AMERICAN NATIONAL BANKSHARES INC.
Form 10-Q
August 03, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED June 30, 2018.

o 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: 0-12820

AMERICAN NATIONAL BANKSHARES INC.
(Exact name of registrant as specified in its charter)

VIRGINIA	54-1284688
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
628 Main Street	
Danville, Virginia	24541
(Address of principal executive offices)	(Zip Code)

(434) 792-5111
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).
Yes x No o

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

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

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

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

At July 27, 2018, the Company had 8,711,427 shares of Common Stock outstanding, $1 par value.

AMERICAN NATIONAL BANKSHARES INC.
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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
American National Bankshares Inc.
Consolidated Balance Sheets
(Dollars in thousands, except per share data)

	(Unaudited) June 30, 2018	(*) December 31, 2017
Assets		
Cash and due from banks	$24,042	$ 28,594
Interest-bearing deposits in other banks	9,300	23,883
Equity securities, at fair value	2,177	—
Securities available for sale, at fair value	341,247	321,337
Restricted stock, at cost	5,463	6,110
Loans held for sale	2,296	1,639
Loans, net of unearned income	1,339,379	1,336,125
Less allowance for loan losses	(13,508)	(13,603)
Net loans	1,325,871	1,322,522
Premises and equipment, net	25,879	25,901
Other real estate owned, net of valuation allowance of $114 in 2018 and $147 in 2017	1,124	1,225
Goodwill	43,872	43,872
Core deposit intangibles, net	1,037	1,191
Bank owned life insurance	18,674	18,460
Accrued interest receivable and other assets	23,549	21,344
Total assets	$1,824,531	$ 1,816,078
Liabilities		
Demand deposits -- noninterest bearing	$420,795	$ 394,344
Demand deposits -- interest bearing	251,056	226,914
Money market deposits	383,963	403,024
Savings deposits	132,839	126,786
Time deposits	372,093	383,658
Total deposits	1,560,746	1,534,726
Short-term borrowings:		
Customer repurchase agreements	6,776	10,726
Other short-term borrowings	5,500	24,000
Junior subordinated debt	27,876	27,826
Accrued interest payable and other liabilities	10,285	10,083
Total liabilities	1,611,183	1,607,361
Shareholders' equity		
Preferred stock, $5 par, 2,000,000 shares authorized, none outstanding	—	—
Common stock, $1 par, 20,000,000 shares authorized, 8,708,127 shares outstanding at June 30, 2018 and 8,650,547 shares outstanding at December 31, 2017	8,654	8,604
Capital in excess of par value	77,496	76,179
Retained earnings	135,108	127,010

Accumulated other comprehensive loss, net	(7,910)	(3,076)
Total shareholders' equity	213,348	208,717
Total liabilities and shareholders' equity	$ 1,824,531	$ 1,816,078

(*) - Derived from audited consolidated financial statements.

The accompanying notes are an integral part of the consolidated financial statements.

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American National Bankshares Inc.
Consolidated Statements of Income
(Dollars in thousands, except per share data) (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Interest and Dividend Income:				
Interest and fees on loans	$14,766	$13,752	$29,423	$26,456
Interest and dividends on securities:				
Taxable	1,540	1,133	2,864	2,287
Tax-exempt	423	509	842	1,144
Dividends	78	84	158	163
Other interest income	185	125	373	234
Total interest and dividend income	16,992	15,603	33,660	30,284
Interest Expense:				
Interest on deposits	1,873	1,352	3,698	2,552
Interest on short-term borrowings	2	14	12	42
Interest on long-term borrowings	—	81	—	161
Interest on junior subordinated debt	329	244	619	483
Total interest expense	2,204	1,691	4,329	3,238
Net Interest Income	14,788	13,912	29,331	27,046
Provision for Loan Losses	(30)	350	(74)	650
Net Interest Income After Provision for Loan Losses	14,818	13,562	29,405	26,396
Noninterest Income:				
Trust fees	945	908	1,874	1,820
Service charges on deposit accounts	592	607	1,204	1,196
Other fees and commissions	679	627	1,321	1,234
Mortgage banking income	491	462	941	991
Securities gains, net	289	331	410	590
Brokerage fees	209	192	431	384
Income from Small Business Investment Companies	171	6	326	32
Other	187	215	389	372
Total noninterest income	3,563	3,348	6,896	6,619
Noninterest Expense:				
Salaries	5,095	4,733	10,092	9,532
Employee benefits	1,111	1,061	2,286	2,181
Occupancy and equipment	1,100	1,148	2,228	2,216
FDIC assessment	132	134	278	263
Bank franchise tax	291	263	572	519
Core deposit intangible amortization	77	203	154	368
Data processing	467	502	889	989
Software	354	271	659	550
Other real estate owned, net	25	68	55	111
Other	2,350	2,328	4,491	4,423
Total noninterest expense	11,002	10,711	21,704	21,152
Income Before Income Taxes	7,379	6,199	14,597	11,863
Income Taxes	1,399	1,920	2,805	3,521
Net Income	$5,980	$4,279	$11,792	$8,342

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Net Income Per Common Share:				
Basic	$ 0.69	$ 0.50	$ 1.36	$ 0.97
Diluted	$ 0.69	$ 0.49	$ 1.36	$ 0.96
Average Common Shares Outstanding:				
Basic	8,692,107	8,640,648	8,680,739	8,636,954
Diluted	8,704,726	8,659,165	8,695,860	8,655,173

The accompanying notes are an integral part of the consolidated financial statements.

American National Bankshares Inc.
Consolidated Statements of Comprehensive Income
(Dollars in thousands) (Unaudited)

	Three Months Ended June 30,	
	2018	2017
Net income	$5,980	$4,279
Other comprehensive income (loss):		
Unrealized gains (losses) on securities available for sale	(1,446)	879
Tax effect	325	(307)
Reclassification adjustment for gains on sales of securities	—	(331)
Tax effect	—	116
Unrealized losses on cash flow hedges	(237)	—
Tax effect	53	—
Other comprehensive income (loss)	(1,305)	357
Comprehensive income	$4,675	$4,636

The accompanying notes are an integral part of the consolidated financial statements.

American National Bankshares Inc.
Consolidated Statements of Comprehensive Income
(Dollars in thousands) (Unaudited)

	Six Months Ended June 30,	
	2018	2017
Net income	$11,792	$8,342
Other comprehensive income (loss):		
Unrealized gains (losses) on securities available for sale	(5,180)	1,890
Tax effect	1,186	(661)
Reclassification adjustment for gains on sales of securities	(8)	(590)
Tax effect	2	207
Unrealized losses on cash flow hedges	(237)	—
Tax effect	53	—
Other comprehensive income (loss)	(4,184)	846
Comprehensive income	$7,608	$9,188

The accompanying notes are an integral part of the consolidated financial statements.

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American National Bankshares Inc.
Consolidated Statements of Changes in Shareholders' Equity
Six Months Ended June 30, 2018 and 2017
(Dollars in thousands, except per share data) (Unaudited)

	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, December 31, 2016	$ 8,578	$75,076	$119,600	$ (1,874)	$ 201,380
Net income	—	—	8,342	—	8,342
Other comprehensive income	—	—	—	846	846
Stock options exercised (3,300 shares)	3	70	—	—	73
Vesting of restricted stock (6,468 shares)	7	(7)	—	—	—
Equity based compensation (21,562 shares)	7	552	—	—	559
Cash dividends paid, $0.48 per share	—	—	(4,147)	—	(4,147)
Balance, June 30, 2017	$ 8,595	$75,691	$123,795	$ (1,028)	$ 207,053
Balance, December 31, 2017	$ 8,604	$76,179	$127,010	$ (3,076)	$ 208,717
Net income	—	—	11,792	—	11,792
Other comprehensive loss	—	—	—	(4,184)	(4,184)
Reclassification for ASU 2016-01 adoption	—	—	650	(650)	—
Stock options exercised (32,010 shares)	32	743	—	—	775
Vesting of restricted stock (10,101 shares)	10	(10)	—	—	—
Equity based compensation (25,570 shares)	8	584	—	—	592
Cash dividends paid, $0.50 per share	—	—	(4,344)	—	(4,344)
Balance, June 30, 2018	$ 8,654	$77,496	$135,108	$ (7,910)	$ 213,348

The accompanying notes are an integral part of the consolidated financial statements.

American National Bankshares Inc.
Consolidated Statements of Cash Flows
(Dollars in thousands) (Unaudited)

	Six Months Ended June 30,	
	2018	2017
Cash Flows from Operating Activities:		
Net income	$11,792	$8,342
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	(74)	650
Depreciation	933	913
Net accretion of acquisition accounting adjustments	(804)	(1,029)
Core deposit intangible amortization	154	368
Net amortization of securities	859	996
Net gains on sale or call of securities	(8)	(590)
Unrealized holding gains on equity securities	(402)	—
Gain on sale of loans held for sale	(941)	(774)
Proceeds from sales of loans held for sale	39,145	43,421
Originations of loans held for sale	(38,861)	(39,030)
Net (gain) loss on other real estate owned	(25)	3
Valuation allowance on other real estate owned	22	74
Net gain on sale of premises and equipment	(3)	—
Equity based compensation expense	592	559
Earnings on bank owned life insurance	(214)	(218)
Deferred income tax (benefit) expense	(27)	1,138
Net change in interest receivable	(62)	263
Net change in other assets	(875)	(1,232)
Net change in interest payable	(2)	(13)
Net change in other liabilities	(34)	(1,204)
Net cash provided by operating activities	11,165	12,637
Cash Flows from Investing Activities:		
Proceeds from sales of equity securities	431	—
Proceeds from sales of securities available for sale	22,066	55,403
Proceeds from maturities, calls and paydowns of securities available for sale	16,000	26,075
Purchases of securities available for sale	(66,221)	(14,585)
Net change in restricted stock	647	723
Net increase in loans	(2,952)	(123,113)
Proceeds from sale of premises and equipment	24	—
Purchases of premises and equipment	(932)	(1,739)
Proceeds from sales of other real estate owned	636	78
Net cash used in investing activities	(30,301)	(57,158)
Cash Flows from Financing Activities:		
Net change in demand, money market, and savings deposits	37,585	81,875
Net change in time deposits	(11,565)	10,326
Net change in customer repurchase agreements	(3,950)	9,116
Net change in other short-term borrowings	(18,500)	(20,000)
Common stock dividends paid	(4,344)	(4,147)
Proceeds from exercise of stock options	775	73

Net cash provided by financing activities	1	77,243
Net Increase (Decrease) in Cash and Cash Equivalents	(19,135)	32,722
Cash and Cash Equivalents at Beginning of Period	52,477	53,207
Cash and Cash Equivalents at End of Period	$33,342	$85,929

The accompanying notes are an integral part of the consolidated financial statements.

AMERICAN NATIONAL BANKSHARES INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Note 1 – Accounting Policies

The consolidated financial statements include the accounts of American National Bankshares Inc. (the "Company") and its wholly owned subsidiary, American National Bank and Trust Company (the "Bank"). The Bank offers a wide variety of retail, commercial, secondary market mortgage lending, and trust and investment services which also include non-deposit products such as mutual funds and insurance policies.

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, goodwill and intangible assets, unfunded pension liability, other-than-temporary impairment of securities, accounting for merger and acquisition activity, accounting for acquired loans with specific credit-related deterioration, the valuation of deferred tax assets and liabilities, and the valuation of other real estate owned ("OREO").

All significant inter-company transactions and accounts are eliminated in consolidation, with the exception of the AMNB Trust and the MidCarolina Trusts, as detailed in Note 8.

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the results of the interim periods. The results of operations for the interim periods are not necessarily indicative of the results that may occur for any other period. Certain reclassifications have been made to prior period balances to conform to the current period presentation. These reclassifications did not have an impact on net income and were considered immaterial. These statements should be read in conjunction with the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

Adoption of New Accounting Standards

On January 1, 2018, the Company adopted Accounting Standards Update ("ASU") 2016-01, "Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," which amended the guidance on the classification and measurement of financial instruments. Upon adoption of ASU 2016-01, the Company reclassified $650,000 from accumulated other comprehensive loss to retained earnings for the difference in amortized cost and fair value. In 2018, the Company recognized the equity securities fair value change in net income. Previously, the fair value changes were recognized, net of tax, in other comprehensive loss. The adoption of ASU 2016-01 did not have a material effect on the Company's consolidated financial statements.

During the first quarter of 2018, the Company adopted ASU 2014-09, "Revenue from Contracts with Customers", and all subsequent amendments to the ASU (collectively "ASC 606"), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as OREO. The majority of the Company's revenue is from interest income, including loans and securities, that are outside the scope of the standard. The services that fall within the scope of the standard are presented within noninterest income on the consolidated statement of income and are recognized as revenue as the Company satisfies its obligations to the customer. The revenue that falls within the scope of ASC 606 is primarily related to service charges on deposit accounts, cardholder and merchant income, wealth advisory services income, other service charges and fees, sales of other real estate, insurance commissions and miscellaneous fees. ASC 606 did not result in a change to the accounting for any in-scope revenue streams; as such, no cumulative effect adjustment was recorded.

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-02, "Leases (Topic 842)." Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company has analyzed all leases currently in place and determined the adoption of ASU 2016-02 will not have a material impact on its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this ASU, among other things, require the measurement of 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. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this ASU are effective for Securities and Exchange Commission ("SEC") filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Company has formed a committee to address the adoption of the standard and engaged a third party vendor to assist with the data gathering and analysis. The Company is currently assessing the impact that ASU 2016-13 will have on its 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 amendments in this ASU simplify how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Instead, under the amendments in this ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. Public business entities that are SEC filers should adopt the amendments in this ASU for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect the adoption of ASU 2017-04 to have a material impact on its consolidated financial statements.

In March 2017, the FASB issued ASU 2017-08, "Receivables-Nonrefundable Fees and Other Costs (Subtopic 310 20), Premium Amortization on Purchased Callable Debt Securities." The amendments in this ASU shorten the amortization period for certain callable debt securities purchased at a premium. Upon adoption of the standard, premiums on these qualifying callable debt securities will be amortized to the earliest call date. Discounts on purchased debt securities will continue to be accreted to maturity. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. Upon transition, entities should apply the guidance on a modified retrospective basis, with a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption and provide the disclosures required for a change in accounting principle. The Company is currently assessing the impact that ASU 2017-08 will have on its consolidated financial statements.

In August 2017, the FASB issued ASU 2017-12, “Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities.” The amendments in this ASU modify the designation and measurement guidance for hedge accounting as well as provide for increased transparency regarding the presentation of economic results on both the financial statements and related footnotes. Certain aspects of hedge effectiveness assessments will also be simplified upon implementation of this update. The amendments are effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted, including adoption in any interim period. The Company is currently assessing the impact that ASU 2017-12 will have on its consolidated financial statements.

In February 2018, the FASB issued ASU 2018-03, “Technical Corrections and Improvements to Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.” The amendments provide targeted improvements to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Specifically, the amendments include clarifications related to: measurement elections, transition requirements, and adjustments associated with equity securities without readily determinable fair values; fair value measurement requirements for forward contracts and purchased options on equity securities; presentation requirements for hybrid financial liabilities for which the fair value option has been elected; and measurement requirements for liabilities denominated in a foreign currency for which the fair value option has been elected. The amendments are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years beginning after June 15, 2018. Early adoption is permitted. The Company does not expect the adoption of ASU 2018-03 to have a material impact on its consolidated financial statements.

In June 2018, the FASB issued ASU 2018-07, "Compensation- Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting." The amendments expand the scope of Topic 718 to include share-based payments issued to non-employees for goods or services, which were previously excluded. The amendments will align the accounting for share-based payments to nonemployees and employees more similarly. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Company does not expect the adoption of ASU 2018-07 to have a material impact on its consolidated financial statements.

Note 2 – Securities

The amortized cost and fair value of investments in debt and equity securities at June 30, 2018 and December 31, 2017 were as follows (dollars in thousands):

	June 30, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities available for sale:				
Federal agencies and GSEs	$137,147	$ —	$ 4,302	$132,845
Mortgage-backed and CMOs	110,341	145	3,014	107,472
State and municipal	92,952	706	656	93,002
Corporate	7,826	131	29	7,928
Total securities available for sale	$348,266	$ 982	$ 8,001	$341,247

The Company adopted ASU 2016-01 effective January 1, 2018 and had equity securities with a fair value of $2,177,000 at June 30, 2018 and recognized in income $402,000 of unrealized holding gains in the first six months of 2018. During the six months ended June 30, 2018, the Company sold $431,000 in equity securities at fair value.

	December 31, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Securities available for sale:				
Federal agencies and GSEs	$114,246	$ 8	$ 2,127	$112,127
Mortgage-backed and CMOs	106,163	293	1,140	105,316
State and municipal	92,711	1,262	347	93,626
Corporate	7,842	234	14	8,062
Equity securities	1,383	823	—	2,206
Total securities available for sale	$322,345	$ 2,620	$ 3,628	$321,337

Restricted Stock

Due to restrictions placed upon the Bank's common stock investment in the Federal Reserve Bank of Richmond ("FRB") and Federal Home Loan Bank of Atlanta ("FHLB"), these securities have been classified as restricted equity securities and carried at cost. The restricted securities are not subject to the investment security classification and are included as a separate line item on the Company's consolidated balance sheets. The FRB requires the Bank to maintain stock with a par value equal to 3.00% of its outstanding capital and an additional 3.00% is on call. The FHLB requires the Bank to maintain stock in an amount equal to 4.25% of outstanding borrowings and a specific percentage of the Bank's total assets. The cost of restricted stock at June 30, 2018 and December 31, 2017 was as follows (dollars in thousands):

	June 30, 2018	December 31, 2017
FRB stock	$ 3,603	$ 3,587
FHLB stock	1,860	2,523
Total restricted stock	$ 5,463	$ 6,110

Temporarily Impaired Securities

The following table shows estimated fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2018. The reference point for determining when securities are in an unrealized loss position is month-end. Therefore, it is possible that a security's market value exceeded its amortized cost on other days during the past twelve-month period.

Available for sale securities that have been in a continuous unrealized loss position are as follows (dollars in thousands):

	Total		Less than 12 Months		12 Months or More	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Federal agencies and GSEs	$127,846	$ 4,302	$75,470	$ 1,206	$52,376	$ 3,096
Mortgage-backed and CMOs	99,504	3,014	75,725	1,887	23,779	1,127
State and municipal	46,908	656	39,967	320	6,941	336
Corporate	1,497	29	481	19	1,016	10
Total	$275,755	$ 8,001	$191,643	$ 3,432	$84,112	$ 4,569

Federal agencies and GSEs: The unrealized losses on the Company's investment in 28 government sponsored entities ("GSE") securities were caused by interest rate increases. Twelve of these securities were in an unrealized loss position for 12 months or more. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2018.

Mortgage-backed securities: The unrealized losses on the Company's investment in 65 GSE mortgage-backed securities were caused by interest rate increases. Seventeen of these securities were in an unrealized loss position for 12 months or more. The contractual cash flows of those investments are guaranteed by an agency of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost basis of the Company's investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2018.

Collateralized Mortgage Obligations: The unrealized losses associated with three private GSE collateralized mortgage obligations ("CMO") were due to normal market fluctuations. One of these securities was in an unrealized loss position for 12 months or more. The contractual cash flows of those investments are guaranteed by an agency of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost basis of the Company's investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of its amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2018.

State and municipal securities: The unrealized losses on 66 state and municipal securities were caused by interest rate increases. Eleven of these securities were in an unrealized loss position for 12 months or more. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2018.

Corporate securities: The unrealized losses on two corporate securities were caused by interest rate increases. One of these securities was in an unrealized loss position for 12 months or more. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at June 30, 2018.

Restricted stock: When evaluating restricted stock for impairment, its value is based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The Company does not consider restricted stock to be other-than-temporarily impaired at June 30, 2018, and no impairment has been recognized.

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The table below shows estimated fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities had been in a continuous unrealized loss position, at December 31, 2017 (dollars in thousands):

	Total		Less than 12 Months		12 Months or More	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Federal agencies and GSEs	$99,133	$ 2,127	$45,474	$ 321	$53,659	$ 1,806
Mortgage-backed and CMOs	90,806	1,140	64,449	533	26,357	607
State and municipal	34,550	347	27,442	159	7,108	188
Corporate	1,529	14	495	5	1,034	9
Total	$226,018	$ 3,628	$137,860	$ 1,018	$88,158	$ 2,610

Other-Than-Temporarily-Impaired Securities

As of June 30, 2018 and December 31, 2017, there were no securities classified as other-than-temporarily impaired.

Realized Gains and Losses

The following table presents the gross realized gains and losses on and the proceeds from the sale of securities available for sale during the three and six months ended June 30, 2018 and 2017 (dollars in thousands):

	Three Months Ended June 30, 2018	Six Months Ended June 30, 2018
Realized gains (losses):		
Gross realized gains	$—	$105
Gross realized losses	—	(97)
Net realized gains	$—	$8
Proceeds from sales of securities	$—	$22,066

	Three Months Ended June 30, 2017	Six Months Ended June 30, 2017
Realized gains (losses):		
Gross realized gains	$341	$605
Gross realized losses	(10)	(15)
Net realized gains	$331	$590
Proceeds from sales of securities	$13,884	$55,403

Note 3 – Loans

Loans, excluding loans held for sale, at June 30, 2018 and December 31, 2017, were comprised of the following (dollars in thousands):

	June 30, 2018	December 31, 2017
Commercial	$291,454	$ 251,666
Commercial real estate:		
Construction and land development	96,740	123,147
Commercial real estate	633,128	637,701
Residential real estate:		
Residential	207,374	209,326
Home equity	105,558	109,857

Consumer	5,125	4,428
Total loans	$1,339,379	$ 1,336,125

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Acquired Loans

The outstanding principal balance and the carrying amount of these loans, including FASB Accounting Standards Codification ("ASC") 310-30, included in the consolidated balance sheets at June 30, 2018 and December 31, 2017 are as follows (dollars in thousands):

	June 30, 2018	December 31, 2017
Outstanding principal balance	$70,321	$ 79,523
Carrying amount	65,136	73,796

The outstanding principal balance and related carrying amount of acquired impaired loans, for which the Company applies ASC 310-30 to account for interest earned, as of the indicated dates are as follows (dollars in thousands):

	June 30, 2018	December 31, 2017
Outstanding principal balance	$25,839	$ 27,876
Carrying amount	21,720	23,430

The following table presents changes in the accretable yield on acquired impaired loans, for which the Company applies FASB ASC 310-30, for the six months ended June 30, 2018 and the year ended December 31, 2017 (dollars in thousands):

	June 30, 2018	December 31, 2017
Balance at January 1	$4,890	$ 6,103
Accretion	(1,348)	(3,117)
Reclassification from nonaccretable difference	478	1,006
Other changes, net*	1,192	898
	$5,212	$ 4,890

* This line item represents changes in the cash flows expected to be collected due to the impact of non-credit changes such as prepayment assumptions, changes in interest rates on variable rate acquired impaired loans, and discounted payoffs that occurred in the period.

Past Due Loans

The following table shows an analysis by portfolio segment of the Company's past due loans at June 30, 2018 (dollars in thousands):

	30-59 Days Past Due	60-89 Days Past Due	90 Days + Past Due and Still Accruing	Non-Accrual Loans	Total Past Due	Current	Total Loans
Commercial	$75	$ —	$ —	$526	$601	$290,853	$291,454
Commercial real estate:							
Construction and land development	—	—	—	33	33	96,707	96,740
Commercial real estate	48	30	—	228	306	632,822	633,128
Residential:							
Residential	257	—	229	941	1,427	205,947	207,374
Home equity	55	—	—	133	188	105,370	105,558
Consumer	32	—	—	—	32	5,093	5,125
Total	$467	$ 30	$ 229	$1,861	$2,587	$1,336,792	$1,339,379

The following table shows an analysis by portfolio segment of the Company's past due loans at December 31, 2017 (dollars in thousands):

	30-59 Days Past Due	60-89 Days Past Due	90 Days + Past Due and Still Accruing	Non-Accrual Loans	Total Past Due	Current	Total Loans
Commercial	$ 92	$ —	$ —	$ 90	$ 182	$ 251,484	$ 251,666
Commercial real estate:							
Construction and land development	—	—	—	36	36	123,111	123,147
Commercial real estate	86	—	280	489	855	636,846	637,701
Residential:							
Residential	282	71	79	1,343	1,775	207,551	209,326
Home equity	141	16	—	243	400	109,457	109,857
Consumer	21	5	—	—	26	4,402	4,428
Total	$ 622	$ 92	$ 359	$ 2,201	$ 3,274	$ 1,332,851	$ 1,336,125

Impaired Loans

The following table presents the Company's impaired loan balances by portfolio segment, excluding acquired impaired loans, at June 30, 2018 (dollars in thousands):

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$ 159	$ 158	$ —	$ 161	$ 6
Commercial real estate:					
Construction and land development	—	—	—	—	—
Commercial real estate	516	513	—	612	19
Residential:					
Residential	1,142	1,144	—	1,023	14
Home equity	158	158	—	147	6
Consumer	—	—	—	5	—
	$ 1,975	$ 1,973	$ —	$ 1,948	$ 45
With a related allowance recorded:					
Commercial	$ 387	$ 384	$ 196	$ 435	$ 9
Commercial real estate:					
Construction and land development*	33	34	—	35	—
Commercial real estate*	28	28	—	30	—
Residential					
Residential	182	181	12	465	5
Home equity*	132	135	—	200	1
Consumer*	—	—	—	—	—
	$ 762	$ 762	$ 208	$ 1,165	$ 15
Total:					
Commercial	$ 546	$ 542	$ 196	$ 596	$ 15
Commercial real estate:					
Construction and land development	33	34	—	35	—
Commercial real estate	544	541	—	642	19
Residential:					
Residential	1,324	1,325	12	1,488	19
Home equity	290	293	—	347	7
Consumer	—	—	—	5	—
	$ 2,737	$ 2,735	$ 208	$ 3,113	$ 60

* Allowance is reported as zero in the table due to presentation in thousands and rounding.

In the table above, recorded investment may exceed unpaid principal balance due to acquired loans with a premium and loans where unearned costs exceed unearned fees.

The following table presents the Company's impaired loan balances by portfolio segment, excluding acquired impaired loans, at December 31, 2017 (dollars in thousands):

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$ 4	$ 4	$ —	$ 19	$ 1
Commercial real estate:					
Construction and land development	—	—	—	56	4
Commercial real estate	791	789	—	1,069	66
Residential:					
Residential	717	719	—	575	41
Home equity	142	142	—	109	10
Consumer	5	5	—	6	1
	$ 1,659	$ 1,659	$ —	$ 1,834	$ 123
With a related allowance recorded:					
Commercial	$ 202	$ 201	$ 154	$ 150	$ 16
Commercial real estate:					
Construction and land development*	37	37	—	56	—
Commercial real estate*	34	32	—	126	11
Residential:					
Residential	1,022	1,022	12	1,174	27
Home equity	263	261	1	251	1
Consumer*	—	—	—	5	—
	$ 1,558	$ 1,553	$ 167	$ 1,762	$ 55
Total:					
Commercial	$ 206	$ 205	$ 154	$ 169	$ 17
Commercial real estate:					
Construction and land development	37	37	—	112	4
Commercial real estate	825	821	—	1,195	77
Residential:					
Residential	1,739	1,741	12	1,749	68
Home equity	405	403	1	360	11
Consumer	5	5	—	11	1
	$ 3,217	$ 3,212	$ 167	$ 3,596	$ 178

* Allowance is reported as zero in the table due to presentation in thousands and rounding.

In the table above, recorded investment may exceed unpaid principal balance due to acquired loans with a premium and loans where unearned costs exceed unearned fees.

The following tables show the detail of loans modified as troubled debt restructurings ("TDRs") during the three and six months ended June 30, 2018 included in the impaired loan balances (dollars in thousands):

	Loans Modified as a TDR for the Three Months Ended June 30, 2018		
Loan Type	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial	—	$ —	$ —
Commercial real estate	—	—	—
Construction and land development	—	—	—
Home Equity	—	—	—
Residential real estate	—	—	—
Consumer	—	—	—
Total	—	$ —	$ —

	Loans Modified as a TDR for the Six Months Ended June 30, 2018		
Loan Type	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial	—	$ —	$ —
Commercial real estate	—	—	—
Construction and land development	—	—	—
Home Equity	—	—	—
Residential real estate	1	11	11
Consumer	—	—	—
Total	1	$ 11	$ 11

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The following tables show the detail of loans modified as TDRs during the three and six months ended June 30, 2017 included in the impaired loan balances (dollars in thousands):

	Loans Modified as a TDR for the Three Months Ended June 30, 2017		
Loan Type	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial	1	$ 5	$ 5
Commercial real estate	—	—	—
Construction and land development	—	—	—
Home Equity	1	36	36
Residential real estate	—	—	—
Consumer	—	—	—
Total	2	$ 41	$ 41

	Loans Modified as a TDR for the Six Months Ended June 30, 2017		
Loan Type	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial	3	$ 73	$ 73
Commercial real estate	—	—	—
Construction and land development	—	—	—
Home Equity	2	57	57
Residential real estate	—	—	—
Consumer	—	—	—
Total	5	$ 130	$ 130

During the three and six months ended June 30, 2018 and 2017, the Company had no loans that subsequently defaulted within twelve months of modification. The Company defines defaults as one or more payments that occur more than 90 days past the due date, charge-off or foreclosure subsequent to modification.

Residential Real Estate in Process of Foreclosure

The Company had $195,000 in residential real estate loans in the process of foreclosure at June 30, 2018 and $808,000 and $629,000 in residential OREO at June 30, 2018 and December 31, 2017, respectively.

Risk Grades

The following table shows the Company's loan portfolio broken down by internal risk grading as of June 30, 2018 (dollars in thousands):

Commercial and Consumer Credit Exposure

Credit Risk Profile by Internally Assigned Grade

	Commercial	Construction and Land Development	Commercial Real Estate Other	Residential	Home Equity
Pass	$ 287,321	$ 93,064	$ 625,248	$ 200,852	$ 104,771
Special Mention	3,111	1,814	4,188	2,090	—
Substandard	1,022	1,862	3,692	4,432	787
Doubtful	—	—	—	—	—
Total	$ 291,454	$ 96,740	$ 633,128	$ 207,374	$ 105,558

Consumer Credit Exposure

Credit Risk Profile Based on Payment Activity

	Consumer
Performing	$ 5,125
Nonperforming	—
Total	$ 5,125

The following table shows the Company's loan portfolio broken down by internal risk grading as of December 31, 2017 (dollars in thousands):

Commercial and Consumer Credit Exposure

Credit Risk Profile by Internally Assigned Grade

	Commercial	Construction and Land Development	Commercial Real Estate Other	Residential	Home Equity
Pass	$ 248,714	$ 114,502	$ 625,861	$ 200,405	$ 107,705
Special Mention	1,763	7,114	6,914	4,438	1,325
Substandard	1,189	1,531	4,926	4,483	827
Doubtful	—	—	—	—	—
Total	$ 251,666	$ 123,147	$ 637,701	$ 209,326	$ 109,857

Consumer Credit Exposure

Credit Risk Profile Based on Payment Activity

	Consumer
Performing	$ 4,415
Nonperforming	13
Total	$ 4,428

Loans classified in the Pass category typically are fundamentally sound and risk factors are reasonable and acceptable.

Loans classified in the Special Mention category typically have been criticized internally, by loan review or the loan officer, or by external regulators under the current credit policy regarding risk grades.

Loans classified in the Substandard category typically have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt; they are typically characterized by the possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Loans classified in the Doubtful category typically have all the weaknesses inherent in loans classified as substandard, plus the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts,

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conditions, and values highly questionable and improbable. However, these loans are not yet rated as loss because certain events may occur that may salvage the debt.

Consumer loans are classified as performing or nonperforming. A loan is nonperforming when payments of interest and principal are past due 90 days or more, or payments are less than 90 days past due, but there are other good reasons to doubt that payment will be made in full.

Note 4 – Allowance for Loan Losses and Reserve for Unfunded Lending Commitments

Changes in the allowance for loan losses and the reserve for unfunded lending commitments as of the indicated dates and periods are presented below (dollars in thousands):

	Six Months Ended June 30, 2018	Year Ended December 31, 2017	Six Months Ended June 30, 2017
Allowance for Loan Losses			
Balance, beginning of period	$13,603	$ 12,801	$12,801
Provision for loan losses	(74)	1,016	650
Charge-offs	(174)	(690)	(134)
Recoveries	153	476	315
Balance, end of period	$13,508	$ 13,603	$13,632
Reserve for Unfunded Lending Commitments			
Balance, beginning of period	$206	$ 203	$203
Provision for unfunded commitments	13	3	4
Charge-offs	—	—	—
Balance, end of period	$219	$ 206	$207

The reserve for unfunded loan commitments is included in other liabilities.

The following table presents changes in the Company's allowance for loan losses by portfolio segment and the related loan balance total by segment at and for the six months ended June 30, 2018 (dollars in thousands):

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Total
Allowance for Loan Losses					
Balance at December 31, 2017:	$ 2,413	$ 8,321	$ 2,825	$ 44	$ 13,603
Provision for loan losses	352	(434)	(14)	22	(74)
Charge-offs	(10)	(11)	(86)	(67)	(174)
Recoveries	63	3	36	51	153
Balance at June 30, 2018:	$ 2,818	$ 7,879	$ 2,761	$ 50	$ 13,508
Balance at June 30, 2018:					
Allowance for Loan Losses					
Individually evaluated for impairment	$ 196	$ —	$ 12	$ —	$ 208
Collectively evaluated for impairment	2,622	7,842	2,576	50	13,090
Acquired impaired loans	—	37	173	—	210
Total	$ 2,818	$ 7,879	$ 2,761	$ 50	$ 13,508
Loans					
Individually evaluated for impairment	$ 546	$ 577	$ 1,614	$ —	$ 2,737
Collectively evaluated for impairment	290,555	718,552	300,705	5,110	1,314,922
Acquired impaired loans	353	10,739	10,613	15	21,720

Total	$ 291,454	$ 729,868	$ 312,932	$ 5,125	$ 1,339,379

The following table presents changes in the Company's allowance for loan losses by portfolio segment and the related loan balance total by segment at and for the year ended December 31, 2017 (dollars in thousands):

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer	Total
Allowance for Loan Losses					
Balance at December 31, 2016:	$ 2,095	$ 7,355	$ 3,303	$ 48	$ 12,801
Provision for loan losses	377	999	(391)	31	1,016
Charge-offs	(282)	(93)	(172)	(143)	(690)
Recoveries	223	60	85	108	476
Balance at December 31, 2017:	$ 2,413	$ 8,321	$ 2,825	$ 44	$ 13,603
Balance at December 31, 2017:					
Allowance for Loan Losses					
Individually evaluated for impairment	$ 154	$ —	$ 13	$ —	$ 167
Collectively evaluated for impairment	2,259	8,203	2,645	44	13,151
Acquired impaired loans	—	118	167	—	285
Total	$ 2,413	$ 8,321	$ 2,825	$ 44	$ 13,603
Loans					
Individually evaluated for impairment	$ 206	$ 862	$ 2,144	$ 5	$ 3,217
Collectively evaluated for impairment	251,185	747,819	306,066	4,408	1,309,478
Acquired impaired loans	275	12,167	10,973	15	23,430
Total	$ 251,666	$ 760,848	$ 319,183	$ 4,428	$ 1,336,125

The allowance for loan losses is allocated to loan segments based upon historical loss factors, risk grades on individual loans, portfolio analysis of smaller balance homogenous loans, and qualitative factors. Qualitative factors include trends in delinquencies, nonaccrual loans, and loss rates; trends in volume and terms of loans, effects of changes in risk selection, underwriting standards, and lending policies; experience of lending officers, other lending staff and loan review; national, regional, and local economic trends and conditions; legal, regulatory and collateral factors; and concentrations of credit.

Note 5 – Goodwill and Other Intangible Assets

The Company records as goodwill the excess of the purchase price over the fair value of the identifiable net assets acquired. Impairment testing is performed annually, as well as when an event triggering impairment may have occurred. The Company performs its annual analysis as of June 30 each fiscal year. Accounting guidance permits preliminary assessment of qualitative factors to determine whether more substantial impairment testing is required. The Company chose to bypass the preliminary assessment and utilized a two-step process for impairment testing of goodwill. The first step tests for impairment, while the second step, if necessary, measures the impairment. No indicators of impairment were identified as of June 30, 2018.

Core deposit intangibles resulting from the acquisition of MidCarolina Financial Corporation ("MidCarolina") in July 2011 were $6,556,000 and are being amortized on an accelerated basis over 108 months. Core deposit intangibles resulting from the acquisition of MainStreet BankShares, Inc. ("MainStreet") in January 2015 were $1,839,000 and are being amortized on an accelerated basis over 120 months.

The changes in the carrying amount of goodwill and intangibles for the six months ended June 30, 2018, are as follows (dollars in thousands):

	Goodwill	Intangibles
Balance at December 31, 2017	$ 43,872	$ 1,191
Additions	—	—
Amortization	—	(154)

Impairment	—	—
Balance at June 30, 2018	$ 43,872	$ 1,037

Note 6 – Short-term Borrowings

Short-term borrowings consist of customer repurchase agreements, overnight borrowings from the FHLB, and federal funds purchased. The Company has federal funds lines of credit established with two correspondent banks in the amounts of $15,000,000, each, and, additionally, has access to the FRB's discount window. All short-term borrowings at December 31, 2017 and June 30,2018 were FHLB advances. Customer repurchase agreements are collateralized by securities of the U.S. Government or its agencies ("GSEs"). They mature daily. The interest rates may be changed at the discretion of the Company. The securities underlying these agreements remain under the Company's control. FHLB overnight borrowings contain floating interest rates that may change daily at the discretion of the FHLB. Federal funds purchased are unsecured overnight borrowings from other financial institutions. Short-term borrowings consisted of the following at June 30, 2018 and December 31, 2017 (dollars in thousands):

	June 30, 2018	December 31, 2017
Customer repurchase agreements	$6,776	$ 10,726
Other short-term borrowings	5,500	24,000
	$12,276	$ 34,726

Note 7 – Long-term Borrowings

Under the terms of its collateral agreement with the FHLB, the Company provides a blanket lien covering all of its residential first mortgage loans, second mortgage loans, home equity lines of credit, and commercial real estate loans. In addition, the Company pledges as collateral its capital stock in the FHLB and deposits with the FHLB. The Company has a line of credit with the FHLB equal to 30% of the Company's assets, subject to the amount of collateral pledged. As of June 30, 2018, $551,670,000 in eligible collateral was pledged under the blanket floating lien agreement which covers both short-term and long-term borrowings.

In the regular course of conducting its business, the Company takes deposits from political subdivisions of the states of Virginia and North Carolina. At June 30, 2018, the Bank's public deposits totaled $241,400,000. The Company is required to provide collateral to secure the deposits that exceed the insurance coverage provided by the Federal Deposit Insurance Corporation ("FDIC"). This collateral can be provided in the form of certain types of government or agency bonds or letters of credit from the FHLB. At June 30, 2018, the Company had $190,000,000 in letters of credit with the FHLB outstanding, as well as $101,944,000 in agency, state, and municipal securities pledged to provide collateral for such deposits.

Note 8 – Junior Subordinated Debt

On April 7, 2006, AMNB Statutory Trust I, a Delaware statutory trust and a wholly owned unconsolidated subsidiary of the Company, issued $20,000,000 of preferred securities (the "Trust Preferred Securities") in a private placement pursuant to an applicable exemption from registration. The Trust Preferred Securities mature on June 30, 2036, but may be redeemed at the Company's option beginning on September 30, 2011. Distributions are cumulative and will accrue from the date of original issuance, but may be deferred by the Company from time to time for up to 20 consecutive quarterly periods. The Company has guaranteed the payment of all required distributions on the Trust Preferred Securities. The proceeds of the Trust Preferred Securities received by the trust, along with proceeds of $619,000 received by the trust from the issuance of common securities by the trust to the Company, were used to purchase $20,619,000 of the Company's junior subordinated debt securities (the "Junior Subordinated Debt"), issued pursuant to junior subordinated debentures entered into between the Company and Wilmington Trust Company, as trustee. The proceeds of the Junior Subordinated Debt were used to fund the cash portion of the merger consideration to the former shareholders of Community First Financial Corporation in connection with the Company's acquisition of that company in 2006, and for general corporate purposes.

On July 1, 2011, in connection with the MidCarolina merger, the Company assumed $8,764,000 in junior subordinated debt to MidCarolina Trust I and MidCarolina Trust II, two separate Delaware statutory trusts (the "MidCarolina Trusts"), to fully and unconditionally guarantee the preferred securities issued by the MidCarolina Trusts. These long-term obligations, which currently qualify as Tier 1 capital, constitute a full and unconditional guarantee by the Company of the MidCarolina Trusts' obligations. The MidCarolina Trusts were not consolidated in the Company's financial statements.

In accordance with ASC 810-10-15-14, "Consolidation – Overall – Scope and Scope Exceptions," the Company did not eliminate through consolidation the Company's $619,000 equity investment in AMNB Statutory Trust I or the $264,000 equity investment in the MidCarolina Trusts. Instead, the Company reflected this equity investment in the "Accrued interest receivable and other assets" line item in the consolidated balance sheets.

A description of the junior subordinated debt securities outstanding payable to the trusts is shown below as of June 30, 2018 and December 31, 2017 (dollars in thousands):

Issuing Entity	Date Issued	Interest Rate	Maturity Date	Principal Amount June 30, 2018	December 31, 2017
AMNB Trust I	4/7/2006	Libor plus 1.35%	6/30/2036	$20,619	$ 20,619
MidCarolina Trust I	10/29/2002	Libor plus 3.45%	11/7/2032	4,349	4,322
MidCarolina Trust II	12/3/2003	Libor plus 2.95%	10/7/2033	2,908	2,885
				$27,876	$ 27,826

The principal amounts reflected above for the MidCarolina Trusts are net of fair value adjustments of $1,506,000 and $1,557,000 at June 30, 2018 and December 31, 2017, respectively. The original fair value adjustments of $1,197,000 and $1,021,000 were recorded as a result of the acquisition of MidCarolina on July 1, 2011, and are being amortized into interest expense over the remaining lives of the respective borrowings.

Note 9 - Derivative Financial Instruments and Hedging Activities

The Company uses derivative financial instruments ("derivatives") primarily to manage risks to the Company associated with changing interest rates. The Company's derivatives are hedging instruments in a qualifying hedge accounting relationship (cash flow or fair value hedge).

The Company designates derivatives as cash flow hedges when they are used to manage exposure to variability in cash flows on variable rate borrowings such as the Company's trust preferred capital notes. The Company uses interest rate swap agreements as part of its hedging strategy by exchanging variable-rate interest payments on a notional amount equal to the principal amount of the borrowings for fixed-rate interest payments, with such interest rates set based on benchmarked interest rates.

All interest rate swaps were entered into with counterparties that met the Company's credit standards and the agreements contain collateral provisions protecting the at-risk party. The Company believes that the credit risk inherent in these derivative contracts is not significant.

Terms and conditions of the interest rate swaps vary and amounts receivable or payable are recognized as accrued under the terms of the agreements. The Company assesses the effectiveness of each hedging relationship on a periodic basis. In accordance with ASC 815, "Derivatives and Hedging," the effective portions of the derivatives' unrealized gains or losses are recorded as a component of other comprehensive income. Based on the Company's assessment, its cash flow hedges are highly effective, but to the extent that any ineffectiveness exists in the hedge relationships, the amounts would be recorded in interest income and interest expense in the Company's consolidated statements of income.

(Dollars in thousands)	June 30, 2018				
	Notional Amount	Positions	Assets	Liabilities	Cash Collateral Pledged
Cash flow hedges:					
Interest rate swaps:					
Variable-rate to fixed-rate swaps with counterparty	$28,500	3	$ —	$ 237	$350,000

Note 10 – Stock Based Compensation

The Company's 2018 Equity Compensation Plan ("2018 Plan") was adopted by the Board of Directors of the Company on February 20, 2018, and approved by shareholders on May 15, 2018, at the Company's 2018 Annual Meeting of Shareholders. The 2018 Plan provides for the granting of restricted stock awards and incentive and non-statutory options to employees and directors on a periodic basis, at the discretion of the Board of Directors or a Board designated committee. The 2018 Plan authorizes the issuance of up to 675,000 shares of common stock. The 2018 Plan replaced the Company's stock incentive plan that was approved by the shareholders at the 2008 Annual

Meeting and expired in February 2018 (the "2008 Plan").

Stock Options

Accounting guidance requires that compensation cost relating to share-based payment transactions be recognized in the financial statements with measurement based upon the fair value of the equity or liability instruments issued.

A summary of stock option transactions for the six months ended June 30, 2018 is as follows:

	Option Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at December 31, 2017	50,985	$ 24.09		
Acquired in acquisition	—	—		
Granted	—	—		
Exercised	(32,010)	24.23		
Forfeited	—	—		
Expired	(1,650)	33.33		
Outstanding at June 30, 2018	17,325	$ 22.94	0.45 years	$ 295
Exercisable at June 30, 2018	17,325	$ 22.94	0.45 years	$ 295

The fair value of options is estimated at the date of grant using the Black-Scholes option pricing model and expensed over the options' vesting period. No stock options have been granted since 2009. As of June 30, 2018, there were no unrecognized compensation expenses related to nonvested stock option grants.

Restricted Stock

The Company from time-to-time grants shares of restricted stock to key employees and non-employee directors. These awards help align the interests of these employees and directors with the interests of the shareholders of the Company by providing economic value directly related to increases in the value of the Company's common stock. The value of the stock awarded is established as the fair value of the stock at the time of the grant. The Company recognizes expense, equal to the total value of such awards, ratably over the vesting period of the stock grants. The majority of the restricted stock granted cliff vests at the end of a 36 month period beginning on the date of the grant. The remainder vests one-third each year beginning on the date of the grant. Nonvested restricted stock activity for the six months ended June 30, 2018 is summarized in the following table.

Restricted Stock	Shares	Weighted Average Grant Date Value
Nonvested at December 31, 2017	46,501	$ 26.28
Granted	18,192	39.52
Vested	(10,101)	21.62
Forfeited	(483)	34.70
Nonvested at June 30, 2018	54,109	$ 31.53

As of June 30, 2018 and December 31, 2017, there was $965,000 and $538,000, respectively, in unrecognized compensation cost related to nonvested restricted stock granted under the 2008 Plan. The weighted average period over which this cost is expected to be recognized is 1.46 years. The share based compensation expense for nonvested restricted stock was $292,000 and $304,000 during the first six months of 2018 and 2017, respectively.

The Company offers its outside directors alternatives with respect to director compensation. For 2018, the regular quarterly board retainer will be received in the form of shares of immediately vested, but restricted stock with a market value of $7,500. Monthly meeting fees can be received as $725 per meeting in cash or $900 in immediately vested, but restricted stock. Only outside directors receive board fees. The Company issued 7,861 and 7,109 shares and recognized share based compensation expense of $300,000 and $255,000 during the first six months of 2018 and 2017, respectively.

Note 11 – Earnings Per Common Share

The following shows the weighted average number of shares used in computing earnings per common share and the effect on weighted average number of shares of potentially dilutive common stock. Potentially dilutive common stock had no effect on income available to common shareholders. Nonvested restricted shares are included in the computation of basic earnings per share as the holder is entitled to full shareholder benefits during the vesting period including voting rights and sharing in nonforfeitable dividends. The following table presents basic and diluted earnings per share for the three and six month periods ended June 30, 2018 and 2017.

	Three Months Ended June 30,			
	2018		2017	
	Shares	Per Share Amount	Shares	Per Share Amount
Basic earnings per share	8,692,107	$ 0.69	8,640,648	$ 0.50
Effect of dilutive securities - stock options	12,619	—	18,517	(0.01)
Diluted earnings per share	8,704,726	$ 0.69	8,659,165	$ 0.49

	Six Months Ended June 30,			
	2018		2017	
	Shares	Per Share Amount	Shares	Per Share Amount
Basic earnings per share	8,680,739	$ 1.36	8,636,954	$ 0.97
Effect of dilutive securities - stock options	15,121	—	18,219	(0.01)
Diluted earnings per share	8,695,860	$ 1.36	8,655,173	$ 0.96

Outstanding stock options on common stock that were not included in computing diluted earnings per share for the six month periods ended June 30, 2018 and 2017 because their effects were anti-dilutive, averaged 0 and 660 shares, respectively. There were no anti-dilutive stock options for the three month periods ended June 30, 2018 and 2017.

Note 12 – Employee Benefit Plans

The following information for the six months ended June 30, 2018 and 2017 pertains to the Company's non-contributory defined benefit pension plan which was frozen in 2009. If lump sum payments exceed the service cost plus interest cost, an additional settlement charge will apply (dollars in thousands):

Components of Net Periodic Benefit Cost	Six Months Ended June 30,	
	2018	2017
Service cost	$—	$—
Interest cost	118	118
Expected return on plan assets	(177)	(177)
Recognized loss due to settlement	111	70
Recognized net actuarial loss	124	109
Net periodic cost	$176	$120

Note 13 – Fair Value of Financial Instruments

Determination of Fair Value

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the fair value measurements and disclosures topic of FASB ASC 820, the fair value of an instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various instruments. In cases where 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 estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

Fair Value Hierarchy

In accordance with this guidance, the Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 –	Valuation is based on quoted prices in active markets for identical assets and liabilities.
Level 2 –	Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.
Level 3 –	Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

The following describes the valuation techniques used by the Company to measure certain financial assets and financial liabilities recorded at fair value on a recurring basis in the financial statements:

Securities available for sale: Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2). If no observable market data is available, valuations are based upon third party model based techniques (Level 3). There were no securities recorded with a Level 3 valuation at June 30, 2018 or December 31, 2017.

Derivative asset (liability) - cash flow hedges: Cash flow hedges are recorded at fair value on a recurring basis. Cash flow hedges are valued by a third party using significant assumptions that are observable in the market and can be corroborated by market data. All of the Company's cash flow hedges are classified as Level 2.

The following table presents the balances of financial assets measured at fair value on a recurring basis at the dates indicated (dollars in thousands):

	Fair Value Measurements at June 30, 2018 Using			
Description	Balance at June 30, 2018	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Assets:				
Securities available for sale:				
Federal agencies and GSEs	$132,845	$ —	$ 132,845	$ —
Mortgage-backed and CMOs	107,472	—	107,472	—
State and municipal	93,002	—	93,002	—
Corporate	7,928	—	7,928	—
Total securities available for sale	$341,247	$ —	$ 341,247	$ —
Equity securities	$2,177	$ —	$ 2,177	$ —
Liabilities:				
Derivative - cash flow hedges	$237	$ —	$ 237	$ —

	Fair Value Measurements at December 31, 2017 Using			
Description	Balance at December 31, 2017	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Assets:				
Securities available for sale:				
Federal agencies and GSEs	$112,127	$ —	$ 112,127	$ —
Mortgage-backed and CMOs	105,316	—	105,316	—
State and municipal	93,626	—	93,626	—
Corporate	8,062	—	8,062	—
Equity securities	2,206	—	2,206	—
Total securities available for sale	$321,337	$ —	$ 321,337	$ —

Certain assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Company to measure certain assets recorded at fair value on a nonrecurring basis in the financial statements:

Loans held for sale: Loans held for sale are carried at fair value. These loans currently consist of one-to-four family residential loans originated for sale in the secondary market. Fair value is based on the price secondary markets are currently offering for similar loans using observable market data which is not materially different than cost due to the short duration between origination and sale (Level 2). As such, the Company records any fair value adjustments on a nonrecurring basis. No nonrecurring fair value adjustments were recorded on loans held for sale during the six month period ended June 30, 2018 or the year ended December 31, 2017. Gains and losses on the sale of loans are recorded within mortgage banking income on the consolidated statements of income.

Impaired loans: Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreements will not be collected when due. The measurement of the loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the Company's collateral is real estate. The value of real estate collateral is determined utilizing a market valuation approach based on an appraisal, of one year or less, conducted by an independent, licensed appraiser using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the property is more than one year old and not solely based on observable market comparables or management determines the fair value of the collateral is further impaired below the appraised value, then a Level 3 valuation is considered to measure the fair value. The value of business equipment is based upon an outside appraisal, of one year or less, if deemed significant, or the net book value on the applicable business's financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivable collateral are based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the allowance for loan losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the consolidated statements of income.

OREO: Measurement for fair values for OREO are the same as impaired loans. Any fair value adjustments are recorded in the period incurred as a valuation allowance against other real estate owned with the associated expense included in other real estate owned expense, net on the consolidated statements of income.

The following table summarizes the Company's assets that were measured at fair value on a nonrecurring basis at the dates indicated (dollars in thousands):

	Fair Value Measurements at June 30, 2018 Using			
	Balance at June 30,	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
Description	2018	Level 1	Level 2	Level 3
Assets:				
Loans held for sale	$2,296	$ —	$ 2,296	$ —
Impaired loans, net of valuation allowance	554	—	—	554
Other real estate owned, net	1,124	—	—	1,124

	Fair Value Measurements at December 31, 2017 Using			
	Balance at December 31,	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
Description	2017	Level 1	Level 2	Level 3
Assets:				
Loans held for sale	$1,639	$ —	$ 1,639	$ —
Impaired loans, net of valuation allowance	1,391	—	—	1,391
Other real estate owned, net	1,225	—	—	1,225

The following tables summarize the Company's quantitative information about Level 3 fair value measurements at the dates indicated:

Quantitative Information About Level 3 Fair Value Measurements at June 30, 2018

Assets	Valuation Technique	Unobservable Input	Rate
Impaired loans	Discounted appraised value	Selling cost	8.00%
	Discounted cash flow analysis	Market rate for borrower (discount rate)	3.25% - 9.80%

Other real estate owned, net	Discounted appraised value	Selling cost	8.00%

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Quantitative Information About Level 3 Fair Value Measurements at December 31, 2017

Assets	Valuation Technique	Unobservable Input	Rate
Impaired loans	Discounted appraised value	Selling cost	8.00%
	Discounted cash flow analysis	Market rate for borrower (discount rate)	3.25% - 9.80%
Other real estate owned, net	Discounted appraised value	Selling cost	8.00%

ASC 825, "Financial Instruments," requires disclosure about fair value of financial instruments for interim periods and excludes certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

The carrying values and the exit pricing concept fair values of the Company's financial instruments at June 30, 2018 are as follows (dollars in thousands):

	Fair Value Measurements at June 30, 2018 Using				
		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs	Fair Value
	Carrying Value	Level 1	Level 2	Level 3	Balance
Financial Assets:					
Cash and cash equivalents	$33,342	$33,342	$—	$—	$33,342
Equity securities	2,177		2,177		2,177
Securities available for sale	341,247	—	341,247	—	341,247
Restricted stock	5,463	—	5,463	—	5,463
Loans held for sale	2,296	—	2,296	—	2,296
Loans, net of allowance	1,325,871	—	—	1,325,283	1,325,283
Bank owned life insurance	18,674	—	18,674	—	18,674
Accrued interest receivable	5,293	—	5,293	—	5,293
Financial Liabilities:					
Deposits	$1,560,746	$—	$1,566,931	$—	$1,566,931
Repurchase agreements	6,776	—	6,776	—	6,776
Other short-term borrowings	5,500	—	5,500	—	5,500
Junior subordinated debt	27,876	—	—	22,554	22,554
Accrued interest payable	672	—	672	—	672
Derivative - cash flow hedges	237	—	237	—	237

The carrying values and estimated fair values of the Company's financial instruments at December 31, 2017 are as follows (dollars in thousands):

		Fair Value Measurements at December 31, 2017 Using			
		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs	Fair Value
	Carrying Value	Level 1	Level 2	Level 3	Balance
Financial Assets:					
Cash and cash equivalents	$ 52,477	$ 52,477	$ —	$ —	$ 52,477
Securities available for sale	321,337	—	321,337	—	321,337
Restricted stock	6,110	—	6,110	—	6,110
Loans held for sale	1,639	—	1,639	—	1,639
Loans, net of allowance	1,322,522	—	—	1,317,737	1,317,737
Bank owned life insurance	18,460	—	18,460	—	18,460
Accrued interest receivable	5,231	—	5,231	—	5,231