

AMES NATIONAL CORP  
Form 10-Q  
November 06, 2015  
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**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, 2015

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)

<b>IOWA</b>	<b>42-1039071</b>
(State or Other Jurisdiction of Incorporation or Organization)	(I. R. S. Employer 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.



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AMES NATIONAL CORPORATION

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	<b>September 30, 2015</b>	<b>December 31, 2014</b>
<b>ASSETS</b>		
Cash and due from banks	\$26,140,701	\$23,730,257
Federal funds sold	-	6,000
Interest bearing deposits in financial institutions	40,155,352	31,463,382
Securities available-for-sale	546,016,890	542,502,381
Loans receivable, net	690,315,150	658,440,998
Loans held for sale	916,322	704,850
Bank premises and equipment, net	16,828,000	15,956,989
Accrued income receivable	8,540,727	7,471,023
Other real estate owned	3,418,108	8,435,885
Deferred income taxes	1,978,434	2,633,177
Core deposit intangible, net	1,403,982	1,730,231
Goodwill	6,732,216	6,732,216
Other assets	896,580	1,223,328
<b>Total assets</b>	<b>\$1,343,342,462</b>	<b>\$1,301,030,717</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Deposits		
Demand, noninterest bearing	\$187,652,406	\$188,725,609
NOW accounts	300,533,481	298,581,556
Savings and money market	350,538,471	321,700,422
Time, \$250,000 and over	35,178,437	36,169,601
Other time	187,474,843	206,946,069
<b>Total deposits</b>	<b>1,061,377,638</b>	<b>1,052,123,257</b>
Securities sold under agreements to repurchase	52,065,563	51,265,011
Federal Home Loan Bank (FHLB) advances	50,253,477	14,467,737
Other borrowings	13,000,000	23,000,000
Dividend payable	1,862,183	1,675,964
Accrued expenses and other liabilities	4,378,121	3,824,330
<b>Total liabilities</b>	<b>1,182,936,982</b>	<b>1,146,356,299</b>
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, \$2 par value, authorized 18,000,000 shares; issued and outstanding 9,310,913 shares as of September 30, 2015 and December 31, 2014	18,621,826	18,621,826
Additional paid-in capital	20,878,728	20,878,728

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Retained earnings	116,214,889	110,701,847
Accumulated other comprehensive income - net unrealized gain on securities available-for-sale	4,690,037	4,472,017
<b>Total stockholders' equity</b>	<b>160,405,480</b>	<b>154,674,418</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$1,343,342,462</b>	<b>\$1,301,030,717</b>

See Notes to Consolidated Financial Statements.

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## AMES NATIONAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

*(unaudited)*

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Interest income:				
Loans, including fees	\$7,808,414	\$6,722,179	\$22,920,161	\$19,708,190
Securities:				
Taxable	1,506,702	1,792,258	4,639,398	5,407,157
Tax-exempt	1,433,537	1,538,531	4,399,623	4,857,733
Interest bearing deposits and federal funds sold	94,364	67,183	288,411	213,259
<b>Total interest income</b>	<b>10,843,017</b>	<b>10,120,151</b>	<b>32,247,593</b>	<b>30,186,339</b>
Interest expense:				
Deposits	744,958	803,098	2,276,004	2,557,799
Other borrowed funds	257,791	299,434	898,565	897,781
<b>Total interest expense</b>	<b>1,002,749</b>	<b>1,102,532</b>	<b>3,174,569</b>	<b>3,455,580</b>
<b>Net interest income</b>	<b>9,840,268</b>	<b>9,017,619</b>	<b>29,073,024</b>	<b>26,730,759</b>
Provision for loan losses	37,797	55,145	1,036,610	130,020
<b>Net interest income after provision for loan losses</b>	<b>9,802,471</b>	<b>8,962,474</b>	<b>28,036,414</b>	<b>26,600,739</b>
Noninterest income:				
Wealth management income	671,699	686,955	2,040,956	2,108,150
Service fees	445,706	426,588	1,285,063	1,194,862
Securities gains, net	111,622	79,501	608,926	214,582
Gain on sale of loans held for sale	206,072	224,554	705,370	473,733
Merchant and card fees	350,310	281,766	1,016,783	831,405
Gain (loss) on the sale of premises and equipment, net	-	-	(1,132 )	1,242,209
Other noninterest income	164,568	129,326	467,217	443,505
<b>Total noninterest income</b>	<b>1,949,977</b>	<b>1,828,690</b>	<b>6,123,183</b>	<b>6,508,446</b>
Noninterest expense:				
Salaries and employee benefits	3,882,484	3,513,375	11,418,395	10,235,563
Data processing	720,232	656,715	2,089,363	1,823,635
Occupancy expenses, net	414,868	366,258	1,408,464	1,185,066
FDIC insurance assessments	169,692	164,535	519,962	490,231
Professional fees	346,665	332,988	951,835	963,876
Business development	254,757	303,026	719,689	726,503
Other real estate owned expense (income), net	(104,380 )	(19,908 )	605,830	(198 )

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Core deposit intangible amortization	103,251	76,959	326,249	203,707
Other operating expenses, net	194,639	272,474	773,430	776,248
<b>Total noninterest expense</b>	<b>5,982,208</b>	<b>5,666,422</b>	<b>18,813,217</b>	<b>16,404,631</b>
<b>Income before income taxes</b>	<b>5,770,240</b>	<b>5,124,742</b>	<b>15,346,380</b>	<b>16,704,554</b>
Provision for income taxes	1,670,389	1,393,256	4,246,790	4,592,054
<b>Net income</b>	<b>\$4,099,851</b>	<b>\$3,731,486</b>	<b>\$11,099,590</b>	<b>\$12,112,500</b>
Basic and diluted earnings per share	\$0.44	\$0.40	\$1.19	\$1.30
Dividends declared per share	\$0.20	\$0.18	\$0.60	\$0.54

See Notes to Consolidated Financial Statements.

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>
Net income	\$4,099,851	\$3,731,486	\$11,099,590	\$12,112,500
Other comprehensive income (losses), before tax:				
Unrealized gains (losses) on securities before tax:				
Unrealized holding gains (losses) arising during the period	2,649,038	(572,017 )	954,990	7,800,643
Less: reclassification adjustment for gains realized in net income	111,622	79,501	608,926	214,582
Other comprehensive income (losses), before tax	2,537,416	(651,518 )	346,064	7,586,061
Tax effect related to other comprehensive income (loss)	(938,843 )	241,062	(128,044 )	(2,806,843 )
Other comprehensive income (losses), net of tax	1,598,573	(410,456 )	218,020	4,779,218
Comprehensive income	\$5,698,424	\$3,321,030	\$11,317,610	\$16,891,718

See Notes to Consolidated Financial Statements.

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## AMES NATIONAL CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

*(unaudited)*

Nine Months Ended September 30, 2015 and 2014

	Common Stock	Additional Paid-in-Capital	Retained Earnings	Accumulated Other Comprehensive Income, Net of Taxes	Treasury Stock	Total Stockholders' Equity
<b>Balance, December 31, 2013</b>	\$ 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 )
<b>Balance, September 30, 2014</b>	\$ 18,865,830	\$ 22,651,222	\$ 109,239,104	\$ 5,230,350	\$(2,016,498)	\$ 153,970,008
<b>Balance, December 31, 2014</b>	\$ 18,621,826	\$ 20,878,728	\$ 110,701,847	\$ 4,472,017	\$-	\$ 154,674,418
Net income	-	-	11,099,590	-	-	11,099,590
Other comprehensive income	-	-	-	218,020	-	218,020
Cash dividends declared, \$0.60 per share	-	-	(5,586,548 )	-	-	(5,586,548 )
<b>Balance, September 30, 2015</b>	\$ 18,621,826	\$ 20,878,728	\$ 116,214,889	\$ 4,690,037	\$-	\$ 160,405,480

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, 2015 and 2014**

	<b>2015</b>	<b>2014</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 11,099,590	\$ 12,112,500
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,036,610	130,020
Provision for off-balance sheet commitments	7,000	53,000
Amortization, net	2,590,850	3,133,065
Amortization of core deposit intangible asset	326,249	203,707
Depreciation	812,607	605,100
Deferred income taxes	526,700	557,853
Securities gains, net	(608,926 )	(214,582 )
(Gain) loss on sale of premises and equipment, net	1,132	(1,242,209 )
Impairment of other real estate owned	614,687	-
(Gain) on sale of other real estate owned, net	(88,164 )	(7,175 )
Change in assets and liabilities:		
(Increase) in loans held for sale	(211,472 )	(151,805 )
(Increase) in accrued income receivable	(1,069,704 )	(921,324 )
(Increase) decrease in other assets	321,674	(452,695 )
Increase in accrued expenses and other liabilities	546,791	115,795
<b>Net cash provided by operating activities</b>	<b>15,905,624</b>	<b>13,921,250</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of securities available-for-sale	(87,374,515)	(61,818,547)
Proceeds from sale of securities available-for-sale	21,305,694	31,688,263
Proceeds from maturities and calls of securities available-for-sale	60,365,412	57,120,089
Net (increase) in interest bearing deposits in financial institutions	(8,691,970 )	(12,182,001)
Decrease in federal funds sold	6,000	-
Net (increase) in loans	(32,535,238)	(6,705,707 )
Net proceeds from the sale of other real estate owned	4,594,675	78,990
Net proceeds from the sale of bank premises and equipment	-	1,746,444
Purchase of bank premises and equipment, net	(1,679,676 )	(1,329,925 )
Cash acquired, net of cash paid, for acquired bank offices	-	16,428,981
Other	(28,812 )	(19,673 )
<b>Net cash provided by (used in) investing activities</b>	<b>(44,038,430)</b>	<b>25,006,914</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Increase (decrease) in deposits	9,357,287	(53,879,019)
Increase in securities sold under agreements to repurchase	800,552	25,762,071
Payments on FHLB borrowings and other borrowings	(10,414,260)	(7,054,374 )

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Proceeds from short-term FHLB borrowings, net	36,200,000	2,500,000
Dividends paid	(5,400,329 )	(4,841,676 )
<b>Net cash provided by (used in) financing activities</b>	<b>30,543,250</b>	<b>(37,512,998)</b>
<b>Net increase in cash and due from banks</b>	<b>2,410,444</b>	<b>1,415,166</b>
<b>CASH AND DUE FROM BANKS</b>		
Beginning	23,730,257	24,270,031
Ending	\$26,140,701	\$25,685,197

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	<b>2015</b>	<b>2014</b>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash payments for:		
Interest	\$3,377,794	\$3,602,255
Income taxes	3,246,791	4,147,836
<b>SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES</b>		
Transfer of loans receivable to other real estate owned	\$74,609	\$111,109
Business Combination: (Assets acquired and liabilities assumed at fair value)		
Interest bearing deposits in financial institutions acquired	\$-	\$5,719,000
Securities available-for-sale acquired	-	10,602,454
Loans receivable acquired	-	44,620,021
Bank premises and equipment acquired	-	3,864,900
Accrued interest receivable acquired	-	230,332
Other real estate owned acquired	-	1,267,720
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

See Notes to Consolidated Financial Statements.

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**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, 2015 and 2014 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, 2014 (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, 2015, Company management has performed a goodwill impairment analysis and determined goodwill was not impaired.

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 purchased loans are included in the impaired loan category in the financial statements.

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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 August 29, 2014, 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.

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 are classified as 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.

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3. Dividends

On August 12, 2015, the Company declared a cash dividend on its common stock, payable on November 13, 2015 to stockholders of record as of October 30, 2015, equal to \$0.20 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, 2015 and 2014 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, 2014.

6. Fair Value Measurements

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

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

Level 2: Inputs to the valuation methodology include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices

that are observable for the asset or liability (such as interest rates, volatility, prepayment speeds, credit risk); or inputs derived principally from or can be corroborated by observable market data by correlation or other means.

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

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The following table presents the balances of assets measured at fair value on a recurring basis by level as of September 30, 2015 and December 31, 2014. *(in thousands)*

Description	Total	Level 1	Level 2	Level 3
<b>2015</b>				
U.S. government treasuries	\$1,479	\$1,479	\$-	\$ -
U.S. government agencies	108,911	-	108,911	-
U.S. government mortgage-backed securities	102,740	-	102,740	-
State and political subdivisions	278,016	-	278,016	-
Corporate bonds	49,675	-	49,675	-
Equity securities, common stock	757	757	-	-
Equity securities, other	4,439	-	4,439	-
	\$546,017	\$2,236	\$543,781	\$ -
<b>2014</b>				
U.S. government treasuries	\$1,447	\$1,447	\$-	\$ -
U.S. government agencies	87,307	-	87,307	-
U.S. government mortgage-backed securities	120,985	-	120,985	-
State and political subdivisions	281,776	-	281,776	-
Corporate bonds	47,320	-	47,320	-
Equity securities, common stock	758	758	-	-
Equity securities, other	2,909	-	2,909	-
	\$542,502	\$2,205	\$540,297	\$ -

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.

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, 2015.



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Certain assets are measured at fair value on a nonrecurring basis; that is, they are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets carried on the balance sheet (after specific reserves) by caption and by level within the valuation hierarchy as of September 30, 2015 and December 31, 2014. *(in thousands)*

Description	Total	Level 1	Level 2	Level 3
<b>2015</b>				
Loans receivable	\$630	\$ -	\$ -	\$630
Other real estate owned	3,418	-	-	3,418
Total	\$4,048	\$ -	\$ -	\$4,048
<b>2014</b>				
Loans receivable	\$692	\$ -	\$ -	\$692
Other real estate owned	8,436	-	-	8,436
Total	\$9,128	\$ -	\$ -	\$9,128

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

Other Real Estate Owned: Other real estate owned in the table above consists of real estate obtained through foreclosure. Other real estate owned is recorded at fair value less estimated selling costs, at the date of transfer, with any impairment amount charged to the allowance for loan losses. Subsequent to the transfer, other real estate owned is carried at the lower of cost or fair value, less estimated selling costs, with any impairment amount recorded as a noninterest expense. The carrying value of other real estate owned is not re-measured to fair value on a recurring basis but is subject to fair value adjustments when the carrying value exceeds the fair value less estimated selling costs. Management uses appraised values and adjusts for trends observed in the market and for disposition costs in determining the value of other real estate owned. A valuation allowance was recorded for the excess of the asset's recorded investment over the amount determined by the fair value, less estimated selling costs. This valuation allowance is a component of the allowance for other real estate owned. The valuation allowance was \$3,852,000 as of September 30, 2015 and \$6,389,000 as of December 31, 2014. The Company considers these fair value measurements as level 3.



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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, 2015 and December 31, 2014 are as follows: *(in thousands)*

<b>2015</b>				
	Estimated	Valuation		Range
	Fair	Techniques	Unobservable Inputs	(Average)
	Value			
Impaired Loans	\$630	Evaluation of collateral	Estimation of value	NM*
Other real estate owned	\$3,418	Appraisal	Appraisal adjustment	3%- 10% (6%)
<b>2014</b>				
	Estimated	Valuation		Range
	Fair	Techniques	Unobservable Inputs	(Average)
	Value			
Impaired Loans	\$692	Evaluation of collateral	Estimation of value	NM*
Other real estate owned	\$8,436	Appraisal	Appraisal adjustment	4%- 10% (7%)

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

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, 2015 and December 31, 2014 are not carried at fair value in their entirety on the consolidated balance sheets.

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

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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.

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.

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

Deposits: 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: The carrying amounts of securities sold under agreements to repurchase 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 carrying 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.

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The estimated fair values of the Company's financial instruments as described above as of September 30, 2015 and December 31, 2014 are as follows: *(in thousands)*

	Fair Value Hierarchy Level	2015 Carrying Amount	Estimated Fair Value	2014 Carrying Amount	Estimated Fair Value
Financial assets:					
Cash and due from banks	Level 1	\$26,141	\$26,141	\$23,730	\$23,730
Federal funds sold	Level 1	-	-	6	6
Interest bearing deposits	Level 1	40,155	40,155	31,463	31,463
Securities available-for-sale	See previous table	546,017	546,017	542,502	542,502
Loans receivable, net	Level 2	690,315	691,520	658,441	656,896
Loans held for sale	Level 2	916	916	705	705
Accrued income receivable	Level 1	8,541	8,541	7,471	7,471
Financial liabilities:					
Deposits	Level 2	\$1,061,378	\$1,062,829	\$1,052,123	\$1,052,082
Securities sold under agreements to repurchase	Level 1	52,066	52,066	51,265	51,265
FHLB advances	Level 2	50,253	50,924	14,468	15,281
Other borrowings	Level 2	13,000	14,004	23,000	24,339
Accrued interest payable	Level 1	436	436	536	536

The methodologies used to determine fair value as of September 30, 2015 did not change from the methodologies described in the December 31, 2014 Annual Financial Statements.

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## 7. Debt and Equity Securities

The amortized cost of securities available-for-sale and their fair values as of September 30, 2015 and December 31, 2014 are summarized below: *(in thousands)*

<b>2015:</b>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government treasuries	\$ 1,441	\$ 38	\$ -	\$ 1,479
U.S. government agencies	107,720	1,340	(149 )	108,911
U.S. government mortgage-backed securities	100,253	2,530	(43 )	102,740
State and political subdivisions	274,100	4,367	(451 )	278,016
Corporate bonds	49,989	322	(636 )	49,675
Equity securities, common stock	630	127	-	757
Equity securities, other	4,439	-	-	4,439
	\$ 538,572	\$ 8,724	\$ (1,279 )	\$ 546,017

<b>2014:</b>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government treasuries	\$ 1,431	\$ 16	\$ -	\$ 1,447
U.S. government agencies	86,997	822	(512 )	87,307
U.S. government mortgage-backed securities	118,349	2,744	(108 )	120,985
State and political subdivisions	277,328	5,097	(649 )	281,776
Corporate bonds	47,760	471	(911 )	47,320
Equity securities, common stock	630	128	-	758
Equity securities, other	2,909	-	-	2,909
	\$ 535,404	\$ 9,278	\$ (2,180 )	\$ 542,502

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

Three Months Ended September 30, <b>2015</b>		Nine Months Ended September 30, <b>2015</b>	
<b>2014</b>		<b>2015</b>	<b>2014</b>

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Proceeds from sales of securities available-for-sale	\$5,926	\$28,209	\$21,306	\$31,688
Gross realized gains on securities available-for-sale	126	232	623	367
Gross realized losses on securities available-for-sale	(14 )	(152 )	(14 )	(152 )
Tax provision applicable to net realized gains on securities available-for-sale	42	30	227	80

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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, 2015 and December 31, 2014 are as follows: *(in thousands)*

<b>2015:</b>	Less than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
Securities available-for-sale:						
U.S. government agencies	\$12,731	\$ (67 )	\$6,828	\$ (82 )	\$19,559	\$ (149 )
U.S. government mortgage-backed securities	5,670	(43 )	-	-	5,670	(43 )
State and political subdivisions	44,365	(312 )	10,805	(139 )	55,170	(451 )
Corporate bonds	16,882	(152 )	14,690	(484 )	31,572	(636 )
	\$79,648	\$ (574 )	\$32,323	\$ (705 )	\$111,971	\$ (1,279 )

<b>2014:</b>	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available-for-sale:						
U.S. government agencies	\$14,016	\$ (64 )	\$17,523	\$ (448 )	\$31,539	\$ (512 )
U.S. government mortgage-backed securities	6,934	(20 )	16,123	(88 )	23,057	(108 )
State and political subdivisions	45,618	(252 )	24,880	(397 )	70,498	(649 )
Corporate bonds	8,937	(73 )	20,724	(838 )	29,661	(911 )
	\$75,505	\$ (409 )	\$79,250	\$ (1,771 )	\$154,755	\$ (2,180 )

Gross unrealized losses on debt securities totaled \$1,279,000 as of September 30, 2015. 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.

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## 8.Loans Receivable and Credit Disclosures

Activity in the allowance for loan losses, on a disaggregated basis, for the three and nine months ended September 30, 2015 and 2014 is as follows: *(in thousands)*

**Three Months Ended September 30, 2015**

	1-4 Family Residential		Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
	Construction Real Estate	Real Estate						
Balance, June 30, 2015	\$823	\$ 1,826	\$ 3,590	\$ 812	\$ 1,263	\$ 1,338	\$ 220	\$9,872
Provision (credit) for loan losses	145	(9 )	(129 )	(20 )	97	(44 )	(2 )	38
Recoveries of loans charged-off	15	2	-	-	-	-	16	33
Loans charged-off	-	(1 )	-	-	-	-	(15 )	(16 )
Balance, September 30, 2015	\$968	\$ 1,817	\$ 3,461	\$ 792	\$ 1,360	\$ 1,294	\$ 235	\$9,927

**Nine Months Ended September 30, 2015**

	1-4 Family Residential		Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
	Construction Real Estate	Real Estate						
Balance, December 31, 2014	\$495	\$ 1,648	\$ 3,214	\$ 737	\$ 1,247	\$ 1,312	\$ 186	\$8,839
Provision (credit) for loan losses	438	154	247	55	113	(18 )	48	1,037
Recoveries of loans charged-off	35	22	-	-	-	-	24	81
Loans charged-off	-	(7 )	-	-	-	-	(23 )	(30 )
Balance, September 30, 2015	\$968	\$ 1,817	\$ 3,461	\$ 792	\$ 1,360	\$ 1,294	\$ 235	\$9,927

**Three Months Ended September 30, 2014**

	1-4 Family Residential		Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
	Construction Real Estate	Real Estate						

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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

**Nine Months Ended September 2014**

1-4

Family

	Construction	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

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Allowance for loan losses disaggregated on the basis of impairment analysis method as of September 30, 2015 and December 31, 2014 is as follows: *(in thousands)*

2015	Construction	1-4 Family Residential	Commercial	Agricultural	Commercial	Agricultural	Consumer and Other	Total
	Real Estate	Real Estate	Real Estate	Real Estate				
Individually evaluated for impairment	\$ -	\$ 265	\$ 6	\$ -	\$ 161	\$ -	\$ -	\$ 432
Collectively evaluated for impairment	968	1,552	3,455	792	1,199	1,294	235	9,495
Balance September 30, 2015	\$ 968	\$ 1,817	\$ 3,461	\$ 792	\$ 1,360	\$ 1,294	\$ 235	\$ 9,927

2014	Construction	1-4 Family Residential	Commercial	Agricultural	Commercial	Agricultural	Consumer and Other	Total
	Real Estate	Real Estate	Real Estate	Real Estate				
Individually evaluated for impairment	\$ -	\$ 244	\$ 33	\$ -	\$ 60	\$ -	\$ -	\$ 337
Collectively evaluated for impairment	495	1,524	3,181	737	1,067	1,312	186	8,502
Balance December 31, 2014	\$ 495	\$ 1,768	\$ 3,214	\$ 737	\$ 1,127	\$ 1,312	\$ 186	\$ 8,839

Loans receivable disaggregated on the basis of impairment analysis method as of September 30, 2015 and December 31, 2014 is as follows: *(in thousands)*:

2015	Construction	1-4 Family Residential	Commercial	Agricultural	Commercial	Agricultural	Consumer and Other	Total
	Real Estate	Real Estate	Real Estate	Real Estate				
Individually evaluated for impairment	\$ -	\$ 1,066	\$ 611	\$ -	\$ 206	\$ 11	\$ 2	\$ 1,896
Collectively evaluated for impairment	65,197	124,318	239,481	64,125	105,475	78,931	20,916	698,443
	\$ 65,197	\$ 125,384	\$ 240,092	\$ 64,125	\$ 105,681	\$ 78,942	\$ 20,918	\$ 700,339

Balance September  
30, 2015

2014	Construction	1-4 Family Residential	Commercial	Agricultural	Commercial	Agricultural	Consumer and Other	Total
	Real Estate	Real Estate	Real Estate	Real Estate			Real Estate	
Individually evaluated for impairment	\$ 195	\$ 811	\$ 833	\$ -	\$ 540	\$ 19	\$ 9	\$ 2,407
Collectively evaluated for impairment	35,821	121,966	256,221	57,449	92,163	85,590	15,754	664,964
Balance December 31, 2014	\$ 36,016	\$ 122,777	\$ 257,054	\$ 57,449	\$ 92,703	\$ 85,609	\$ 15,763	\$ 667,371

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.

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The following is a recap of impaired loans, on a disaggregated basis, as of September 30, 2015 and December 31, 2014: *(in thousands)*

	2015			2014		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no specific reserve recorded:						
Real estate - construction	\$-	\$ -	\$ -	\$195	\$ 346	\$ -
Real estate - 1 to 4 family residential	298	303	-	24	29	-
Real estate - commercial	505	1,073	-	675	1,204	-
Real estate - agricultural	-	-	-	-	-	-
Commercial	18	24	-	456	535	-
Agricultural	11	13	-	19	19	-
Consumer and other	2	3	-	9	6	-
Total loans with no specific reserve:	834	1,416	-	1,378	2,139	-
With an allowance recorded:						
Real estate - construction	-	-	-	-	-	-
Real estate - 1 to 4 family residential	768	900	265	787	903	244
Real estate - commercial	106	111	6	158	158	33
Real estate - agricultural	-	-	-	-	-	-
Commercial	188	263	161	84	84	60
Agricultural	-	-	-	-	-	-
Consumer and other	-	-	-	-	-	-
Total loans with specific reserve:	1,062	1,274	432	1,029	1,145	337
Total						
Real estate - construction	-	-	-	195	346	-
Real estate - 1 to 4 family residential	1,066	1,203	265	811	932	244
Real estate - commercial	611	1,184	6	833	1,362	33
Real estate - agricultural	-	-	-	-	-	-
Commercial	206	287	161	540	619	60
Agricultural	11	13	-	19	19	-
Consumer and other	2	3	-	9	6	-
	\$1,896	\$ 2,690	\$ 432	\$2,407	\$ 3,284	\$ 337

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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, 2015 and 2014: *(in thousands)*

	<b>Three Months Ended September 30,</b>			
	<b>2015</b>		<b>2014</b>	
	Average Interest Recorded Income		Average Interest Recorded Income	
	Investment	Recognized	Investment	Recognized
With no specific reserve recorded:				
Real estate - construction	\$51	\$ 62	\$419	\$ -
Real estate - 1 to 4 family residential	250	-	185	7
Real estate - commercial	525	-	374	-
Real estate - agricultural	-	-	-	-
Commercial	94	-	274	-
Agricultural	11	-	19	-
Consumer and other	4	-	8	-
Total loans with no specific reserve:	935	62	1,279	7
With an allowance recorded:				
Real estate - construction	-	-	-	-
Real estate - 1 to 4 family residential	761	-	209	-
Real estate - commercial	129	-	160	-
Real estate - agricultural	-	-	-	-
Commercial	131	-	274	-
Agricultural	-	-	2	-
Consumer and other	-	-	4	-
Total loans with specific reserve:	1,021	-	649	-
Total				
Real estate - construction	51	62	419	-
Real estate - 1 to 4 family residential	1,011	-	394	7
Real estate - commercial	654	-	534	-
Real estate - agricultural	-	-	-	-
Commercial	225	-	548	-
Agricultural	11	-	21	-
Consumer and other	4	-	12	-
	\$1,956	\$ 62	\$1,928	\$ 7

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	<b>Nine Months Ended September 30,</b>			
	<b>2015</b>		<b>2014</b>	
	Average Interest	Average Interest	Average Interest	Average Interest
	Recorded Income	Recorded Income	Recorded Income	Recorded Income
	Investment Recognized	Investment Recognized	Investment Recognized	Investment Recognized
With no specific reserve recorded:				
Real estate - construction	\$ 121	\$ 129	\$ 461	\$ -
Real estate - 1 to 4 family residential	161	-	230	12
Real estate - commercial	579	23	318	206
Real estate - agricultural	-	-	-	-
Commercial	276	3	158	-
Agricultural	13	-	19	-
Consumer and other	5	2	23	-
Total loans with no specific reserve:	1,155	157	1,209	218
With an allowance recorded:				
Real estate - construction	-	-	-	-
Real estate - 1 to 4 family residential	772	-	279	-
Real estate - commercial	143	-	103	-
Real estate - agricultural	-	-	-	-
Commercial	106	-	519	70
Agricultural	-	-	3	-
Consumer and other	-	-	2	-
Total loans with specific reserve:	1,021	-	906	70
Total				
Real estate - construction	121	129	461	-
Real estate - 1 to 4 family residential	933	-	509	12
Real estate - commercial	722	23	421	206
Real estate - agricultural	-	-	-	-
Commercial	382	3	677	70
Agricultural	13	-	22	-
Consumer and other	5	2	25	-
	\$2,176	\$ 157	\$2,115	\$ 288

The interest foregone on nonaccrual loans for the three months ended September 30, 2015 and 2014 was approximately \$39,000 and \$30,000, respectively. The interest foregone on nonaccrual loans for the nine months ended September 30, 2015 and 2014 was approximately \$127,000 and \$92,000, respectively

The Company had loans meeting the definition of a troubled debt restructuring (TDR) of \$801,000 as of September 30, 2015, of which all were included in impaired loans and nonaccrual loans. The Company had TDRs of \$1,129,000 as of December 31, 2014, all of which were included in impaired and nonaccrual loans.



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The following tables sets forth information on the Company's TDRs, on a disaggregated basis, occurring in the three and nine months ended September 30, 2015 and 2014: *(dollars in thousands)*

	<b>Three Months Ended September 30, 2015</b>		<b>2014</b>	
	Pre-Modification Outstanding	Post-Modification Outstanding	Pre-Modification Outstanding	Post-Modification Outstanding
	Number of Recorded Commitment	Recorded Investment	Number of Recorded Commitment	Recorded Investment
Real estate - construction	- \$ -	\$ -	- \$ -	\$ -
Real estate - 1 to 4 family residential	-	-	1	25
Real estate - commercial	-	-	-	-
Real estate - agricultural Commercial	-	-	-	-
Agricultural	-	-	-	-
Consumer and other	-	-	-	-
	- \$ -	\$ -	1 \$ 25	\$ 25

	<b>Nine Months Ended September 30, 2015</b>		<b>2014</b>	
	Pre-Modification Outstanding	Post-Modification Outstanding	Pre-Modification Outstanding	Post-Modification Outstanding
	Number of Recorded Commitment	Recorded Investment	Number of Recorded Commitment	Recorded Investment
Real estate - construction	- \$ -	\$ -	- \$ -	\$ -
Real estate - 1 to 4 family residential	-	-	1	25
Real estate - commercial	-	-	1	43
Real estate - agricultural Commercial	-	-	-	-
Agricultural	-	-	1	19
Consumer and other	-	-	1	6
	- \$ -	\$ -	4 \$ 93	\$ 93

The Company did not grant any concessions on any loans experiencing financial difficulties during the three and nine months ended September 30, 2015.

The Company restructured one loan during the three months ended September 30, 2014. However, 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 loan's maturity dates were extended one year with interest only until maturity. A 1-4 family residential loan's term was extended beyond normal terms.

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, 2015 had a payment default. Two TDR loans modified during the twelve months ended September 30, 2014 had a payment defaults. These modified TDR loans had a balance as of September 30, 2014 of \$132,000.

There were no charge-offs related to TDRs for the nine months ended September 30, 2015. There were two charge-offs related to TDRs for the nine months ended September 30, 2014 in the amount of \$48,000. 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.

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An aging analysis of the recorded investments in loans, on a disaggregated basis, as of September 30, 2015 and December 31, 2014, is as follows: *(in thousands)*

2015	90 Days			Current	Total	90 Days
	30-89	or Greater	Total			or Greater
	Past Due	Past Due	Past Due			Accruing
Real estate - construction	\$-	\$ -	\$-	\$65,197	\$65,197	\$ -
Real estate - 1 to 4 family residential	957	317	1,274	124,110	125,384	84
Real estate - commercial	106	-	106	239,986	240,092	-
Real estate - agricultural	-	-	-	64,125	64,125	-
Commercial	63	121	184	105,497	105,681	-
Agricultural	100	67	167	78,775	78,942	-
Consumer and other	45	-	45	20,873	20,918	-
	\$1,271	\$ 505	\$1,776	\$698,563	\$700,339	\$ 84
2014	90 Days			Current	Total	90 Days
	30-89	or Greater	Total			or Greater
	Past Due	Past Due	Past Due			Accruing
Real estate - construction	\$64	\$ -	\$64	\$35,952	\$36,016	\$ -
Real estate - 1 to 4 family residential	888	57	945	121,832	122,777	36
Real estate - commercial	467	45	512	256,542	257,054	-
Real estate - agricultural	28	-	28	57,421	57,449	-
Commercial	264	84	348	92,355	92,703	-
Agricultural	-	-	-	85,609	85,609	-
Consumer and other	63	-	63	15,700	15,763	-
	\$1,774	\$ 186	\$1,960	\$665,411	\$667,371	\$ 36

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The credit risk profile by internally assigned grade, on a disaggregated basis, as of September 30, 2015 and December 31, 2014 is as follows: *(in thousands)*

<b>2015</b>	Construction	Commercial	Agricultural	Commercial	Agricultural	Total
	Real Estate	Real Estate	Real Estate			
Pass	\$ 59,275	\$ 213,552	\$ 57,453	\$ 93,265	\$ 72,410	\$495,955
Watch	4,897	19,541	6,508	9,979	6,104	47,029
Special Mention	-	393	-	210	81	684
Substandard	1,025	5,995	164	2,021	336	9,541
Substandard-Impaired	-	611	-	206	11	828
	\$ 65,197	\$ 240,092	\$ 64,125	\$ 105,681	\$ 78,942	\$554,037

<b>2014</b>	Construction	Commercial	Agricultural	Commercial	Agricultural	Total
	Real Estate	Real Estate	Real Estate			
Pass	\$ 30,055	\$ 223,775	\$ 51,024	\$ 79,117	\$ 78,387	\$462,358
Watch	3,893	18,617	6,275	10,086	6,827	45,698
Special Mention	-	1,296	88	585	-	1,969
Substandard	1,873	12,532	62	2,376	395	17,238
Substandard-Impaired	195	834	-	539	-	1,568
	\$ 36,016	\$ 257,054	\$ 57,449	\$ 92,703	\$ 85,609	\$528,831

The credit risk profile based on payment activity, on a disaggregated basis, as of September 30, 2015 and December 31, 2014 is as follows:

<b>2015</b>	1-4 Family	Consumer	Total
	Residential Real Estate	and Other	
Performing	\$ 124,208	\$ 20,915	\$ 145,123
Non-performing	1,176	3	1,179
	\$ 125,384	\$ 20,918	\$ 146,302

<b>2014</b>	1-4 Family	Consumer	Total
	Residential Real Estate	and Other	

Performing	\$ 121,928	\$ 15,756	\$ 137,684
Non-performing	849	7	856
	\$ 122,777	\$ 15,763	\$ 138,540

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## 9. Other Real Estate Owned

The following table provides the composition of other real estate owned as of September 30, 2015 and December 31, 2014: *(in thousands)*

	<b>2015</b>	<b>2014</b>
Construction and land development	\$2,636	\$5,385
1 to 4 family residential real estate	601	1,270
Commercial real estate	181	1,781
	<b>\$3,418</b>	<b>\$8,436</b>

The Company is actively marketing the assets referred to 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.

## 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. 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. The following sets forth the carrying amounts and accumulated amortization of core deposit intangible assets at September 30, 2015 and December 31, 2014: *(in thousands)*

<b>2015</b>		<b>2014</b>	
Gross	Accumulated	Gross	Accumulated

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Amount Amortization    Amount Amortization

Core deposit intangible asset    \$2,518    \$ 1,114            \$2,518    \$ 788

The weighted average life of the core deposit intangible is 3 years as of September 30, 2015 and December 31, 2014.

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The following sets forth the activity related to core deposit intangible assets for the three and nine months ended September 30, 2015 and 2014: *(in thousands)*

	<b>Three Months Ended September 30, 2015</b>		<b>Nine Months Ended September 30, 2014</b>	
Beginning core deposit intangible, net	\$1,507	\$902	\$1,730	\$1,029
Acquisition	\$-	\$1,018	\$-	\$1,018
Amortization	(103 )	(77 )	(326 )	(204 )
Ending core deposit intangible, net	\$1,404	\$1,843	\$1,404	\$1,843

Estimated remaining amortization expense on core deposit intangible for the years ending December 31<sup>st</sup> is as follows:  
*(in thousands)*

2015	\$95
2016	354
2017	299
2018	251
2019	127
2020	71
After	207
	\$1,404

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## 12. Secured Borrowings

The following sets forth the pledged collateral at estimated fair value related to securities sold under repurchase agreements and term repurchase agreements as of September 30, 2015 and December 31, 2014: *(in thousands)*

	2015			2014		
	Overnight	Greater than 90 days	Total	Overnight	Greater than 90 days	Total
Securities sold under agreements to repurchase:						
U.S. government treasuries	\$1,479	\$-	\$1,479	\$1,447	\$-	\$1,447
U.S. government agencies	47,718	-	47,718	46,880	-	46,880
U.S. government mortgage-backed securities	42,508	-	42,508	51,472	-	51,472
<b>Total</b>	<b>\$91,705</b>	<b>\$-</b>	<b>\$91,705</b>	<b>\$99,799</b>	<b>\$-</b>	<b>\$99,799</b>
Term repurchase agreements:						
U.S. government agencies	\$-	\$14,607	\$14,607	\$-	\$12,151	\$12,151
U.S. government mortgage-backed securities	-	727	727	-	1,771	1,771
<b>Total</b>	<b>\$-</b>	<b>\$15,334</b>	<b>\$15,334</b>	<b>\$-</b>	<b>\$13,922</b>	<b>\$13,922</b>
<b>Total borrowings</b>	<b>\$91,705</b>	<b>\$15,334</b>	<b>\$107,039</b>	<b>\$99,799</b>	<b>\$13,922</b>	<b>\$113,721</b>

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

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## 13.Regulatory Matters

The Company and the Banks capital amounts and ratios are as follows:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2015:						
Total capital (to risk- weighted assets):						
Consolidated	\$ 159,220	16.8 %	\$ 75,723	8.0 %	N/A	N/A
Boone Bank & Trust	14,384	16.1	7,128	8.0	\$ 8,910	10.0 %
First National Bank	73,310	15.0	39,060	8.0	48,825	10.0
Reliance State Bank	23,883	14.1	13,521	8.0	16,901	10.0
State Bank & Trust	19,458	15.7	9,906	8.0	12,383	10.0
United Bank & Trust	14,531	20.4	5,712	8.0	7,140	10.0
Tier 1 capital (to risk- weighted assets):						
Consolidated	\$ 148,783	15.7 %	\$ 56,792	6.0 %	N/A	N/A
Boone Bank & Trust	13,420	15.1	5,346	6.0	\$ 7,128	8.0 %
First National Bank	68,300	14.0	29,295	6.0	39,060	8.0
Reliance State Bank	22,088	13.1	10,141	6.0	13,521	8.0
State Bank & Trust	17,909	14.5	7,430	6.0	9,906	8.0
United Bank & Trust	13,768	19.3	4,284	6.0	5,712	8.0
Tier 1 capital (to average- weighted assets):						
Consolidated	\$ 148,783	11.4 %	\$ 52,309	4.0 %	N/A	N/A
Boone Bank & Trust	13,420	10.1	5,322	4.0	\$ 6,652	5.0 %
First National Bank	68,300	9.6	28,327	4.0	35,409	5.0
Reliance State Bank	22,088	10.8	8,159	4.0	10,199	5.0
State Bank & Trust	17,909	11.2	6,390	4.0	7,987	5.0
United Bank & Trust	13,768	12.7	4,352	4.0	5,441	5.0
Common equity tier 1 capital (to risk-weighted assets):						
Consolidated	\$ 148,783	15.7 %	\$ 42,594	4.5 %	N/A	N/A
Boone Bank & Trust	13,420	15.1	4,010	4.5	\$ 5,792	6.5 %
First National Bank	68,300	14.0	21,971	4.5	31,736	6.5
Reliance State Bank	22,088	13.1	7,606	4.5	10,986	6.5
State Bank & Trust	17,909	14.5	5,572	4.5	8,049	6.5
United Bank & Trust	13,768	19.3	3,213	4.5	4,641	6.5



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	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2014:						
Total capital (to risk- weighted assets):						
Consolidated	\$151,146	16.6 %	\$72,879	8.0 %	N/A	N/A
Boone Bank & Trust	13,948	15.7	7,123	8.0	\$8,904	10.0 %
First National Bank	69,174	14.7	37,568	8.0	46,960	10.0
Reliance State Bank	21,727	13.2	13,166	8.0	16,457	10.0
State Bank & Trust	18,708	15.8	9,485	8.0	11,856	10.0
United Bank & Trust	14,089	21.3	5,295	8.0	6,618	10.0
Tier 1 capital (to risk- weighted assets):						
Consolidated	\$141,739	15.6 %	\$36,440	4.0 %	N/A	N/A
Boone Bank & Trust	13,084	14.7	3,562	4.0	\$5,342	6.0 %
First National Bank	65,112	13.9	18,784	4.0	28,176	6.0
Reliance State Bank	19,966	12.1	6,583	4.0	9,874	6.0
State Bank & Trust	17,224	14.5	4,742	4.0	7,113	6.0
United Bank & Trust	13,313	20.1	2,647	4.0	3,971	6.0
Tier 1 capital (to average- weighted assets):						
Consolidated	\$141,739	11.0 %	\$51,604	4.0 %	N/A	N/A
Boone Bank & Trust	13,084	9.8	5,325	4.0	\$6,656	5.0 %
First National Bank	65,112	9.4	27,671	4.0	34,589	5.0
Reliance State Bank	19,966	9.6	8,321	4.0	10,402	5.0
State Bank & Trust	17,224	10.9	6,318	4.0	7,898	5.0
United Bank & Trust	13,313	12.3	4,315	4.0	5,394	5.0

The September 30, 2015 capital ratios are calculated under the Basel III capital rules that became effective on January 1, 2015. Capital ratios prior to January 1, 2015 were calculated under the prompt corrective capital rules that were in effect for those periods.

As disclosed in the Company's Form 10-K filed with the Securities and Exchange Commission on March 12, 2015, in July of 2013, the Federal Reserve Board and the FDIC issued final rules implementing the Basel III regulatory capital framework and related Dodd-Frank Wall Street Reform and Consumer Protection Act changes. The rules revise minimum capital requirements and adjust prompt corrective action thresholds. The final rules revise the regulatory capital elements, add a new common equity Tier I capital ratio, increase the minimum Tier 1 capital ratio requirements and implement a new capital conservation buffer. The rules also permit certain banking organizations to

retain, through a one-time election, the existing treatment for accumulated other comprehensive income. The Company and the Banks have made the election to retain the existing treatment for accumulated other comprehensive income. The final rules took effect for the Company and the Banks on January 1, 2015, subject to a transition period for certain parts of the rules.

The September 30, 2015 table above includes the new regulatory capital ratio requirements that became effective on January 1, 2015. Beginning in 2016, an additional capital conservation buffer will be added to the minimum requirements for capital adequacy purposes, subject to a three year phase-in period. The capital conservation buffer will be fully phased-in on January 1, 2019 at 2.5 percent. A banking organization with a conservation buffer of less than 2.5 percent (or the required phase-in amount in years prior to 2019) will be subject to limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers. At the present time, the ratios for the Company and the Banks are sufficient to meet the fully phased-in conservation buffer.

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14. 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, 2015, but prior to November 6, 2015, that provided additional evidence about conditions that existed at September 30, 2015. There were no other significant events or transactions that provided evidence about conditions that did not exist at September 30, 2015.

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

**Overview**

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

The Company does not engage in any material business activities apart from its ownership of the Banks. Products and services offered by the Banks are for commercial and consumer purposes including loans, deposits and wealth management services. The Banks also offer investment services through a third-party broker-dealer. The Company employs thirteen individuals to assist with financial reporting, human resources, audit, compliance, marketing, technology systems and the coordination of management activities, in addition to 207 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.

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) Merchant and card fees. The Company's principal expenses are: (i) interest expense on deposit accounts and other borrowings; (ii) provision for loan losses; (iii) salaries and employee benefits; (iv) data processing costs associated with maintaining the Banks' loan and deposit functions; (v) occupancy expenses for maintaining the Bank's facilities; (vi) professional fees; and (vii) other real estate owned expenses. 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.

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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 operates all three bank offices previously operated by First Bank in West Des Moines, Iowa and Johnston, Iowa.

The Company had net income of \$4,100,000, or \$0.44 per share, for the three months ended September 30, 2015, compared to net income of \$3,731,000, or \$0.40 per share, for the three months ended September 30, 2014. Total equity capital as of September 30, 2015 totaled \$160.4 million or 11.9% of total assets.

The increase in quarterly earnings can be primarily attributed to increased loan interest income driven by a higher loan volume from loans acquired as well as new loan originations.

Net loan recoveries totaled \$17,000 for the three months ended September 30, 2015 and net loan charge-offs totaled \$42,000 for the three months ended September 30, 2014. The provision for loan losses totaled \$38,000 and \$55,000 for the three months ended September 30, 2015 and 2014, respectively.

The Company had net income of \$11,100,000, or \$1.19 per share, for the nine months ended September 30, 2015, compared to net income of \$12,113,000, or \$1.30 per share, for the nine months ended September 30, 2014.

The decrease in year-to-date earnings can be primarily attributed to the one-time gain on the sale of premises and equipment in 2014 of \$1,242,000 with no corresponding gain in 2015, higher provision for loan losses, increased noninterest expense associated with the Acquisition and other real estate owned impairment write downs.

Net loan recoveries totaled \$51,000 for the nine months ended September 30, 2015 and net loan charge-offs totaled \$172,000 for the nine months ended September 30, 2014. The provision for loan losses totaled \$1,037,000 and \$130,000 for the nine months ended September 30, 2015 and 2014, 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

## **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, 2015.

## **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 6,348 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.

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## Selected Indicators for the Company and the Industry

	<b>3 Months Ended September 30, 2015</b>		<b>9 Months Ended</b>		<b>3 Months Ended June 30, 2015</b>		<b>Years Ended December 31, 2014</b>				<b>2013</b>			
	Company		Company		Company*		Company		Industry		Company		Industry	
Return on assets	1.24 %	1.12 %	1.01 %	1.09 %	1.21 %	1.01 %	1.14 %	1.07 %						
Return on equity	10.35 %	9.36 %	8.48 %	9.74 %	10.09 %	9.03 %	9.76 %	9.56 %						
Net interest margin	3.36 %	3.32 %	3.32 %	3.06 %	3.31 %	3.14 %	3.18 %	3.26 %						
Efficiency ratio	50.74 %	53.45 %	54.88 %	59.22 %	53.37 %	61.88 %	52.78 %	60.54 %						
Capital ratio	12.00 %	11.93 %	11.86 %	9.53 %	12.05 %	9.46 %	11.67 %	9.41 %						

\*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 1.24% and 1.20% for the three months ended September 30, 2015 and 2014, respectively. The increase in this ratio in 2015 from the previous period is due to an increase in net income attributed primarily to interest income associated with an increase in average loan balances in 2015.

## 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 10.35% and 9.73% for the three months ended September 30, 2015 and 2014, respectively. The increase in this ratio in 2015 from the previous period is due to the increase in net income attributed primarily to interest income associated with an increase in average loan balances in 2015.

#### Net Interest Margin

The net interest margin for the three months ended September 30, 2015 and 2014 was 3.36% and 3.32%, 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 2015 is primarily the result of an increase in the average balance of loans, offset in part by a decrease in the average balances of investment securities.

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### 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 50.74% and 52.24% for the three months ended September 30, 2015 and 2014, respectively. The decrease in the efficiency ratio in 2015 from the previous period is primarily the result higher loan 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 12.00% as of September 30, 2015 is significantly higher than the industry average as of June 30, 2015.

### Industry Results

The FDIC Quarterly Banking Profile reported the following results for the second quarter of 2015:

#### Improving Earnings Trend Remains Broad-Based

FDIC-insured commercial banks and savings institutions earned \$43 billion in net income in second quarter 2015, an increase of \$2.9 billion (7.3 percent) compared with second quarter 2014. Higher net operating revenue and lower noninterest expenses outweighed increased expenses for loan-loss provisions. Almost 60 percent of all banks—58.9 percent—reported year-over-year growth in quarterly net income, while only 5.6 percent were unprofitable in the quarter. In second quarter 2014, 6.8 percent of all banks reported net losses. The average return on assets rose slightly to 1.09 percent, from 1.07 percent in the 2014 quarter.

#### Margins Rebound Slightly From 30-Year Low

Net operating revenue—the sum of net interest income and total noninterest income—totaled \$172.9 billion in the quarter, up \$3.6 billion (2.1 percent) from the year before. More than two-thirds of all banks—67.9 percent— reported higher net operating income. Net interest income increased by \$2.4 billion (2.3 percent), as average interest-bearing assets were 5.3 percent higher than a year earlier. The industry net interest margin of 3.06 percent was down from 3.15 percent in second quarter 2014, but was up slightly from the 30-year low of 3.02 percent in first quarter 2015. Noninterest income rose by \$1.2 billion (1.9 percent), as servicing income grew by \$1.8 billion (63.9 percent), and trading revenue declined by \$904 million (14.1 percent).

#### Net Charge-Off Rate Improves to Pre-Crisis Level

Net charge-offs declined for a 20th consecutive quarter, falling \$1.1 billion (11.2 percent) from the 2014 level. The average net charge-off rate fell to 0.42 percent in the quarter, down from 0.50 percent the year before. This is the lowest quarterly charge-off rate for the industry since third quarter 2006. Charge-offs were down, year over year, in all major loan categories except commercial and industrial (C&I) loans and auto loans. C&I net charge-offs were \$146 million (15.7 percent) higher than the 2014 quarter, while auto loan charge-offs were up \$71 million (21.2 percent).

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Noncurrent Rate Continues to Improve

The amount of noncurrent loans and leases (90 days or more past due or in nonaccrual status) fell by \$8.3 billion (5.4 percent) during the three months ended June 30. This is the 21st consecutive quarterly decline in noncurrent loan balances. Noncurrent C&I loans increased by \$1.5 billion (15.4 percent) during the quarter, and noncurrent auto loans rose by \$40 million (4.4 percent). Noncurrent levels declined in all other major loan categories, led by a \$6.4 billion (6.7 percent) decline in noncurrent residential mortgage loans. At the end of June, more than a third of the industry's \$144.7 billion in noncurrent loan balances (\$50 billion, or 34.6 percent) consisted of loans with U.S. government guarantees, or loans covered by loss-sharing agreements with the FDIC.

Banks Continue to Release Reserves

Insured institutions reduced their loan-loss reserves for a 21st consecutive quarter. Reserve balances declined by \$1.4 billion (1.2 percent) during the quarter, as net charge-offs of \$8.9 billion exceeded loan-loss provisions of \$8.1 billion. This is the smallest quarterly decline in industry reserves since banks began reducing them in second quarter 2010. The industry's ratio of reserves to total loans and leases fell from 1.45 percent to 1.40 percent during the quarter. This is the lowest average since year-end 2007. However, the average coverage ratio of reserves to noncurrent loans rose for the 11th quarter in a row, from 79.1 percent to 82.7 percent, because of the decline in noncurrent loan balances.

Capital Growth Is Modest

Banks added \$4.5 billion to equity capital during the quarter. The modest 0.3 percent increase reflected a reduced contribution from retained earnings and a decline in unrealized gains in available-for-sale securities portfolios. Retained earnings totaled \$14.4 billion, which was \$3.8 billion (20.9 percent) less than in second quarter 2014. Banks declared \$28.6 billion in dividends in the second quarter, up \$6.7 billion (30.8 percent) versus the 2014 quarter. Higher interest rates lowered the market values of securities portfolios. Accumulated other comprehensive income, a component of equity capital that includes unrealized gains on securities held for sale, declined by \$12.9 billion. The industry's equity-to-assets ratio rose from 11.18 percent to 11.23 percent during the quarter. At mid-year, 98.6 percent of all FDIC-insured institutions, representing 99.9 percent of industry assets, met or exceeded the requirements for well-capitalized banks, as defined for Prompt Corrective Action purposes.

Non-Operational Deposit Balances Decline

Total deposit balances fell by \$25.8 billion (0.2 percent), as at least one large bank reduced its non-operational deposits (wholesale funds in excess of the level needed to provide operational services to wholesale customers) to avoid a regulatory capital surcharge. Deposits in foreign offices declined by \$34.1 billion (2.5 percent), and domestic office deposits rose by \$8.3 billion (0.1 percent). Domestic deposits in interest-bearing accounts fell by \$37.1 billion (0.5 percent), while noninterest-bearing deposits increased by \$45.4 billion (1.5 percent). Nondeposit liabilities declined by \$34.1 billion, as trading liabilities fell by \$57.9 billion (18.9 percent). Federal Home Loan Bank advances rose by \$40.7 billion (9.4 percent), and other unsecured borrowings increased by \$38.6 billion (13.1 percent).

#### Only One Bank Failure in the Quarter

The number of insured commercial banks and savings institutions reporting quarterly financial results in the second quarter fell to 6,348 from 6,419 reporters in the first quarter. During the quarter, 66 institutions were merged into other banks, while one insured institution failed. This is the first time since fourth quarter 2007 that there has been only one failure in a quarter. For a sixth consecutive quarter, no new charters were added. Banks reported 2,042,386 full-time equivalent employees in the second quarter, down from 2,042,688 in the first quarter and 2,059,827 in second quarter 2014. The number of insured institutions on the FDIC's "Problem List" declined for a 17th consecutive quarter, from 253 to 228. Total assets of problem institutions fell from \$60.3 billion to \$56.5 billion.

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**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, 2014 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.

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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, 2015, no conditions indicated impairment has incurred. The next annual test will be performed in the fourth quarter of 2015. 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, 2015**

The following highlights a comparative discussion of the major components of net income and their impact for the three months ended September 30, 2015 and 2014:

**AVERAGE BALANCES AND INTEREST RATES**

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

**AVERAGE BALANCE SHEETS AND INTEREST RATES**

	<b>Three Months Ended September 30,</b>					
	<b>2015</b>			<b>2014</b>		
	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
<b>ASSETS</b>						
<i>(dollars in thousands)</i>						
Interest-earning assets						
Loans 1						
Commercial	\$101,382	\$ 1,124	4.44 %	\$86,166	\$ 950	4.41 %
Agricultural	77,403	914	4.72 %	71,628	859	4.79 %
Real estate	490,282	5,585	4.56 %	413,355	4,745	4.59 %
Consumer and other	19,505	185	3.80 %	14,163	168	4.74 %
Total loans (including fees)	688,572	7,808	4.54 %	585,312	6,722	4.59 %
Investment securities						
Taxable	276,205	1,507	2.18 %	302,713	1,792	2.37 %
Tax-exempt 2	261,882	2,205	3.37 %	272,817	2,366	3.47 %
Total investment securities	538,087	3,712	2.76 %	575,530	4,158	2.89 %
Interest bearing deposits with banks and federal funds sold	38,397	94	0.98 %	26,386	67	1.01 %

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Total interest-earning assets	1,265,056	\$ 11,614	3.67 %	1,187,228	\$ 10,947	3.69 %
Noninterest-earning assets	55,804			61,693		
TOTAL ASSETS	\$1,320,860			\$1,248,921		

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,**

	<b>2015</b>			<b>2014</b>		
	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>						
<i>(dollars in thousands)</i>						
Interest-bearing liabilities						
Deposits						
NOW, savings accounts and money markets	\$ 655,533	\$ 288	0.18 %	\$ 581,618	\$ 262	0.18 %
Time deposits > \$100,000	89,196	199	0.89 %	95,774	227	0.95 %
Time deposits < \$100,000	136,131	258	0.76 %	144,915	314	0.87 %
Total deposits	880,860	745	0.34 %	822,307	803	0.39 %
Other borrowed funds	81,583	258	1.26 %	100,597	299	1.19 %
Total Interest-bearing liabilities	962,443	1,003	0.42 %	922,904	1,102	0.48 %
Noninterest-bearing liabilities						
Demand deposits	193,518			166,219		
Other liabilities	6,431			6,425		
Stockholders' equity	158,468			153,373		
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 1,320,860</b>			<b>\$ 1,248,921</b>		
Net interest income		\$ 10,611	3.36 %		\$ 9,845	3.32 %
Spread Analysis						
Interest income/average assets	\$ 11,614	3.52 %		\$ 10,947	3.51 %	
	\$ 1,003	0.30 %		\$ 1,102	0.35 %	

Interest expense/average  
assets

Net interest income/average assets	\$ 10,611	3.21	%	\$ 9,845	3.15	%
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#### Net Interest Income

For the three months ended September 30, 2015 and 2014, the Company's net interest margin adjusted for tax exempt income was 3.36% and 3.32%, respectively. Net interest income, prior to the adjustment for tax-exempt income, for the three months ended September 30, 2015 totaled \$9,840,000 compared to \$9,018,000 for the three months ended September 30, 2014.

For the three months ended September 30, 2015, interest income increased \$723,000, or 7.1%, when compared to the same period in 2014. The increase from 2014 was primarily attributable to higher average balance of loans, offset in part by lower average balances of investment securities. The higher average balances of loans were due primarily to favorable economic conditions that fueled loan demand and to a lesser extent the Acquisition. The lower average balances of investments were primarily due to maturities and calls.

Interest expense decreased \$100,000, or 9.1%, for the three months ended September 30, 2015 when compared to the same period in 2014. The lower interest expense for the period is primarily attributable to lower average rates paid on time deposits due to continued low market interest rates and a decrease in average balance of other borrowed funds.

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Provision for Loan Losses

The Company's provision for loan losses was \$38,000 and \$55,000 for the three months ended September 30, 2015 and 2014, respectively. Net loan recoveries were \$17,000 and net loan charge-offs were \$42,000 for the three months ended September 30, 2015 and 2014, respectively. Asset quality indicators for the Company, including impaired and past due loans, remain at favorable levels.

Noninterest Income and Expense

Noninterest income increased \$121,000 for the three months ended September 30, 2015 compared to the same period in 2014. The increase in noninterest income is primarily due to higher merchant and card fees and a higher gain on the sale of securities. The increase in merchant and card income is due primarily to the Acquisition. Exclusive of realized securities gains, noninterest income was 5% higher in the third quarter of 2015 compared to the same period in 2014.

Noninterest expense increased \$316,000 or 5.6% for the three months ended September 30, 2015 compared to the same period in 2014 primarily as a result of increases in salaries and benefits. Salaries and benefits increased primarily due to the Acquisition and normal salary increases. The efficiency ratio for the third quarter of 2015 was 50.74%, compared to 52.24% in 2014.

Income Taxes

The provision for income taxes expense for the three months ended September 30, 2015 and 2014 was \$1,670,000 and \$1,393,000, respectively, representing an effective tax rate of 29% and 27%, respectively. The increase in effective rate is due primarily to impact of a lower level of tax-exempt interest income in 2015 compared to the same quarter in 2014.

Table Of Contents**Income Statement Review for the Nine Months ended September 30, 2015**

The following highlights a comparative discussion of the major components of net income and their impact for the nine months ended September 30, 2015 and 2014:

**AVERAGE BALANCES AND INTEREST RATES**

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

**AVERAGE BALANCE SHEETS AND INTEREST RATES**

	<b>Nine Months Ended September 30,</b>					
	<b>2015</b>			<b>2014</b>		
	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
<b>ASSETS</b>						
<i>(dollars in thousands)</i>						
Interest-earning assets						
Loans 1						
Commercial	\$97,028	\$ 3,305	4.54 %	\$84,543	\$ 2,929	4.62 %
Agricultural	76,044	2,689	4.71 %	71,322	2,576	4.82 %
Real estate	485,392	16,394	4.50 %	397,728	13,723	4.60 %
Consumer and other	17,766	532	3.99 %	13,365	480	4.79 %
Total loans (including fees)	676,230	22,920	4.52 %	566,958	19,708	4.63 %
Investment securities						
Taxable	276,287	4,639	2.24 %	300,219	5,407	2.40 %
Tax-exempt 2	264,631	6,766	3.41 %	286,756	7,470	3.47 %
Total investment securities	540,918	11,405	2.81 %	586,975	12,877	2.93 %
Interest bearing deposits with banks and federal funds sold	46,608	288	0.83 %	36,583	213	0.78 %

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Total interest-earning assets	1,263,756	\$ 34,613	3.65 %	1,190,516	\$ 32,798	3.67 %
Noninterest-earning assets	61,607			57,785		
TOTAL ASSETS	\$1,325,363			\$1,248,301		

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,****2015****2014**

	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>						
<i>(dollars in thousands)</i>						
Interest-bearing liabilities						
Deposits						
NOW, savings accounts and money markets	\$651,101	\$ 847	0.17 %	\$601,347	\$ 855	0.19 %
Time deposits > \$100,000	90,706	613	0.90 %	95,839	705	0.98 %
Time deposits < \$100,000	140,515	816	0.77 %	143,385	997	0.93 %
Total deposits	882,322	2,276	0.34 %	840,571	2,557	0.41 %
Other borrowed funds	86,535	899	1.38 %	82,650	898	1.45 %
Total Interest-bearing liabilities	968,857	3,175	0.44 %	923,221	3,455	0.50 %