

AMES NATIONAL CORP
Form 10-Q
August 07, 2018

Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[Mark One]

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

For the quarterly period ended June 30, 2018

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

For the transition period from _____ to _____

Commission File Number 0-32637

AMES NATIONAL CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

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

Incorporation or Organization) Identification Number)

405 FIFTH STREET

AMES, IOWA 50010

(Address of Principal Executive Offices)

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

Not Applicable

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

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

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

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

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

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

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

COMMON STOCK, \$2.00 PAR VALUE 9,310,913
(Class) (Shares Outstanding at July 31, 2018)

Table of Contents

AMES NATIONAL CORPORATION

INDEX

Page

Part I. Financial Information

Item 1.	<u>Consolidated Financial Statements (Unaudited)</u>	3
	<u>Consolidated Balance Sheets at June 30, 2018 and December 31, 2017</u>	3
	<u>Consolidated Statements of Income for the three and six months ended June 30, 2018 and 2017</u>	4
	<u>Consolidated Statements of Comprehensive Income for the three and Six months ended June 30, 2018 and 2017</u>	5
	<u>Consolidated Statements of Stockholders' Equity for the six months ended June 30, 2018 and 2017</u>	6
	<u>Consolidated Statements of Cash Flows for the six months ended June 30, 2018 and 2017</u>	7
	<u>Notes to Consolidated Financial Statements</u>	9
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	30
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	50
Item 4.	<u>Controls and Procedures</u>	50
Part II.	<u>Other Information</u>	
Item 1.	<u>Legal Proceedings</u>	50
Item 1.A.	<u>Risk Factors</u>	50
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	51
Item 3.	<u>Defaults Upon Senior Securities</u>	51
Item 4.	<u>Mine Safety Disclosures</u>	51
Item 5.	<u>Other Information</u>	51

Item 6.	<u>Exhibits</u>	52
	<u>Signatures</u>	53

2

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

	June 30, 2018	December 31, 2017
ASSETS		
Cash and due from banks	\$20,554,902	\$26,397,550
Interest bearing deposits in financial institutions	41,831,023	43,021,953
Securities available-for-sale	478,733,417	495,321,664
Federal Home Loan Bank (FHLB) and Federal Reserve Bank (FRB) stock, at cost	2,561,200	3,021,200
Loans receivable, net	780,259,704	771,549,655
Loans held for sale	1,480,648	-
Bank premises and equipment, net	15,203,655	15,399,146
Accrued income receivable	7,755,177	8,382,391
Other real estate owned	385,509	385,509
Deferred income taxes, net	4,135,552	2,542,533
Intangible assets, net	934,968	1,091,462
Goodwill	6,732,216	6,732,216
Other assets	1,486,743	1,214,371
Total assets	\$1,362,054,714	\$1,375,059,650
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits		
Demand, noninterest bearing	\$218,222,877	\$227,332,347
NOW accounts	338,858,159	322,392,945
Savings and money market	400,566,104	389,630,180
Time, \$250,000 and over	39,727,075	38,838,782
Other time	154,440,954	156,196,433
Total deposits	1,151,815,169	1,134,390,687
Securities sold under agreements to repurchase	34,107,530	37,424,619
Federal Home Loan Bank (FHLB) advances	2,000,000	13,500,000
Other borrowings	-	13,000,000
Dividends payable	2,141,510	2,048,401
Accrued expenses and other liabilities	4,049,475	3,942,801
Total liabilities	1,194,113,684	1,204,306,508
STOCKHOLDERS' EQUITY		
Common stock, \$2 par value, authorized 18,000,000 shares; issued and outstanding 9,310,913 shares as of June 30, 2018 and December 31, 2017	18,621,826	18,621,826

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

Additional paid-in capital	20,878,728	20,878,728
Retained earnings	133,510,931	131,684,961
Accumulated other comprehensive (loss) - net unrealized (loss) on securities available-for-sale	(5,070,455)	(432,373)
Total stockholders' equity	167,941,030	170,753,142
Total liabilities and stockholders' equity	\$1,362,054,714	\$1,375,059,650

See Notes to Consolidated Financial Statements.

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Interest income:				
Loans, including fees	\$8,996,222	\$8,499,729	\$17,885,077	\$16,615,414
Securities:				
Taxable	1,590,138	1,566,707	3,146,976	3,079,626
Tax-exempt	1,179,607	1,290,808	2,365,953	2,608,870
Interest bearing deposits and federal funds sold	229,726	113,353	395,045	250,526
Total interest income	11,995,693	11,470,597	23,793,051	22,554,436
Interest expense:				
Deposits	1,633,395	1,113,389	2,995,876	2,034,819
Other borrowed funds	151,463	291,343	399,853	570,744
Total interest expense	1,784,858	1,404,732	3,395,729	2,605,563
Net interest income	10,210,835	10,065,865	20,397,322	19,948,873
Provision for loan losses	63,978	766,769	92,978	1,164,343
Net interest income after provision for loan losses	10,146,857	9,299,096	20,304,344	18,784,530
Noninterest income:				
Wealth management income	906,364	734,375	1,657,364	1,433,307
Service fees	334,606	365,753	672,848	724,885
Securities gains, net	-	95,644	-	460,679
Gain on sale of loans held for sale	191,385	226,530	368,585	364,542
Merchant and card fees	366,863	353,479	676,522	668,515
Other noninterest income	191,654	249,367	379,555	453,838
Total noninterest income	1,990,872	2,025,148	3,754,874	4,105,766
Noninterest expense:				
Salaries and employee benefits	4,316,823	3,986,327	8,884,868	8,031,971
Data processing	887,358	850,133	1,668,390	1,673,912
Occupancy expenses, net	459,445	475,556	954,391	1,019,586
FDIC insurance assessments	102,073	111,140	208,068	214,971
Professional fees	354,998	313,528	700,405	611,673
Business development	238,811	222,720	493,359	460,461
Intangible asset amortization	83,919	92,174	171,454	190,976
Other operating expenses, net	269,636	347,836	497,265	672,588

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

Total noninterest expense	6,713,063	6,399,414	13,578,200	12,876,138
Income before income taxes	5,424,666	4,924,830	10,481,018	10,014,158
Provision for income taxes	1,107,400	1,452,500	2,127,000	2,931,700
Net income	\$4,317,266	\$3,472,330	\$8,354,018	\$7,082,458
Basic and diluted earnings per share	\$0.46	\$0.37	\$0.90	\$0.76
Dividends declared per share	\$0.23	\$0.22	\$0.71	\$0.44

See Notes to Consolidated Financial Statements.

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Net income	\$4,317,266	\$3,472,330	\$8,354,018	\$7,082,458
Other comprehensive income (loss), before tax:				
Unrealized gains (losses) on securities before tax:				
Unrealized holding gains (losses) arising during the period	(1,041,258)	3,417,455	(6,074,301)	6,099,537
Less: reclassification adjustment for gains realized in net income	-	95,644	-	460,679
Other comprehensive income (loss), before tax	(1,041,258)	3,321,811	(6,074,301)	5,638,858
Tax effect related to other comprehensive income (loss)	260,314	(1,229,071)	1,518,919	(2,086,378)
Other comprehensive income (loss), net of tax	(780,944)	2,092,740	(4,555,382)	3,552,480
Comprehensive income	\$3,536,322	\$5,565,070	\$3,798,636	\$10,634,938

See Notes to Consolidated Financial Statements.

Table of Contents

AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(unaudited)

Six Months Ended June 30, 2018 and 2017

	Common Stock	Additional Paid- in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net of Taxes	Total Stockholders' Equity
Balance, December 31, 2016	\$18,621,826	\$20,878,728	\$126,181,376	\$ (576,687)	\$165,105,243
Net income	-	-	7,082,458	-	7,082,458
Other comprehensive income	-	-	-	3,552,480	3,552,480
Cash dividends declared, \$0.44 per share	-	-	(4,096,802)	-	(4,096,802)
Balance, June 30, 2017	\$18,621,826	\$20,878,728	\$129,167,032	\$ 2,975,793	\$171,643,379
Balance, December 31, 2017	\$18,621,826	\$20,878,728	\$131,684,961	\$ (432,373)	\$170,753,142
Net income	-	-	8,354,018	-	8,354,018
Other comprehensive (loss)	-	-	-	(4,555,382)	(4,555,382)
The cumulative effect from change in accounting policy (1)	-	-	82,700	(82,700)	-
Cash dividends declared, \$0.71 per share	-	-	(6,610,748)	-	(6,610,748)
Balance, June 30, 2018	\$18,621,826	\$20,878,728	\$133,510,931	\$ (5,070,455)	\$167,941,030

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

See Notes to Consolidated Financial Statements.

6

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

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$8,354,018	\$7,082,458
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	92,978	1,164,343
Provision for off-balance sheet commitments	12,000	10,000
Amortization, net	1,088,865	1,423,539
Amortization of intangible asset	171,454	190,976
Depreciation	548,173	567,889
Deferred income taxes	(74,100)	(314,501)
Securities gains, net	-	(460,679)
(Gain) on sales of loans held for sale	(368,586)	(364,542)
Proceeds from loans held for sale	14,853,787	14,927,797
Originations of loans held for sale	(15,965,849)	(14,864,320)
Loss on sale of premises and equipment, net	5,563	31,557
(Gain) on sale of other real estate owned, net	-	(11,573)
Change in assets and liabilities:		
Decrease in accrued income receivable	627,214	355,296
(Increase) decrease in other assets	(282,739)	(127,899)
Increase (decrease) in accrued expenses and other liabilities	94,674	(176,469)
Net cash provided by operating activities	9,157,452	9,433,872
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of securities available-for-sale	(21,743,179)	(43,240,669)
Proceeds from sale of securities available-for-sale	-	10,823,579
Proceeds from maturities and calls of securities available-for-sale	30,931,429	34,222,958
Purchase of FHLB stock	(874,400)	(1,773,600)
Proceeds from the redemption of FHLB stock	1,334,400	1,744,000
Net decrease in interest bearing deposits in financial institutions	1,190,930	3,610,960
Net (increase) in loans	(8,566,196)	(17,142,504)
Net proceeds from the sale of other real estate owned	-	148,639
Purchase of bank premises and equipment, net	(347,878)	(384,819)
Other	(14,960)	(50,634)
Net cash provided by (used in) investing activities	1,910,146	(12,042,090)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in deposits	17,424,482	17,361,911
(Decrease) in securities sold under agreements to repurchase	(3,317,089)	(19,654,099)

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

Payments on FHLB borrowings and other borrowings	(24,500,000)	(1,000,000)
Dividends paid	(6,517,639)	(4,003,693)
Net cash (used in) financing activities	(16,910,246)	(7,295,881)
Net (decrease) in cash and due from banks	(5,842,648)	(9,904,099)
CASH AND DUE FROM BANKS		
Beginning	26,397,550	29,478,068
Ending	\$20,554,902	\$19,573,969

See Notes to Consolidated Financial Statements.

Table of Contents

AMES NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(unaudited)

Six Months Ended June 30, 2018 and 2017

	2018	2017
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash payments for:		
Interest	\$3,318,116	\$2,595,215
Income taxes	2,346,406	3,468,613
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES		
Transfer of loans receivable to other real estate owned	\$-	\$16,668

See Notes to Consolidated Financial Statements.

Table of Contents

AMES NATIONAL CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements (*unaudited*)

1. Significant Accounting Policies

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

Table of Contents

2. Dividends

On May 9, 2018, the Company declared a cash dividend on its common stock, payable on August 15, 2018 to stockholders of record as of August 1, 2018, equal to \$0.23 per share

3. 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 six months ended June 30, 2018 and 2017 were 9,310,913. The Company had no potentially dilutive securities outstanding during the periods presented.

4. Off-Balance Sheet Arrangements

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

5. Fair Value Measurements

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

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

Level 2: Inputs to the valuation methodology include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatility, prepayment speeds, credit risk); or inputs derived principally from or can be corroborated by observable market data by correlation or other means.

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

Table of Contents

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

Description	Total	Level 1	Level 2	Level 3
2018				
U.S. government treasuries	\$6,762	\$6,762	\$-	\$ -
U.S. government agencies	118,970	-	118,970	-
U.S. government mortgage-backed securities	75,604	-	75,604	-
State and political subdivisions	223,227	-	223,227	-
Corporate bonds	54,170	-	54,170	-
	\$478,733	\$6,762	\$471,971	\$ -
2017				
U.S. government treasuries	\$6,367	\$6,367	\$-	\$ -
U.S. government agencies	111,263	-	111,263	-
U.S. government mortgage-backed securities	81,780	-	81,780	-
State and political subdivisions	237,413	-	237,413	-
Corporate bonds	58,464	-	58,464	-
Equity securities, other	35	35	-	-
	\$495,322	\$6,402	\$488,920	\$ -

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

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

Table of Contents

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

Description	Total	Level 1	Level 2	Level 3
2018				
Loans receivable	\$2,447	\$ -	\$ -	\$2,447
Other real estate owned	386	-	-	386
Total	\$2,833	\$ -	\$ -	\$2,833
2017				
Loans receivable	\$2,606	\$ -	\$ -	\$2,606
Other real estate owned	386	-	-	386
Total	\$2,992	\$ -	\$ -	\$2,992

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

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

Table of Contents

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

		2018			
	Estimated Fair Value	Valuation Techniques	Unobservable Inputs	Range (Average)	
Impaired Loans	\$2,447	Evaluation of collateral	Estimation of value	NM*	
Other real estate owned	\$386	Appraisal	Appraisal adjustment	6% - 8% (7%)	
		2017			
	Estimated Fair Value	Valuation Techniques	Unobservable Inputs	Range (Average)	
Impaired Loans	\$2,606	Evaluation of collateral	Estimation of value	NM*	
Other real estate owned	\$386	Appraisal	Appraisal adjustment	6% - 8% (7%)	

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

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

Fair value of financial instruments:

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

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

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

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

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

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

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

		2018		2017	
	Fair Value Hierarchy Level	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:					
Cash and due from banks	Level 1	\$20,555	\$20,555	\$26,398	\$26,398
Interest bearing deposits	Level 1	41,831	41,831	43,022	43,022
Securities available-for-sale	See previous table	478,733	478,733	495,322	495,322
FHLB and FRB stock	Level 2	2,561	2,561	3,021	3,021
Loans receivable, net	Level 2	780,260	756,494	771,550	768,444
Loans held for sale	Level 2	1,481	1,481	-	-
Accrued income receivable	Level 1	7,755	7,755	8,382	8,382
Financial liabilities:					
Deposits	Level 2	\$1,151,815	\$1,150,690	\$1,134,391	\$1,134,468
Securities sold under agreements to repurchase	Level 1	34,108	34,108	37,425	37,425
FHLB advances	Level 2	2,000	1,945	13,500	13,482
Other borrowings	Level 2	-	-	13,000	13,079
Accrued interest payable	Level 1	486	486	477	477

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

Table of Contents

6. Debt and Equity Securities

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

2018:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government treasuries	\$ 6,924	\$ -	\$ (162)	\$ 6,762
U.S. government agencies	121,229	23	(2,282)	118,970
U.S. government mortgage-backed securities	76,945	122	(1,463)	75,604
State and political subdivisions	224,760	604	(2,137)	223,227
Corporate bonds	55,636	3	(1,469)	54,170
	\$ 485,494	\$ 752	\$ (7,513)	\$ 478,733

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

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

Three Months Ended June 30, 2018	Six Months Ended June 30, 2017
---	--

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

Proceeds from sales of securities available-for-sale	\$-	\$183	\$-	\$10,824
Gross realized gains on securities available-for-sale	-	96	-	463
Gross realized losses on securities available-for-sale	-	-	-	(2)
Tax provision applicable to net realized gains on securities available-for-sale	-	33	-	161

Table of Contents

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

	Less than 12 Months		12 Months or More		Total	
	Estimated	Unrealized	Estimated	Unrealized	Estimated	Unrealized
2018:	Fair	Losses	Fair	Losses	Fair	Losses
	Value		Value		Value	
Securities available-for-sale:						
U.S. government treasuries	\$6,762	\$ (162)	\$-	\$ -	\$6,762	\$ (162)
U.S. government agencies	101,386	(1,876)	9,591	(406)	110,977	(2,282)
U.S. government mortgage-backed securities	60,872	(1,286)	5,797	(177)	66,669	(1,463)
State and political subdivisions	103,605	(1,419)	18,221	(718)	121,826	(2,137)
Corporate bonds	45,413	(1,067)	6,471	(402)	51,884	(1,469)
	\$318,038	\$ (5,810)	\$40,080	\$ (1,703)	\$358,118	\$ (7,513)

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

Gross unrealized losses on debt securities totaled \$7,513,000 as of June 30, 2018. These unrealized losses are generally due to changes in interest rates or general market conditions. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, state or political subdivision, or corporations. Management then determines whether downgrades by bond rating agencies have occurred, and reviews industry analysts' reports. The Company's procedures for evaluating investments in states, municipalities and political subdivisions include but are not limited to reviewing the offering statement and the most current available financial information, comparing yields to yields of bonds of similar credit quality, confirming capacity to repay, assessing operating and financial performance, evaluating the stability of tax revenues, considering debt profiles and local demographics, and for revenue bonds, assessing the source and strength of revenue structures for municipal authorities. These procedures, as applicable, are utilized for all municipal purchases and are utilized in whole or in part for monitoring the portfolio of municipal holdings. The Company does not utilize third party credit

rating agencies as a primary component of determining if the municipal issuer has an adequate capacity to meet the financial commitments under the security for the projected life of the investment, and, therefore, does not compare internal assessments to those of the credit rating agencies. Credit rating downgrades are utilized as an additional indicator of credit weakness and as a reference point for historical default rates. Management concluded that the gross unrealized losses on debt securities were temporary. Due to potential changes in conditions, it is at least reasonably possible that changes in fair values and management's assessments will occur in the near term and that such changes could materially affect the amounts reported in the Company's financial statements.

Table of Contents

7. Loans Receivable and Credit Disclosures

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

Three Months Ended June 30, 2018

	1-4 Family Residential							Consumer and Other	Total
	Construction Real Estate	Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural			
Balance, March 31, 2018	\$804	\$ 1,744	\$ 4,763	\$ 977	\$ 1,750	\$ 1,168	\$ 117	\$11,323	
Provision (credit) for loan losses	42	(13)	79	-	(53)	10	(1)	64	
Recoveries of loans charged-off	-	1	-	-	3	-	6	10	
Loans charged-off	-	-	-	-	(12)	-	(2)	(14)	
Balance, June 30, 2018	\$846	\$ 1,732	\$ 4,842	\$ 977	\$ 1,688	\$ 1,178	\$ 120	\$11,383	

Six Months Ended June 30, 2018

	1-4 Family Residential							Consumer and Other	Total
	Construction Real Estate	Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural			
Balance, December 31, 2017	\$796	\$ 1,716	\$ 4,734	\$ 997	\$ 1,739	\$ 1,171	\$ 168	\$11,321	
Provision (credit) for loan losses	50	13	108	(20)	(59)	7	(6)	93	
Recoveries of loans charged-off	-	3	-	-	21	-	14	38	
Loans charged-off	-	-	-	-	(13)	-	(56)	(69)	
Balance, June 30, 2018	\$846	\$ 1,732	\$ 4,842	\$ 977	\$ 1,688	\$ 1,178	\$ 120	\$11,383	

Three Months Ended June 30, 2017

	1-4 Family Residential							Consumer and Other	Total
	Construction Real Estate	Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural			
Balance, March 31, 2017	\$932	\$ 1,719	\$ 4,276	\$ 898	\$ 1,803	\$ 1,142	\$ 132	\$10,902	

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

Provision (credit) for loan losses	(152)	(9)	161	9	741	12	5	767
Recoveries of loans charged-off	-	3	-	-	27	-	1	31
Loans charged-off	-	-	-	-	(500)	-	(12)	(512)
Balance, June 30, 2017	\$780	\$ 1,713	\$ 4,437	\$ 907	\$ 2,071	\$ 1,154	\$ 126	\$11,188

Six Months Ended June 30, 2017

	1-4 Family							
	Construction	Residential	Commercial	Agricultural	Commercial	Agricultural	Consumer and Other	Total
	Real Estate	Real Estate	Real Estate	Real Estate	Commercial	Agricultural	Other	Total
Balance, December 31, 2016	\$908	\$ 1,711	\$ 3,960	\$ 861	\$ 1,728	\$ 1,216	\$ 123	\$10,507
Provision (credit) for loan losses	(128)	(3)	477	46	815	(62)	19	1,164
Recoveries of loans charged-off	-	5	-	-	28	-	4	37
Loans charged-off	-	-	-	-	(500)	-	(20)	(520)
Balance, June 30, 2017	\$780	\$ 1,713	\$ 4,437	\$ 907	\$ 2,071	\$ 1,154	\$ 126	\$11,188

Table of Contents

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

2018	1-4 Family							Consumer and Other	Total
	Construction Real Estate	Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural			
Individually evaluated for impairment	\$ -	\$ 54	\$ 115	\$ -	\$ 535	\$ 57	\$ 28	\$ 789	
Collectively evaluated for impairment	846	1,678	4,727	977	1,153	1,121	92	10,594	
Balance June 30, 2018	\$ 846	\$ 1,732	\$ 4,842	\$ 977	\$ 1,688	\$ 1,178	\$ 120	\$ 11,383	

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

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

2018	1-4 Family							Consumer and Other	Total
	Construction Real Estate	Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural			
Individually evaluated for impairment	\$ -	\$ 503	\$ 257	\$ -	\$ 2,955	\$ 58	\$ 30	\$ 3,803	
Collectively evaluated for impairment	53,500	147,717	358,870	81,671	67,731	69,368	9,082	787,939	
Balance June 30, 2018	\$ 53,500	\$ 148,220	\$ 359,127	\$ 81,671	\$ 70,686	\$ 69,426	\$ 9,112	\$ 791,742	

2017	1-4 Family						Consumer and Other	Total
	Construction Real Estate	Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural		
Individually evaluated for impairment	\$ -	\$ 689	\$ 901	\$ -	\$ 3,140	\$ -	\$ 80	\$ 4,810
Collectively evaluated for impairment	50,309	145,569	349,725	81,790	70,676	69,806	10,265	778,140
Balance December 31, 2017	\$ 50,309	\$ 146,258	\$ 350,626	\$ 81,790	\$ 73,816	\$ 69,806	\$ 10,345	\$ 782,950

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

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

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no specific reserve recorded:						
Real estate - construction	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Real estate - 1 to 4 family residential	380	518	-	572	677	-
Real estate - commercial	123	594	-	671	1,353	-
Real estate - agricultural	-	-	-	-	-	-
Commercial	64	68	-	125	148	-
Agricultural	-	-	-	-	-	-
Consumer and other	-	-	-	25	44	-
Total loans with no specific reserve:	567	1,180	-	1,393	2,222	-
With an allowance recorded:						
Real estate - construction	-	-	-	-	-	-
Real estate - 1 to 4 family residential	123	149	54	117	180	42
Real estate - commercial	134	134	115	230	230	115
Real estate - agricultural	-	-	-	-	-	-
Commercial	2,891	3,547	535	3,015	3,336	607
Agricultural	58	57	57	-	-	-
Consumer and other	30	34	28	55	43	47
Total loans with specific reserve:	3,236	3,921	789	3,417	3,789	811
Total						
Real estate - construction	-	-	-	-	-	-
Real estate - 1 to 4 family residential	503	667	54	689	857	42
Real estate - commercial	257	728	115	901	1,583	115
Real estate - agricultural	-	-	-	-	-	-
Commercial	2,955	3,615	535	3,140	3,484	607
Agricultural	58	57	57	-	-	-
Consumer and other	30	34	28	80	87	47
	\$ 3,803	\$ 5,101	\$ 789	\$ 4,810	\$ 6,011	\$ 811

Table of Contents

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

	Three Months Ended June 30,			
	2018		2017	
	Average Interest Recorded Income		Average Interest Recorded Income	
	Investment	Recognized	Investment	Recognized
With no specific reserve recorded:				
Real estate - construction	\$-	\$ -	\$-	\$ -
Real estate - 1 to 4 family residential	474	22	538	6
Real estate - commercial	135	-	744	-
Real estate - agricultural	-	-	-	-
Commercial	64	5	1,476	1
Agricultural	-	-	-	-
Consumer and other	-	-	69	-
Total loans with no specific reserve:	673	27	2,827	7
With an allowance recorded:				
Real estate - construction	-	-	32	2
Real estate - 1 to 4 family residential	229	-	178	-
Real estate - commercial	177	-	-	-
Real estate - agricultural	-	-	-	-
Commercial	2,903	-	2,227	-
Agricultural	29	-	-	-
Consumer and other	32	-	2	1
Total loans with specific reserve:	3,370	-	2,439	3
Total				
Real estate - construction	-	-	32	2
Real estate - 1 to 4 family residential	703	22	716	6
Real estate - commercial	312	-	744	-
Real estate - agricultural	-	-	-	-
Commercial	2,967	5	3,703	1
Agricultural	29	-	-	-
Consumer and other	32	-	71	1
	\$4,043	\$ 27	\$5,266	\$ 10

Table of Contents

	Six Months Ended June 30,			
	2018		2017	
	Average Interest	Average Interest	Average Interest	Average Interest
	Recorded Income	Recorded Income	Recorded Income	Recorded Income
	Investment Recognized	Investment Recognized	Investment Recognized	Investment Recognized
With no specific reserve recorded:				
Real estate - construction	\$-	\$ -	\$-	\$ -
Real estate - 1 to 4 family residential	506	45	509	9
Real estate - commercial	314	258	629	-
Real estate - agricultural	-	-	-	-
Commercial	84	5	1,900	1
Agricultural	-	-	-	-
Consumer and other	8	-	71	-
Total loans with no specific reserve:	912	308	3,109	10
With an allowance recorded:				
Real estate - construction	-	-	21	2
Real estate - 1 to 4 family residential	192	-	188	-
Real estate - commercial	194	-	-	-
Real estate - agricultural	-	-	-	-
Commercial	2,940	-	1,883	-
Agricultural	19	-	-	-
Consumer and other	39	1	1	1
Total loans with specific reserve:	3,384	1	2,093	3
Total				
Real estate - construction	-	-	21	2
Real estate - 1 to 4 family residential	698	45	697	9
Real estate - commercial	508	258	629	-
Real estate - agricultural	-	-	-	-
Commercial	3,024	5	3,783	1
Agricultural	19	-	-	-
Consumer and other	47	1	72	1
	\$4,296	\$ 309	\$5,202	\$ 13

The interest foregone on nonaccrual loans for the three months ended June 30, 2018 and 2017 was approximately \$120,000 and \$103,000, respectively. The interest foregone on nonaccrual loans for the six months ended June 30, 2018 and 2017 was approximately \$203,000 and \$201,000, respectively.

Nonaccrual loans at June 30, 2018 and December 31, 2017 were \$3,803,000 and \$4,810,000 respectively.

The Company had loans meeting the definition of a troubled debt restructuring (TDR) of \$2,828,000 as of June 30, 2018, all of which were included in impaired and nonaccrual loans. The Company had TDRs of \$2,984,000 as of December 31, 2017, all of which were included in impaired and nonaccrual loans.

Table of Contents

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

	Three Months Ended June 30,				2017			
	2018				2017			
	Pre-Modification Outstanding		Post-Modification Outstanding		Pre-Modification Outstanding		Post-Modification Outstanding	
	Number of Recorded Contracts	Investment	Number of Recorded Contracts	Investment	Number of Recorded Contracts	Investment	Number of Recorded Contracts	Investment
Real estate - construction	-	\$ -	\$ -	-	\$ -	\$ -	-	\$ -
Real estate - 1 to 4 family residential	-	-	-	-	-	-	-	-
Real estate - commercial	-	-	-	-	-	-	-	-
Real estate - agricultural	-	-	-	-	-	-	-	-
Commercial	3	80	80	2	93	99	2	99
Agricultural	-	-	-	-	-	-	-	-
Consumer and other	-	-	-	-	-	-	-	-
	3	\$ 80	\$ 80	2	\$ 93	\$ 99	2	\$ 99

	Six Months Ended June 30,				2017			
	2018				2017			
	Pre-Modification Outstanding		Post-Modification Outstanding		Pre-Modification Outstanding		Post-Modification Outstanding	
	Number of Recorded Contracts	Investment	Number of Recorded Contracts	Investment	Number of Recorded Contracts	Investment	Number of Recorded Contracts	Investment
Real estate - construction	-	\$ -	\$ -	-	\$ -	\$ -	-	\$ -
Real estate - 1 to 4 family residential	-	-	-	-	-	-	-	-
Real estate - commercial	-	-	-	-	-	-	-	-
Real estate - agricultural	-	-	-	-	-	-	-	-
Commercial	3	80	80	2	93	99	2	99
Agricultural	-	-	-	-	-	-	-	-
Consumer and other	-	-	-	-	-	-	-	-
	3	\$ 80	\$ 80	2	\$ 93	\$ 99	2	\$ 99

During the three and six months ended June 30, 2018, the Company granted concessions to one borrower facing financial difficulties. During the three and six months ended June 30, 2017, the Company granted concessions to two borrowers that were experiencing financial difficulties. The loans were extended beyond their normal terms and on

one loan the interest was capitalized.

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

No TDR modified during the twelve months ended June 30, 2018 and 2017 had payment defaults. There were no charge-offs related to TDRs for the three and six months ended June 30, 2018. An \$80,000 specific reserve was established in the three months ended June 30, 2018. A \$500,000 specific reserve was established in the three months ended June 30, 2017 on a TDR loan. There was \$12,000 and \$257,000 of net charge-offs related to TDRs for the three and six months ended June 30, 2018 and 2017, respectively.

Table of Contents

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

2018	90 Days			Current	Total	90 Days or Greater Accruing
	30-89 Past Due	or Greater Past Due	Total Past Due			
Real estate - construction	\$ 196	\$ -	\$ 196	\$ 53,304	\$ 53,500	\$ -
Real estate - 1 to 4 family residential	1,503	356	1,859	146,361	148,220	96
Real estate - commercial	-	134	134	358,993	359,127	-
Real estate - agricultural	-	-	-	81,671	81,671	-
Commercial	549	333	882	69,804	70,686	-
Agricultural	3	57	60	69,366	69,426	-
Consumer and other	47	-	47	9,065	9,112	-
	\$ 2,298	\$ 880	\$ 3,178	\$ 788,564	\$ 791,742	\$ 96

2017	90 Days			Current	Total	90 Days or Greater Accruing
	30-89 Past Due	or Greater Past Due	Total Past Due			
Real estate - construction	\$ 159	\$ -	\$ 159	\$ 50,150	\$ 50,309	\$ -
Real estate - 1 to 4 family residential	940	414	1,354	144,904	146,258	18
Real estate - commercial	363	629	992	349,634	350,626	-
Real estate - agricultural	655	-	655	81,135	81,790	-
Commercial	275	418	693	73,123	73,816	-
Agricultural	77	-	77	69,729	69,806	-
Consumer and other	77	38	115	10,230	10,345	-
	\$ 2,546	\$ 1,499	\$ 4,045	\$ 778,905	\$ 782,950	\$ 18

Table of Contents

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

2018	Construction	Commercial	Agricultural			Total
	Real Estate	Real Estate	Real Estate	Commercial	Agricultural	
Pass	\$ 50,125	\$ 325,421	\$ 58,933	\$ 49,904	\$ 45,734	\$530,117
Watch	3,375	20,835	16,162	13,673	20,919	74,964
Special Mention	-	10,852	23	2,000	-	12,875
Substandard	-	1,762	6,553	2,153	2,716	13,184
Substandard-Impaired	-	257	-	2,956	57	3,270
	\$ 53,500	\$ 359,127	\$ 81,671	\$ 70,686	\$ 69,426	\$634,410

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

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

2018	1-4 Family		Total
	Residential Real Estate	Consumer and Other	
Performing	\$ 147,622	\$ 9,083	\$156,705
Non-performing	598	29	627
	\$ 148,220	\$ 9,112	\$157,332

2017	1-4 Family		Total
	Residential Real Estate	Consumer and Other	

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

8. Goodwill

Goodwill is not amortized but is evaluated for impairment at least annually. For income tax purposes, goodwill is amortized over fifteen years.

Table of Contents

9. Intangible assets

The following sets forth the carrying amounts and accumulated amortization of the intangible assets at June 30, 2018 and December 31, 2017: *(in thousands)*

	2018		2017	
	Gross Amount	Accumulated Amortization	Gross Amount	Accumulated Amortization
Core deposit intangible asset	\$2,518	\$ 1,994	\$2,518	\$ 1,861
Customer list	535	124	520	86
Total	\$3,053	\$ 2,118	\$3,038	\$ 1,947

The weighted average life of the intangible assets is 2.8 years as of June 30, 2018 and 2.5 years as of December 31, 2017.

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

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2017	
	2018	2017	2018	2017
Beginning intangible asset, net	\$1,019	\$1,238	\$1,091	\$1,353
Adjustment to intangible asset	-	66	15	50
Amortization	(84)	(92)	(171)	(191)
Ending intangible asset, net	\$935	\$1,212	\$935	\$1,212

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

2018	\$158
2019	206
2020	149
2021	149
2022	144
2023	129

Intangible asset, net \$935

Table of Contents

10. Pledged Collateral Related to Securities Sold Under Repurchase Agreements

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

	2018			2017		
	Remaining Overnight	Contractual Greater than 90 days	Maturity of the Total	Remaining Overnight	Contractual Greater than 90 days	Maturity of the Total
Securities sold under agreements to repurchase:						
U.S. government treasuries	\$3,407	\$ -	\$3,407	\$1,474	\$-	\$1,474
U.S. government agencies	46,772	-	46,772	47,323	-	47,323
U.S. government mortgage-backed securities	19,963	-	19,963	22,824	-	22,824
Total	\$70,142	\$ -	\$70,142	\$71,621	\$-	\$71,621
Term repurchase agreements (Other borrowings):						
U.S. government agencies	\$-	\$ -	\$-	\$-	\$14,986	\$14,986
Total pledged collateral	\$70,142	\$ -	\$70,142	\$71,621	\$14,986	\$86,607

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

Table of Contents

11. Regulatory Matters

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

	Actual		For Capital Adequacy Purposes *		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of June 30, 2018:						
Total capital (to risk- weighted assets):						
Consolidated	\$177,657	17.8 %	\$98,379	9.875 %	N/A	N/A
Boone Bank & Trust	15,501	17.1	8,930	9.875	\$9,043	10.0 %
First National Bank	83,450	15.9	51,989	9.875	52,647	10.0
Reliance State Bank	27,475	15.7	17,118	9.875	17,535	10.0
State Bank & Trust	20,345	16.3	12,309	9.875	12,465	10.0
United Bank & Trust	14,895	19.7	7,461	9.875	7,556	10.0
Tier 1 capital (to risk- weighted assets):						
Consolidated	\$165,743	16.6 %	\$78,455	7.875 %	N/A	N/A
Boone Bank & Trust	14,588	16.1	7,122	7.875	\$7,235	8.0 %
First National Bank	77,369	14.7	41,459	7.875	42,118	8.0
Reliance State Bank	25,282	14.4	13,809	7.875	14,028	8.0
State Bank & Trust	18,784	15.1	9,816	7.875	9,972	8.0
United Bank & Trust	14,082	18.6	5,950	7.875	6,045	8.0
Tier 1 capital (to average- weighted assets):						
Consolidated	\$165,743	12.2 %	\$54,501	4.000 %	N/A	N/A
Boone Bank & Trust	14,588	10.9	5,272	4.000	\$6,590	5.0 %
First National Bank	77,369	10.3	30,100	4.000	37,625	5.0
Reliance State Bank	25,282	11.5	8,773	4.000	10,966	5.0
State Bank & Trust	18,784	11.4	6,613	4.000	8,266	5.0
United Bank & Trust	14,082	12.7	4,419	4.000	5,524	5.0
Common equity tier 1 capital (to risk-weighted assets):						
Consolidated	\$165,743	16.6 %	\$63,511	6.375 %	N/A	N/A
Boone Bank & Trust	14,588	16.1	5,765	6.375	\$5,878	6.5 %
First National Bank	77,369	14.7	33,562	6.375	34,220	6.5
Reliance State Bank	25,282	14.4	11,179	6.375	11,398	6.5

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

State Bank & Trust	18,784	15.1	7,946	6.375	8,102	6.5
United Bank & Trust	14,082	18.6	4,817	6.375	4,911	6.5

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

Table of Contents

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

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

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

Table of Contents

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

12. Subsequent Events

Management evaluated subsequent events through the date the financial statements were issued. There were no significant events or transactions occurring after June 30, 2018, but prior to August 7, 2018, that provided additional evidence about conditions that existed at June 30, 2018. There were no other significant events or transactions that provided evidence about conditions that did not exist at June 30, 2018.

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

Overview

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

The Company does not engage in any material business activities apart from its ownership of the Banks. Products and services offered by the Banks are for commercial and consumer purposes including loans, deposits and wealth management services. The Banks also offer investment services through a third-party broker-dealer. The Company employs fourteen individuals to assist with financial reporting, human resources, audit, compliance, marketing, technology systems, training and the coordination of management activities, in addition to 213 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 Banks; (iii) fees on wealth management services provided by those Banks exercising trust powers; (iv) service fees on deposit accounts maintained at the Banks and (v) Merchant and card fees. The Company's principal expenses are: (i) interest expense on deposit accounts and other borrowings; (ii) provision for loan losses; (iii) salaries and employee benefits; (iv) data processing costs associated with maintaining the Banks' loan and deposit functions; (v) occupancy expenses for maintaining the Bank's facilities; and (vi) professional fees. The largest component contributing to the Company's net income is net interest income, which is the difference between interest earned on earning assets (primarily loans and investments) and interest paid on interest bearing liabilities (primarily deposits and other borrowings). One of management's principal functions is to manage the spread between interest earned on earning assets and interest paid on interest bearing liabilities in an effort to maximize net interest income while maintaining an appropriate level of interest rate risk.

Table of Contents

The Company had net income of \$4,317,000, or \$0.46 per share, for the three months ended June 30, 2018, compared to net income of \$3,472,000, or \$0.37 per share, for the three months ended June 30, 2017.

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

Net loan charge-offs totaled \$4,000 and \$481,000 for the three months ended June 30, 2018 and 2017, respectively. The provision for loan losses totaled \$64,000 and \$767,000 for the three months ended June 30, 2018 and 2017, respectively.

The Company had net income of \$8,354,000, or \$0.90 per share, for the six months ended June 30, 2018, compared to net income of \$7,082,000, or \$0.76 per share, for the six months ended June 30, 2017.

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

Net loan charge-offs totaled \$31,000 and \$483,000 for the six months ended June 30, 2018 and 2017, respectively. The provision for loan losses totaled \$93,000 and \$1,164,000 for the six months ended June 30, 2018 and 2017, respectively.

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

Challenges

Key Performance Indicators and Industry Results

Critical Accounting Policies

Income Statement Review

Balance Sheet Review

Asset Quality Review and Credit Risk Management

Liquidity and Capital Resources

Forward-Looking Statements and Business Risks

Non-GAAP Financial Measures

Challenges

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

Key Performance Indicators and Industry Results

Certain key performance indicators for the Company and the industry are presented in the following chart. The industry figures are compiled by the Federal Deposit Insurance Corporation (the "FDIC") and are derived from 5,606 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.

Table of Contents

Selected Indicators for the Company and the Industry

	3		6		3 Months Ended				Years Ended December 31,			
	Months Ended		Months Ended		March 31, 2018		2017		2016			
	Company		Company		Company	Industry*	Company	Industry*	Company	Industry*	Company	Industry
Return on assets	1.26 %	1.22 %	1.19 %	1.28 %	1.00 %	0.97 %	1.18 %	1.04 %				
Return on equity	10.35 %	9.95 %	9.55 %	11.44 %	8.02 %	8.64 %	9.38 %	9.32 %				
Net interest margin	3.16 %	3.17 %	3.19 %	3.32 %	3.25 %	3.25 %	3.36 %	3.13 %				
Efficiency ratio	55.02 %	56.22 %	57.45 %	57.53 %	52.70 %	57.94 %	51.95 %	58.28 %				
Capital ratio	12.18 %	12.30 %	12.43 %	9.66 %	12.48 %	9.62 %	12.60 %	9.48 %				

*Latest available data

Key performances indicators include:

Return on Assets

This ratio is calculated by dividing net income by average assets. It is used to measure how effectively the assets of the Company are being utilized in generating income. The Company's annualized return on average assets was 1.26% and 1.01% for the three months ended June 30, 2018 and 2017, respectively. The increase in this ratio in 2018 from the previous period is primarily due to a decrease in income tax expense and the provision for loan losses.

Return on Equity

This ratio is calculated by dividing net income by average equity. It is used to measure the net income or return the Company generated for the shareholders' equity investment in the Company. The Company's return on average equity was at 10.35% and 8.17% for the three months ended June 30, 2018 and 2017, respectively. The increase in this ratio in 2018 from the previous period is primarily due to a decrease in income tax expense and the provision for loan

losses.

Net Interest Margin

The net interest margin for the three months ended June 30, 2018 and 2017 was 3.16% and 3.25%, 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.

32

Table of Contents

Efficiency Ratio

This ratio is calculated by dividing noninterest expense by net interest income and noninterest income. The ratio is a measure of the Company's ability to manage noninterest expenses. The Company's efficiency ratio was 55.02% and 52.93% for the three months ended June 30, 2018 and 2017, respectively. The efficiency ratio increase for the three months ended June 30, 2018 primarily an increase in salaries and benefits.

Capital Ratio

The average capital ratio is calculated by dividing average total equity capital by average total assets. It measures the level of average assets that are funded by shareholders' equity. Given an equal level of risk in the financial condition of two companies, the higher the capital ratio, generally the more financially sound the company. The Company's capital ratio of 12.18% as of June 30, 2018 is significantly higher than the industry average of 9.62% as of December 31, 2017.

Industry Results

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

Net Income Increases 27.5% From a Year Earlier Due to Higher Net Operating Revenue and a Lower Effective Tax Rate

Aggregate net income for the 5,606 FDIC-insured commercial banks and savings institutions reporting first quarter performance totaled \$56 billion in first quarter 2018, an increase of \$12.1 billion (27.5%) from a year earlier. Improvement in net income was attributable to higher net operating revenue (the sum of net interest income and noninterest income) and a lower effective tax rate, but was offset in part by higher loan-loss provisions and noninterest expense. Using the effective tax rate before the new tax law, estimated net income would have been \$49.4 billion, an increase of \$5.5 billion (12.6%) from first quarter 2017. The average return on assets rose by 24 basis points from first quarter 2017 to 1.28%. Less than 4% of institutions were unprofitable during the quarter, the lowest level since first quarter 1996.

Net Interest Income Rises 8.5% From the Year Before

Net interest income rose by \$10.3 billion (8.5%), as more than four out of five banks (85.9%) reported an increase from 12 months ago. For the past seven consecutive quarters, the annual growth rate for net interest income has exceeded 7.4%. The net interest margin (NIM) increased from 3.19% in first quarter 2017 to 3.32%, due to growth in interest income as interest-bearing assets rose by 3.6%. The improvement in NIM was widespread, as more than two out of three banks (69.4%) reported increases from a year earlier.

Noninterest Income Increases 7.9% From a Year Earlier

Over the past 12 months, noninterest income grew by \$4.9 billion (7.9%) to \$67.4 billion. This increase is the highest 12-month growth rate since third quarter 2014. The annual increase in noninterest income was led by higher trading revenue (up \$1.1 billion, or 14.9%) and other noninterest income (up \$2.4 billion, or 8.8%). More than half (55.1%) of all banks reported increases in noninterest income compared with first quarter 2017.

Noninterest Expense Increases 5.8% From a Year Earlier

Noninterest expenses were \$6.3 billion (5.8%) higher than first quarter 2017, as almost three out of four banks (74%) reported increases. Other noninterest expense rose by \$3.7 billion (8.6%), and salary and employee benefits grew by \$2.3 billion (4.3%). Average assets per employee increased from \$8.2 million in first quarter 2017 to \$8.4 million.

Table of Contents

Provisions Increase Modestly From First Quarter 2017

In the first quarter, banks allocated \$12.4 billion in loan-loss provisions, an increase of \$356.6 million (3%) from a year earlier. Almost 37% of institutions reported higher loan-loss provisions than in first quarter 2017. The increase is due to higher net charge-offs, and a growing loan portfolio. Loan-loss provisions as a percent of net operating revenue totaled 6.2% for the first quarter, down from 6.6% a year ago.

Net Charge-Off Rate Remains Stable

Banks charged off \$12.1 billion in uncollectable loans during the quarter, an increase of \$540.6 million (4.7%) from a year earlier. The annual increase in net charge-offs was led by credit card balances (up \$1.1 billion, or 16.3%). However, less than half (42.9%) of all banks reported a year-over-year increase, and net charge-offs were lower for most major loan categories. The average net-charge off rate remained stable (0.50%) from a year earlier.

Noncurrent Loan Rate Declines Modestly

Noncurrent loan balances (90 days or more past due or in nonaccrual status) were \$3.9 billion (3.4%) lower compared with the previous quarter. Slightly more than half (50.8%) of all banks reported declines in their noncurrent loan balances during the quarter. The decline in noncurrent loan balances was led by residential mortgages (down \$2.8 billion, or 4.9%), commercial and industrial loans (down \$617.2 million, or 3.4%), and credit cards (down \$436.4 million, or 3.7%). The average noncurrent rate declined by 5 basis points from the previous quarter to 1.15%.

Coverage Ratio Rises to 110%

Banks reduced their loan-loss reserves by \$15 million from the previous quarter, with less than one-third (23.8%) of all banks reporting a quarterly decline. Banks with assets greater than \$1 billion, which itemize their reserves, reported the largest quarterly increase in reserves for credit card losses (up \$850.2 million, or 2.3%). Reserves declined for residential real estate losses (down \$654.3 million, or 4.5%) and commercial loan losses (down \$368.5 million, or 1.1%). With noncurrent loan balances declining at a faster quarterly rate than loan-loss reserves, the coverage ratio (loan-loss reserves to noncurrent loan balances) increased from 106.3% in fourth quarter 2017 to 110%. This marks the fourth consecutive quarter that the coverage ratio was above 100%.

Equity Capital Rises Modestly

Bank equity capital rose by \$11.2 billion (0.6%) from the previous quarter. Retained earnings contributed \$25.3 billion to equity growth, but were offset in part by the decline in the market value of available-for-sale securities, which reduced accumulated other comprehensive income by \$25.8 billion. Declared dividends in the first quarter totaled \$30.7 billion, an increase of \$3.3 billion (12.2%) from the year-earlier quarter. At the end of the quarter, 99.5% of all insured institutions, which account for 99.98% of total industry assets, met or exceeded the requirements for the highest regulatory capital category as defined for Prompt Corrective Action purposes.

Table of Contents

Loan Balances Rise 4.9% Over 12 Months

Total loan and lease balances rose by \$31.3 billion (0.3%) from fourth quarter 2017. Commercial and industrial loans increased by \$38.6 billion (1.9%), nonfarm nonresidential loans grew by \$11.5 billion (0.8%), and residential mortgage loans rose by \$8.8 billion (0.4%). Credit card balances posted a seasonal decline of \$44.6 billion (5.2%). Over the past 12 months, total loan and lease balances rose by \$455.2 billion (4.9%), exceeding last quarter's annual growth rate of 4.5%. Commercial and industrial loans increased by \$91.8 billion (4.7%), residential mortgage loans grew by \$87.8 billion (4.4%), credit card balances rose by \$64.3 billion (8.5%), and nonfarm nonresidential loans increased by \$56.1 billion (4.2%). Home equity lines of credit declined by \$31.6 billion (7.3%) over the past 12 months. Unused loan commitments increased by 5.5% from a year earlier, the highest annual growth rate since first quarter 2016.

Deposits Increase From the Previous Quarter

Total deposits grew by \$129.7 billion (1%) in the first quarter. Domestic interest-bearing deposits increased by \$176.1 billion (2%), while noninterest-bearing deposits fell by \$655.9 million (0.02%). Nondeposit liabilities declined by \$24.1 billion (1.2%), led by other liabilities (down \$30.7 billion, or 1.9%) and borrowings from Federal Home Loan Banks (down \$28.6 billion, or 4.9%). Domestic deposits in accounts less than \$250,000 rose by \$169.7 billion (2.9%) from fourth quarter 2017.

Three New Charters Added in First Quarter 2018

There were 5,607 FDIC-insured commercial banks and savings institutions at the end of first quarter 2018, a decline from 5,670 the year before. The number of institutions on the FDIC's "Problem Bank List" fell from 95 to 92. During the quarter, 65 institutions were absorbed by merger transactions, three new charters were added, and there were no failures.

Critical Accounting Policies

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

judgments that affect the reported amounts of assets, liabilities, revenues and expenses.

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

Allowance for Loan Losses

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

Table of Contents

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

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

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

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

Goodwill

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

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Reconciliation of net interest income and annualized net interest margin on an FTE basis to GAAP:				
Net interest income (GAAP)	\$ 10,211	\$ 10,066	\$ 20,397	\$ 19,949
Tax-equivalent adjustment ⁽¹⁾	313	695	629	1,405
Net interest income on an FTE basis (non-GAAP)	10,524	10,761	21,026	21,354
Average interest-earning assets	\$ 1,330,909	\$ 1,325,985	\$ 1,324,875	\$ 1,324,522
Net interest margin on an FTE basis (non-GAAP)	3.16	% 3.25	% 3.17	% 3.22

(1) Computed on a tax-equivalent basis using an incremental federal income tax rate of 21 percent for the three and six months ended June 30, 2018 and 35 percent for the three and six months ended June 30, 2017, adjusted to reflect the effect of the tax-exempt interest

income
associated
with owning
tax-exempt
securities and
loans.

37

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

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

AVERAGE BALANCES AND INTEREST RATES

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

AVERAGE BALANCE SHEETS AND INTEREST RATES

	Three Months Ended June 30,					
	2018			2017		
	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
ASSETS						
<i>(dollars in thousands)</i>						
Interest-earning assets						
Loans 1						
Commercial	\$72,939	\$927	5.08 %	\$79,493	\$879	4.42 %
Agricultural	68,992	945	5.48 %	71,939	946	5.26 %
Real estate	637,835	7,008	4.40 %	613,289	6,537	4.26 %
Consumer and other	8,240	116	5.62 %	11,241	138	4.91 %
Total loans (including fees)	788,006	8,996	4.57 %	775,962	8,500	4.38 %
Investment securities						
Taxable	271,835	1,590	2.34 %	272,735	1,567	2.30 %
Tax-exempt 2	223,979	1,493	2.67 %	244,088	1,986	3.25 %
Total investment securities	495,814	3,083	2.49 %	516,823	3,553	2.75 %
Interest bearing deposits with banks and federal funds sold	47,089	230	1.95 %	33,200	113	1.37 %
Total interest-earning assets	1,330,909	\$12,309	3.70 %	1,325,985	\$12,166	3.67 %

Noninterest-earning assets	38,895	48,727
TOTAL ASSETS	\$1,369,804	\$1,374,712

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

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

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

	Three Months Ended June 30,					
	2018			2017		
	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
LIABILITIES AND STOCKHOLDERS' EQUITY						
<i>(dollars in thousands)</i>						
Interest-bearing liabilities						
Deposits						
NOW, savings accounts and money markets	\$744,936	\$ 1,070	0.57 %	\$728,850	\$ 656	0.36 %
Time deposits	193,897	564	1.16 %	197,492	458	0.93 %
Total deposits	938,833	1,634	0.70 %	926,342	1,114	0.48 %
Other borrowed funds	44,124	151	1.37 %	76,769	291	1.52 %
Total Interest-bearing liabilities	982,957	1,785	0.73 %	1,003,111	1,405	0.56 %
Noninterest-bearing liabilities						
Demand deposits	211,586			194,505		
Other liabilities	8,487			7,064		
Stockholders' equity	166,774			170,032		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$1,369,804			\$1,374,712		
Net interest income		\$ 10,524	3.16 %		\$ 10,761	3.25 %
Spread Analysis						
Interest income/average assets	\$12,309	3.59 %		\$12,166	3.54 %	
Interest expense/average assets	\$1,785	0.52 %		\$1,405	0.41 %	
Net interest income/average assets	\$10,524	3.07 %		\$10,761	3.13 %	

Net Interest Income

For the three months ended June 30, 2018 and 2017, the Company's net interest margin adjusted for tax exempt income was 3.16% and 3.25%, respectively. Net interest income, prior to the adjustment for tax-exempt income, for the three months ended June 30, 2018 totaled \$10,211,000 compared to \$10,066,000 for the three months ended June 30, 2017.

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

For the three months ended June 30, 2018, interest income increased \$525,000, or 5%, when compared to the same period in 2017. The increase from 2017 was primarily attributable to higher rates on loans. The higher rates on loans were primarily due to an increase in general market interest rates, as the Federal Reserve Bank increased short term interest rate targets by 0.75% since June 30, 2017.

Interest expense increased \$380,000, or 27%, for the three months ended June 30, 2018 when compared to the same period in 2017. The higher interest expense for the period is primarily attributable to higher rates on deposits due to market interest rates and competitive pressures.

Table of Contents

Provision for Loan Losses

The Company's provision for loan losses was \$64,000 and \$767,000 for the three months ended June 30, 2018 and 2017, respectively. An increase in the specific reserve on one commercial credit was the primary factor for the provision for loan losses for the quarter ended June 30, 2017, with no significant growth in the loan portfolio for the quarter ended June 30, 2018. Net loan charge-offs were \$4,000 and \$481,000 for the three months ended June 30, 2018 and 2017, respectively. While the current provision for loan losses are not related to agricultural loans, the Iowa agricultural economy remains challenged as the result of the current low grain prices, potential tariff concerns on Iowa exports and excessive rainfall in a portion of our markets.

Noninterest Income and Expense

Noninterest income decreased \$34,000 for the three months ended June 30, 2018 compared to the same period in 2017. The decrease in noninterest income is primarily due to lower security gains and other noninterest income, offset in part by higher wealth management income. The higher wealth management income was primarily due to an increase in one time estate fees. Exclusive of realized securities gains, noninterest income was 3% higher in the second quarter of 2018 compared to the same period in 2017.

Noninterest expense increased \$314,000 or 5% for the three months ended June 30, 2018 compared to the same period in 2017 primarily as a result of increases in salaries and employee benefits. This increase in salaries and benefits was primarily due to increases in employee benefit costs, additional personnel, changes in the Company's paid time off benefits and normal salary increases. The efficiency ratio was 55.0% for the second quarter of 2018 as compared to 52.9% in 2017.

Income Taxes

The provision for income taxes expense for the three months ended June 30, 2018 and 2017 was \$1,107,000 and \$1,453,000, respectively, representing an effective tax rate of 20% and 29%, respectively. The expected combined federal and state tax rate was 25% and 37% for the three months ended June 30, 2018 and 2017, respectively. The lower expected tax rate in 2018 is due to the enactment of the Tax Cut and Jobs Act Bill on December 22, 2017. The lower than expected effective tax rate for both periods is primarily due to tax-exempt interest income.

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

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

AVERAGE BALANCES AND INTEREST RATES

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

AVERAGE BALANCE SHEETS AND INTEREST RATES

	Six Months Ended June 30,					
	2018			2017		
	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
ASSETS						
<i>(dollars in thousands)</i>						
Interest-earning assets						
Loans 1						
Commercial	\$73,180	\$1,795	4.90 %	\$77,310	\$1,693	4.38 %
Agricultural	68,776	1,913	5.56 %	69,674	1,781	5.11 %
Real estate	634,953	13,949	4.39 %	607,575	12,863	4.23 %
Consumer and other	8,532	228	5.34 %	11,429	278	4.87 %
Total loans (including fees)	785,441	17,885	4.55 %	765,988	16,615	4.34 %
Investment securities						
Taxable	271,924	3,147	2.31 %	270,092	3,080	2.28 %
Tax-exempt 2	225,197	2,995	2.66 %	246,706	4,013	3.25 %
Total investment securities	497,121	6,142	2.47 %	516,798	7,093	2.74 %
Interest bearing deposits with banks and federal funds sold	42,313	395	1.87 %	41,736	251	1.20 %
Total interest-earning assets	1,324,875	\$24,422	3.69 %	1,324,522	\$23,959	3.62 %

Noninterest-earning assets	40,125	49,217
TOTAL ASSETS	\$1,365,000	\$1,373,739

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

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

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

	Six Months Ended June 30,					
	2018			2017		
	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
LIABILITIES AND STOCKHOLDERS' EQUITY						
<i>(dollars in thousands)</i>						
Interest-bearing liabilities						
Deposits						
NOW, savings accounts and money markets	\$733,157	\$1,901	0.52 %	\$720,989	\$1,135	0.31 %
Time deposits	194,481	1,095	1.13 %	199,465	900	0.90 %
Total deposits	927,638	2,996	0.65 %	920,454	2,035	0.44 %
Other borrowed funds	51,832	400	1.54 %	77,896	571	1.47 %
Total Interest-bearing liabilities	979,470	3,396	0.69 %	998,350	2,606	0.52 %
Noninterest-bearing liabilities						
Demand deposits	209,169			199,555		
Other liabilities	8,456			7,414		
Stockholders' equity	167,905			168,420		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$1,365,000			\$1,373,739		
Net interest income		\$21,026	3.17 %		\$21,353	3.22 %
Spread Analysis						
Interest income/average assets	\$24,422	3.58 %		\$23,959	3.49 %	
Interest expense/average assets	\$3,396	0.50 %		\$2,606	0.38 %	
Net interest income/average assets	\$21,026	3.08 %		\$21,353	3.11 %	

Net Interest Income

For the six months ended June 30, 2018 and 2017, the Company's net interest margin adjusted for tax exempt income was 3.17% and 3.22%, respectively. Net interest income, prior to the adjustment for tax-exempt income, for the six months ended June 30, 2018 totaled \$20,397,000 compared to \$19,949,000 for the six months ended June 30, 2017.

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

For the six months ended June 30, 2018, interest income increased \$1,239,000, or 5%, when compared to the same period in 2017. The increase from 2017 was primarily attributable to increased loan rates and recognition of nonaccrual loan interest income on loans, offset by a decrease in interest income on tax-exempt investments.

Interest expense increased \$790,000, or 30%, for the six months ended June 30, 2018 when compared to the same period in 2017. The higher interest expense for the period is primarily attributable to higher rates on deposits due to market interest rates and competitive pressures.

Table of Contents

Provision for Loan Losses

The Company's provision for loan losses was \$93,000 and \$1,164,000 for the six months ended June 30, 2018 and 2017, respectively. An increase in the specific reserve on one loan credit and the growth in the loan portfolio was the primary factor for the provision for loan losses for the six months ended June 30, 2017, with no significant growth in the loan portfolio for the six months ended June 30, 2018. Net loan charge-offs were \$31,000 and \$483,000 for the six months ended June 30, 2018 and 2017, respectively. While the current provision for loan losses are not related to agricultural loans, the Iowa agricultural economy remains challenged as the result of the current low grain prices, potential tariff concerns on Iowa exports and excessive rainfall in a portion of our markets.

Noninterest Income and Expense

Noninterest income decreased \$351,000 for the six months ended June 30, 2018 compared to the same period in 2017. The decrease in noninterest income is primarily due to lower security gains, offset in part by higher wealth management income. The higher wealth management income was primarily due to an increase in one time estate fees. Exclusive of realized securities gains, noninterest income was 3% higher for the six months ended June 30, 2018 as compared to the same period in 2017.

Noninterest expense increased \$702,000 or 5% for the six months ended June 30, 2018 compared to the same period in 2017 primarily as a result of increases in salaries and employee benefits. This increase in salaries and benefits was primarily due to a one-time \$1,000 bonus paid to full-time employees, increases in employee benefit costs, additional personnel, changes in the Company's paid time off benefits and normal salary increases. The efficiency ratio was 56.2% for the six months ended June 30, 2018 as compared to 53.5% in 2017.

Income Taxes

The provision for income taxes expense for the six months ended June 30, 2018 and 2017 was \$2,127,000 and \$2,932,000, respectively, representing an effective tax rate of 20% and 29%, respectively. The expected combined federal and state tax rate was 25% and 37% for the six months ended June 30, 2018 and 2017, respectively. The lower expected tax rate in 2018 is due to the enactment of the Tax Cut and Jobs Act Bill on December 22, 2017. The lower than expected effective tax rate for both periods is primarily due to tax-exempt interest income.

Balance Sheet Review

As of June 30, 2018, total assets were \$1,362,055,000, a \$13,005,000 decrease compared to December 31, 2017. The decrease in assets was due primarily to a decrease in cash and due from banks and securities available-for-sale, offset in part by an increase in loans. This decrease in asset funding was primarily due to a decrease in FHLB advances and other borrowings, offset in part by an increase in deposits.

Investment Portfolio

The investment portfolio totaled \$478,733,000 as of June 30, 2018, a decrease of \$16,589,000 from the December 31, 2017 balance of \$495,322,000. The decrease in the investment portfolio was primarily due to maturities and call on municipal bonds.

On a quarterly basis, the investment portfolio is reviewed for other-than-temporary impairment. As of June 30, 2018, gross unrealized losses of \$7,513,000, are considered to be temporary in nature due to the interest rate environment of 2018 and other general economic factors. As a result of the Company's favorable liquidity position, the Company does not have the intent to sell securities with an unrealized loss at the present time. In addition, management believes it is more likely than not that the Company will hold these securities until recovery of their fair value to cost basis and avoid considering present unrealized loss positions to be other-than-temporary.

Table of Contents

At June 30, 2018, the Company's investment securities portfolio included securities issued by 256 government municipalities and agencies located within 20 states with a fair value of \$223.2 million. At December 31, 2017, the Company's investment securities portfolio included securities issued by 272 government municipalities and agencies located within 25 states with a fair value of \$261.6 million. No one municipality or agency represents a concentration within this segment of the investment portfolio. The largest exposure to any one municipality or agency as of June 30, 2018 was \$4.3 million (approximately 2.0% of the fair value of the governmental municipalities and agencies) represented by the Dubuque, Iowa Community School District to be repaid by sales tax revenues and property taxes.

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

Table of Contents

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

	2018		2017	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Obligations of states and political subdivisions:				
General Obligation bonds:				
Iowa	\$53,078	\$52,451	\$56,029	\$55,829
Texas	11,521	11,457	12,141	12,174
Pennsylvania	9,725	9,689	8,719	8,745
Washington	6,961	6,766	7,017	6,900
Other (2018: 13 states; 2017: 17 states)	19,544	19,630	22,023	22,228
Total general obligation bonds	\$100,829	\$99,993	\$105,929	\$105,876
Revenue bonds:				
Iowa	\$114,333	\$113,693	\$122,044	\$122,140
Other (2018: 9 states; 2017: 9 states)	9,598	9,541	9,376	9,397
Total revenue bonds	\$123,931	\$123,234	\$131,420	\$131,537
Total obligations of states and political subdivisions	\$224,760	\$223,227	\$237,349	\$237,413

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

	2018		2017	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Revenue bonds by revenue source				
Sales tax	\$72,868	\$72,788	\$74,631	\$74,973
Water	11,776	11,528	12,763	12,611
College and universities, primarily dormitory revenues	9,240	9,193	10,452	10,443
Leases	9,556	9,454	9,383	9,331

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

Electric	7,371	7,345	7,382	7,416
Other	13,120	12,926	16,809	16,763
Total revenue bonds by revenue source	\$123,931	\$123,234	\$131,420	\$131,537

Loan Portfolio

The loan portfolio, net of the allowance for loan losses, totaled \$780,260,000, \$771,550,000 and \$768,208,000 as of June 30, 2018, December 31, 2017 and June 30, 2017, respectively. Loan demand has moderated since year end.

Table of Contents

Deposits

Deposits totaled \$1,151,815,000, \$1,134,391,000 and \$1,126,771,000 as of June 30, 2018, December 31, 2017 and June 30, 2017, respectively. The increase in deposits since December 31, 2017 was primarily due to increases in commercial and public funds NOW account balances, retail savings account balances and money market account balances, offset in part by a decrease in retail NOW account balances. The increase in deposits since June 30, 2017 was primarily due to increases in retail and commercial demand deposit and retail savings account balances.

Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase totaled \$34,108,000 as of June 30, 2018, a decrease of \$3,317,000, or 9%, from the December 31, 2017 balance of \$37,425,000.

Off-Balance Sheet Arrangements

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

Asset Quality Review and Credit Risk Management

The Company's credit risk is historically centered in the loan portfolio, which on June 30, 2018 totaled \$780,260,000 compared to \$771,550,000 as of December 31, 2017. Net loans comprise 57% of total assets as of June 30, 2018. The object in managing loan portfolio risk is to reduce the risk of loss resulting from a customer's failure to perform according to the terms of a transaction and to quantify and manage credit risk on a portfolio basis. The Company's level of problem loans (consisting of nonaccrual loans and loans past due 90 days or more) as a percentage of total loans was 0.49% at June 30, 2018, as compared to 0.62% at December 31, 2017 and 0.66% at June 30, 2017. The Company's level of problem loans as a percentage of total loans at June 30, 2018 of 0.49% is slightly lower than the Company's peer group (334 bank holding companies with assets of \$1 billion to \$3 billion) of 0.66% as of March 31, 2018.

Impaired loans, net of specific reserves, totaled \$3,014,000 as of June 30, 2018 and have decreased \$985,000 as compared to the impaired loans of \$3,999,000 as of December 31, 2017.

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

The Company had TDRs of \$2,828,000 as of June 30, 2018, all of which were included in impaired and nonaccrual loans. The Company had TDRs of \$2,984,000 as of December 31, 2017, all of which were included in impaired and nonaccrual loans.

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

Table of Contents

For TDRs that were on nonaccrual status before the modification, a specific reserve may already be recorded. In periods subsequent to modification, the Company will continue to evaluate all TDRs for possible impairment and, as necessary, recognize impairment through the allowance. A \$80,000 specific reserve was established in the three and six months ended June 30, 2018 on a TDR loan, respectively. The Company had \$12,000 of charge-offs related to TDRs for the six months ended June 30, 2018. A \$500,000 specific reserve was established in the six months ended June 30, 2017 on a TDR loan. The Company had \$12,000 and \$257,000 of net charge-offs related to TDRs for the six months ended June 30, 2018 and 2017, respectively.

Loans past due 90 days or more that are still accruing interest are reviewed no less frequently than quarterly to determine if there continues to be a strong reason that the credit should not be placed on non-accrual. As of June 30, 2018, non-accrual loans totaled \$3,803,000 and there was a loan in the amount of \$96,000 that was past due 90 days and still accruing. This compares to non-accrual loans of \$4,810,000 and loans past due 90 days and still accruing totaled \$18,000 as of December 31, 2017. Other real estate owned totaled \$386,000 as of June 30, 2018 and December 31, 2017.

The agricultural real estate and agricultural operating loan portfolio classifications remain elevated as a result of lower grain prices. The watch and special mention loans in these categories totaled \$37,104,000 as of June 30, 2018 as compared to \$42,754,000 as of December 31, 2017. The substandard loans in these categories totaled \$9,326,000 as of June 30, 2018 as compared to \$2,725,000 as of December 31, 2017. The Iowa agricultural economy remains challenged as the result of the current low grain prices, potential tariff concerns on Iowa exports and excessive rainfall in a portion of our markets.

The allowance for loan losses as a percentage of outstanding loans as of June 30, 2018 was 1.44%, as compared to 1.45% at December 31, 2017. The allowance for loan losses totaled \$11,383,000 and \$11,321,000 as of June 30, 2018 and December 31, 2017, respectively. Net charge-offs of loans totaled \$31,000 and \$483,000 for the six months ended June 30, 2018 and 2017, respectively.

The allowance for loan losses is management's best estimate of probable losses inherent in the loan portfolio as of the balance sheet date. Factors considered in establishing an appropriate allowance include: an assessment of the financial condition of the borrower, a realistic determination of value and adequacy of underlying collateral, the condition of the local economy and the condition of the specific industry of the borrower, an analysis of the levels and trends of loan categories and a review of delinquent and classified loans.

Liquidity and Capital Resources

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

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

Table of Contents

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

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

Review of the Company's Current Liquidity Sources

Review of Statements of Cash Flows

Company Only Cash Flows

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

Capital Resources

Review of the Company's Current Liquidity Sources

Liquid assets of cash and due from banks and interest-bearing deposits in financial institutions as of June 30, 2018 and December 31, 2017 totaled \$62,386,000 and \$69,420,000, respectively, and provide an adequate level of liquidity given current economic conditions.

Other sources of liquidity available to the Banks as of June 30, 2018 include outstanding lines of credit with the FHLB of Des Moines, Iowa of \$185,490,000, with \$2,000,000 of outstanding FHLB advances. Federal funds borrowing capacity at correspondent banks was \$109,035,000, with no outstanding federal fund purchase balances as of June 30, 2018. The Company had securities sold under agreements to repurchase totaling \$34,108,000 as of June 30, 2018.

Total investments as of June 30, 2018 were \$478,733,000 compared to \$495,322,000 as of December 31, 2017. These investments provide the Company with a significant amount of liquidity since all of the investments are classified as available-for-sale as of June 30, 2018.

The investment portfolio serves an important role in the overall context of balance sheet management in terms of balancing capital utilization and liquidity. The decision to purchase or sell securities is based upon the current

assessment of economic and financial conditions, including the interest rate environment, liquidity and credit considerations. The portfolio's scheduled maturities and payments represent a significant source of liquidity.

Review of Statements of Cash Flows

Net cash provided by operating activities for the six months ended June 30, 2018 totaled \$9,157,000 compared to \$9,434,000 for the six months ended June 30, 2017.

Net cash provided by (used in) investing activities for the six months ended June 30, 2018 was \$1,910,000 compared to \$(12,042,000) for the six months ended June 30, 2017. The increase of \$13,952,000 in cash provided by investing activities was primarily due to lower purchases of securities of \$21,497,000 and a net increase in the change in the loan portfolio of \$8,576,000, offset in part by decreases in the proceeds from the sale of securities available-for-sale of \$10,824,000.

Net cash used in financing activities for the six months ended June 30, 2018 totaled \$16,910,000 compared to \$7,296,000 for the six months ended June 30, 2017. The change of \$9,614,000 in net cash used in financing activities was primarily due to repayments on FHLB and other borrowings, offset in part by a net decrease in the change in the securities sold under agreements to repurchase. As of June 30, 2018, the Company did not have any external debt financing, off-balance sheet financing arrangements, or derivative instruments linked to its stock.

Table of Contents

Company Only Cash Flows

The Company's liquidity on an unconsolidated basis is heavily dependent upon dividends paid to the Company by the Banks. The Banks provide adequate liquidity to pay the Company's expenses and stockholder dividends. Dividends paid by the Banks to the Company amounted to \$5,690,000 and \$5,345,000 for the six months ended June 30, 2018 and 2017, respectively. Various federal and state statutory provisions limit the amounts of dividends banking subsidiaries are permitted to pay to their holding companies without regulatory approval. Federal Reserve policy further limits the circumstances under which bank holding companies may declare dividends. For example, a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition. In addition, the Federal Reserve and the FDIC have issued policy statements, which provide that insured banks and bank holding companies should generally pay dividends only out of current operating earnings. Federal and state banking regulators may also restrict the payment of dividends by order. The quarterly dividend declared by the Company increased to \$0.23 per share in 2018 from \$0.22 per share in 2017.

The Company, on an unconsolidated basis, has interest bearing deposits totaling \$13,101,000 as of June 30, 2018 that are presently available to provide additional liquidity to the Banks.

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

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

Capital Resources

The Company's total stockholders' equity as of June 30, 2018 totaled \$167,941,000 and was \$2,812,000 lower than the \$170,753,000 recorded as of December 31, 2017. The decrease in stockholders' equity was primarily due to an increase in other comprehensive loss and dividends declared, offset in part by net income. The increase in other comprehensive loss is created by higher market interest rates compared to December 31, 2017, which resulted in lower fair values in the securities available-for-sale portfolio. At June 30, 2018 and December 31, 2017, stockholders' equity as a percentage of total assets was 12.33% and 12.42%, respectively. The capital levels of the Company exceed applicable regulatory guidelines as of June 30, 2018.

Table of Contents

Forward-Looking Statements and Business Risks

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Item 4. Controls and Procedures

As of the end of the period covered by this report, an evaluation was performed under the supervision and with the participation of the Company's management, including the Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in

Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended). Based on that evaluation, the Company's management, including the Principal Executive Officer and Principal Financial Officer, concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms.

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

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Not applicable

Item 1.A. Risk Factors

None.

Table of Contents

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

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

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

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Maximum Number of Shares that May Yet Be Purchased Under The Plan
April 1, 2018 to April 30, 2018	-	\$ -	-	100,000
May 1, 2018 to May 31, 2018	-	\$ -	-	100,000
June 1, 2018 to June 30, 2018	-	\$ -	-	100,000
Total	-		-	

Item 3. Defaults Upon Senior Securities

Not applicable

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other information

Not applicable

51

Table of Contents

Item 6. Exhibits

2 Stock purchase agreement (incorporated by reference to Exhibit 2 to the Form 10-Q filed on May 8, 2018).

31.1 Certification of Principal Executive Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.

31.2 Certification of Principal Financial Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.

32.1 Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350.

32.2 Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350.

101.INS XBRL Instance Document (1)

101.SCH XBRL Taxonomy Extension Schema Document (1)

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document (1)

101.LAB XBRL Taxonomy Extension Label Linkbase Document (1)

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

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

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

Table of Contents

SIGNATURES

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

AMES NATIONAL CORPORATION

DATE: August 7, 2018

By: /s/ John P. Nelson

John P. Nelson, Chief Executive Officer and President

By: /s/ John L. Pierschbacher

John L. Pierschbacher, Chief Financial Officer

Table of Contents

EXHIBIT INDEX

The following exhibits are filed herewith:

Exhibit No. Description

2 Stock purchase agreement (incorporated by reference to Exhibit 2 to the Form 10-Q filed on May 8, 2018).

31.1 Certification of Principal Executive Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.

31.2 Certification of Principal Financial Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.

32.1 Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350.

32.2 Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350.

101.INS XBRL Instance Document (1)

101.SCH XBRL Taxonomy Extension Schema Document (1)

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document (1)

101.LAB XBRL Taxonomy Extension Label Linkbase Document (1)

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

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

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