

AMES NATIONAL CORP
Form 10-Q
November 07, 2014
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, 2014

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, or a smaller reporting company. See definition of "accelerated filer", "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

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

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

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

COMMON STOCK, \$2.00 PAR VALUE	9,310,913
(Class)	

(Shares Outstanding
at October 31, 2014)

Table Of Contents

AMES NATIONAL CORPORATION

INDEX

	Page
Part I. Financial Information	
<u>Item 1. Consolidated Financial Statements (Unaudited)</u>	3
<u>Consolidated Balance Sheets at September 30, 2014 and December 31, 2013</u>	3
<u>Consolidated Statements of Income for the three and nine months ended September 30, 2014 and 2013</u>	4
<u>Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2014 and 2013</u>	5
<u>Consolidated Statements of Stockholders' Equity for the nine months ended September 30, 2014 and 2013</u>	6
<u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2014 and 2013</u>	7
<u>Notes to Consolidated Financial Statements</u>	9
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	28
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	48
<u>Item 4. Controls and Procedures</u>	48
Part II. Other Information	
<u>Item 1. Legal Proceedings</u>	49
<u>Item 1.A. Risk Factors</u>	49
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	49
<u>Item 3. Defaults Upon Senior Securities</u>	49
<u>Item 4. Mine Safety Disclosures</u>	50

<u>Item 5. Other Information</u>	50
<u>Item 6. Exhibits</u>	50
<u>Signatures</u>	51

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

	September 30, 2014	December 31, 2013
ASSETS		
Cash and due from banks	\$25,685,197	\$24,270,031
Interest bearing deposits in financial institutions	41,529,118	23,628,117
Securities available-for-sale	568,103,061	580,039,080
Loans receivable, net	615,701,355	564,501,547
Loans held for sale	447,423	295,618
Bank premises and equipment, net	15,984,355	11,892,329
Accrued income receivable	8,589,329	7,437,673
Other real estate owned	10,187,794	8,861,107
Deferred income taxes	1,662,407	5,027,103
Core deposit intangible, net	1,843,857	1,029,564
Goodwill	6,732,216	5,600,749
Other assets	1,695,913	501,242
Total assets	\$1,298,162,025	\$1,233,084,160
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits		
Demand, noninterest bearing	\$175,656,528	\$179,946,472
NOW accounts	294,207,846	299,788,852
Savings and money market	315,650,511	289,307,102
Time, \$100,000 and over	98,705,314	97,077,717
Other time	155,565,574	145,683,035
Total deposits	1,039,785,773	1,011,803,178
Securities sold under agreements to repurchase and federal funds purchased	68,194,012	39,616,644
Federal Home Loan Bank (FHLB) advances	16,986,152	14,540,526
Other borrowings	13,000,000	20,000,000
Dividend payable	1,675,964	1,489,746
Accrued expenses and other liabilities	4,550,116	3,527,882
Total liabilities	1,144,192,017	1,090,977,976

STOCKHOLDERS' EQUITY

Common stock, \$2 par value, authorized 18,000,000 shares; issued 9,432,915 shares as of September 30, 2014 and December 31, 2013; outstanding 9,310,913 shares as of September 30, 2014 and December 31, 2013	18,865,830	18,865,830
Additional paid-in capital	22,651,222	22,651,222
Retained earnings	109,239,104	102,154,498
Accumulated other comprehensive income - net unrealized gain on securities available-for-sale	5,230,350	451,132
Treasury stock, at cost; 122,002 shares at September 30, 2014 and December 31, 2013	(2,016,498)	(2,016,498)
Total stockholders' equity	153,970,008	142,106,184
Total liabilities and stockholders' equity	\$1,298,162,025	\$1,233,084,160

See Notes to Consolidated Financial Statements.

Table Of Contents

AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Interest income:				
Loans, including fees	\$6,722,179	\$6,569,005	\$19,708,190	\$18,874,279
Securities:				
Taxable	1,792,258	1,357,658	5,407,157	4,137,431
Tax-exempt	1,538,531	1,737,687	4,857,733	5,212,498
Interest bearing deposits and federal funds sold	67,183	86,126	213,259	304,172
Total interest income	10,120,151	9,750,476	30,186,339	28,528,380
Interest expense:				
Deposits	803,098	924,219	2,557,799	2,919,660
Other borrowed funds	299,434	315,116	897,781	905,966
Total interest expense	1,102,532	1,239,335	3,455,580	3,825,626
Net interest income	9,017,619	8,511,141	26,730,759	24,702,754
Provision for loan losses	55,145	92,388	130,020	165,962
Net interest income after provision for loan losses	8,962,474	8,418,753	26,600,739	24,536,792
Noninterest income:				
Wealth management income	686,955	532,709	2,108,150	1,631,478
Service fees	426,588	402,062	1,194,862	1,179,889
Securities gains, net	79,501	204,738	214,582	637,979
Gain on sale of loans held for sale	224,554	268,658	473,733	969,578
Merchant and card fees	281,766	271,485	831,405	884,583
Gain on the sale of premises and equipment, net	-	-	1,242,209	-
Other noninterest income	129,326	140,081	443,505	448,214
Total noninterest income	1,828,690	1,819,733	6,508,446	5,751,721
Noninterest expense:				
Salaries and employee benefits	3,513,375	3,288,760	10,235,563	9,736,156
Data processing	656,715	581,301	1,823,635	1,781,152
Occupancy expenses, net	366,258	358,739	1,185,066	1,103,920

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

FDIC insurance assessments	164,535	173,878	490,231	506,629
Professional fees	332,988	313,174	963,876	853,202
Business development	303,026	255,899	726,503	649,283
Other real estate owned, net	(19,908)	(14,436)	(198)	653,302
Core deposit intangible amortization	76,959	65,751	203,707	207,949
Other operating expenses, net	272,474	207,437	776,248	696,195
Total noninterest expense	5,666,422	5,230,503	16,404,631	16,187,788
Income before income taxes	5,124,742	5,007,983	16,704,554	14,100,725
Provision for income taxes	1,393,256	1,295,916	4,592,054	3,524,028
Net income	\$3,731,486	\$3,712,067	\$12,112,500	\$10,576,697
Basic and diluted earnings per share	\$0.40	\$0.40	\$1.30	\$1.14
Dividends declared per share	\$0.18	\$0.16	\$0.54	\$0.48

See Notes to Consolidated Financial Statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income	\$3,731,486	\$3,712,067	\$12,112,500	\$10,576,697
Other comprehensive income (loss), before tax:				
Unrealized gains (losses) on securities before tax:				
Unrealized holding gains (losses) arising during the period	(572,017)	4,563,574	7,800,643	(14,424,859)
Less: reclassification adjustment for gains realized in net income	79,501	204,738	214,582	637,979
Other comprehensive income (loss) before tax	(651,518)	4,358,836	7,586,061	(15,062,838)
Tax effect related to other comprehensive income (loss)	241,062	(1,612,769)	(2,806,843)	5,573,250
Other comprehensive income (loss), net of tax	(410,456)	2,746,067	4,779,218	(9,489,588)
Comprehensive income	\$3,321,030	\$6,458,134	\$16,891,718	\$1,087,109

See Notes to Consolidated Financial Statements.

Table Of Contents

AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(unaudited)

Nine Months Ended September 30, 2014 and 2013

	Common Stock	Additional Paid- in-Capital	Retained Earnings	Accumulated Other Comprehensive Income, Net of Taxes	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 2012	\$ 18,865,830	\$ 22,651,222	\$ 94,159,839	\$ 11,075,342	\$(2,016,498)	\$ 144,735,735
Net income	-	-	10,576,697	-	-	10,576,697
Other comprehensive (loss)	-	-	-	(9,489,588)	-	(9,489,588)
Cash dividends declared, \$0.48 per share	-	-	(4,469,239)	-	-	(4,469,239)
Balance, September 30, 2013	\$ 18,865,830	\$ 22,651,222	\$ 100,267,297	\$ 1,585,754	\$(2,016,498)	\$ 141,353,605
Balance, December 31, 2013	\$ 18,865,830	\$ 22,651,222	\$ 102,154,498	\$ 451,132	\$(2,016,498)	\$ 142,106,184
Net income	-	-	12,112,500	-	-	12,112,500
Other comprehensive income	-	-	-	4,779,218	-	4,779,218
Cash dividends declared, \$0.54 per share	-	-	(5,027,894)	-	-	(5,027,894)
Balance, September 30, 2014	\$ 18,865,830	\$ 22,651,222	\$ 109,239,104	\$ 5,230,350	\$(2,016,498)	\$ 153,970,008

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, 2014 and 2013**

	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 12,112,500	\$ 10,576,697
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	130,020	165,962
Provision for off-balance sheet commitments	53,000	25,700
Amortization, net, securities available-for-sale	3,133,065	4,881,915
Amortization of core deposit intangible asset	203,707	207,949
Depreciation	605,100	588,729
Debit (credit) for deferred income taxes	557,853	(162,516)
Securities gains, net	(214,582)	(637,979)
(Gain) on sale of premises and equipment, net	(1,242,209)	-
Impairment of other real estate owned	-	670,000
(Gain) on sale of other real estate owned, net	(7,175)	(32,601)
Change in assets and liabilities:		
(Increase) decrease in loans held for sale	(151,805)	402,426
(Increase) in accrued income receivable	(921,324)	(917,171)
(Increase) decrease in other assets	(452,695)	1,893,136
Increase in accrued expenses and other liabilities	115,795	330,819
Net cash provided by operating activities	13,921,250	17,993,066
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of securities available-for-sale	(61,818,547)	(133,272,394)
Proceeds from sale of securities available-for-sale	31,688,263	28,314,668
Proceeds from maturities and calls of securities available-for-sale	57,120,089	90,110,257
Net (increase) decrease in interest bearing deposits in financial institutions	(12,182,001)	10,383,741
Net (increase) in loans	(6,705,707)	(18,638,285)
Net proceeds from the sale of other real estate owned	78,990	493,360
Net proceeds from the sale of bank premises and equipment	1,746,444	-
Purchase of bank premises and equipment, net	(1,329,925)	(419,973)
Cash acquired, net of cash paid, for acquired bank offices	16,428,981	-
Other	(19,673)	-
Net cash provided by (used in) investing activities	25,006,914	(23,028,626)

CASH FLOWS FROM FINANCING ACTIVITIES

(Decrease) in deposits	(53,879,019)	(27,567,314)
Increase in securities sold under agreements to repurchase and federal funds purchased	25,762,071	4,884,943
Proceeds from FHLB borrowings	-	2,000,000
Payments on FHLB borrowings and other borrowings	(7,054,374)	(2,052,671)
Proceeds from short-term FHLB borrowings, net	2,500,000	23,000,000
Dividends paid	(4,841,676)	(4,376,120)
Net cash used in financing activities	(37,512,998)	(4,111,162)
Net increase (decrease) in cash and due from banks	1,415,166	(9,146,722)

CASH AND DUE FROM BANKS

Beginning	24,270,031	34,805,371
Ending	\$25,685,197	\$25,658,649

Table Of Contents**AMES NATIONAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)***(unaudited)***Nine Months Ended September 30, 2014 and 2013**

	2014	2013
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash payments for:		
Interest	\$3,602,255	\$4,169,666
Income taxes	4,147,836	3,580,854
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES		
Transfer of loans receivable to other real estate owned	\$111,109	\$213,749
Business Combination:		
Fair value of interest bearing deposits in financial institutions acquired	\$5,719,000	\$-
Fair value of securities available-for-sale acquired	10,602,454	-
Fair value of loans receivable acquired	44,620,021	-
Fair value of bank premises and equipment acquired	3,864,900	-
Fair value of accrued interest receivable acquired	230,332	-
Fair value of other real estate owned acquired	1,267,720	-
Fair value of other tangible assets acquired	748,511	-
Goodwill	1,131,467	-
Core deposit intangible	1,018,000	-
Deposits assumed	81,962,650	-
Securities sold under repurchase agreements to repurchase assumed	2,815,297	-
Other liabilities assumed	853,439	-

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, 2014 and 2013 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, 2013 (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, 2014, Company management has performed a goodwill impairment analysis and determined goodwill was not impaired.

New Accounting Pronouncements: In January 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-04, Receivables—Troubled Debt Restructuring by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure. The update clarifies when an in substance foreclosure occurs, that is, when a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan. This is the point when

the consumer mortgage loan should be derecognized and the real property recognized. For public companies, this update will be effective for interim and annual periods beginning after December 31, 2014 and early adoption is permitted. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-11, "Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures." The new guidance aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. The amendments in the ASU also require expanded disclosures about the nature of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. The amendments in this ASU are effective for public companies for the first interim or annual period beginning after December 15, 2014. The adoption of this ASU may result in additional disclosures but is not expected to impact significantly the Company's consolidated financial statements.

Table Of Contents

2. Branch Acquisition

On August 29, 2014, First National Bank (FNB) completed the purchase of three bank branches of First Bank located in West Des Moines and Johnston, 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 were recorded at fair value at the date of acquisition and were reflected in the September 30, 2014 financial statements as such. These branches were purchased for cash consideration of \$4.1 million. As a result of the acquisition, the Company recorded a core deposit intangible asset of \$1,018,000 and goodwill of \$1,131,000. The results of operations for this acquisition have been included since the transaction date of August 29, 2014. The fair value of credit deteriorated purchased loans related to this Acquisition is \$1,507,000. These purchase loans are included in the impaired loan category in the financial statements. Non-routine expenses associated with this transaction were approximately \$123,000 for the nine months ended September 30, 2014.

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	\$4,147,680
Recognized amounts of identifiable assets acquired and liabilities assumed:	
Cash and Due from Banks	\$20,576,661
Interest bearing deposits in financial institutions	5,719,000
Securities available-for-sale	10,602,454
Loans receivable	44,620,021
Accrued interest receivable	230,332
Bank premises and equipment	3,864,900
Other real estate owned	1,267,720
Core deposit intangible asset	1,018,000
Other assets	748,511
Deposits	(81,962,650)
Securities sold under agreements to repurchase	(2,815,297)
Accrued interest payable and other liabilities	(853,439)
Total identifiable net assets	\$3,016,213
Goodwill	\$1,131,467

On August 29, 2014, the contractual balance of loans receivable acquired was \$45,584,000 and the contractual balance of the deposits assumed was \$81,841,000. Loans receivable acquired include commercial real estate, 1-4 family real estate, commercial operating and consumer loans.

Table Of Contents

The acquired loans at contractual values as of August 29, 2014 were determined to be risk rated as follows:

Pass	\$29,840,000
Watch	6,659,000
Special Mention	1,478,000
Substandard	5,460,000
Deteriorated credit	2,147,000

Total loans acquired at book value \$45,584,000

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 nine years. The loan market valuation is accreted to income on a declining basis over a six year period. The time deposits market valuation is amortized to expense on a declining basis over a two year period.

The excess cash in the transaction has been utilized through reductions in federal funds purchased and other borrowings at FNB. Going forward any excess cash will be used in the form of investment and or loan growth.

3.Dividends

On August 13, 2014, the Company declared a cash dividend on its common stock, payable on November 14, 2014 to stockholders of record as of October 31, 2014, equal to \$0.18 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, 2014 and 2013 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, 2013.

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 process 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.

Table Of Contents

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.

The following table presents the balances of assets measured at fair value on a recurring basis by level as of September 30, 2014 and December 31, 2013. *(in thousands)*

Description	Total	Level 1	Level 2	Level 3
2014				
U.S. government treasuries	\$1,437	\$1,437	\$-	\$ -
U.S. government agencies	93,916	-	93,916	-
U.S. government mortgage-backed securities	133,156	-	133,156	-
State and political subdivisions	288,030	-	288,030	-
Corporate bonds	47,783	-	47,783	-
Equity securities, financial industry common stock	769	769	-	-
Equity securities, other	3,012	-	3,012	-
	\$568,103	\$2,206	\$565,897	\$ -
2013				
U.S. government agencies	\$61,178	\$-	\$61,178	\$ -
U.S. government mortgage-backed securities	155,142	-	155,142	-
State and political subdivisions	315,224	-	315,224	-
Corporate bonds	44,752	-	44,752	-
Equity securities, financial industry common stock	841	841	-	-
Equity securities, other	2,902	-	2,902	-
	\$580,039	\$841	\$579,198	\$ -

Level 1 securities include equity securities traded on an active exchange, such as the New York Stock Exchange, as well as U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets. U.S. government mortgage-backed securities, state and political subdivisions, most corporate bonds and other equity securities 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.

Table Of Contents

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 nine months ended September 30, 2014.

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 with the valuation hierarchy as of September 30, 2014 and December 31, 2013. *(in thousands)*

Description	Total	Level 1	Level 2	Level 3
2014				
Loans receivable	\$297	\$ -	\$ -	\$297
Other real estate owned	10,188	-	-	10,188
Total	\$10,485	\$ -	\$ -	\$10,485
2013				
Loans receivable	\$648	\$ -	\$ -	\$648
Other real estate owned	8,861	-	-	8,861
Total	\$9,509	\$ -	\$ -	\$9,509

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 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. Subsequent to the transfer, other real estate owned is carried at the lower of cost or fair value, less estimated selling costs. 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 \$4,644,000 as of September 30, 2014 and December 31, 2013. The Company considers these fair values 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, 2014 and December 31, 2013 are as follows: *(in thousands)*

	2014 Fair Value	Valuation Techniques	Range of Unobservable Inputs	Range (Average)
Impaired Loans	\$ 274	Evaluation of collateral	Estimation of value	NM*
Other real estate owned	\$ 10,188	Appraisal	Appraisal adjustment	6%-10% (8%)
	2013 Fair Value	Valuation Techniques	Range of Unobservable Inputs	Range (Average)
Impaired Loans	\$ 648	Evaluation of collateral	Estimation of value	NM*
Other real estate owned	\$ 8,861	Appraisal	Appraisal adjustment	6%-10% (8%)

* 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.

Accounting principles generally accepted in the United State of America (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, 2014 and December 31, 2013 are not carried at fair value in their entirety on the consolidated balance sheets.

Cash and due from banks and interest bearing deposits in financial institutions: The recorded amount of these assets approximates fair value.

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 equity securities traded on an active exchange, such as the New York Stock Exchange, as well as U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets. U.S government mortgage-backed securities, state and political subdivisions, some corporate bonds and other equity securities are reported at fair value utilizing Level 2 inputs.

Table Of Contents

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

Loans receivable: The fair value of loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates, which reflect the credit and interest rate risk inherent in the loan. The estimate of maturity is based on the historical experience, with repayments for each loan classification modified, as required, by an estimate of the effect of current economic and lending conditions. The effect of nonperforming loans is considered in assessing the credit risk inherent in the fair value estimate.

Deposit liabilities: Fair values of deposits with no stated maturity, such as noninterest-bearing demand deposits, savings and NOW accounts, and money market accounts, are equal to the amount payable on demand as of the respective balance sheet date. Fair values of certificates of deposit are based on the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

Securities sold under agreements to repurchase and federal funds purchased: The carrying amounts of securities sold under agreements to repurchase and federal funds purchased approximate fair value because of the generally short-term nature of the instruments.

FHLB advances and other borrowings: Fair values of FHLB advances and other borrowings are estimated using discounted cash flow analysis based on interest rates currently being offered with similar terms.

Accrued income receivable and accrued interest payable: The carrying amounts of accrued income receivable and accrued interest payable approximate fair value.

Commitments to extend credit and standby letters of credit: The fair values of commitments to extend credit and standby letters of credit are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreement and credit worthiness of the counterparties. The carry value and fair value of the commitments to extend credit and standby letters of credit are not considered significant.

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.

Table Of Contents

The estimated fair values of the Company's financial instruments as described above as of September 30, 2014 and December 31, 2013 are as follows: *(in thousands)*

	Fair Value Hierarchy Level	2014		2013	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:					
Cash and due from banks	Level 1	\$25,685	\$25,685	\$24,270	\$24,270
Interest bearing deposits	Level 1	41,529	41,529	23,628	23,628
Securities available-for-sale	See previous table	568,103	568,103	580,039	580,039
Loans receivable, net	Level 2	615,701	617,261	564,502	562,073
Loans held for sale	Level 2	447	447	296	296
Accrued income receivable	Level 1	8,589	8,589	7,438	7,438
Financial liabilities:					
Deposits	Level 2	\$1,039,786	\$1,042,096	\$1,011,803	\$1,014,150
Securities sold under agreements to repurchase	Level 1	68,194	68,194	39,617	39,617
FHLB advances	Level 2	16,986	17,877	14,541	15,441
Other borrowings	Level 2	13,000	14,451	20,000	22,033
Accrued interest payable	Level 1	549	549	594	594

The methodologies used to determine fair value as of September 30, 2014 did not change from the methodologies described in the December 31, 2013 Annual Financial Statements.

7. Debt and Equity Securities

The amortized cost of securities available-for-sale and their fair values as of September 30, 2014 and December 31, 2013 are summarized below: *(in thousands)*

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2014:				
U.S. government treasuries	\$ 1,428	\$ 9	\$ -	\$1,437
U.S. government agencies	93,654	1,013	(751)	93,916

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

U.S. government mortgage-backed securities	130,458	3,037	(339)	133,156
State and political subdivisions	282,371	6,216	(557)	288,030
Corporate bonds	48,248	608	(1,073)	47,783
Equity securities, financial industry common stock	630	139	-	769
Equity securities, other	3,012	-	-	3,012
	\$ 559,801	\$ 11,022	\$ (2,720)	\$ 568,103

Table Of Contents

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2013:				
U.S. government agencies	\$ 61,569	\$ 1,117	\$ (1,508)	\$ 61,178
U.S. government mortgage-backed securities	153,857	2,847	(1,562)	155,142
State and political subdivisions	314,177	5,056	(4,009)	315,224
Corporate bonds	46,187	756	(2,192)	44,751
Equity securities, financial industry common stock	630	211	-	841
Equity securities, other	2,903	-	-	2,903
	\$ 579,323	\$ 9,987	\$ (9,271)	\$ 580,039

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

	Three Months Ended September 30, 2014 2013		Nine Months Ended September 30, 2014 2013	
Proceeds from sales of securities available-for-sale	\$28,209	\$12,697	\$31,688	\$28,315
Gross realized gains on securities available-for-sale	232	261	367	696
Gross realized losses on securities available-for-sale	(152)	56	(152)	58
Tax provision applicable to net realized gains on securities available-for-sale	30	76	80	238

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, 2014 and December 31, 2013 are as follows: *(in thousands)*

	Less than 12 Months Unrealized Fair Value Losses		12 Months or More Unrealized Fair Value Losses		Total Fair Value Unrealized Losses	
2014:						
Securities available-for-sale:						
U.S. government agencies	\$22,327	\$ (127)	\$17,366	\$ (624)	\$39,693	\$ (751)
U.S. government mortgage-backed securities	5,278	(20)	29,104	(319)	34,382	(339)
State and political subdivisions	18,715	(91)	36,056	(466)	54,771	(557)
Corporate bonds	7,043	(75)	23,669	(998)	30,712	(1,073)

\$53,363 \$ (313) \$106,195 \$ (2,407) \$159,558 \$ (2,720)

Table Of Contents

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
2013:						
Securities available-for-sale:						
U.S. government agencies	\$31,806	\$ (1,508)	\$-	\$ -	\$31,806	\$ (1,508)
U.S. government mortgage-backed securities	71,327	(1,479)	2,772	(83)	74,099	(1,562)
State and political subdivisions	99,974	(3,029)	15,438	(980)	115,412	(4,009)
Corporate bonds	21,382	(1,151)	8,798	(1,041)	30,180	(2,192)
	\$224,489	\$ (7,167)	\$27,008	\$ (2,104)	\$251,497	\$ (9,271)

Gross unrealized losses on debt securities totaled \$2,720,000 as of September 30, 2014. 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, whether downgrades by bond rating agencies have occurred, and industry analysts' reports. 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.

8.Loan Receivable and Credit Disclosures

Activity in the allowance for loan losses, on a disaggregated basis, for the three and nine months ended September 30, 2014 and 2013 is as follows: *(in thousands)*

	Three Months Ended September 30, 2014							
	1-4 Family Residential		Commercial	Agricultural	Commercial Agricultural		Consumer and Other	Total
	Real Estate	Real Estate	Real Estate	Real Estate	Commercial	Agricultural		
Balance, June 30 2014	\$514	\$ 1,503	\$ 3,144	\$ 694	\$ 1,396	\$ 1,106	\$ 160	\$8,517
Provision (credit) for loan losses	(3)	97	12	(2)	(75)	5	21	55
Recoveries of loans charged-off	-	2	15	-	1	-	4	22
Loans charged-off	-	(35)	-	-	(17)	-	(12)	(64)
Balance, September 30 2014	\$511	\$ 1,567	\$ 3,171	\$ 692	\$ 1,305	\$ 1,111	\$ 173	\$8,530

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

Nine Months Ended September 30 2014

	1-4 Family Construction Real Estate	Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Balance, December 31, 2013	\$ 392	\$ 1,523	\$ 3,230	\$ 686	\$ 1,435	\$ 1,165	\$ 141	\$ 8,572
Provision (credit) for loan losses	119	178	(74)	6	(130)	(54)	85	130
Recoveries of loans charged-off	-	9	15	-	17	-	15	56
Loans charged-off	-	(143)	-	-	(17)	-	(68)	(228)
Balance, September 30, 2014	\$ 511	\$ 1,567	\$ 3,171	\$ 692	\$ 1,305	\$ 1,111	\$ 173	\$ 8,530

Table Of Contents

Three Months Ended September 30, 2013

	1-4 Family							Total
	Construction Real Estate	Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	
Balance, June 30, 2013	\$ 332	\$ 1,456	\$ 3,002	\$ 591	\$ 1,343	\$ 921	\$ 174	\$7,819
Provision (credit) for loan losses	(111)	40	162	21	(78)	68	(10)	92
Recoveries of loans charged-off	-	2	17	-	1	-	4	24
Loans charged-off	-	(18)	-	-	-	-	(14)	(32)
Balance, September 30, 2013	\$ 221	\$ 1,480	\$ 3,181	\$ 612	\$ 1,266	\$ 989	\$ 154	\$7,903

Nine Months Ended September 30, 2013

	1-4 Family							Total
	Construction Real Estate	Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	
Balance, December 31, 2012	\$ 375	\$ 1,433	\$ 2,859	\$ 523	\$ 1,461	\$ 945	\$ 177	\$7,773
Provision (credit) for loan losses	(154)	88	305	89	(198)	44	(8)	166
Recoveries of loans charged-off	-	40	17	-	3	-	12	72
Loans charged-off	-	(81)	-	-	-	-	(27)	(108)
Balance, September 30, 2013	\$ 221	\$ 1,480	\$ 3,181	\$ 612	\$ 1,266	\$ 989	\$ 154	\$7,903

Allowance for loan losses disaggregated on the basis of impairment analysis method as of September 30, 2014 and December 31, 2013 is as follows: *(in thousands)*

2014

	1-4 Family							Total
	Construction Real Estate	Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	
Individually evaluated for impairment	\$ -	\$ 47	\$ 34	\$ -	\$ 190	\$ -	\$ 3	\$274
	511	1,520	3,137	692	1,115	1,111	170	8,256

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

Collectively evaluated for
impairment

Balance September 30,
2014 \$ 511 \$ 1,567 \$ 3,171 \$ 692 \$ 1,305 \$ 1,111 \$ 173 \$8,530

2013

	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Individually evaluated for impairment	\$ -	\$ 122	\$ 20	\$ -	\$ 330	\$ 5	\$ -	\$477
Collectively evaluated for impairment	392	1,401	3,210	686	1,105	1,160	141	8,095
Balance December 31, 2013	\$ 392	\$ 1,523	\$ 3,230	\$ 686	\$ 1,435	\$ 1,165	\$ 141	\$8,572

Table Of Contents

Loans receivable disaggregated on the basis of impairment analysis method as of September 30, 2014 and December 31, 2013 is as follows (*in thousands*):

	2014							Total
	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	
Individually evaluated for impairment	\$ 412	\$ 503	\$ 864	\$ -	\$ 724	\$ 19	\$ 11	\$ 2,533
Collectively evaluated for impairment	32,974	134,784	222,248	55,297	88,215	73,575	14,670	621,763
Balance September 30, 2014	\$ 33,386	\$ 135,287	\$ 223,112	\$ 55,297	\$ 88,939	\$ 73,594	\$ 14,681	\$ 624,296
	2013							
	2013							Total
	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	
Individually evaluated for impairment	\$ 510	\$ 784	\$ 526	\$ -	\$ 816	\$ 24	\$ 61	\$ 2,721
Collectively evaluated for impairment	23,418	107,506	205,585	53,834	86,007	81,302	12,734	570,386
Balance December 31, 2013	\$ 23,928	\$ 108,290	\$ 206,111	\$ 53,834	\$ 86,823	\$ 81,326	\$ 12,795	\$ 573,107

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. The credit deteriorated loans acquired as a part of the Acquisition have been included in the following information. 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

The following is a recap of impaired loans, on a disaggregated basis, at September 30, 2014 and December 31, 2013:
(in thousands)

	2014			2013		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no specific reserve recorded:						
Real estate - construction	\$412	\$ 412	\$ -	\$510	\$ 510	\$ -
Real estate - 1 to 4 family residential	304	304	-	483	483	-
Real estate - commercial	705	705	-	480	480	-
Real estate - agricultural	-	-	-	-	-	-
Commercial	514	514	-	43	43	-
Agricultural	19	19	-	19	19	-
Consumer and other	8	8	-	61	61	-
Total loans with no specific reserve:	1,962	1,962	-	1,596	1,596	-
With an allowance recorded:						
Real estate - construction	-	-	-	-	-	-
Real estate - 1 to 4 family residential	199	214	47	301	301	122
Real estate - commercial	159	159	34	46	46	20
Real estate - agricultural	-	-	-	-	-	-
Commercial	210	210	190	773	773	330
Agricultural	-	-	-	5	5	5
Consumer and other	3	3	3	-	-	-
Total loans with specific reserve:	571	586	274	1,125	1,125	477
Total						
Real estate - construction	412	412	-	510	510	-
Real estate - 1 to 4 family residential	503	518	47	784	784	122
Real estate - commercial	864	864	34	526	526	20
Real estate - agricultural	-	-	-	-	-	-
Commercial	724	724	190	816	816	330
Agricultural	19	19	-	24	24	5
Consumer and other	11	11	3	61	61	-
	\$2,533	\$ 2,548	\$ 274	\$2,721	\$ 2,721	\$ 477

Table Of Contents

The following is a recap of the average recorded investment and interest income recognized on impaired loans for the three and nine months ended September 30, 2014 and 2013: *(in thousands)*

	Three Months Ended September 30, 2014		September 30, 2013	
	Average Interest Recorded Investment	Interest Recognized	Average Interest Recorded Investment	Interest Recognized
With no specific reserve recorded:				
Real estate - construction	\$419	\$ -	\$805	\$ -
Real estate - 1 to 4 family residential	185	7	478	8
Real estate - commercial	374	-	1,382	207
Real estate - agricultural	-	-	-	-
Commercial	274	-	41	12
Agricultural	19	-	-	-
Consumer and other	8	-	7	-
Total loans with no specific reserve:	1,279	7	2,713	227
With an allowance recorded:				
Real estate - construction	-	-	195	93
Real estate - 1 to 4 family residential	209	-	334	-
Real estate - commercial	160	-	46	-
Real estate - agricultural	-	-	-	-
Commercial	274	-	813	-
Agricultural	2	-	5	-
Consumer and other	4	-	-	-
Total loans with specific reserve:	649	-	1,393	93
Total				
Real estate - construction	419	-	1,000	93
Real estate - 1 to 4 family residential	394	7	812	8
Real estate - commercial	534	-	1,428	207
Real estate - agricultural	-	-	-	-
Commercial	548	-	854	12
Agricultural	21	-	5	-
Consumer and other	12	-	7	-
	\$1,928	\$ 7	\$4,106	\$ 320

Table Of Contents

	Nine Months Ended September 30,			
	2014		2013	
	Average Interest Recorded	Investment Recognized	Average Interest Recorded	Investment Recognized
With no specific reserve recorded:				
Real estate - construction	\$461	\$ -	\$919	\$ -
Real estate - 1 to 4 family residential	230	12	569	8
Real estate - commercial	318	206	1,189	209
Real estate - agricultural	-	-	-	-
Commercial	158	-	58	12
Agricultural	19	-	-	-
Consumer and other	23	-	5	-
Total loans with no specific reserve:	1,209	218	2,740	229
With an allowance recorded:				
Real estate - construction	-	-	313	93
Real estate - 1 to 4 family residential	279	-	420	-
Real estate - commercial	103	-	1,147	-
Real estate - agricultural	-	-	-	-
Commercial	519	70	745	-
Agricultural	3	-	6	-
Consumer and other	2	-	-	-
Total loans with specific reserve:	906	70	2,631	93
Total				
Real estate - construction	461	-	1,232	93
Real estate - 1 to 4 family residential	509	12	989	8
Real estate - commercial	421	206	2,336	209
Real estate - agricultural	-	-	-	-
Commercial	677	70	803	12
Agricultural	22	-	6	-
Consumer and other	25	-	5	-
	\$2,115	\$ 288	\$5,371	\$ 322

The interest foregone on nonaccrual loans for the three months ended September 30, 2014 and 2013 was approximately \$34,000 and \$73,000, respectively. The interest foregone on nonaccrual loans for the nine months ended September 30, 2014 and 2013 was approximately \$95,000 and \$239,000, respectively.

The Company had loans meeting the definition of a troubled debt restructuring (TDR) of \$723,000 as of September 30, 2014, of which all were included in impaired loans and nonaccrual loans. The Company had TDRs of \$1,424,000 as of December 31, 2013, all of which were included in impaired loans, \$1,237,000 was included as nonaccrual loans and \$187,000 was on accrual status.

Table Of Contents

The following table sets forth information on the Company's TDRs, on a disaggregated basis, occurring in the three and nine months ended September 30, 2014 and 2013: *(dollars in thousands)*

	Three Months Ended September 30,				2013			
	2014				2013			
	Pre-Modification		Post-Modification		Pre-Modification		Post-Modification	
	Number of	Recorded	Number of	Recorded	Number of	Recorded	Number of	Recorded
Contracts	Investment	Contracts	Investment	Contracts	Investment	Contracts	Investment	
Real estate - construction	-	\$ -	\$ -	-	\$ -	-	\$ -	
Real estate - 1 to 4 family residential	1	25	25	-	-	-	-	
Real estate - commercial	-	-	-	-	-	-	-	
Real estate - agricultural	-	-	-	-	-	-	-	
Commercial	-	-	-	-	-	-	-	
Agricultural	-	-	-	-	-	-	-	
Consumer and other	-	-	-	-	-	-	-	
	1	\$ 25	\$ 25	-	\$ -	-	\$ -	
	Nine Months Ended September 30,				2013			
	2014				2013			
	Pre-Modification		Post-Modification		Pre-Modification		Post-Modification	
	Number of	Recorded	Number of	Recorded	Number of	Recorded	Number of	Recorded
Contracts	Investment	Contracts	Investment	Contracts	Investment	Contracts	Investment	
Real estate - construction	-	\$ -	\$ -	-	\$ -	-	\$ -	
Real estate - 1 to 4 family residential	1	25	25	-	-	-	-	
Real estate - commercial	1	43	43	-	-	-	-	
Real estate - agricultural	-	-	-	-	-	-	-	
Commercial	-	-	-	1	130	130	-	
Agricultural	1	19	19	-	-	-	-	
Consumer and other	1	6	6	-	-	-	-	
	4	\$ 93	\$ 93	1	\$ 130	130	\$ 130	

The Company restructured one loan during the three months ended September 30, 2014. During the nine months ended September 30, 2014, the Company granted concessions to three borrowers experiencing financial difficulties. A

commercial real estate loan was restructured as an interest only loan for a period of time. An agricultural and consumer loans maturity date was extended one year with interest only until maturity. A 1-4 family residential loans terms were extended beyond normal terms.

There was no new TDR activity in the three months ended September 30, 2013. However, during the nine months ended September 30, 2013, the Company restructured one loan by granting concessions to a borrower experiencing financial difficulties. The loan was restricted with a collateral shortfall.

A TDR loan is considered to have payment default when it is past due 60 days or more.

No TDR loan modified during the twelve months ended September 30, 2014 had a payment default. Two TDR loans modified during the twelve months ended September 30, 2013 had payment defaults. These modified TDR loans had a balance as of September 30, 2013 of \$132,000.

Table Of Contents

There was two charge-off related to TDRs for the nine months ended September 30, 2014 in the amount of \$48,000 and no charge-offs related to TDRs for the nine months ended September 30, 2013. For the nine months ended September 30, 2014, the specific reserves were reduced by \$100,000 as a result of one TDR that is no longer considered impaired. For the nine months ended September 30, 2013, there was no impact on specific reserves due to TDRs.

An aging analysis of the recorded investments in loans, on a disaggregated basis, as of September 30, 2014 and December 31, 2013, is as follows: (*in thousands*)

2014

	30-89 Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total	90 Days or Greater Accruing
Real estate - construction	\$-	\$ -	\$-	\$33,386	\$33,386	\$ -
Real estate - 1 to 4 family residential	1,031	114	1,145	134,142	135,287	-
Real estate - commercial	277	159	436	222,676	223,112	-
Real estate - agricultural	-	-	-	55,297	55,297	-
Commercial	822	89	911	88,028	88,939	-
Agricultural	-	-	-	73,594	73,594	-
Consumer and other	40	-	40	14,641	14,681	-
	\$2,170	\$ 362	\$2,532	\$621,764	\$624,296	\$ -

2013

	30-89 Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total	90 Days or Greater Accruing
Real estate - construction	\$-	\$-	\$-	\$23,928	\$23,928	\$ -
Real estate - 1 to 4 family residential	1,059	4,000	5,059	103,231	108,290	27
Real estate - commercial	-	46	46	206,065	206,111	-
Real estate - agricultural	-	-	-	53,834	53,834	-
Commercial	88	375	463	86,360	86,823	-
Agricultural	-	-	-	81,326	81,326	-
Consumer and other	35	-	35	12,760	12,795	-
	\$1,182	\$4,421	\$5,603	\$567,504	\$573,107	\$ 27

The credit risk profile by internally assigned grade, on a disaggregated basis, as of September 30, 2014 and December 31, 2013 is as follows: *(in thousands)*

2014

	Construction Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Total
Pass	\$ 27,123	\$ 187,646	\$ 51,819	\$ 74,659	\$ 69,265	\$410,512
Watch	2,826	19,371	3,367	10,310	4,056	39,930
Special Mention	-	1,130	-	567	88	1,785
Substandard	3,025	14,101	111	2,679	166	20,082
Substandard-Impaired	412	864	-	724	19	2,019
	\$ 33,386	\$ 223,112	\$ 55,297	\$ 88,939	\$ 73,594	\$474,328

25

Table Of Contents

2013

	Construction Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Total
Pass	\$ 16,887	\$ 169,659	\$ 51,486	\$ 73,073	\$ 78,476	\$389,581
Watch	3,545	20,267	2,051	10,717	1,963	38,543
Special Mention	-	798	-	796	9	1,603
Substandard	2,986	14,862	297	1,421	854	20,420
Substandard-Impaired	510	526	-	816	24	1,876
	\$ 23,928	\$ 206,112	\$ 53,834	\$ 86,823	\$ 81,326	\$452,023

The credit risk profile based on payment activity, on a disaggregated basis, as of September 30, 2014 and December 31, 2013 is as follows:

2014

	1-4 Family Residential Real Estate	Consumer and Other	Total
Performing	\$ 134,817	\$ 14,672	\$ 149,489
Non-performing	470	9	479
	\$ 135,287	\$ 14,681	\$ 149,968

2013

	1-4 Family Residential Real Estate	Consumer and Other	Total
Performing	\$ 107,667	\$ 12,740	\$ 120,407
Non-performing	623	55	678
	\$ 108,290	\$ 12,795	\$ 121,085

9. Other Real Estate Owned

The following table provides the composition of other real estate owned as of September 30, 2014 and December 31, 2013: *(in thousands)*

	2014	2013
Construction and land development	\$7,064	\$6,751
1 to 4 family residential real estate	1,343	1,296
Commercial real estate	1,781	814
	\$10,188	\$8,861

The Company is actively marketing the assets referred in the table above. 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. The assets above are primarily located in the metropolitan Des Moines, Iowa and Ames, Iowa areas.

Table Of Contents

10. Goodwill

As of August 29, 2014, FNB acquired three bank branches located in West Des Moines and Johnston, Iowa, which resulted in the recognition of \$1.1 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 the West Des Moines and Johnston, Iowa branches with FNB. Goodwill was also recognized in 2012 due to an acquisition which resulted in an expanded market area. The goodwill resulted from a premium paid related to these acquisitions. The goodwill is not amortized but is evaluated for impairment at least annually. For income tax purposes, goodwill is amortized over fifteen years.

11. Core deposit intangible asset

In conjunction with the Acquisition of the three bank branches in 2014, the Company recorded \$1.0 million in core deposit intangible assets. In conjunction with the 2012 acquisition, the Company recorded a \$1.5 million core deposit intangible asset. The following sets forth the carrying amounts and accumulated amortization of core deposit intangible assets at September 30, 2014 and December 31, 2013: *(in thousands)*

	2014		2013	
	Gross Amount	Accumulated Amortization	Gross Amount	Accumulated Amortization
Core deposit intangible asset	\$ 2,518	\$ 674	\$ 1,500	\$ 470

The weighted average life of the core deposit intangible is 4 years and 5 years as of September 30, 2014 and December 31, 2013, respectively.

The following sets forth the activity related to core deposit intangible assets for the three and nine months ended September 30, 2014 and 2013: *(in thousands)*

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Beginning core deposit intangible, net	\$903	\$1,161	\$1,030	\$1,303
Purchases	1,018	-	1,018	-
Amortization	(77)	(66)	(204)	(208)
Ending core deposit intangible, net	\$1,844	\$1,095	\$1,844	\$1,095

Table Of Contents

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

2014	\$113
2015	422
2016	354
2017	299
2018	251
2019	127
After	278
	\$1,844

12. 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, 2014, but prior to November 7, 2014, that provided additional evidence about conditions that existed at September 30, 2014. There were no other significant events or transactions that provided evidence about conditions that did not exist at September 30, 2014.

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 twelve individuals to assist with financial reporting, human resources, audit, compliance, marketing,

technology systems and the coordination of management activities, in addition to 211 full-time equivalent individuals employed by the Banks.

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.

Table Of Contents

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 Company and Banks; (iii) fees on wealth management services provided by those Banks exercising trust powers; (iv) service charges on deposit accounts maintained at the Banks and (v) ATM 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; and (v) occupancy expenses for maintaining the Banks' facilities. 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.

On August 29, 2014, First National purchased substantially all of the assets, including loans, and assumed substantially all of the liabilities, including deposit accounts, of First Bank., an Iowa state chartered bank located in West Des Moines, Iowa for \$4.1 million. First National will operate all three bank offices previously operated by First Bank in West Des Moines, Iowa and Johnston, Iowa.

The Company had net income of \$3,731,000, or \$0.40 per share, for the three months ended September 30, 2014, compared to net income of \$3,712,000, or \$0.40 per share, for the three months ended September 30, 2013. Total equity capital as of September 30, 2014 totaled \$154.0 million or 11.9% of total assets.

The increase in quarterly earnings can be primarily attributed to increases in loan and taxable securities available-for-sale interest income, offset in part by increases in noninterest expenses.

Net loan charge-offs totaled \$42,000 and \$8,000 for the three months ended September 30, 2014 and 2013, respectively. The provision for loan losses totaled \$55,000 and \$92,000 for the three months ended September 30, 2014 and 2013, respectively.

The Company had net income of \$12,113,000, or \$1.30 per share, for the nine months ended September 30, 2014, compared to net income of \$10,577,000, or \$1.14 per share, for the nine months ended September 30, 2013.

The increase in the nine months earnings can be primarily attributed to increases in loan and taxable securities available-for-sale interest income, the gain on the sale of premises and equipment and a decrease in the other real estate owned expenses. The Company sold its office location near Iowa State University in Ames, Iowa (University office), but the Company will maintain a presence near the campus. Excluding the after tax one-time gain on the sale

of premises and equipment, net income of \$11,334,000 or \$1.22 per share in 2014, would have still exceeded 2013 earnings of \$10,577,000, or \$1.14 per share, a 7% increase.

Net loan charge-offs totaled \$172,000 and \$36,000 for the nine months ended September 30, 2014 and 2013, respectively. The provision for loan losses totaled \$130,000 and \$166,000 for the nine months ended September 30, 2014 and 2013, 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

Table Of Contents**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, 2014.

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 6,656 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

	3 Months Ended September 30, 2014		9 Months Ended June 30, 2014		3 Months Ended June 30, 2014		Years Ended December 31,			
	Company	Industry	Company*	Industry	Company	Industry	Company	Industry	Company	Industry
Return on assets	1.20 %	1.29 %	1.23 %	1.04 %	1.14 %	1.07 %	1.24 %	1.00 %		
Return on equity	9.73 %	10.78 %	10.27 %	9.27 %	9.76 %	9.56 %	10.08 %	8.92 %		
Net interest margin	3.32 %	3.29 %	3.30 %	3.16 %	3.18 %	3.26 %	3.35 %	3.42 %		
Efficiency ratio	52.24 %	49.35 %	50.49 %	60.96 %	52.78 %	60.54 %	52.33 %	61.60 %		
Capital ratio	12.28 %	12.00 %	12.01 %	9.57 %	11.67 %	9.41 %	12.31 %	9.15 %		

*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 1.20% and 1.24% for the three months ended September 30, 2014 and 2013, respectively. The decrease in this ratio in 2014 from the previous period is due to an increase in average assets in 2014, with net income remaining relatively unchanged.

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 9.73% and 10.77% for the three months ended September 30, 2014 and 2013, respectively. The decrease in this ratio in 2014 from the previous period is due to an increase in the average equity due in part to net income, reduced by dividends, and an increase in the accumulated other comprehensive income.

Table Of Contents

Net Interest Margin

The net interest margin for the three months ended September 30, 2014 and 2013 was 3.32% and 3.28%, 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. The increase in this ratio in 2014 is primarily the result of an increase in the average balance of loans and higher yields on taxable securities available-for-sale.

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 52.24% and 50.63% for the three months ended September 30, 2014 and 2013, respectively. The change in the efficiency ratio in 2014 from the previous period is primarily the result of increased net interest income.

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 12.28% as of September 30, 2014 is significantly higher than the industry average as of June 30, 2014.

Industry Results

The FDIC Quarterly Banking Profile reported the following results for the second quarter of 2014:

Lower Expenses Contribute to Improvement in Earnings

The impact of the rise in medium-and long-term interest rates in second quarter 2013 remained evident in year-over-year earnings comparisons in second quarter 2014. The negative effect on noninterest income, particularly income from mortgage lending and from trading, was greater at large banks, while the positive implications of a steeper yield curve for net interest margins, combined with strengthening loan growth, were more significant for smaller institutions. The 6,656 FDIC-insured institutions filing financial results for second quarter 2014 reported combined net income of \$40.2 billion. This is \$2 billion (5.3%) more than the industry reported in second quarter 2013. Net operating revenue (the sum of net interest income and total noninterest income) was \$1.5 billion (0.9%) lower than in second quarter 2013, as a decline in noninterest income from mortgage sales, securitization and servicing outweighed an increase in net interest income. Earnings benefited from lower expenses for loan-loss provisions, goodwill impairment, and payrolls. A majority of banks—57.5%—reported year-over-year increases in quarterly earnings, and only 6.8% of banks were unprofitable, down from 8.4% a year ago. This is the lowest proportion of unprofitable institutions since first quarter 2006. The average return on assets for the quarter was 1.07%, slightly above the 1.06% average in the year-ago quarter.

Table Of Contents

Revenues Decline From Year-Ago Level for Fourth Consecutive Quarter

Net interest income posted the largest year-over-year increase in 14 quarters, rising by \$2 billion (1.9%), as interest-earning assets were 6.4% above year-ago levels. Almost 72% of all institutions reported year-over-year growth in quarterly net interest income. The average net interest margin fell to 3.15% from 3.25% in second quarter 2013. This is the lowest quarterly margin for the industry since third quarter 1989. Margin pressure was most evident at large banks. Nine of the ten largest banks reported lower quarterly margins than a year ago, whereas 55.2% of all banks reported year-over-year margin increases. Noninterest income was \$3.6 billion (5.3%) lower than a year earlier, as income from sales, securitization, and servicing of 1-to-4 family residential mortgages fell by \$3.7 billion (42.5%). Trading income declined for a fourth consecutive quarter, falling by \$721 million (10.1%). Reduced expenses outweighed the weakness in revenues compared with the year before. Banks set aside \$6.6 billion in provisions for loan and lease losses during the quarter, a \$1.9 billion (22.4%) decline from second quarter 2013 and the lowest quarterly provision total since second quarter 2006. Expenses for goodwill impairment totaled \$192 million, down from \$4.4 billion in second quarter 2013, when two institutions reported large impairment charges. Expenses for salaries and employee benefits were \$399 million (0.8%) lower as the industry reported 37,282 fewer employees than the year before. Itemized litigation expenses were \$2 billion higher than in second quarter 2013.

Charge-Offs Fall to Seven-Year Low

Loan losses declined year over year for a 16th consecutive quarter, falling to \$9.9 billion from \$14.1 billion in second quarter 2013. This is the lowest quarterly net charge-off total for the industry since second quarter 2007. The decline was led by 1-to-4 family residential mortgage loans, where net charge-offs fell by \$2.2 billion (74.7%). Net charge-offs were down year over year in all major loan categories except auto loans, where charge-offs increased \$31 million (10.4%). Slightly more than half of all banks—50.8%—reported lower quarterly net charge-offs than in second quarter 2013.

Noncurrent Loan Rate Falls to Six-Year Low

Noncurrent loan balances improved for a 17th consecutive quarter, falling by \$13.4 billion (6.9%) during the three months ended June 30. Noncurrent balances declined in all major loan categories except auto loans, where they increased by \$28 million (3.2%). The largest decline occurred in noncurrent 1-to-4 family residential mortgages, which fell by \$8 billion (6.4%). Noncurrent real estate loans secured by nonfarm nonresidential properties fell by \$1.9 billion (9.6%), and noncurrent real estate construction loans declined by \$1.2 billion (15.9%). At the end of the quarter, the industry's noncurrent loan rate was 2.24%, the lowest level since second quarter 2008.

Reserve Coverage of Noncurrent Loans Improves for Seventh Consecutive Quarter

Loan-loss reserves declined for a 17th consecutive quarter, as charge-offs removed more from reserves than banks added in provisions. Reserve balances fell by \$4.1 billion (3.1%) during the quarter, as net charge-offs exceeded loss provisions by \$3.3 billion. More than one-third of all banks (38.3%) reduced their loan-loss reserves. Despite the decline in reserves, the industry's coverage ratio of reserves to noncurrent loans and leases rose from 67.8% to 70.5%, thanks to the larger reduction in noncurrent loan balances. This is the seventh consecutive quarter that the coverage ratio has improved. The ratio is at its highest level since year-end 2008.

Rebound in Securities Values Bolsters Equity Growth

Equity capital rose by \$34.2 billion (2%) during the quarter. Retained earnings added \$17.6 billion to equity growth. Lower interest rates produced a \$20 billion increase in unrealized gains on available-for-sale securities, which also contributed to the growth in equity. In addition, goodwill increased by \$3.8 billion (1.3%). Tier 1 regulatory capital, unaffected by changes in unrealized securities gains and goodwill, increased by \$19.8 billion (1.4%). The average equity-to-asset ratio rose from 11.23% to 11.26%, the highest level in almost two years. The average Tier 1 leverage ratio rose from 9.54% to 9.57%, the highest level for this regulatory capital ratio since risk-based capital standards were enacted in 1991. Insured institutions declared \$22.6 billion in dividends in second quarter, up from \$20.9 billion in second quarter 2013. At the end of the quarter, 98.4% of all insured institutions, representing 99.8% of all insured institution assets, met or exceeded the requirements for the highest regulatory capital category as defined for Prompt Corrective Action purposes.

Table Of Contents

Increase in Loan Balances Is Largest Since 2007

Total assets increased by \$263.1 billion (1.8%), as loan and lease balances grew by \$178.5 billion (2.3%), investment securities portfolios rose by \$58.6 billion (1.9%), and balances at Federal Reserve banks increased by \$28.2 billion (2.3%). The growth in loan balances was the largest quarterly increase since fourth quarter 2007 (excluding a change in accounting rules in first quarter 2010). Loan growth was led by commercial and industrial loans (up \$49.9 billion, 3.1%), 1-to-4 family residential mortgages (up \$22.7 billion, 1.2%), credit card balances (up \$20 billion, 3%), and auto loans (up \$10.9 billion, 3%). All major loan categories posted increases during the quarter except home equity lines of credit (down \$4.4 billion, 0.9%). Loans to small businesses and farms rose by \$8.2 billion (1.3%), the largest quarterly increase since banks began reporting small-business loan data on a quarterly basis in 2010. Banks' holdings of available-for-sale securities increased by \$13.9 billion (0.6%), as a result of a \$20 billion increase in their market values; the book value of the industry's available-for-sale portfolio registered a slight \$6.1 billion decline. In contrast, banks increased their portfolios of held-to-maturity securities by \$44.7 billion (8.3%). Unfunded loan commitments increased by \$132.2 billion (2.1%), the largest quarterly increase since first quarter 2010. Growth in unfunded commitments was led by a \$44.5 billion (2.8%) increase in unfunded commercial and industrial loan commitments.

Large Denomination Noninterest-Bearing Deposits Post Strong Growth

Total deposits increased by \$172.4 billion (1.5%) in the quarter. Growth was led by balances in accounts larger than \$250,000, which increased by \$157.5 billion (3.2%). Balances in domestic deposit accounts of \$250,000 or less declined by \$13.5 billion (0.3%). Noninterest-bearing accounts in domestic offices were up \$115 billion (4.3%), while deposits in foreign offices rose by \$35.8 billion (2.6%). Nondeposit interest-bearing liabilities increased by \$56.5 billion (3%), as banks increased their borrowings from Federal Home Loan Banks by \$45.6 billion (11.6%). Almost 90% of the growth in FHLB advances consisted of short-term borrowings (maturing or repricing in one year or less). Banks also increased their unsecured nondeposit borrowings that mature in one to three years by \$17.5 billion (21.7%). Almost 90% of the \$228.9 billion increase in liabilities during the quarter consisted of liabilities maturing or repricing in one year or less.

“Problem List” Shrinks to Smallest Level in Over Five Years

The number of insured institutions filing quarterly financial reports declined from 6,730 to 6,656 in the second quarter. Mergers absorbed 61 institutions during the quarter, while seven institutions failed. No new charters were added in the quarter. The number of institutions on the FDIC's “Problem List” declined from 411 to 354. This is the smallest number of “problem” institutions since the end of first quarter 2009, and is 60% below the most recent peak level of 888 “problem” institutions at the end of first quarter 2011. Total assets of “problem” institutions declined from \$126.1 billion to \$110.2 billion. The number of full-time equivalent employees at FDIC-insured institutions increased from 2,058,867 to 2,060,002, but remained below the year-earlier level of 2,097,284.

Table Of Contents

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, 2013 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" contained in the Company's Annual Report. Based on its consideration of accounting policies that involve the most complex and subjective estimates and judgments, management has identified its most critical accounting policies to be those related to the allowance for loan losses, valuation of other real estate owned, the assessment of other-than-temporary impairment of certain securities available-for-sale and the valuation of goodwill.

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 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 change 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.

Other Real Estate Owned

Real estate properties acquired through or in lieu of foreclosure are initially recorded at the fair value less estimated selling cost at the date of foreclosure. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, independent appraisals or evaluations are periodically

performed by management and property held for sale is carried at the lower of the new cost basis or fair value less cost to sell. Impairment losses are measured as the amount by which the carrying amount of a property exceeds its fair value, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of its cost basis or fair value less cost to sell. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. The portion of interest costs relating to development of real estate is capitalized. The appraisals or evaluations are inherently subjective and require estimates that are susceptible to significant revisions as more information becomes available. Due to potential changes in conditions, it is at least reasonably possible that changes in fair values 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

Other-Than-Temporary Impairment of Available-for-Sale Securities

Declines in the fair value of securities available-for-sale below their cost that are deemed to be other-than-temporary are generally 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 change 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 two acquisitions. For the purposes of goodwill impairment testing, determination of the fair value of the reporting units involves the use of significant estimates and assumptions. Through September 30, 2014, no conditions indicated impairment has incurred. The next annual test will be performed in the fourth quarter of 2014. Actual future test results may differ from the present evaluation of impairment due to changes in the conditions used at the time of that evaluation.

Table Of Contents**Income Statement Review for the Three Months ended September 30, 2014**

The following highlights a comparative discussion of the major components of net income and their impact for the three months ended September 30, 2014 and 2013:

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,					
	2014			2013		
	Average balance	Revenue/expense	Yield/rate	Average balance	Revenue/expense	Yield/rate
ASSETS						
<i>(dollars in thousands)</i>						
Interest-earning assets						
Loans 1						
Commercial	\$86,166	\$ 950	4.41 %	\$77,574	\$ 964	4.97 %
Agricultural	71,628	859	4.79 %	68,159	903	5.30 %
Real estate	413,355	4,745	4.59 %	368,220	4,503	4.89 %
Consumer and other	14,163	168	4.74 %	14,522	199	5.49 %
Total loans (including fees)	585,312	6,722	4.59 %	528,475	6,569	4.97 %
Investment securities						
Taxable	302,713	1,792	2.37 %	293,262	1,400	1.91 %
Tax-exempt 2	272,817	2,366	3.47 %	297,021	2,608	3.51 %
Total investment securities	575,530	4,158	2.89 %	590,283	4,008	2.72 %
	26,386	67	1.01 %	31,061	86	1.11 %

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

Interest bearing deposits with banks and federal funds sold

Total interest-earning assets	1,187,228	\$ 10,947	3.69 %	1,149,819	\$ 10,663	3.71 %
Noninterest-earning assets	61,693			51,489		
TOTAL ASSETS	\$1,248,921			\$1,201,308		

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 of 35%.

Table Of Contents

AVERAGE BALANCE SHEETS AND INTEREST RATES

	Three Months ended September 30,					
	2014			2013		
	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
LIABILITIES AND STOCKHOLDERS' EQUITY						
<i>(dollars in thousands)</i>						
Interest-bearing liabilities						
Deposits						
NOW, savings accounts and money markets	\$581,618	\$ 262	0.18 %	\$564,759	\$ 274	0.19 %
Time deposits > \$100,000	95,774	227	0.95 %	94,589	257	1.09 %
Time deposits < \$100,000	144,915	314	0.87 %	148,073	393	1.06 %
Total deposits	822,307	803	0.39 %	807,421	924	0.46 %
Other borrowed funds	100,597	299	1.19 %	79,746	315	1.58 %
Total Interest-bearing liabilities	922,904	1,102	0.48 %	887,167	1,239	0.56 %
Noninterest-bearing liabilities						
Demand deposits	166,219			170,501		
Other liabilities	6,425			5,827		
Stockholders' equity	153,373			137,813		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$1,248,921			\$1,201,308		
Net interest income		\$ 9,845	3.32 %		\$ 9,424	3.28 %
Spread Analysis						
Interest income/average assets	\$10,947	3.51 %		\$10,663	3.55 %	
Interest expense/average assets	\$1,102	0.35 %		\$1,239	0.41 %	
Net interest income/average assets	\$9,845	3.15 %		\$9,424	3.14 %	

Net Interest Income

For the three months ended September 30, 2014 and 2013, the Company's net interest margin adjusted for tax exempt income was 3.32% and 3.28%, respectively. Net interest income, prior to the adjustment for tax-exempt income, for

the three months ended September 30, 2014 totaled \$9,018,000 compared to \$8,511,000 for the three months ended September 30, 2013.

For the three months ended September 30, 2014, interest income increased \$370,000, or 3.8%, when compared to the same period in 2013. The increase from 2013 was primarily attributable higher average balance of loans and higher average yields on taxable securities available-for-sale. The higher average balances were due primarily to increased loan demand and to a lesser extent the Acquisition. The higher yield on taxable securities available-for-sale is due primarily to the slowdown in the payments received on U.S. Government mortgage-backed securities.

Interest expense decreased \$137,000, or 11.0%, for the three months ended September 30, 2014 when compared to the same period in 2013. The lower interest expense for the period is primarily attributable to lower average rates paid on time deposits. The lower yields were due primarily to continued low market interest rates.

Table Of Contents

Provision for Loan Losses

The Company's provision for loan losses was \$55,000 and \$92,000 for the three months ended September 30, 2014 and 2013, respectively. Net loan charge-offs were \$42,000 and \$8,000 for the three months ended September 30, 2014 and 2013, respectively.

Noninterest Income and Expense

Noninterest income increased \$9,000 or 0.5% for the three months ended September 30, 2014 compared to the same period in 2013. The increase in noninterest income is primarily due to increases in wealth management income and service fees, offset in part by decreases in securities gains and gain on the sale of loans held for sale. Wealth management income increased primarily due to market value driven account fees, as market value have increased on managed assets, and estate settlement fees. Service fees increased primarily due to the Acquisition. The decrease in the gain on the sale of loans held for sale due to decreased secondary market volume as refinancing activity has slowed. Excluding net security gains, non-interest income increased \$134,000, or 8.3%.

Noninterest expense increased \$436,000 or 8.3% for the three months ended September 30, 2014 compared to the same period in 2013 primarily as a result of increased salaries and benefits, data processing costs and other operating expenses. The increase in salaries and benefits was mainly the result of additional payroll costs as a result of the Acquisition and normal salary increases. The increase in data processing and other expenses was mainly the result of costs associated with the Acquisition.

Income Taxes

The provision for income taxes expense for the three months ended September 30, 2014 and 2013 was \$1,393,000 and \$1,296,000, representing an effective tax rate of 27% and 26%, respectively. The increase in the effective rate is due primarily to an increase in the percentage of taxable income to total income as a result of a higher volume of taxable earning assets.

Table Of Contents**Income Statement Review for the Nine Months ended September 30, 2014**

The following highlights a comparative discussion of the major components of net income and their impact for the nine months ended September 30, 2014 and 2013:

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

	Nine Months ended September 30,					
	2014			2013		
	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
ASSETS						
<i>(dollars in thousands)</i>						
Interest-earning assets						
Loans 1						
Commercial	\$84,543	\$2,929	4.62 %	\$80,196	\$2,878	4.78 %
Agricultural	71,322	2,576	4.82 %	67,384	2,700	5.34 %
Real estate	397,728	13,723	4.60 %	356,864	12,693	4.74 %
Consumer and other	13,365	480	4.79 %	14,813	604	5.43 %
Total loans (including fees)	566,958	19,708	4.63 %	519,257	18,874	4.85 %
Investment securities						
Taxable	300,219	5,407	2.40 %	297,868	4,179	1.87 %
Tax-exempt 2	286,756	7,470	3.47 %	294,706	7,952	3.60 %
Total investment securities	586,975	12,877	2.93 %	592,574	12,131	2.73 %
	36,583	213	0.78 %	48,449	304	0.84 %

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

Interest bearing deposits with banks and federal funds sold

Total interest-earning assets	1,190,516	\$ 32,798	3.67 %	1,160,280	\$ 31,310	3.60 %
Noninterest-earning assets	57,785			61,853		
TOTAL ASSETS	\$1,248,301			\$1,222,133		

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 of 35%.

Table Of Contents

AVERAGE BALANCE SHEETS AND INTEREST RATES

	Nine Months ended September 30,					
	2014			2013		
	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
LIABILITIES AND STOCKHOLDERS'						
EQUITY						
<i>(dollars in thousands)</i>						
Interest-bearing liabilities						
Deposits						
NOW, savings accounts and money markets	\$601,347	\$ 855	0.19 %	\$587,072	\$ 870	0.20 %
Time deposits > \$100,000	95,839	705	0.98 %	96,691	823	1.14 %
Time deposits < \$100,000	143,385	997	0.93 %	150,975	1,227	1.08 %
Total deposits	840,571	2,557	0.41 %	834,738	2,920	0.47 %
Other borrowed funds	82,650	898	1.45 %	70,022	906	1.73 %
Total Interest-bearing liabilities	923,221	3,455	0.50 %	904,760	3,826	0.56 %
Noninterest-bearing liabilities						
Demand deposits	169,187			167,774		
Other liabilities	6,140			6,560		
Stockholders' equity	149,753			143,039		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$1,248,301			\$1,222,133		
Net interest income		\$29,343	3.29 %		\$27,484	3.16 %
Spread Analysis						
Interest income/average assets	\$32,798	3.50 %		\$31,310	3.42 %	
Interest expense/average assets	\$3,455	0.37 %		\$3,826	0.42 %	
Net interest income/average assets	\$29,343	3.13 %		\$27,484	3.00 %	

Net Interest Income

For the nine months ended September 30, 2014 and 2013, the Company's net interest margin adjusted for tax exempt income was 3.29% and 3.16%, respectively. Net interest income, prior to the adjustment for tax-exempt income, for

the nine months ended September 30, 2014 totaled \$26,731,000 compared to \$24,703,000 for the nine months ended September 30, 2013.

For the nine months ended September 30, 2014, interest income increased \$1,658,000, or 5.8%, when compared to the same period in 2013. The increase from 2013 was primarily attributable an increase in the average balance of real estate loans and higher yields on taxable securities available-for-sale. The higher average balances of real estate loans were due primarily to increased loan demand and to a lesser extent the Acquisition. The higher yield on taxable securities available-for-sale is due primarily to the slowdown in the payments received on U.S. Government mortgage-backed securities.

Interest expense decreased \$371,000, or 9.7%, for the nine months ended September 30, 2014 when compared to the same period in 2013. The lower interest expense for the period is primarily attributable to lower average rates paid on time deposits. The lower yields were due primarily to continued low market interest rates.

Table Of Contents

Provision for Loan Losses

The Company's provision for loan losses was \$130,000 and \$166,000 for the nine months ended September 30, 2014 and 2013, respectively. Net loan charge-offs were \$172,000 and \$36,000 for the nine months ended September 30, 2014 and 2013, respectively.

Noninterest Income and Expense

Noninterest income increased \$756,000 or 13.2% for the nine months ended September 30, 2014 compared to the same period in 2013. The increase in noninterest income is primarily due to the gain on the sale of the Company's office location near Iowa State University in Ames, Iowa and an increase in wealth management services income. These positive non-interest income factors were partially offset by a decrease in the level of gains realized on the sale of loans held for sale and a decrease in securities gains. The decrease in the gain realized on the sale of loans held for sale due to decreased secondary market volume as refinancing activity has slowed. Excluding net security gains and the gain on the sale and disposal of premises and equipment, non-interest income decreased \$62,000, or 1.2%.

Noninterest expense increased \$217,000 or 1.3% for the nine months ended September 30, 2014 compared to the same period in 2013 primarily as a result of increased salaries and benefits due to normal salary increases, higher incentive pay and additional payroll costs associated with the Acquisition. This increase in noninterest expense was offset by lower other real estate owned expenses. The lower other real estate owned expense was due to no impairment write downs in 2014 as compared to a \$670,000 impairment write down in 2013. Excluding impairment write downs of other real estate owned, noninterest expense increased \$887,000, or 5.7%.

Income Taxes

The provision for income taxes expense for the nine months ended September 30, 2014 and 2013 was \$4,592,000 and \$3,524,000, representing an effective tax rate of 27% and 25%, respectively. The increase in the effective rate is due primarily to an increase in the percentage of taxable income to total income as a result of a higher volume of taxable earning assets.

Balance Sheet Review

As of September 30, 2014, total assets were \$1,298,162,000, a \$65,078,000 increase compared to December 31, 2013. The increase in assets, primarily loans, was mainly due to the Acquisition.

Investment Portfolio

The investment portfolio totaled \$568,103,000 as of September 30, 2014, a decrease of \$11,936,000 or 2.0% from the December 31, 2013 balance of \$580,039,000. The decrease in the investment portfolio was primarily due to pay downs of U.S. government mortgage-backed securities and maturities of state and political subdivision bonds, offset in part by purchases of U.S. government agencies portfolio and an increase in the unrealized gain on securities.

Table Of Contents

On a quarterly basis, the investment portfolio is reviewed for other-than-temporary impairment. As of September 30, 2014, gross unrealized losses of \$2,720,000, are considered to be temporary in nature due to the increasing interest rate environment of 2014 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, 2014, the Company's investment securities portfolio included securities issued by 302 government municipalities and agencies located within 24 states with a fair value of \$288.0 million. At December 31, 2013, the Company's investment securities portfolio included securities issued by 315 government municipalities and agencies located within 25 states with a fair value of \$315.2 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, 2014 was \$5.5 million (approximately 1.9% of the fair value of the governmental municipalities and agencies) represented by the Urbandale, 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, 2014 and December 31, 2013 identifying the state in which the issuing government municipality or agency operates. (*Dollars in thousands*)

	At September 30, 2014		At December 31, 2013	
	Amortized Fair Cost	Fair Value	Amortized Fair Cost	Fair Value
Obligations of states and political subdivisions:				
General Obligation bonds:				
Iowa	\$76,465	\$77,777	\$89,366	\$90,186
Texas	11,407	11,745	12,158	12,194
Minnesota	9,364	9,535	10,675	10,822
Pennsylvania	7,371	7,404	7,352	7,259
Other (2014: 16 states; 2013: 17 states)	30,622	31,197	36,825	37,120
Total general obligation bonds	\$135,229	\$137,658	\$156,376	\$157,581
Revenue bonds:				
Iowa	\$135,130	\$138,179	\$147,962	\$147,880
Other (2014: 13 states; 2013: 10 states)	12,012	12,193	9,839	9,763
Total revenue bonds	\$147,142	\$150,372	\$157,801	\$157,643
Total obligations of states and political subdivisions	\$282,371	\$288,030	\$314,177	\$315,224

As of September 30, 2014 and December 31, 2013, 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 9 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. (*Dollars in thousands*)

	At September 30, 2014		At December 31, 2013	
	Amortized Fair Cost	Fair Value	Amortized Fair Cost	Fair Value
Revenue bonds by revenue source				
Sales tax	\$86,467	\$88,909	\$92,533	\$92,905

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

College and universities, primarily dormitory revenues	14,010	14,168	15,609	15,341
Water	12,674	12,713	13,264	12,988
Leases	9,971	9,997	10,202	9,977
Electric	7,140	7,391	5,951	6,091
Other	16,880	17,194	20,242	20,341
Total revenue bonds by revenue source	\$147,142	\$150,372	\$157,801	\$157,643

Loan Portfolio

The loan portfolio, net of the allowance for loan losses of \$8,530,000, totaled \$615,701,000 as of September 30, 2014, an increase of \$51,199,000, or 9.07%, from the December 31, 2013 balance of \$564,502,000. The increase in the loan portfolio is primarily due to the Acquisition. The increase in the loan portfolio was primarily in the one-to-four family real estate and commercial real estate portfolios.

Table Of Contents

Deposits

Deposits totaled \$1,039,786,000 as of September 30, 2014, an increase of \$27,983,000, or 2.8%, from the December 31, 2013 balance of \$1,011,803,000. The increase in deposits occurred was due to the Acquisition, offset in part by the transfer of deposits to securities sold under agreements to repurchase. The increase in deposits was primarily in the primarily in savings accounts, money market accounts and other time deposits.

Securities Sold Under Agreements to Repurchase and Federal Funds Purchased

Securities sold under agreements to repurchase and federal funds purchased totaled \$68,194,000 as of September 30, 2014, an increase of \$28,577,000, or 72.1%, from the December 31, 2013 balance of \$39,617,000. The increase was primarily related to a commercial customer transferring funds to a repurchase account from a commercial checking account and an increase in an existing commercial customer's repurchase account balance.

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, 2013.

Asset Quality Review and Credit Risk Management

The Company's credit risk is historically centered in the loan portfolio, which on September 30, 2014 totaled \$615,701,000 compared to \$564,502,000 as of December 31, 2013. Net loans comprise 47.4% of total assets as of September 30, 2014. 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 a transaction 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 0.41% at September 30, 2014, as compared to 0.44% at December 31, 2013 and 0.52% at September 30, 2013. The Company's level of problem loans as a percentage of total loans at September 30, 2014 of 0.41% is lower than the Company's peer group (344 bank holding companies with assets of \$1 billion to \$3 billion) of 1.26% as of June 30, 2014.

Impaired loans, net of specific reserves, totaled \$2,259,000 as of September 30, 2014 and were relatively unchanged as compared to the impaired loans of \$2,244,000 as of December 31, 2013 and \$2,420,000 as of September 30, 2013. The impaired loans as of September 30, 2014 include credit deteriorated loans from the Acquisition, offset by credit improvements and payments received on other impaired loans during the nine months ended September 30, 2014.

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 \$723,000 as of September 30, 2014, of which all were included in impaired loans and on nonaccrual status. The Company had TDRs of \$1,424,000 as of December 31, 2013, all of which were included in impaired loans with \$1,237,000 on nonaccrual status and \$187,000 included on accrual status.

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, recognizes impairment through the allowance. The Company had two charge-off related to TDRs for the nine months ended September 30, 2014 in the amount of \$48,000 and no charge-offs for the nine months ended September 30, 2013.

Loans past due 90 days or more that are still accruing interest are reviewed no less frequently than quarterly to determine if there is a strong reason that the credit should not be placed on non-accrual. As of September 30, 2014, non-accrual loans totaled \$2,532,000; there were no loans past due 90 days and still accruing. This compares to non-accrual loans of \$2,508,000 and \$27,000 loans past due 90 days and still accruing as of December 31, 2013. Other real estate owned totaled \$10,188,000 as of September 30, 2014 and \$8,861,000 as of December 31, 2013.

The allowance for loan losses as a percentage of outstanding loans as of September 30, 2014 and December 31, 2013 was 1.37 and 1.50%, respectively. The decrease in the percentage of allowance for loan losses to gross loans can be primarily attributed to the Acquisition, as the purchased loan portfolio is initially recorded without an allowance for loan loss. The allowance for loan losses totaled \$8,530,000 and \$8,572,000 as of September 30, 2014 and December 31, 2013, respectively. Net charge-offs of loans totaled \$172,000 and \$36,000 for the nine months ended September 30, 2014 and 2013, 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.

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.

Table Of Contents

As of September 30, 2014, 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, 2014 and December 31, 2013 totaled \$67,214,000 and \$47,898,000, respectively, and provide a level of liquidity.

Other sources of liquidity available to the Banks as of September 30, 2014 include outstanding lines of credit with the Federal Home Loan Bank of Des Moines, Iowa of \$120,943,000, with \$16,986,000 of outstanding FHLB advances at September 30, 2014. Federal funds borrowing capacity at correspondent banks was \$108,542,000, with \$2,336,000 of outstanding federal fund balances as of September 30, 2014. The Company had securities sold under agreements to repurchase totaling \$65,858,000 and long-term repurchase agreements of \$13,000,000 as of September 30, 2014.

Total investments as of September 30, 2014 were \$568,103,000 compared to \$580,039,000 as of December 31, 2013. 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, 2014.

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 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, 2014 totaled \$13,921,000 compared to the \$17,993,000 for the nine months ended September 30, 2013. The decrease of \$4,072,000 in net cash provided by operating activities was primarily due to an increase in other assets, an increase in the gain on the sale of premises and equipment and a decrease in amortization, offset by an increase in net income.

Net cash provided by (used in) investing activities for the nine months ended September 30, 2014 was \$25,007,000 and compares to \$(23,029,000) for the nine months ended September 30, 2013. The change in cash provided by investing activities of \$48,036,000 was primarily due to changes in securities available-for-sale, cash acquired from bank offices and changes in loans, offset by increases in interest bearing deposits in financial institutions.

Table Of Contents

Net cash used in financing activities for the nine months ended September 30, 2014 totaled \$37,513,000 compared to \$4,111,000 for the nine months ended September 30, 2013. The increase of \$33,402,000 in net cash used in financing activities was primarily due to a decrease in deposits and payments on FHLB and other borrowings, offset in part by an increase in securities sold under agreements to repurchase. As of September 30, 2014, 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 Company requires adequate liquidity to pay its expenses and pay stockholder dividends. For the nine months ended September 30, 2014, dividends paid by the Banks to the Company amounted to \$5,700,000 compared to \$5,400,000 for the same period in 2013. 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 \$0.18 per share in 2014 from \$0.16 per share in 2013.

The Company, on an unconsolidated basis, has interest bearing deposits and marketable investment securities totaling \$8,357,000 as of September 30, 2014 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, 2014 that are of concern to management.

Capital Resources

The Company's total stockholders' equity as of September 30, 2014 totaled \$153,970,000 and was higher than the \$142,106,000 recorded as of December 31, 2013. The increase in stockholders' equity was primarily due to net income, reduced by dividends declared and increased by accumulated other comprehensive income. The increase in other comprehensive income is created by 2014 market interest rates trending lower, which resulted in higher fair values in the securities available-for-sale portfolio. At September 30, 2014 and December 31, 2013, stockholders' equity as a percentage of total assets was 11.86% and 11.52%, respectively. The capital levels of the Company exceed applicable regulatory guidelines as of September 30, 2014.

In early July 2013, the Federal Reserve Board and the FDIC issued interim final rules implementing the Basel III regulatory capital framework and related Dodd-Frank Wall Street Reform and Consumer Protection Act changes. The rules revise minimum capital requirements and adjust prompt corrective action thresholds. The interim final rule revises the regulatory capital elements, adds a new common equity Tier I capital ratio, and increases the minimum Tier I capital ratio requirement. The revisions also permit banking organizations to retain, through a one-time election, the existing treatment for accumulated other comprehensive income and implement a new capital conservation buffer. The final rule will become effective January 1, 2015, subject to a transition period. The final rules require continued review and analysis, but management believes the Company and its' affiliate banks will remain well-capitalized.

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; the Company's ability to successfully integrate the assets being purchased from First Bank into its operations on a timely and cost effective basis; 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 2014 changed significantly when compared to 2013.

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.

Table Of Contents

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.

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, 2013, 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, 2014, 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, 2014.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Maximum Number of Shares that May Yet Be Purchased Under The Plan
July 1, 2014 to July 31, 2014	-	\$ -	-	100,000

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

August 1, 2014 to August 31, 2014	-	\$	-	-	100,000
September 1, 2014 to September 30, 2014	-	\$	-	-	100,000
Total	-			-	

Item3.Defaults Upon Senior Securities

Not applicable

Table Of Contents

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other information

Not applicable

Item 6. Exhibits

- 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.SCH XBRL 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 7, 2014 By: /s/ Thomas H. Pohlman

Thomas H. Pohlman, Chief Executive Officer and President

By: /s/ John P. Nelson

John P. Nelson, Chief Financial Officer and Vice President

Table Of Contents

EXHIBIT INDEX

The following exhibits are filed herewith:

Exhibit No.	Description
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.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.