BALANCE SHEETS AND INTEREST RATES**

|   | <b>Nine Months Ended September 30,</b> |                     |                |                    |                     |                |
|---|--|---------------------|----------------|--------------------|---------------------|----------------|
|   | <b>2018</b>                            |                     |                | <b>2017</b>        |                     |                |
|   | Average<br>balance                     | Revenue/<br>expense | Yield/<br>rate | Average<br>balance | Revenue/<br>expense | Yield/<br>rate |
| <b>LIABILITIES AND STOCKHOLDERS'<br/>EQUITY</b>       |  |                     |                |                    |                     |                |
| <i>(dollars in thousands)</i>                         |  |                     |                |                    |                     |                |
| Interest-bearing liabilities                          |  |                     |                |                    |                     |                |
| Deposits  |  |                     |                |                    |                     |                |
| NOW, savings accounts and money markets               | \$733,072                              | \$ 3,009            | 0.55 %         | \$717,946          | \$ 1,819            | 0.34 %         |
| Time deposits   | 195,217                                | 1,727               | 1.18 %         | 198,602            | 1,385               | 0.93 %         |
| Total deposits  | 928,289                                | 4,736               | 0.68 %         | 916,548            | 3,204               | 0.47 %         |
| Other borrowed funds                                  | 49,563                                 | 534                 | 1.44 %         | 75,662             | 863                 | 1.52 %         |
| <b>Total Interest-bearing liabilities</b>             | <b>977,852</b>                         | <b>5,270</b>        | <b>0.72 %</b>  | <b>992,210</b>     | <b>4,067</b>        | <b>0.55 %</b>  |
| Noninterest-bearing liabilities                       |  |                     |                |                    |                     |                |
| Demand deposits                                       | 211,120                                |                     |                | 200,020            |                     |                |
| Other liabilities                                     | 8,141                                  |                     |                | 7,319              |                     |                |
| Stockholders' equity                                  | 168,323                                |                     |                | 169,955            |                     |                |
| <b>TOTAL LIABILITIES AND<br/>STOCKHOLDERS' EQUITY</b> | <b>\$1,365,437</b>                     |                     |                | <b>\$1,369,504</b> |                     |                |
| <br>  |  |                     |                |                    |                     |                |
| Net interest income                                   |  | \$31,900            | 3.21 %         |                    | \$32,157            | 3.25 %         |
| Spread Analysis                                       |  |                     |                |                    |                     |                |
| Interest income/average assets                        | \$37,171                               | 3.63 %              |                | \$36,224           | 3.53 %              |                |
| Interest expense/average assets                       | \$5,270                                | 0.51 %              |                | \$4,067            | 0.40 %              |                |
| Net interest income/average assets                    | \$31,900                               | 3.12 %              |                | \$32,157           | 3.13 %              |                |

**Net Interest Income**

For the nine months ended September 30, 2018 and 2017, the Company's net interest margin adjusted for tax exempt income was 3.21% and 3.25%, respectively. Net interest income, prior to the adjustment for tax-exempt income, for the nine months ended September 30, 2018 totaled \$30,983,000 compared to \$30,100,000 for the nine months ended September 30, 2017.

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

For the nine months ended September 30, 2018, interest income increased \$2,086,000, or 6%, when compared to the same period in 2017. The increase from 2017 was primarily attributable to increased loan rates and recognition of nonaccrual loan interest income on loans. Nonaccrual interest income recognized in the nine months ended September 30, 2018 and 2017 was \$289,000. Loan interest rates increased in conjunction with general market interest rates, as the Federal Reserve Bank increased short term interest rate targets by 1.00% since September 30, 2017.



## Table of Contents

Interest expense increased \$1,203,000, or 30%, for the nine months ended September 30, 2018 when compared to the same period in 2017. The higher interest expense for the period is primarily attributable to higher rates on deposits due to market interest rates and competitive pressures.

### Provision for Loan Losses

The Company's provision for loan losses was \$193,000 and \$1,222,000 for the nine months ended September 30, 2018 and 2017, respectively. An increase in the specific reserve on one loan credit and the growth in the loan portfolio was the primary factor for the provision for loan losses for the six months ended June 30, 2017, with no significant growth in the loan portfolio, excluding the Acquisition, for the six months ended June 30, 2018. Net loan charge-offs were \$226,000 and \$589,000 for the nine months ended September 30, 2018 and 2017, respectively. While the current provision for loan losses are not related to agricultural loans, the Iowa agricultural economy remains challenged as the result of the current low grain prices, potential tariff concerns on Iowa exports and excessive rainfall in a portion of our markets.

### Noninterest Income and Expense

Noninterest income decreased \$49,000 for the nine months ended September 30, 2018 compared to the same period in 2017. The decrease in noninterest income is primarily due to lower security gains, offset in part by higher wealth management income and a gain on the foreclosure of other real estate owned. The higher wealth management income was primarily due to an increase in estate fees. Exclusive of realized securities gains, noninterest income was 8% higher for the nine months ended September 30, 2018 as compared to the same period in 2017.

Noninterest expense increased \$1,394,000 or 7% for the nine months ended September 30, 2018 compared to the same period in 2017 primarily as a result of non-routine costs associated with the Acquisition of \$340,000 and increases in salaries and employee benefits. This increase in salaries and benefits was primarily due to normal salary increases, additional personnel and a one-time \$1,000 bonus paid to full-time employees. The efficiency ratio was 55.7% for the nine months ended September 30, 2018 as compared to 53.2% in 2017.

### Income Taxes

The provision for income taxes expense for the nine months ended September 30, 2018 and 2017 was \$3,328,000 and \$4,662,000, respectively, representing an effective tax rate of 21% and 30%, respectively. The expected combined federal and state tax rate was 25% and 37% for the nine months ended September 30, 2018 and 2017, respectively.

The lower expected tax rate in 2018 is due to the enactment of the Tax Cut and Jobs Act Bill on December 22, 2017. The lower than expected effective tax rate for both periods is primarily due to tax-exempt interest income.

### **Balance Sheet Review**

As of September 30, 2018, total assets were \$1,448,252,000, a \$73,193,000 increase compared to December 31, 2017. The increase in assets, primarily loans, and asset funding, primarily deposits, was mainly due to the Acquisition.

### **Investment Portfolio**

The investment portfolio totaled \$474,442,000 as of September 30, 2018, a decrease of \$20,880,000 from the December 31, 2017 balance of \$495,322,000. The decrease in securities available-for-sale is primarily due to payments and maturities of mortgage backed securities and municipals and higher unrealized loss in the investment portfolio as higher market interest rates caused a decline in the fair value of the investment portfolio. This decline was offset in part by the Acquisition and purchases of U.S. agency securities.

Table of Contents

On a quarterly basis, the investment portfolio is reviewed for other-than-temporary impairment. As of September 30, 2018, gross unrealized losses of \$9,345,000, are considered to be temporary in nature due to the interest rate environment of 2018 and other general economic factors. As a result of the Company's favorable liquidity position, the Company does not have the intent to sell securities with an unrealized loss at the present time. In addition, management believes it is more likely than not that the Company will hold these securities until recovery of their fair value to cost basis and avoid considering present unrealized loss positions to be other-than-temporary.

At September 30, 2018, the Company's investment securities portfolio included securities issued by 272 government municipalities and agencies located within 19 states with a fair value of \$221.9 million. At December 31, 2017, the Company's investment securities portfolio included securities issued by 272 government municipalities and agencies located within 25 states with a fair value of \$261.6 million. No one municipality or agency represents a concentration within this segment of the investment portfolio. The largest exposure to any one municipality or agency as of September 30, 2018 was \$3.7 million (approximately 2.0% of the fair value of the governmental municipalities and agencies) represented by the West Des Moines, Iowa Community School District to be repaid by sales tax revenues and property taxes.

The Company's procedures for evaluating investments in states, municipalities and political subdivisions include but are not limited to reviewing the offering statement and the most current available financial information, comparing yields to yields of bonds of similar credit quality, confirming capacity to repay, assessing operating and financial performance, evaluating the stability of tax revenues, considering debt profiles and local demographics, and for revenue bonds, assessing the source and strength of revenue structures for municipal authorities. These procedures, as applicable, are utilized for all municipal purchases and are utilized in whole or in part for monitoring the portfolio of municipal holdings. The Company does not utilize third party credit rating agencies as a primary component of determining if the municipal issuer has an adequate capacity to meet the financial commitments under the security for the projected life of the investment, and, therefore, does not compare internal assessments to those of the credit rating agencies. Credit rating downgrades are utilized as an additional indicator of credit weakness and as a reference point for historical default rates.

Table of Contents

The following table summarizes the total general obligation and revenue bonds in the Company's investment securities portfolios as of September 30, 2018 and December 31, 2017 identifying the state in which the issuing government municipality or agency operates. (*Dollars in thousands*)

|   | <b>2018</b>      |                      | <b>2017</b>      |                      |
|---|------------------|----------------------|------------------|----------------------|
|   | Amortized Cost   | Estimated Fair Value | Amortized Cost   | Estimated Fair Value |
| Obligations of states and political subdivisions:             |                  |                      |                  |                      |
| General Obligation bonds:                                     |                  |                      |                  |                      |
| Iowa  | \$59,668         | \$58,816             | \$56,029         | \$55,829             |
| Texas   | 11,475           | 11,353               | 12,141           | 12,174               |
| Pennsylvania  | 9,729            | 9,637                | 8,719            | 8,745                |
| Washington  | 6,934            | 6,702                | 7,017            | 6,900                |
| Other (2018: 12 states; 2017: 17 states)                      | 18,743           | 18,742               | 22,023           | 22,228               |
| <b>Total general obligation bonds</b>                         | <b>\$106,549</b> | <b>\$105,250</b>     | <b>\$105,929</b> | <b>\$105,876</b>     |
| Revenue bonds:  |                  |                      |                  |                      |
| Iowa  | \$108,389        | \$107,210            | \$122,044        | \$122,140            |
| Other (2018: 9 states; 2017: 9 states)                        | 9,576            | 9,470                | 9,376            | 9,397                |
| <b>Total revenue bonds</b>                                    | <b>\$117,965</b> | <b>\$116,680</b>     | <b>\$131,420</b> | <b>\$131,537</b>     |
| <b>Total obligations of states and political subdivisions</b> | <b>\$224,514</b> | <b>\$221,930</b>     | <b>\$237,349</b> | <b>\$237,413</b>     |

As of September 30, 2018 and December 31, 2017, the revenue bonds in the Company's investment securities portfolios were issued by government municipalities and agencies to fund public services such as community school facilities, college and university dormitory facilities, water utilities and electrical utilities. The revenue bonds are to be paid from primarily 5 revenue sources. The revenue sources that represent 5% or more, individually, as a percent of the total revenue bonds are summarized in the following table. (*in thousands*)

|  | <b>2018</b>    |                      | <b>2017</b>    |                      |
|--|----------------|----------------------|----------------|----------------------|
|  | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| Revenue bonds by revenue source                        |                |                      |                |                      |
| Sales tax  | \$60,506       | \$60,111             | \$74,631       | \$74,973             |
| Water  | 14,574         | 14,252               | 12,763         | 12,611               |
| College and universities, primarily dormitory revenues | 8,619          | 8,545                | 10,452         | 10,443               |
| Leases   | 9,541          | 9,381                | 9,383          | 9,331                |

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

|                                       |           |           |           |           |
|---------------------------------------|-----------|-----------|-----------|-----------|
| Electric                              | 8,541     | 8,484     | 7,382     | 7,416     |
| Other                                 | 16,184    | 15,907    | 16,809    | 16,763    |
| Total revenue bonds by revenue source | \$117,965 | \$116,680 | \$131,420 | \$131,537 |

Loan Portfolio

The loan portfolio, net of the allowance for loan losses, totaled \$859,830,000, \$771,550,000 and \$764,229,000 as of September 30, 2018, December 31, 2017 and September 30, 2017, respectively. Loan demand has moderated since year end. The increase in the loan portfolio is primarily due to the Acquisition.

## Table of Contents

### Deposits

Deposits totaled \$1,215,761,000, \$1,134,391,000 and \$1,114,538,000 as of September 30, 2018, December 31, 2017 and September 30, 2017, respectively. The increase in deposits since December 31, 2017 was primarily due to the Acquisition.

### Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase totaled \$48,859,000 as of September 30, 2018, an increase of \$11,434,000, or 31%, from the December 31, 2017 balance of \$37,425,000. The increase was due primarily to an increase in the balances of two existing customers.

### Off-Balance Sheet Arrangements

The Company is party to financial instruments with off-balance-sheet risk in the normal course of business. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. No material changes in the Company's off-balance sheet arrangements have occurred since December 31, 2017.

### **Asset Quality Review and Credit Risk Management**

The Company's credit risk is historically centered in the loan portfolio, which on September 30, 2018 totaled \$859,830,000 compared to \$771,550,000 as of December 31, 2017. Net loans comprise 59% of total assets as of September 30, 2018. The object in managing loan portfolio risk is to reduce the risk of loss resulting from a customer's failure to perform according to the terms of an agreement and to quantify and manage credit risk on a portfolio basis. The Company's level of problem loans (consisting of nonaccrual loans and loans past due 90 days or more) as a percentage of total loans was 0.42% at September 30, 2018, as compared to 0.62% at December 31, 2017 and 0.62% at September 30, 2017. The Company's level of problem loans as a percentage of total loans at September 30, 2018 of 0.42% is slightly lower than the Company's peer group (329 bank holding companies with assets of \$1 billion to \$3 billion) of 0.64% as of June 30, 2018.

Impaired loans, net of specific reserves, totaled \$3,041,000 as of September 30, 2018 and have decreased \$958,000 as compared to the impaired loans of \$3,999,000 as of December 31, 2017.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payment of principal and interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. The Company applies its normal loan review procedures to identify loans that should be evaluated for impairment.

The Company had TDRs of \$2,716,000 as of September 30, 2018, all of which were included in impaired and nonaccrual loans. The Company had TDRs of \$2,984,000 as of December 31, 2017, all of which were included in impaired and nonaccrual loans.

Table of Contents

TDRs are monitored and reported on a quarterly basis. Certain TDRs are on nonaccrual status at the time of restructuring. These borrowings are typically returned to accrual status after the following: sustained repayment performance in accordance with the restructuring agreement for a reasonable period of at least six months; and, management is reasonably assured of future performance. If the TDR meets these performance criteria and the interest rate granted at the modification is equal to or greater than the rate that the Company was willing to accept at the time of the restructuring for a new loan with comparable risk, then the loan will return to performing status.

For TDRs that were on nonaccrual status before the modification, a specific reserve may already be recorded. In periods subsequent to modification, the Company will continue to evaluate all TDRs for possible impairment and, as necessary, recognize impairment through the allowance. An \$80,000 specific reserve was established in the nine months ended September 30, 2018 on a TDR loan. The Company had \$12,000 of charge-offs related to TDRs for the nine months ended September 30, 2018. A \$530,000 specific reserve was established in the nine months ended September 30, 2017 on a TDR loan. The Company had \$12,000 and \$257,000 of net charge-offs related to TDRs for the nine months ended September 30, 2018 and 2017, respectively.

Loans past due 90 days or more that are still accruing interest are reviewed no less frequently than quarterly to determine if there continues to be a strong reason that the credit should not be placed on non-accrual. As of September 30, 2018, non-accrual loans totaled \$3,639,000 and there were no loans past due 90 days and still accruing. This compares to non-accrual loans of \$4,810,000 and loans past due 90 days and still accruing totaled \$18,000 as of December 31, 2017. Other real estate owned totaled \$730,000 and \$386,000 as of September 30, 2018 and December 31, 2017, respectively.

The agricultural real estate and agricultural operating loan portfolio classifications remain elevated as a result of lower grain prices. The watch and special mention loans in these categories totaled \$44,354,000 as of September 30, 2018 as compared to \$42,754,000 as of December 31, 2017. The substandard loans in these categories totaled \$9,761,000 as of September 30, 2018 as compared to \$2,725,000 as of December 31, 2017. The Iowa agricultural economy remains challenged as the result of the current low grain prices, potential tariff concerns on Iowa exports and excessive rainfall in most of our markets.

The allowance for loan losses as a percentage of outstanding loans as of September 30, 2018 was 1.30%, as compared to 1.45% at December 31, 2017. The decrease in the percentage of allowance for loan losses to gross loans can be primarily attributed to the Acquisition. The purchased loan portfolio is initially recorded without an allowance for loan loss, as the credit risk is reflected in the fair value of loans on the acquisition date. The allowance for loan losses totaled \$11,288,000 and \$11,321,000 as of September 30, 2018 and December 31, 2017, respectively. Net charge-offs of loans totaled \$226,000 and \$589,000 for the nine months ended September 30, 2018 and 2017, respectively.

The allowance for loan losses is management's best estimate of probable losses inherent in the loan portfolio as of the balance sheet date. Factors considered in establishing an appropriate allowance include: an assessment of the financial



condition of the borrower, a realistic determination of value and adequacy of underlying collateral, the condition of the local economy and the condition of the specific industry of the borrower, an analysis of the levels and trends of loan categories and a review of delinquent and classified loans.

### **Liquidity and Capital Resources**

Liquidity management is the process by which the Company, through its Banks' Asset and Liability Committees (ALCO), ensures that adequate liquid funds are available to meet its financial commitments on a timely basis, at a reasonable cost and within acceptable risk tolerances. These commitments include funding credit obligations to borrowers, funding of mortgage originations pending delivery to the secondary market, withdrawals by depositors, maintaining adequate collateral for pledging for public funds, trust deposits and borrowings, paying dividends to shareholders, payment of operating expenses, funding capital expenditures and maintaining deposit reserve requirements.

Table of Contents

Liquidity is derived primarily from core deposit growth and retention; principal and interest payments on loans; principal and interest payments, sale, maturity and prepayment of securities available-for-sale; net cash provided from operations; and access to other funding sources. Other funding sources include federal funds purchased lines, FHLB advances and other capital market sources.

As of September 30, 2018, the level of liquidity and capital resources of the Company remain at a satisfactory level. Management believes that the Company's liquidity sources will be sufficient to support its existing operations for the foreseeable future.

The liquidity and capital resources discussion will cover the following topics:

Review of the Company's Current Liquidity Sources

Review of Statements of Cash Flows

Company Only Cash Flows

Review of Commitments for Capital Expenditures, Cash Flow Uncertainties and Known Trends in Liquidity and Cash Flows Needs

Capital Resources

Review of the Company's Current Liquidity Sources

Liquid assets of cash and due from banks and interest-bearing deposits in financial institutions as of September 30, 2018 and December 31, 2017 totaled \$63,367,000 and \$69,420,000, respectively, and provide an adequate level of liquidity given current economic conditions.

Other sources of liquidity available to the Banks as of September 30, 2018 include outstanding lines of credit with the FHLB of Des Moines, Iowa of \$187,592,000, with \$8,400,000 of outstanding FHLB advances. Federal funds borrowing capacity at correspondent banks was \$108,917,000, with no outstanding federal fund purchase balances as of September 30, 2018. The Company had securities sold under agreements to repurchase totaling \$48,859,000 as of September 30, 2018.

Total investments as of September 30, 2018 were \$474,442,000 compared to \$495,322,000 as of December 31, 2017. These investments provide the Company with a significant amount of liquidity since all of the investments are classified as available-for-sale as of September 30, 2018.

The investment portfolio serves an important role in the overall context of balance sheet management in terms of balancing capital utilization and liquidity. The decision to purchase or sell securities is based upon the current assessment of economic and financial conditions, including the interest rate environment, liquidity and credit considerations. The portfolio's scheduled maturities and payments represent a significant source of liquidity.

#### Review of Statements of Cash Flows

Net cash provided by operating activities for the nine months ended September 30, 2018 totaled \$15,471,000 compared to \$13,553,000 for the nine months ended September 30, 2017. The increase in the net cash provided by operating activities was \$1,918,000. This increase was primarily due to an increase in net income of \$1,802,000.

Table of Contents

Net cash provided by (used in) investing activities for the nine months ended September 30, 2018 was \$9,570,000 compared to \$(4,184,000) for the nine months ended September 30, 2017. The increase of \$13,754,000 in cash provided by investing activities was primarily due to lower purchases of securities of \$22,557,000 and a net decrease in the change in the interest bearing deposits in financial institutions of \$10,197,000, offset in part by decreases in the proceeds from the sale of securities available-for-sale of \$11,757,000 and cash paid, net of cash acquired used in the Acquisition of \$13,443,000.

Net cash used in financing activities for the nine months ended September 30, 2018 totaled \$26,120,000 compared to \$15,759,000 for the nine months ended September 30, 2017. The increase in cash used in financing activities was \$10,361,000. This increase was primarily due to an increase in repayments on FHLB of \$23,500,000 and a net decrease in the change in deposits of \$6,924,000, offset in part by a net increase in the change in the securities sold under agreements to repurchase of \$21,771,000. As of September 30, 2018, the Company did not have any external debt financing, off-balance sheet financing arrangements, or derivative instruments linked to its stock.

Company Only Cash Flows

The Company's liquidity on an unconsolidated basis is heavily dependent upon dividends paid to the Company by the Banks. The Banks provide adequate liquidity to pay the Company's expenses and stockholder dividends. Dividends paid by the Banks to the Company amounted to \$8,790,000 and \$7,655,000 for the nine months ended September 30, 2018 and 2017, respectively. Various federal and state statutory provisions limit the amounts of dividends banking subsidiaries are permitted to pay to their holding companies without regulatory approval. Federal Reserve policy further limits the circumstances under which bank holding companies may declare dividends. For example, a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition. In addition, the Federal Reserve and the FDIC have issued policy statements, which provide that insured banks and bank holding companies should generally pay dividends only out of current operating earnings. Federal and state banking regulators may also restrict the payment of dividends by order. The quarterly dividend declared by the Company increased to \$0.23 per share in 2018 from \$0.22 per share in 2017.

The Company, on an unconsolidated basis, has interest bearing deposits totaling \$14,169,000 as of September 30, 2018 that are presently available to provide additional liquidity to the Banks.

Review of Commitments for Capital Expenditures, Cash Flow Uncertainties and Known Trends in Liquidity and Cash Flows Needs

No other material capital expenditures or material changes in the capital resource mix are anticipated at this time. The primary cash flow uncertainty would be a sudden decline in deposits causing the Banks to liquidate securities. Historically, the Banks have maintained an adequate level of short-term marketable investments to fund the temporary declines in deposit balances. There are no known trends in liquidity and cash flow needs as of September 30, 2018 that are of concern to management.

#### Capital Resources

The Company's total stockholders' equity as of September 30, 2018 totaled \$168,630,000 and was \$2,123,000 lower than the \$170,753,000 recorded as of December 31, 2017. The decrease in stockholders' equity was primarily due to an increase in other comprehensive loss and dividends declared, offset in part by net income. The increase in other comprehensive loss is created by higher market interest rates compared to December 31, 2017, which resulted in lower fair values in the securities available-for-sale portfolio. At September 30, 2018 and December 31, 2017, stockholders' equity as a percentage of total assets was 11.64% and 12.42%, respectively. The capital levels of the Company exceed applicable regulatory guidelines as of September 30, 2018.

Table of Contents

**Forward-Looking Statements and Business Risks**

The Private Securities Litigation Reform Act of 1995 provides the Company with the opportunity to make cautionary statements regarding forward-looking statements contained in this Quarterly Report, including forward-looking statements concerning the Company's future financial performance and asset quality. Any forward-looking statement contained in this Quarterly Report is based on management's current beliefs, assumptions and expectations of the Company's future performance, taking into account all information currently available to management. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to management. If a change occurs, the Company's business, financial condition, liquidity, results of operations, asset quality, plans and objectives may vary materially from those expressed in the forward-looking statements. The risks and uncertainties that may affect the actual results of the Company include, but are not limited to, the following: economic conditions, particularly in the concentrated geographic area in which the Company and its affiliate banks operate; competitive products and pricing available in the marketplace; changes in credit and other risks posed by the Company's loan and investment portfolios, including declines in commercial or residential real estate values or changes in the allowance for loan losses dictated by new market conditions or regulatory requirements; fiscal and monetary policies of the U.S. government; changes in governmental regulations affecting financial institutions (including regulatory fees and capital requirements); changes in prevailing interest rates; credit risk management and asset/liability management; the financial and securities markets; the availability of and cost associated with sources of liquidity; and other risks and uncertainties inherent in the Company's business, including those discussed under the headings "Risk Factors" and "Forward-Looking Statements and Business Risks" in the Company's Annual Report. Management intends to identify forward-looking statements when using words such as "believe", "expect", "intend", "anticipate", "estimate", "should" or similar expressions. Undue reliance should not be placed on these forward-looking statements. The Company undertakes no obligation to revise or update such forward-looking statements to reflect current events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

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

The Company's market risk is comprised primarily of interest rate risk arising from its core banking activities of lending and deposit taking. Interest rate risk results from the changes in market interest rates which may adversely affect the Company's net interest income. Management continually develops and applies strategies to mitigate this risk. Management does not believe that the Company's primary market risk exposure and how it has been managed year-to-date in 2018 changed significantly when compared to 2017.

**Item 4. Controls and Procedures**

As of the end of the period covered by this report, an evaluation was performed under the supervision and with the participation of the Company's management, including the Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended). Based on that evaluation, the Company's management, including the Principal Executive Officer and Principal Financial Officer, concluded that

the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms.

There was no change in the Company's internal control over financial reporting that occurred during the Company's last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Not applicable

Item 1.A. Risk Factors

None.

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

In November, 2017, the Company approved a Stock Repurchase Plan which provided for the repurchase of up to 100,000 shares of the Company's common stock. As of September 30, 2018, there were 100,000 shares remaining to be purchased under the plan.

The following table provides information with respect to purchase made by or on behalf of the Company or any "affiliated purchases" (as defined in rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of the Company's common stock during the three months ended September 30, 2018.

| <b>Period</b>                 | <b>Total<br/>Number<br/>of Shares<br/>Purchased</b> | <b>Average<br/>Price<br/>Paid<br/>Per<br/>Share</b> | <b>Total<br/>Number<br/>of Shares<br/>Purchased<br/>as<br/>Part of<br/>Publicly<br/>Announced<br/>Plans</b> | <b>Maximum<br/>Number<br/>of<br/>Shares<br/>that<br/>May Yet<br/>Be<br/>Purchased<br/>Under<br/>The Plan</b> |
|-------------------------------|---|---|---|--|
| July 1, 2018 to July 31, 2018 | -   | \$ -  | -   | 100,000  |



Edgar Filing: AMES NATIONAL CORP - Form 10-Q

|   |   |    |   |   |         |
|---|---|----|---|---|---------|
| August 1, 2018 to August 31, 2018       | - | \$ | - | - | 100,000 |
| September 1, 2018 to September 30, 2018 | - | \$ | - | - | 100,000 |
| Total                                   | - |    |   | - |         |

Item 3. Defaults Upon Senior Securities

Not applicable

Item 4. Mine Safety Disclosures

Not applicable

Table of Contents

Item 5. Other information

Not applicable

Item 6. Exhibits

- 2 Stock purchase agreement (incorporated by reference to Exhibit 2 to the Form 10-Q filed on May 8, 2018).
- 2.1 Agreement and Plan of Merger
- 31.1 Certification of Principal Executive Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Principal Financial Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350.
- 32.2 Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350.

101.INS XBRL Instance Document (1)

101.SCHXBRL Taxonomy Extension Schema Document (1)

101.CALXBRL Taxonomy Extension Calculation Linkbase Document (1)

101.LABXBRL Taxonomy Extension Label Linkbase Document (1)

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document (1)

101.DEF XBRL Taxonomy Extension Definition Linkbase Document (1)

(1) These interactive data files shall not be deemed filed for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under those sections.

Table of Contents

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.

AMES NATIONAL CORPORATION

DATE: November 6, 2018

By: /s/ John P. Nelson

John P. Nelson, Chief Executive Officer and  
President

By: /s/ John L. Pierschbacher

John L. Pierschbacher, Chief Financial  
Officer

Table of Contents

EXHIBIT INDEX

The following exhibits are filed herewith:

| Exhibit No. | Description  |
|-------------|--|
| 2           | Stock purchase agreement (incorporated by reference to Exhibit 2 to the Form 10-Q filed on May 8, 2018). |
| 2.1         | Agreement and Plan of Merger   |
| 31.1        | Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002   |
| 31.2        | Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002   |
| 32.1        | Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350                          |
| 32.2        | Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350                          |
| 101.INS     | XBRL Instance Document (1)   |
| 101.SCH     | XBRL Taxonomy Extension Schema Document (1)  |
| 101.CAL     | XBRL Taxonomy Extension Calculation Linkbase Document (1)  |
| 101.LAB     | XBRL Taxonomy Extension Label Linkbase Document (1)  |
| 101.PRE     | XBRL Taxonomy Extension Presentation Linkbase Document (1)   |
| 101.DEF     | XBRL Taxonomy Extension Definition Linkbase Document (1)   |

(1) These interactive data files shall not be deemed filed for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under those sections.