# BUILDING STRONGER COMMUNITIES.

FCN BANC CORP

2017 Annual Report


## TABLE OF CONTENTS

People First ........................................ 2
Community Business ................................ 3
Strength ............................................... 4
Board of Directors .................................. 5
Highlights ............................................ 6
Graphs ................................................. 7
Independent Auditor's Report ................... 8
Financial Statements ............................... 9

# THE BANK NEXT DOOR

While other banks spent the year merging, selling out, and leaving communities, FCN continued doing what we do best… building stronger communities. We stood shoulder to shoulder with friends and neighbors in 2017 and reminded them what we're about. From the Connersville Shred Day to Canoefest/ Fireworks in Brookville to the Tuesday night summer concert series in Harrison and all the local 4H fairs in between, FCN people showed through their actions that we are a local bank that people can count on.

# PEOPLE FIRST

Banking is about people above all else. Our people spent 2017 reminding our customers that they are the priority at FCN. They take great pride in providing stellar customer service which seems to be becoming rarer these days. They treat our customers like people, not accounts. They go the extra mile, especially when it would be easier not to. We have dozens of remarkable stories of FCN people going above and beyond for customers in 2017, but in the interest of conserving space, we'll share just one, as related by the FCN employee herself.

*"A customer reached for the door right at 4:00 as I was locking it for the day. I could tell they needed help, so I let them in and locked it behind them. They sat down across from me and said, "I need to remove an owner from my accounts. I was kicked out of my house without any of my belongings, not even a phone to call someone to pick me up." I just listened as they spoke. "I had to walk a mile and a half, so I could call someone to come get me." At this point I wanted to cry for them. "I've spent all day trying to find a place to live. How do you order checks without an address?" After over an hour we had taken care of most of what they needed. The next day, we made calls to update their banking information with their automatic debits. I can't imagine being in their position. I was glad I could provide a little help when they needed it."*

# COMMUNITY BUSINESS

The advantage of being a community bank is knowing the businesses in your communities. 2017 was another year in which FCN people spent a majority of their time out in the community helping small businesses. Local business owners truly appreciate the service that FCN gives them – personal, responsive service. They like that we know their names when they walk in, we know how they like to do their banking, and we understand their time is valuable. A great example of the difference FCN makes to businesses in the community is a concrete contracting business. Three years ago, none of the big banks would give them the time of day, but FCN helped them out and obtained SBA financing. A little over three years later, this company employs over 20 people in the community, they have purchased a building with cash, and have almost paid off their original loan. Imagine if FCN hadn't recognized their potential. That's the power of a community bank.

# STRENGTH

Dear Shareholders:

While the U.S. economy has been recovering slowly, yet unevenly, since the depths of the recession in 2009, fiscal year 2017 was characterized by strong performance in several key indices. Business and consumer confidence began to fuel capital investment and job creation. The labor market improved to pre-crisis employment levels. Strength was also seen with increases in residential and commercial construction activity. While the passage of the 2017 Tax Reform Act at the end of the year is expected to fuel further economic growth, its provisions impacted the final, reported 2017 earnings for FCN.

On an after-tax basis, earnings for FCN in 2017 were $3,995,199 compared to $3,961,785 in 2016. This equates to earnings of $2.66 per share versus $2.63 per share last year. The Bank, like many financial institutions, was required to devalue its deferred tax assets at year-end to reflect the lower marginal tax rates going into effect on January 1st. The negative adjustment to FCN's deferred tax asset was $350,490. In addition, it was advantageous for the Bank to sell certain investments at year-end at the higher effective tax rate.

Before taxes and these adjustments, FCN generated pre-tax earnings of $5,738,622 compared to $5,360,464 in 2016. This was a result of yet another strong year for our core banking operations. Gross loans including 1-4 family held for sale increased 4.1% to $242.3 million. This was in spite of a 20% decline in 1-4 family mortgage loan refinancing. Growth was experienced in the commercial loan sector and in construction and development loans. Asset quality continues to be especially strong with loan delinquencies less than 1% of gross loans. Non-interest-bearing deposits increased 13.5% during the year while interest-bearing deposits dropped $1.9 million to $311.5 million.

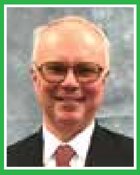
For 2017, FCN posted an after-tax Return on Average Assets of .91% compared to .93% in 2016. Return on Average Equity also dropped to 8.80% from 9.07% the previous year. The Tier 1 Capital Leverage strengthened from 9.94% to 10.15%. With the momentum of the core banking operations and the lower tax environment, we believe the Bank is well-positioned for a strong 2018.

This year we will experience two local banks in our market complete the sale of their operations to out-of-town holding companies. FCN is committed to remaining locally-owned and serving our customers and communities in southeast Indiana and southwest Ohio. All of us at FCN have rededicated ourselves to our mission of "serving our communities by designing financial products to build stronger businesses and families for generations to come."

This re-dedication to our mission can be seen in the design of this Annual Report. This design is part of a new campaign we are launching "**FCN Bank. Building stronger communities**." Moving forward, this theme will be part of our advertising and marketing efforts to remind the people in our community of our priorities. We will continuously remind people that FCN is committed to staying in our communities and continuing to serve our friends and neighbors. So, look for the FCN green this coming year with bold, attention-getting words!

The Annual Meeting of FCN Banc Corp. will be Tuesday, May 15, 2018 at 10:00AM at the Schilling Center located at 900 Mill Street in Brookville, Indiana. The Directors and Employees look forward to seeing you there.

Sincerely,



Kenneth T. Wanstrath
*Chairman, Board of Directors*

Thomas D. Horninger
*President & CEO*

FCN BANC CORP

## FCN BANC CORP OFFICERS

Kenneth T. Wanstrath, Chairman
Thomas D. Horninger, President
James R. Clark, IV, Secretary
April A. Berne, Treasurer

## DIRECTORS EMERITUS

Fred Chappelow
James A. Hyde
Randall W. Listerman
Jane C. Ludwig
Edwin D. Roberts
Donald R. Smith
Keith L. Tebbe

## 2017 BOARD OF DIRECTORS

### FRONT ROW

Thomas D. Horninger
*President & CEO, FCN Bank, N.A.*

Kenneth R. Wanstrath
*President, New Point Stone*

Arthur K. Hildebrand
*President of FCN Banc Corp. and*
*President & CEO, FCN Bank, N.A. – Retired*

### BACK ROW

Dr. K. Andrew Yaryan
*Owner, Yaryan Eye Care Centers*

Brad M. Tebbe
*Owner, Brad M. Tebbe CPA, LLC*

Kevin D. Lyons
*President & Partner, Hawk Insurance Agency*

Ronald J. Knueven
*CPA & Shareholder, RSBK Partners, PC*

Devin W. Listerman
*Senior Vice President, Pure Health Solutions*

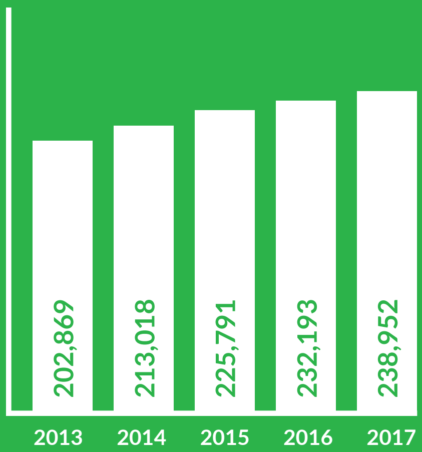
# HIGHLIGHTS

## FCN Banc Corp. Financial Highlights

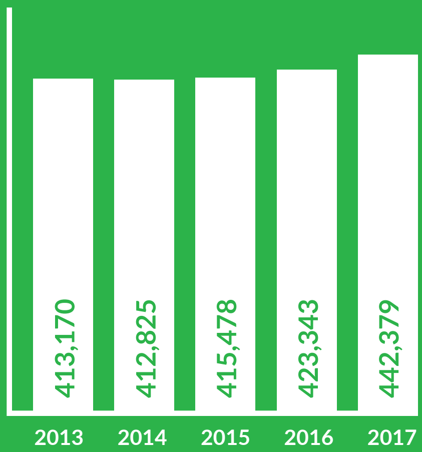
For the years ended December 31, 2017 and 2016
(in thousands, except per share data)

| Earnings & Dividends | 2017 | 2016 | % Change |
|---|---|---|---|
| Net Income | 3,995 | 3,962 | 0.83% |
| Cash Dividends Declared | 1,683 | 1,625 | 3.57% |
| **Per Share** | | | |
| Earnings | 2.66 | 2.63 | 1.14% |
| Cash Dividends Declared | 1.12 | 1.08 | 3.70% |
| Year-End Book Value | 31.07 | 29.34 | 5.90% |
| Year-End Market Price | 29.50 | 29.50 | 0.00% |
| **At Year-End** | | | |
| Assets | 442,379 | 432,343 | 2.32% |
| Loans and Leases | 238,952 | 232,193 | 2.91% |
| Deposits | 384,049 | 377,186 | 1.82% |
| Shareholders' Equity | 46,697 | 44,095 | 5.90% |
| **Key Ratios** | | | |
| Return on Average Assets (ROA) | 0.91% | 0.93% | -2.27% |
| Return on Average Equity (ROE) | 8.80% | 9.07% | -2.92% |
| Net Interest Margin | 3.31% | 3.17% | 4.28% |
| **Efficiency Ratio** | 63.70% | 61.60% | 3.42% |
| Average Shareholders' Equity to Average Assets | 10.38% | 10.31% | 0.67% |
| **Actuals** | | | |
| Number of Shares | 1,502,740 | 1,502,740 | 0.00% |

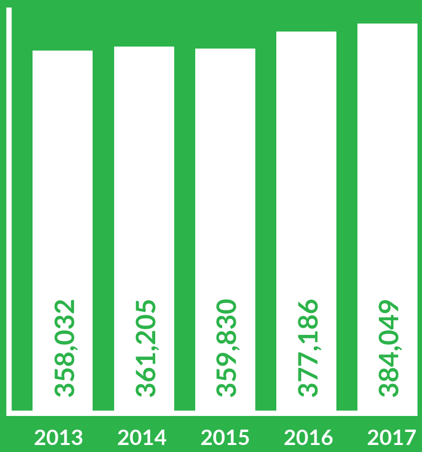
# GRAPHS



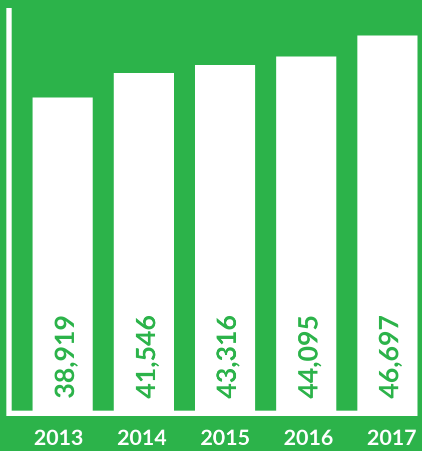

**NET LOANS**
(in Thousands)



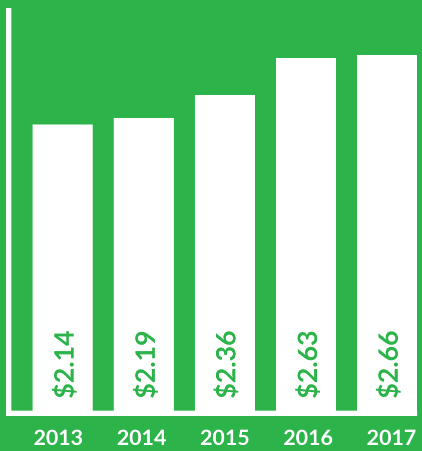

**TOTAL ASSETS**
(in Thousands)




**TOTAL DEPOSITS**
(in Thousands)




**SHAREHOLDERS’ EQUITY**
(in Thousands)




**EARNINGS PER SHARE**

One East Fourth Street, Suite 1200, Cincinnati, Ohio 45202
P. 513.241.3111 | F. 513.241.1212 | cshco.com

**INDEPENDENT AUDITORS' REPORT**

Board of Directors
FCN Banc Corp.

We have audited the accompanying consolidated statements of financial condition of FCN Banc Corp. as of December 31, 2017 and 2016, and the related consolidated statements of earnings, comprehensive income, shareholders' equity and cash flows for the years then ended.

**Management's Responsibility for the Financial Statements**
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

**Auditors' Responsibility**
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risk of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purposes of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**
In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of FCN Banc Corp. as of December 31, 2017 and 2016, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Clark, Schaefer, Hackett & Co.

Cincinnati, Ohio
March 20, 2018

# FINANCIAL STATEMENTS

# CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

December 31, 2017 and 2016
(in thousands, except per share data)

| **ASSETS** | **2017** | **2016** |
|---|---|---|
| Cash and due from banks | $ 4,015 | $ 4,737 |
| Interest-bearing deposits in other financial institutions | 22,368 | 18,699 |
| Federal funds sold | 259 | 54 |
| Cash and cash equivalents | 26,642 | 23,490 |
| | | |
| Investment securities designated as available for sale - at market | 72,555 | 71,669 |
| Investment securities designated as held to maturity - at amortized cost | 3,344 | 3,913 |
| Mortgage-backed securities designated as available for sale - at market | 74,025 | 76,627 |
| Loans held for sale - at lower of cost or fair value | 3,390 | 535 |
| Loans receivable - net | 238,952 | 232,193 |
| Office premises and equipment - at depreciated cost | 5,453 | 5,689 |
| Real estate acquired through foreclosure - net | 164 | - |
| Federal Reserve and Federal Home Loan Bank stock - at cost | 1,104 | 1,104 |
| Accrued interest receivable on loans | 854 | 726 |
| Accrued interest receivable on investments and interest-bearing deposits | 700 | 668 |
| Accrued interest receivable on mortgage-backed securities | 166 | 167 |
| Bank owned life insurance | 10,552 | 10,292 |
| Prepaid expenses and other assets | 1,637 | 1,677 |
| Goodwill | 2,119 | 2,119 |
| Prepaid income taxes | - | 176 |
| Deferred income taxes | 722 | 1,298 |
| | | |
| Total assets | **$442,379** | **$432,343** |
| | | |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Deposits | | |
| Non-interest bearing | $ 72,476 | $ 63,694 |
| Interest bearing | 311,573 | 313,492 |
| Total deposits | 384,049 | 377,186 |
| | | |
| Short-term borrowings | 9,307 | 8,775 |
| Accrued interest payable | 365 | 394 |
| Investments payable | 19 | 19 |
| Dividends payable | 421 | 406 |
| Accrued income taxes | 69 | - |
| Other liabilities | 1,452 | 1,468 |
| Total liabilities | 395,682 | 388,248 |
| | | |
| Shareholders' equity | | |
| Common stock - $6.25 par value, 10,000,000 shares authorized; 1,576,960 shares issued | 9,856 | 9,856 |
| Additional paid-in capital | 620 | 620 |
| Retained earnings - restricted | 37,299 | 35,016 |
| Treasury shares - at cost, 74,220 shares at December 31, 2017 and 2016, respectively | (1,251) | (1,251) |
| Accumulated comprehensive gain (loss), unrealized gains (losses) on securities designated as available for sale, net of related tax effects | 173 | (146) |
| Total shareholders' equity | 46,697 | 44,095 |
| | | |
| Total liabilities and shareholders' equity | **$442,379** | **$432,343** |

The accompanying notes are an integral part of these statements.

# CONSOLIDATED STATEMENTS OF EARNINGS

December 31, 2017 and 2016
(in thousands, except per share data)

| | 2017 | 2016 |
|---|---|---|
| **Interest income** | | |
| Loans | $ 11,097 | $ 10,524 |
| Investment securities | 1,903 | 1,990 |
| Mortgage-backed securities | 1,467 | 1,373 |
| Interest-bearing deposits and other | 353 | 208 |
| Total interest income | 14,820 | 14,095 |
| Interest expense | | |
| Deposits | 1,652 | 1,729 |
| FHLB advances | - | 3 |
| Short-term borrowings | 80 | 68 |
| Total interest expense | 1,732 | 1,800 |
| Net interest income | 13,088 | 12,295 |
| Provision for losses on loans | - | 75 |
| Net interest income after provision for losses on loans | 13,088 | 12,220 |
| **Noninterest income (expense)** | | |
| Service charges on deposit accounts | 438 | 434 |
| Gain (loss) on sale of investments and mortgage-backed securities | (56) | 18 |
| Gain on sale of loans | 275 | 360 |
| Service charges on sold loans | 304 | 312 |
| Loss on disposal of premises and equipment | - | (33) |
| Loss on sale of real estate acquired through foreclosure | - | (39) |
| Check and ATM card fees | 528 | 445 |
| Increase in cash surrender value of bank owned life insurance | 260 | 270 |
| Other operating | 971 | 93 |
| Total noninterest income | 2,720 | 1,860 |
| **Noninterest expense** | | |
| Employee compensation and benefits | 5,410 | 5,215 |
| Occupancy and equipment | 580 | 554 |
| Equipment expense | 388 | 331 |
| Audit and examination fees | 447 | 365 |
| Software maintenance fees | 456 | 358 |
| FDIC premium | 143 | 172 |
| Marketing | 241 | 261 |
| Other operating | 2,405 | 1,463 |
| Total noninterest expense | 10,070 | 8,719 |
| Earnings before income taxes | 5,738 | 5,361 |
| **Income taxes** | | |
| Current | 1,318 | 944 |
| Deferred | 425 | 455 |
| Total income taxes | 1,743 | 1,399 |
| NET EARNINGS | **$ 3,995** | **$ 3,962** |
| Basic earnings per share | **$2.66** | **$2.63** |
| Weighted-average shares outstanding | **1,502,740** | **1,505,192** |

The accompanying notes are an integral part of these statements.

# CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

December 31, 2017 and 2016
(in thousands)

| | 2017 | 2016 |
|---|---|---|
| **Net earnings** | $3,995 | $3,962 |
| Other comprehensive income, net of tax: | | |
| Unrealized holding gains (losses) on securities during the year, net of taxes (benefits) of $142 and $(785) for the years ended December 31, 2017 and 2016, respectively | 282 | (1,469) |
| Reclassification adjustment for realized (gains) losses included in earnings, net of tax expense (benefit) of $(19) and $6 for the years ended December 31, 2017 and 2016, respectively | 37 | (12) |
| Comprehensive income | **$4,314** | **$2,481** |

The accompanying notes are an integral part of these statements.

# CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

December 31, 2017 and 2016
(in thousands, except per share data)

| | Common shares outstanding | Common stock | Additional paid-in capital | Retained earnings | Treasury stock | Unrealized gains (losses) on securities designated as available for sale | Total |
|---|---|---|---|---|---|---|---|
| **Balance at January 1, 2016** | 1,505,338 | $9,856 | $620 | $32,679 | $(1,174) | $1,335 | $43,316 |
| Net earnings for the year ended December 31, 2016 | - | - | - | 3,962 | - | - | 3,962 |
| Purchase of treasury shares - at cost | (2,598) | - | - | - | (77) | - | (77) |
| Unrealized losses on securities designated as available for sale, net of recognized sales and related tax effects | - | - | - | - | - | (1,481) | (1,481) |
| Cash dividends of $1.08 per share | - | - | - | (1,625) | - | - | (1,625) |
| **Balance at December 31, 2016** | **1,502,740** | **$9,856** | **$620** | **$35,016** | **$(1,251)** | **$(146)** | **$44,095** |
| Net earnings for the year ended December 31, 2017 | - | - | - | 3,995 | - | - | 3,995 |
| Unrealized losses on securities designated as available for sale, net of recognized sales and related tax effects | - | - | - | - | - | 290 | 290 |
| Reclassification of stranded tax effects from change in federal tax rate | - | - | - | (29) | - | 29 | - |
| Cash dividends of $1.12 per share | - | - | - | (1,683) | - | - | (1,683) |
| **Balance at December 31, 2017** | **1,502,740** | **$9,856** | **$620** | **$37,299** | **$(1,251)** | **$173** | **$46,697** |

The accompanying notes are an integral part of these statements.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

December 31, 2017 and 2016
(in thousands)

| | 2017 | 2016 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net earnings for the year | $ 3,995 | $ 3,962 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation | 398 | 329 |
| Amortization | 244 | 256 |
| Amortization of premiums on investments and mortgage-backed securities, net | 954 | 693 |
| Amortization of deferred loan origination fees | (107) | (98) |
| Loss (gain) on sale of investments and mortgage-backed securities | 56 | (18) |
| Loans originated for sale in the secondary market | (25,431) | (28,349) |
| Proceeds from sale of loans in the secondary market | 22,851 | 28,921 |
| Gain on sale of loans | (275) | (360) |
| Earnings on cash surrender value of life insurance | (260) | (270) |
| Provision for losses on loans | - | 75 |
| Loss on disposal of premises and equipment | - | 33 |
| Loss on sale of real estate acquired through foreclosure | - | 39 |
| Effects of change in operating assets and liabilities: | | |
| Accrued interest receivable on loans | (128) | (76) |
| Accrued interest receivable on investments | (32) | (32) |
| Accrued interest receivable on mortgage-backed securities | 1 | (3) |
| Prepaid expenses and other assets | (193) | (643) |
| Accrued interest payable | (29) | (38) |
| Other liabilities | (16) | 573 |
| Income taxes | | |
| Current | 245 | (264) |
| Deferred | 425 | 455 |
| Net cash provided by operating activities | $ 2,698 | $ 5,185 |
| | | |
| **Cash flows from investing activities:** | | |
| Purchase of investment securities designated as available for sale | (13,085) | (14,384) |
| Purchase of investment securities designated as held to maturity | - | (2) |
| Maturities of investment securities designated as available for sale | 12,241 | 17,227 |
| Maturities of investment securities designated as held to maturity | 567 | 500 |
| Purchase of mortgage-backed securities designated as available for sale | (19,935) | (25,215) |
| Proceeds from sale of mortgage-backed securities designated as available for sale | 5,681 | 4,405 |
| Principal repayments on mortgage-backed securities | 16,247 | 16,816 |
| Loan disbursements | (86,411) | (78,097) |
| Principal repayments on loans | 79,549 | 71,713 |
| Purchases of and additions to office premises and equipment | (162) | (1,424) |
| Proceeds from sale of real estate acquired through foreclosure | 35 | 45 |
| Net cash used in investing activities | $(5,273) | $(8,146) |
| | | |
| Net cash used in operating and investing activities (subtotal carried forward) | $(2,575) | $(3,231) |

The accompanying notes are an integral part of these statements.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

December 31, 2017 and 2016
(in thousands)

| | 2017 | 2016 |
|---|---|---|
| Net cash used in operating and investing activities (subtotal brought forward) | $ (2,575) | $ (3,231) |
| **Cash flows from financing activities:** | | |
| Net increase in deposit accounts | 6,863 | 17,356 |
| Net increase in short-term borrowings | 532 | 270 |
| Repayment of Federal Home Loan Bank advances | - | (2,000) |
| Dividends on common stock | (1,668) | (1,610) |
| Purchase of treasury shares | - | (77) |
| Net cash provided by financing activities | 5,727 | 13,939 |
| Net increase in cash and cash equivalents | 3,152 | 10,708 |
| Cash and cash equivalents at beginning of year | 23,490 | 12,782 |
| Cash and cash equivalents at end of year | **$ 26,642** | **$ 23,490** |
| **Supplemental disclosure of cash flow information:** | | |
| Cash paid during the year for: | | |
| Income taxes | **$ 1,055** | **$ 1,209** |
| Interest on deposits and borrowings | **$ 1,761** | **$ 1,838** |
| **Supplemental disclosure of noncash investing and financing activities:** | | |
| Transfers from loans to real estate acquired through foreclosure | **$ 199** | **$ -** |
| Recognition of mortgage servicing rights in accordance with Accounting standards | **$ 220** | **$ 280** |
| Dividends declared but unpaid | **$ 421** | **$ 406** |
| Reclassification of stranded tax effects from change in federal tax rate between unrealized gains on securities designated as available for sale and retained earnings | **$ 29** | **$ -** |

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE A - SUMMARY OF ACCOUNTING POLICIES**

FCN Banc Corp. (the "Corporation") is a bank holding company whose activities are primarily limited to holding the common shares of FCN Bank, NA, a nationally-chartered bank (the "Bank"). The Bank conducts a general banking business in southeast Indiana and southwest Ohio which consists of attracting deposits from the general public and applying those funds to the origination of loans for residential, consumer and commercial purposes. The Bank's wholly-owned subsidiary, FCN Holdings, Inc., was incorporated in 2002 for the primary purpose of managing a significant portion of the Bank's investment portfolio. In 2016, FCN Risk Management, Inc. was created as a wholly-owned subsidiary of the Corporation in order to provide property, casualty and liability insurance coverage to the Corporation.

The Bank's profitability is significantly dependent on its net interest income, which is the difference between interest income generated from interest-earning assets (i.e. loans and investments) and the interest expense paid on interest-bearing liabilities (i.e. customer deposits and borrowed funds). Net interest income is affected by the relative amount of interest-earning assets and interest-bearing liabilities and the interest received or paid on these balances. The level of interest rates paid or received by the Bank can be significantly influenced by a number of environmental factors, such as governmental monetary policy, that are outside of management's control.

The financial information presented herein has been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). In preparing consolidated financial statements in accordance with U.S. GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and revenues and expenses during the reporting period. A significant estimate is the allowance for loan losses. Actual results could differ from such estimates.

The following is a summary of the Corporation's significant accounting policies, which have been consistently applied in the preparation of the accompanying consolidated financial statements.

1. Principles of Consolidation

The consolidated financial statements of the Corporation include the accounts of both wholly-owned subsidiaries, the Bank and FCN Risk Management, Inc. The Bank's financial statements include its wholly-owned subsidiary, FCN Holdings, Inc. All significant intercompany balances and transactions have been eliminated.

2. Investment and Mortgage-Backed Securities

The Corporation accounts for investment and mortgage-backed securities in accordance with Standards for "Accounting for Certain Investments in Debt and Equity Securities," which requires that investments be categorized as held to maturity, trading, or available for sale. Securities classified as held-to-maturity are carried at cost only if the Corporation has the positive intent and ability to hold these securities to maturity. Securities designated as available for sale are carried at fair value with resulting unrealized gains or losses recorded to shareholders' equity. At December 31, 2017 and 2016, substantially all of the Bank's securities were classified as available for sale. Premiums or discounts associated with the purchase of investment securities are amortized or accreted using the interest method to arrive at periodic interest income at a constant effective yield on the net investment.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE A - SUMMARY OF ACCOUNTING POLICIES (CONTINUED)**

3. Loans Receivable

Loans held in portfolio are stated at the principal amount outstanding, adjusted for net deferred loan origination fees and the allowance for loan losses. Interest is accrued as earned, unless the collectability of the loan is in doubt. Uncollectible interest on loans that are contractually past due is charged off, or an allowance is established based on management's periodic evaluation. The allowance is established by a charge to interest income equal to all interest previously accrued, and income is subsequently recognized only to the extent that cash payments are received until, in management's judgment, the borrower's ability to make periodic interest and principal payments has returned to normal, in which case the loan is returned to accrual status. If the ultimate collectability of the loan is in doubt, in whole or in part, all payments received on nonaccrual loans are applied to reduce principal until such doubt is eliminated.

Loans held for sale are carried at the lower of cost or fair value, determined in the aggregate. In computing cost, deferred loan origination fees are deducted from the principal balances of the related loans. Fair value is determined by reference to price quotations of government-sponsored enterprises in the secondary mortgage market. There were approximately $3,390,000 and $535,000 in loans held for sale at December 31, 2017 and 2016, respectively. These loans were settled within 30 days of these financial statements without fluctuation in their fair value.

The Bank accounts for mortgage servicing rights in accordance with the provisions of "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," which requires the Bank recognize as separate assets, rights to service mortgage loans for others, regardless of how those servicing rights are acquired. These standards require an entity to choose either the amortization method or the fair value measurement method for measuring each class of separately recognized servicing assets and servicing liabilities. The Bank has chosen to measure servicing assets using the amortization method.

The Bank added new mortgage servicing rights of approximately $220,000 and $280,000 and recorded amortization related to mortgage servicing rights totaling approximately $233,000 and $251,000 for the years ended December 31, 2017 and 2016, respectively. At December 31, 2017, the carrying value and fair value of the Bank's mortgage servicing rights totaled approximately $703,000 and $1,200,000, respectively. At December 31, 2016, the carrying value and fair value of the Bank's mortgage servicing rights totaled approximately $716,000 and $1,040,000, respectively.

4. Loan Origination Fees

The Bank accounts for loan origination fees in accordance with standards for "Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases." Pursuant to the provisions of this standard, origination fees received from loans, net of certain direct origination costs, are deferred and amortized to interest income using the interest method, giving effect to actual loan prepayments. Additionally, this standard generally limits the definition of loan origination costs to the direct costs attributable to originating a loan, i.e. principally actual personnel costs. Fees received for loan commitments that are expected to be drawn upon, based on the Bank's experience with similar commitments, are deferred and amortized over the life of the loan using the level-yield method. Fees for other loan commitments are deferred and amortized over the loan commitment period on a straight-line basis.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE A - SUMMARY OF ACCOUNTING POLICIES (CONTINUED)**

5. Allowance for Loan Losses

It is the Bank's policy to provide valuation allowances for estimated losses on loans based on past loss experience, trends in the level of delinquent and problem loans, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral and current economic conditions in the primary lending area. When the collection of a loan becomes doubtful, or otherwise troubled, the Bank records a loan loss provision equal to the difference between the present value of expected future cash flows or fair value of the property securing the loan and the loan's carrying value. Major loans and major lending areas are reviewed periodically to determine potential problems. The allowance for loan losses is increased by charges to earnings and decreased by charge-offs (net of recoveries).

The Bank accounts for impaired loans in accordance with standards for "Accounting by Creditors for Impairment of a Loan." These standards require that impaired loans be measured based upon the present value of expected future cash flows discounted at the loan's effective interest rate or, as an alternative, at the loan's observable market price or fair value of the collateral for collateral dependent loans. The Bank's current procedures for evaluating impaired loans result in carrying such loans at the lower of cost or fair value.

A loan is defined as impaired when, based on current information and events, it is probable that the bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. In applying the provisions of this standard, the Bank considers its investment in one-to-four-family residential loans and consumer installment loans to be homogeneous and therefore excluded from separate identification for evaluation of impairment. With respect to the Bank's investment in nonresidential and multi-family residential real estate loans and commercial loans, and its evaluation of impairment thereof, such loans are generally collateral dependent and, as a result, are carried as a practical expedient at the lower of cost or fair value of the underlying collateral.

Loans which are more than 90 days delinquent are considered to constitute more than a minimum delay in repayment and are evaluated for impairment under these standards at that time. Loans more than 90 days delinquent are generally classified as non-accrual.

The allowance for impaired loans is included in the Bank's general allowance for credit losses. The provision necessary to increase this allowance is included in the Bank's overall provision for losses on loans.

6. Real Estate Acquired Through Foreclosure

Real estate acquired through foreclosure is carried at the lower of the loan's unpaid principal balance (cost) or fair value less estimated selling expenses at the date of acquisition. In determining the lower of cost or fair value at acquisition, adjustments are charged to the allowance for loan losses. All subsequent adjustments to fair value are included in the statement of earnings, while costs relating to development and improvement of property are capitalized. Costs relating to holding real estate acquired through foreclosure, net of rental income, are charged against earnings as incurred.

7. Investment in Federal Home Loan Bank Stock

The Bank is required, as a condition of membership in the Federal Home Loan Bank of Indianapolis (FHLB), to maintain an investment in FHLB common stock. The stock is redeemable at par and, therefore, its cost is equivalent to its redemption value. The Bank's ability to redeem FHLB shares is dependent on the redemption practices of the FHLB of Indianapolis. At December 31, 2017, the FHLB of Indianapolis placed no restrictions on redemption of shares in excess of a member's required investment in the stock.

**NOTE A - SUMMARY OF ACCOUNTING POLICIES (CONTINUED)**

8. Office Premises and Equipment

Office premises and equipment are carried at cost and include expenditures which extend the useful lives of existing assets. Maintenance, repairs and minor renewals are expensed as incurred. For financial reporting, depreciation and amortization are provided on the straight-line and accelerated methods over the useful lives of the assets, estimated to be twenty-five to forty years for buildings, five to thirty-nine years for building improvements, five to fifteen years for furniture and equipment and three years for software. An accelerated depreciation method is used for tax reporting purposes.

9. Goodwill and Intangible Assets

The Bank recorded goodwill resulting from a branch purchase transaction completed in December 2003, totaling $2.1 million. Pursuant to accounting standards for "Goodwill and Intangible Assets" goodwill is subject to an impairment evaluation. Management has determined that no impairment charge related to goodwill was necessary for the years ended December 31, 2017 and 2016. The Bank is amortizing the goodwill for tax purposes over a fifteen-year period.

10. Income Taxes

The Corporation accounts for income taxes pursuant to standards for "Accounting for Income Taxes." In accordance with these standards, a deferred tax liability or deferred tax asset is computed by applying the current statutory tax rates to net taxable or deductible temporary differences between the tax basis of an asset or liability and its reported amount in the consolidated financial statements that will result in net taxable or deductible amounts in future periods. Deferred tax assets are recorded only to the extent that the amount of net deductible temporary differences or carry forward attributes may be utilized against current period earnings, carried back against prior years' earnings, offset against taxable temporary differences reversing in future periods, or utilized to the extent of management's estimate of future taxable income. Deferred tax liabilities are provided on the total amount of net temporary differences taxable in the future.

Deferral of income taxes results primarily from the different methods of accounting for certain retirement plans, mortgage servicing rights, general loan loss allowances and goodwill. Additional temporary differences result from depreciation computed using accelerated methods for tax purposes.

The Company's policy with regard to interest and penalty is to recognize interest through interest expense and penalties through other expense. In evaluating the Company's tax provisions and accruals, future taxable income, and the reversal of temporary differences, interpretations and tax planning strategies are considered. The Company believes their estimates are appropriate based on current facts and circumstances, and no interest or penalties relating to income taxes were incurred for the years ended December 31, 2017 or 2016.

11. Benefit Plans

The Corporation sponsors a postretirement plan (the "Plan") covering certain directors of the Bank. Based upon calculations received from the benefit plan administrators, the Bank recorded expense of approximately $46,000 for the year ended December 31, 2017 and $55,000 for the year ended December 31, 2016.

The Bank has a contributory 401(k) plan covering substantially all employees. Contributions to the plan are voluntary and are subject to matching by the Bank. The Bank's expense related to the 401(k) plan totaled approximately $112,000 and $116,000 for the years ended December 31, 2017 and 2016, respectively.

The Bank has a profit sharing plan, which provides for additional compensation to employees if the Bank meets certain performance goals. The Bank recorded expense of approximately $217,000 and $157,000 for the profit sharing plan for the years ended December 31, 2017 and 2016, respectively.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE A - SUMMARY OF ACCOUNTING POLICIES (CONTINUED)**

12. Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents includes cash and due from banks and interest-bearing deposits in other financial institutions with original maturities of less than 90 days.

13. Fair Value of Financial Instruments

Standards for “Disclosures about Fair Value of Financial Instruments” require disclosures of fair value of financial instruments, both assets and liabilities, whether or not recognized in the consolidated statement of financial condition, for which it is practicable to estimate that value. For financial instruments where quoted market prices are not available, fair values are based on estimates using present value and other valuation methods.

The methods used are greatly affected by the assumptions applied, including the discount rate and estimates of future cash flows. Therefore, the fair values presented may not represent amounts that could be realized in an exchange for certain financial instruments.

The following methods and assumptions were used by the Corporation in estimating its fair value disclosures for financial instruments at December 31, 2017 and 2016:

Cash and cash equivalents: The carrying amounts presented in the consolidated statements of financial condition for cash and cash equivalents are deemed to approximate fair value.

Investment and mortgage-backed securities: For investment and mortgage-backed securities, fair value is deemed to equal the quoted market price.

Loans receivable: The loan portfolio has been segregated into categories with similar characteristics, such as 1-4 family residential, multi-family residential, nonresidential real estate and consumer. These loan categories were further delineated into fixed-rate and adjustable-rate loans. The fair values for the resultant loan categories were computed via discounted cash flow analysis, using current interest rates offered for loans with similar terms to borrowers of similar credit quality.

Federal Reserve and Federal Home Loan Bank stock: The carrying amounts presented in the consolidated statements of financial condition are deemed to approximate fair value.

Interest Receivable/Payable: The fair values of interest receivable/payable approximate carrying values.

Mortgage Servicing Rights: The Bank accounts for mortgage servicing rights in accordance with the provisions of “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,” which requires that the Bank recognize as separate assets, rights to service mortgage loans for others, regardless of how those servicing rights are acquired. An institution that acquires mortgage servicing rights through either the purchase or origination of mortgage loans and sells those loans with servicing rights retained must allocate some of the cost of the loans to mortgage servicing rights.

Deposits: The fair value of non-interest bearing and interest-bearing demand and savings accounts is deemed to approximate the amount payable on demand at December 31, 2017 and 2016. Fair values for fixed-rate certificates of deposit have been estimated using a discounted cash flow calculation using the interest rates currently offered for deposits of similar remaining maturities.

Short-term borrowings: The actual interest rates at December 31, 2017 and 2016, approximate market rates and, thus, the carrying value closely approximates fair value.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE A - SUMMARY OF ACCOUNTING POLICIES (CONTINUED)**

13. Fair Value of Financial Instruments (continued)

Federal Home Loan Bank advances: The fair value of Federal Home Loan Bank advances has been estimated using discounted cash flow analysis, based on the interest rates currently offered for advances of similar remaining maturities.

Commitments to extend credit: For fixed-rate and adjustable-rate loan commitments, the fair value estimate considers the difference between current levels of interest rates and committed rates. At December 31, 2017 and 2016, the fair value of loan commitments was not material.

Based on the foregoing methods and assumptions, the carrying value and fair value of the Corporation's financial instruments are as follows at December 31:

| | **2017** | | **2016** | |
|---|---|---|---|---|
| | **Carrying value** | **Fair value** | **Carrying value** | **Fair value** |
| | (In thousands) | | | |
| Financial assets | | | | |
| Cash and cash equivalents | $ 26,642 | $ 26,642 | $ 23,490 | $ 23,490 |
| Investment and mortgage-backed securities | 149,924 | 149,917 | 152,209 | 152,246 |
| Loans receivable, including loans held for sale | 242,342 | 245,710 | 232,728 | 236,469 |
| Federal Reserve and Federal Home Loan Bank stock | 1,104 | 1,104 | 1,104 | 1,104 |
| Interest receivable | 1,720 | 1,720 | 1,561 | 1,561 |
| Mortgage servicing rights | 703 | 1,200 | 716 | 1,040 |
| Financial liabilities | | | | |
| Interest payable | $ 365 | $ 365 | $ 394 | $ 394 |
| Deposits | 384,049 | 383,936 | 377,186 | 372,476 |
| Short-term borrowings | 9,307 | 9,307 | 8,775 | 8,775 |

Accounting Standards for Fair Value Measurements defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This standard also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

**NOTE A - SUMMARY OF ACCOUNTING POLICIES (CONTINUED)**

13. Fair Value of Financial Instruments (continued)

Fair value methods and assumptions are set forth below for each type of financial instrument. Following is a description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Investments: Fair value on available for sale securities were based upon a market approach. Securities which are fixed income instruments that are not quoted on an exchange, but are traded in active markets, are valued using prices obtained from our custodian, which used third party data service providers. Available for sale securities includes U.S. agency securities, municipal bonds, corporate investments, student loan-backed securities, and mortgage-backed agency securities.

Impaired Loans: The Bank is predominately an asset based lender with real estate serving as collateral on a substantial majority of loans. Loans which are deemed to be impaired are primarily valued on a nonrecurring basis at the fair values of the underlying real estate collateral. Such fair values are obtained using independent appraisals, which the Corporation considers to be Level 2 inputs.

Real Estate Acquired Through Foreclosure: Real estate acquired through foreclosure assets are adjusted to fair value upon transfer of the loans to foreclosed assets. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value. Fair value is based upon independent appraisals, which the Corporation considers to be Level 2 inputs.

Fair value measurements for certain assets measured at fair value on a recurring basis:

| | | Fair Value Measurements (In thousands) | | |
|---|---|---|---|---|
| | Total | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant other unobservable inputs (Level 3) |
| **December 31, 2017** | | | | |
| Securities available for sale | | | | |
| U.S. Government agency obligations | $11,815 | - | $11,815 | - |
| State and municipal obligations | 56,190 | - | 56,190 | - |
| Corporate debt obligations | 1,775 | - | 1,775 | - |
| Asset-backed securities | 2,775 | - | 2,775 | - |
| U.S. Government agency participation certificates | 44,704 | - | 44,704 | - |
| CMO's and REMIC's | 29,321 | - | 29,321 | - |
| | Total | (Level 1) | (Level 2) | (Level 3) |
| **December 31, 2016** | | | | |
| Securities available for sale | | | | |
| U.S. Government agency obligations | $11,875 | - | $11,875 | - |
| State and municipal obligations | 52,138 | - | 52,138 | - |
| Corporate debt obligations | 3,803 | - | 3,803 | - |
| Asset-backed securities | 3,853 | - | 3,853 | - |
| U.S. Government agency participation certificates | 45,089 | - | 45,089 | - |
| CMO's and REMIC's | 31,538 | - | 31,538 | - |

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE A - SUMMARY OF ACCOUNTING POLICIES (CONTINUED)**

13. Fair Value of Financial Instruments (continued)

Fair value measurements for certain assets measured at fair value on a recurring basis:

| | | Fair Value Measurements (In thousands) | | |
|---|---|---|---|---|
| | Total | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant other unobservable inputs (Level 3) |
| **December 31, 2017** | | | | |
| Collateral Dependent Impaired Loans | $4,060 | - | 4,060 | - |
| Foreclosed Assets | 164 | - | 164 | - |
| **December 31, 2016** | | | | |
| Collateral Dependent Impaired Loans | $5,251 | - | 5,251 | - |
| Foreclosed Assets | - | - | - | - |

Goodwill arising from business combinations represents the value attributable to unidentifiable intangible elements in the business acquired. Goodwill recorded by the Bank in connection with its branch acquisitions relates to the inherent value in the business acquired and this value is dependent upon the Bank's ability to provide quality, cost-effective services in a competitive market place. As such, goodwill value is supported ultimately by revenue that is driven by the volume of business transacted. A decline in earnings as a result of a lack of growth or the inability to deliver cost-effective services over sustained periods can lead to impairment of goodwill that could adversely impact earnings in future periods. Goodwill is not amortized but is tested for impairment when indicators of impairment exist, or at least annually, to determine the reasonableness of the recorded amount. The balance of goodwill at December 31, 2017 and 2016 was $2,119,000.

14. Bank-Owned Life Insurance

The Bank has purchased life insurance policies on certain key executives. Bank-owned life insurance is recorded at its cash surrender value, or the amount that can be realized.

15. Advertising

Advertising costs are expensed when incurred. The Corporation's advertising expense totaled approximately $241,000 and $261,000 for the years ended December 31, 2017 and 2016, respectively.

16. Earnings Per Share

Basic earnings per share are computed based upon the weighted-average common shares outstanding during the year. Weighted-average common shares outstanding totaled 1,502,740 and 1,505,192 for the years ended December 31, 2017 and 2016, respectively.

Diluted earnings per share are computed by taking into consideration common shares outstanding and dilutive potential common share equivalents. The Corporation had no dilutive or potentially dilutive securities during the years ended December 31, 2017 and 2016.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE A - SUMMARY OF ACCOUNTING POLICIES (CONTINUED)**

17. Concentrations

The Corporation may at times maintain deposits in other financial institutions which exceed federally insured limits. The Corporation has not experienced any losses in such accounts and management does not believe it is exposed to significant risk on cash and cash equivalents. No deposit amounts in other financial institutions exceeded federally insured limits at December 31, 2017.

The Bank grants mortgage and other loans to customers located primarily in the south-eastern counties of Indiana and the south-western counties of Ohio. As such, a substantial portion of its debtors' ability to repay their loans is dependent upon the financial and economic health of the regional economy.

18. Reclassifications

Certain prior year amounts have been reclassified to conform to the 2017 consolidated financial statement presentation.

19. Recently Adopted Accounting Pronouncement

Accounting Standards Update 2018-02 was issued in February 2018 and allows for the reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The Corporation has early adopted this amendment and the reclassification is reflected in the consolidated financial statements.

20. Subsequent Events

The Corporation evaluates events and transactions occurring subsequent to the date of the consolidated financial statements for matters requiring recognition or disclosure in the consolidated financial statements. The accompanying consolidated financial statements consider events through March 20, 2018, date the consolidated financial statements were available to be issued.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE B - INVESTMENT AND MORTGAGE-BACKED SECURITIES**

The amortized cost, gross unrealized gains, gross unrealized losses and estimated fair value of investment securities at December 31, 2017 and 2016 are as follows (in thousands):

| 2017 | Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
|---|---|---|---|---|
| **Available for sale:** | | | | |
| U.S. Government agency obligations | $11,917 | $ - | $ 102 | $11,815 |
| State and municipal obligations | 55,537 | 843 | 190 | 56,190 |
| Corporate debt obligations | 1,801 | - | 26 | 1,775 |
| Asset-backed securities | 2,752 | 23 | - | 2,775 |
| Total securities available for sale | 72,007 | 866 | 318 | 72,555 |
| **Held to maturity:** | | | | |
| Investment in Section 42 housing | 299 | - | - | 299 |
| State and municipal obligations | 3,045 | 27 | 34 | 3,038 |
| | 3,344 | 27 | 34 | 3,337 |
| Total investment securities | **$75,351** | **$ 893** | **$352** | **$75,892** |

| 2016 | Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
|---|---|---|---|---|
| **Available for sale:** | | | | |
| U.S. Government agency obligations | $11,934 | $ 1 | $ 60 | $11,875 |
| State and municipal obligations | 51,926 | 879 | 667 | 52,138 |
| Corporate debt obligations | 3,798 | 7 | 2 | 3,803 |
| Asset-backed securities | 3,891 | 2 | 40 | 3,853 |
| Total securities available for sale | 71,549 | 889 | 769 | 71,669 |
| **Held to maturity:** | | | | |
| Investment in Section 42 housing | 349 | - | - | 349 |
| State and municipal obligations | 3,564 | 41 | 4 | 3,601 |
| | 3,913 | 41 | 4 | 3,950 |
| Total investment securities | **$75,462** | **$ 930** | **$773** | **$75,619** |

## NOTE B - INVESTMENT AND MORTGAGE-BACKED SECURITIES (CONTINUED)

The amortized cost and estimated fair value of investment securities by term to maturity at December 31 are shown below.

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Amortized cost | Estimated fair value | Amortized cost | Estimated fair value |
| | (In thousands) | | | |
| Due in one year or less | $ 9,382 | $ 9,373 | $ 9,499 | $ 9,525 |
| Due after one year to five years | 34,082 | 34,445 | 39,714 | 40,306 |
| Due after five years to ten years | 19,612 | 19,736 | 15,946 | 15,933 |
| Due after ten years | 12,275 | 12,338 | 10,303 | 9,855 |
| | **$75,351** | **$75,892** | **$75,462** | **$75,619** |

The amortized cost, gross unrealized gains, gross unrealized losses and estimated fair values of mortgage-backed securities at December 31, 2017 and 2016 are presented below.

| | 2017 | | | |
|---|---|---|---|---|
| | Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
| | (In thousands) | | | |
| **Available for sale:** | | | | |
| U.S. Government agency participation certificates | $44,735 | $273 | $ 304 | $44,704 |
| CMOs and REMICs | 29,618 | 31 | 328 | 29,321 |
| Total mortgage-backed securities | **$74,353** | **$304** | **$632** | **$74,025** |

| | 2016 | | | |
|---|---|---|---|---|
| | Amortized cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
| | (In thousands) | | | |
| **Available for sale:** | | | | |
| U.S. Government agency participation certificates | $45,248 | $363 | $ 522 | $45,089 |
| CMOs and REMICs | 31,721 | 117 | 300 | 31,538 |
| Total mortgage-backed securities | **$76,969** | **$480** | **$822** | **$76,627** |

## NOTE B - INVESTMENT AND MORTGAGE-BACKED SECURITIES (CONTINUED)

The amortized cost and estimated fair value of mortgage-backed securities at December 31, by contractual terms to maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may generally prepay obligations without prepayment penalties.

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Amortized cost | Estimated fair value | Amortized cost | Estimated fair value |
| | (In thousands) | | | |
| Due within one year | $ 605 | $ 607 | $ 844 | $ 853 |
| Due after one year to five years | 65,396 | 65,118 | 62,434 | 62,222 |
| Due after five years to ten years | 6,082 | 6,025 | 12,418 | 12,281 |
| Due after ten years | 2,270 | 2,275 | 1,273 | 1,271 |
| Total mortgage-backed securities | **$74,353** | **$74,025** | **$76,969** | **$76,627** |

The tables below indicate the length of time individual securities have been in a continuous unrealized loss position at December 31, 2017 and 2016:

| | Less than 12 months | | | 12 months or longer | | | Total | | |
|---|---|---|---|---|---|---|---|---|---|
| **Description of securities** | **Number of investments** | **Fair value** | **Unrealized losses** | **Number of investments** | **Fair value** | **Unrealized losses** | **Number of investments** | **Fair value** | **Unrealized losses** |
| (Dollars in thousands) | | | | | | | | | |
| December 31, 2017: | | | | | | | | | |
| U.S. Government agency obligations | 9 | $5,706 | $ 44 | 7 | $6,109 | $58 | 16 | $11,815 | $102 |
| State and municipal obligations | 30 | 9,436 | 92 | 20 | 7,908 | 132 | 50 | 17,344 | 224 |
| Corporate debt obligations | 3 | 1,474 | 26 | - | - | - | 3 | 1,474 | 26 |
| Asset-backed securities | - | - | - | - | - | - | - | - | - |
| Mortgage backed securities | 42 | 40,405 | 357 | 19 | 15,000 | 275 | 61 | 55,405 | 632 |
| Total temporarily impaired securities | **84** | **$57,021** | **$519** | **46** | **$29,017** | **$465** | **130** | **$86,038** | **$984** |
| December 31, 2016: | | | | | | | | | |
| U.S. Government agency obligations | 12 | $10,874 | $60 | - | $ - | $ - | 12 | $10,874 | $60 |
| State and municipal obligations | 50 | 18,702 | 668 | 1 | 204 | 3 | 51 | 18,906 | 671 |
| Corporate debt obligations | - | - | - | 2 | 998 | 2 | 2 | 998 | 2 |
| Asset-backed securities | - | - | - | 2 | 1,987 | 40 | 2 | 1,987 | 40 |
| Mortgage backed securities | 45 | 46,476 | 822 | - | - | - | 45 | 46,476 | 822 |
| Total temporarily impaired securities | **107** | **$76,052** | **$1,550** | **5** | **$3,189** | **$45** | **112** | **$79,241** | **$1,595** |

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE B - INVESTMENT AND MORTGAGE-BACKED SECURITIES (CONTINUED)**

Management does not intend to sell any of the debt securities with an unrealized loss and does not believe that it is more likely than not that it will be required to sell a security in an unrealized loss position prior to a recovery in value. The fair values are expected to recover as securities approach maturity dates. The Corporation has evaluated these securities and has determined that the decline in their values is temporary, due to the change in market interest rates.

Securities with a carrying value of $12,514,306 and $8,861,865 were pledged at December 31, 2017 and 2016, respectively to collateralize certain deposits and for other purposes as permitted or required by law. The fair value of pledged securities was $12,491,075 and $8,879,291 at December 31, 2017 and 2016, respectively.

**NOTE C - FINANCING RECEIVABLES**

Loans receivable at December 31, 2017 and 2016 consist of the following:

| | 2017 | 2016 |
|---|---|---|
| Construction | $ 13,910 | $ 11,687 |
| Farmland | 26,424 | 28,596 |
| 1-4 family residential | 93,275 | 89,951 |
| Multi-family residential | 9,591 | 10,339 |
| Nonfarm nonresidential | 49,681 | 50,386 |
| Commercial | 45,460 | 37,271 |
| Consumer | 9,032 | 9,583 |
| | 247,373 | 237,813 |
| Allowance for loan loss | (4,749) | (4,822) |
| Deferred loan fees | (282) | (263) |
| Total net loans | **$242,342** | **$232,728** |
| | | |
| Loans held for sale | $ 3,390 | $ 535 |
| Loans receivable – net | 238,952 | 232,193 |
| Total net loans | **$242,342** | **$232,728** |

The risk characteristics applicable to each segment of the loan portfolio are described as follows:

**Construction Loans.** Construction financing is generally considered to involve a higher degree of risk of loss than long-term financing on improved, occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the property's value at completion of construction and the estimated cost (including interest) of construction. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, we may be required to advance funds beyond the amount originally committed to permit completion of the building. If the estimate of value proves to be inaccurate, we may be confronted, at or before the maturity of the loan, with a building having a value which is insufficient to assure full repayment. If we are forced to foreclose on a building before or at completion due to a default, there can be no assurance that we will be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs.

**NOTE C - FINANCING RECEIVABLES (CONTINUED)**

**Farmland (Agricultural) Loans.** Payments on agricultural loans are typically dependent on the profitable operation or management of the related farm property. The success of the farm may be affected by many factors outside the control of the borrower, including adverse weather conditions that prevent the planting of a crop or limit crop yields, declines in market prices for agricultural products and the impact of government regulations. In addition, many farms are dependent on a limited number of key individuals whose injury or death may significantly affect the successful operation of the farm. If the cash flow from a farming operation is diminished, the borrower's ability to repay the loan may be impaired. For large loan relationships, crop insurance is required when the crops are the Bank's primary collateral.

**1-4 Family Residential.** Residential real estate loans are secured by 1-4 family residences and are generally owner-occupied. The Bank generally establishes a maximum loan-to-value ratio and requires private mortgage insurance if that ratio is exceeded. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market area, such as unemployment levels. Repayment can also be impacted by changes in property values of residential properties. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

**Multi-Family Real Estate.** Loans secured by multi-family and nonresidential real estate generally have larger balances and involve a greater degree of risk than 1-4 family residential mortgage loans. Of primary concern in multi-family and nonresidential real estate lending is the borrower's creditworthiness and the feasibility and cash flow potential of the project. Payments on loans secured by income properties often depend on successful operation and management of the properties. As a result, repayment of such loans may be subject to a greater extent than residential real estate loans to adverse conditions in the real estate market or the economy. To monitor cash flows on income properties, we require borrowers, co-borrowers and loan guarantors of large loan relationships to provide annual financial statements and/or tax returns. In reaching a decision on whether to make a multi-family and nonresidential real estate loan, we consider the net operating income of the property, the borrower's expertise, credit history and profitability and the value of the underlying property. We have generally required that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings before debt service to debt service) of at least 1.20x. Environmental surveys and inspections are generally required for large loans.

**Nonfarm Nonresidential Real Estate.** Nonfarm nonresidential real estate loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Nonfarm nonresidential real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. The characteristics of properties securing the Bank's Nonfarm nonresidential real estate portfolio are diverse, but with geographic location almost entirely in the Bank's market area. Management monitors and evaluates Nonfarm nonresidential real estate loans based on cash flows of borrowers, geography and risk grade criteria.

**Commercial.** Commercial loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets, such as accounts receivable or inventory, and may include a personal guarantee. Short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrowers to collect amounts due from its customers.

**Consumer.** Consumer loans consist of two segments - automobile loans and home equity loans. Automobile loans are generally secured by the automobile being financed or other personal assets. Home equity loans are typically secured by a subordinate interest in 1-4 family residences. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market area, such as unemployment levels, and secondarily on the collateral securing the loan. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

**NOTE C - FINANCING RECEIVABLES (CONTINUED)**

The allowance for credit losses and Recorded Investment in Financing Receivables at December 31, 2017 and December 31, 2016 is as follows:

**December 31, 2017**

| | Construction | Farmland | 1-4 Family Residential | Multi-family Residential | Nonfarm nonresidential | Commercial | Consumer | Total |
|---|---|---|---|---|---|---|---|---|
| **Allowance for loan losses:** | | | | | | | | |
| **Beginning Balance** | 58 | 302 | 1,212 | 184 | 1,151 | 1,816 | 99 | 4,822 |
| **Provision** | 42 | 89 | (12) | (131) | (10) | 1 | 21 | - |
| **Charge-offs** | - | - | (89) | - | (8) | - | (27) | (124) |
| **Recoveries** | - | 4 | 27 | - | 2 | - | 18 | 51 |
| **Ending Balance** | **100** | **395** | **1,138** | **53** | **1,135** | **1,817** | **111** | **4,749** |
| **Ending Balance: Individually evaluated for impairment** | - | - | 182 | - | 158 | 671 | - | 1,011 |
| **Ending Balance: Collectively evaluated for impairment** | 100 | 395 | 956 | 53 | 977 | 1,146 | 111 | 3,738 |
| **Loans receivable:** | | | | | | | | |
| **Ending balance** | **13,910** | **26,424** | **93,275** | **9,591** | **49,681** | **45,460** | **9,032** | **247,373** |
| **Ending Balance: Individually evaluated for impairment** | - | 479 | 3,330 | - | 1,285 | 4,660 | - | 9,754 |
| **Ending Balance: Collectively evaluated for impairment** | 13,910 | 25,945 | 89,945 | 9,591 | 48,396 | 40,800 | 9,032 | 237,619 |

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE C - FINANCING RECEIVABLES (CONTINUED)**

**December 31, 2016**

| | Construction | Farmland | 1-4 Family Residential | Multi-family Residential | Nonfarm nonresidential | Commercial | Consumer | Total |
|---|---|---|---|---|---|---|---|---|
| **Allowance for loan losses:** | | | | | | | | |
| **Beginning Balance** | 88 | 248 | 1,593 | 170 | 1,429 | 1,293 | 121 | 4,942 |
| **Provision** | (30) | 84 | (380) | 14 | (95) | 508 | (26) | 75 |
| **Charge-offs** | - | (31) | (14) | - | (199) | - | - | (244) |
| **Recoveries** | - | 1 | 13 | - | 16 | 15 | 4 | 49 |
| **Ending Balance** | **58** | **302** | **1,212** | **184** | **1,151** | **1,816** | **99** | **4,822** |
| **Ending Balance: Individually evaluated for impairment** | - | 8 | 183 | - | 38 | 692 | - | 921 |
| **Ending Balance: Collectively evaluated for impairment** | 58 | 294 | 1,029 | 184 | 1,113 | 1,124 | 99 | 3,901 |
| **Loans receivable: Ending balance** | **11,687** | **28,596** | **89,951** | **10,339** | **50,386** | **37,271** | **9,583** | **237,813** |
| **Ending Balance: Individually evaluated for impairment** | - | 762 | 3,978 | - | 1,188 | 4,008 | - | 9,936 |
| **Ending Balance: Collectively evaluated for impairment** | 11,687 | 27,834 | 85,973 | 10,339 | 49,198 | 33,263 | 9,583 | 227,877 |

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE C - FINANCING RECEIVABLES (CONTINUED)**

**Credit Risk Profile Categories**
The Corporation assigns credit risk grades to evaluated loans using grading standards employed by regulatory agencies. The following are the Bank's internally assigned grades:

Pass – loans in this category carry lower-risk attributes and currently have a minimal likelihood of loss. These loans represent the Corporation's standard or average loans that require a normal amount of supervision.

Special mention – assets in this category have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose the institution to sufficient risk to warrant adverse classification.

Substandard – an asset classified substandard is protected inadequately by the current net worth and paying capacity of the obligor, or by the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. Any loan 90 days past due will automatically be classified substandard.

Doubtful – an asset classified doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE C - FINANCING RECEIVABLES (CONTINUED)**

The following table summarizes the credit risk profile by internally assigned grade at December 31, 2017 and December 31, 2016:

**December 31, 2017**

| | Construction | Farmland | 1-4 Family Residential | Multi-family Residential | Nonfarm nonresidential | Commercial | Consumer | Total |
|---|---|---|---|---|---|---|---|---|
| **Grade:** | | | | | | | | |
| **Pass** | 13,910 | 24,886 | 90,902 | 8,977 | 46,290 | 43,525 | 8,935 | 237,425 |
| **Special mention** | - | 145 | 1,375 | 614 | 922 | 202 | 97 | 3,355 |
| **Substandard** | - | 1,393 | 998 | - | 2,469 | 1,733 | - | 6,593 |
| **Doubtful** | - | - | - | - | - | - | - | - |
| **Total** | **13,910** | **26,424** | **93,275** | **9,591** | **49,681** | **45,460** | **9,032** | **247,373** |

**December 31, 2016**

| | Construction | Farmland | 1-4 Family Residential | Multi-family Residential | Nonfarm nonresidential | Commercial | Consumer | Total |
|---|---|---|---|---|---|---|---|---|
| **Grade:** | | | | | | | | |
| **Pass** | 11,687 | 27,767 | 87,531 | 9,675 | 46,572 | 35,315 | 9,467 | 228,014 |
| **Special mention** | - | 470 | 1,118 | 664 | 1,240 | 107 | 116 | 3,715 |
| **Substandard** | - | 359 | 1,302 | - | 2,574 | 1,849 | - | 6,084 |
| **Doubtful** | - | - | - | - | - | - | - | - |
| **Total** | **11,687** | **28,596** | **89,951** | **10,339** | **50,386** | **37,271** | **9,583** | **237,813** |

### NOTE C - FINANCING RECEIVABLES (CONTINUED)

The following tables summarize loans by delinquency and nonaccrual status at December 31, 2017 and December 31, 2016:

**December 31, 2017**

| | 30-89 Days Past Due | Over 90 Days Past Due | Total Past Due | Current | Total Loans | Nonaccrual | Recorded Investment 90 Days and Accruing |
|---|---|---|---|---|---|---|---|
| Real Estate: | | | | | | | |
| Construction | - | - | - | 13,910 | 13,910 | - | - |
| Farmland | 18 | 222 | 240 | 26,184 | 26,424 | 478 | - |
| 1-4 family residential | 536 | 454 | 990 | 92,285 | 93,275 | 363 | 119 |
| Multi-family residential | - | - | - | 9,591 | 9,591 | - | - |
| Nonfarm nonresidential | 214 | 396 | 610 | 49,071 | 49,681 | 308 | 89 |
| Commercial | 17 | - | 17 | 45,443 | 45,460 | 833 | - |
| Consumer | 3 | - | 3 | 9,029 | 9,032 | - | - |
| Total | 788 | 1,072 | 1,860 | 245,513 | 247,373 | 1,982 | 208 |

**December 31, 2016**

| | 30-89 Days Past Due | Over 90 Days Past Due | Total Past Due | Current | Total Loans | Nonaccrual | Recorded Investment 90 Days and Accruing |
|---|---|---|---|---|---|---|---|
| Real Estate: | | | | | | | |
| Construction | - | - | - | 11,687 | 11,687 | - | - |
| Farmland | 21 | 247 | 268 | 28,328 | 28,596 | 247 | - |
| 1-4 family residential | 767 | 347 | 1,114 | 88,837 | 89,951 | 100 | 247 |
| Multi-family residential | - | - | - | 10,339 | 10,339 | - | - |
| Nonfarm nonresidential | 236 | 497 | 733 | 49,653 | 50,386 | 583 | - |
| Commercial | - | - | - | 37,271 | 37,271 | - | - |
| Consumer | - | - | - | 9,583 | 9,583 | - | - |
| Total | 1,024 | 1,091 | 2,115 | 235,698 | 237,813 | 930 | 247 |

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE C - FINANCING RECEIVABLES (CONTINUED)**

The following tables summarize impaired loans at December 31, 2017 and December 31, 2016:

**December 31, 2017**

| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| **Loans with no related allowance recorded:** | | | | | |
| **Real Estate:** | | | | | |
| Construction | - | - | - | - | - |
| Farmland | 479 | 525 | - | 363 | 5 |
| 1-4 family residential | 1,536 | 1,656 | - | 1,438 | 63 |
| Multi-family residential | - | - | - | - | - |
| Nonfarm nonresidential | 464 | 662 | - | 523 | 5 |
| Commercial | 3,215 | 3,215 | - | 2,866 | 164 |
| Consumer | - | - | - | - | - |
| Total | 5,694 | 6,058 | - | 5,190 | 237 |
| **Loans with an allowance recorded:** | | | | | |
| **Real Estate:** | | | | | |
| Construction | - | - | - | - | - |
| Farmland | - | - | - | 257 | - |
| 1-4 family residential | 1,794 | 1,950 | 182 | 2,216 | 70 |
| Multi-family residential | - | - | - | - | - |
| Nonfarm nonresidential | 821 | 821 | 158 | 713 | 21 |
| Commercial | 1,445 | 1,445 | 671 | 1,469 | 58 |
| Consumer | - | - | - | - | - |
| Total | 4,060 | 4,216 | 1,011 | 4,655 | 149 |
| **Total impaired loans:** | | | | | |
| **Real Estate:** | | | | | |
| Construction | - | - | - | - | - |
| Farmland | 479 | 525 | - | 620 | 5 |
| 1-4 family residential | 3,330 | 3,606 | 182 | 3,654 | 133 |
| Multi-family residential | - | - | - | - | - |
| Nonfarm nonresidential | 1,285 | 1,483 | 158 | 1,236 | 26 |
| Commercial | 4,660 | 4,660 | 671 | 4,335 | 222 |
| Consumer | - | - | - | - | - |
| Total | 9,754 | 10,274 | 1,011 | 9,845 | 386 |

**NOTE C - FINANCING RECEIVABLES (CONTINUED)**

The following tables summarize impaired loans at December 31, 2017 and December 31, 2016:

**December 31, 2016**

| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| **Loans with no related allowance recorded:** | | | | | |
| **Real Estate:** | | | | | |
| Construction | - | - | - | - | - |
| Farmland | 247 | 278 | - | 256 | 3 |
| 1-4 family residential | 1,339 | 1,361 | - | 879 | 56 |
| Multi-family residential | - | - | - | - | - |
| Nonfarm nonresidential | 583 | 775 | - | 628 | 5 |
| Commercial | 2,516 | 2,516 | - | 2,582 | 128 |
| Consumer | - | - | - | - | - |
| Total | 4,685 | 4,930 | - | 4,345 | 192 |
| **Loans with an allowance recorded:** | | | | | |
| **Real Estate:** | | | | | |
| Construction | - | - | - | - | - |
| Farmland | 515 | 515 | 8 | 525 | 18 |
| 1-4 family residential | 2,639 | 2,639 | 183 | 3,058 | 101 |
| Multi-family residential | - | - | - | - | - |
| Nonfarm nonresidential | 605 | 605 | 38 | 720 | 21 |
| Commercial | 1,492 | 1,492 | 692 | 1,510 | 56 |
| Consumer | - | - | - | - | - |
| Total | 5,251 | 5,251 | 921 | 5,813 | 196 |
| **Total impaired loans:** | | | | | |
| **Real Estate:** | | | | | |
| Construction | - | - | - | - | - |
| Farmland | 762 | 793 | 8 | 781 | 21 |
| 1-4 family residential | 3,978 | 4,000 | 183 | 3,937 | 157 |
| Multi-family residential | - | - | - | - | - |
| Nonfarm nonresidential | 1,188 | 1,380 | 38 | 1,348 | 26 |
| Commercial | 4,008 | 4,008 | 692 | 4,092 | 184 |
| Consumer | - | - | - | - | - |
| Total | 9,936 | 10,181 | 921 | 10,158 | 388 |

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE C - FINANCING RECEIVABLES (CONTINUED)**

If a borrower is experiencing financial difficulty, the Bank may consider, in certain circumstances, modifying the terms of their loan in a troubled debt restructuring (TDR) to maximize collection of amounts due. Within each of the Bank's loan classes, TDRs typically involved either a reduction of the stated interest rate of the loan or an extension of the loan's maturity date(s) with a stated rate lower than the current market rate for a new loan with similar risk. Modifying the terms of loans may result in an increase or decrease in the Allowance for Loan and Lease Losses (ALLL) depending upon the terms modified, the method used to measure the ALLL for a loan prior to modification, and whether any charge-offs were recorded on the loan before or at the time of modification.

At December 31, 2017 and 2016, the Bank had $7.1 million and $8.8 million in TDRs, respectively.

During the year ended December 31, 2017, FCN Bank did not have any new TDR's. During the year ended December 31, 2016, FCN Bank had 4 new TDR's totaling $618,000. The recorded investment totaled $618,000 at the time of restructure and $606,000 at December 31, 2016. Of the 4 new troubled debt restructurings in 2016, 2 were maturity extensions, 1 was given an interest rate reduction, and 1 received both a maturity extension and an interest rate reduction.

The following table summarizes troubled debt restructurings during the year ended December 31, 2016.

**December 31, 2016**

| | Number of Contracts | Pre-modification outstanding recorded investment (in thousands) | Post-modification outstanding recorded investment (in thousands) |
|---|---|---|---|
| **1-4 family residential** | 2 | 426 | 426 |
| **Non-farm nonresidential real estate** | 2 | 192 | 192 |

As a result of these modifications, there was no effect on the overall ALLL.

**NOTE C - FINANCING RECEIVABLES (CONTINUED)**

The Bank considers TDRs that become 90 days past due under the modified terms as subsequently defaulted. The following table provides a summary of subsequent defaults at:

**December 31, 2017**

| | Number of Contracts | Recorded Investment (in thousands) |
|---|---|---|
| **1-4 family residential** | 1 | 59 |

**December 31, 2016**

| | Number of Contracts | Recorded Investment (in thousands) |
|---|---|---|
| **1-4 family residential** | 2 | 201 |

The Bank's lending efforts have historically focused on 1-4 family residential and nonfarm nonresidential real estate and land loans, which comprised approximately $143.0 million, or 58%, of the total loan portfolio at December 31, 2017, and $140.3 million, or 59%, of the total loan portfolio at December 31, 2016. The vast majority of these loans have been underwritten on the basis of no more than a 90% loan-to-value ratio, which has historically provided the Bank with adequate collateral coverage in the event of default. The Bank, as with any lending institution, is subject to the risk that real estate values could deteriorate in its primary lending area of southeast Indiana, thereby impairing collateral values.

In the normal course of business, the Bank has made loans to its directors, officers and their related business interests. In the opinion of management, such loans are consistent with sound lending practices and are within applicable regulatory lending limitations. Loans to officers and directors totaled approximately $2,176,000 and $2,224,000 at December 31, 2017 and 2016, respectively. Activity regarding loans to officers and directors during the year ended December 31, 2017 consisted of $396,000 in net advances, $273,000 of new loans resulting from employment status change and $717,000 in repayments to the Bank.

The Bank has sold whole loans and participating interests in loans in the secondary market, generally retaining servicing on the loans sold. Loans sold and serviced for others totaled approximately $132.3 million and $124.7 million at December 31, 2017 and 2016, respectively.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

## NOTE D - OFFICE PREMISES AND EQUIPMENT

The following table Office premises and equipment, including construction in process, is comprised of the following at December 31:

| | 2017 | 2016 |
|---|---|---|
| | (In thousands) | |
| Land | $ 1,349 | $ 1,349 |
| Buildings and improvements | 5,878 | 5,878 |
| Furniture and equipment | 2,979 | 2,817 |
| | 10,206 | 10,044 |
| Less accumulated depreciation and amortization | (4,753) | (4,355) |
| | **$ 5,453** | **$ 5,689** |

## NOTE E - LEASE

The Bank entered into a lease agreement for a parcel of land upon which a branch office was constructed. The lease agreement expires in 2027 with options to renew the lease agreement upon expiration. During the years ended December 31, 2017 and 2016, $143,000 and $121,000 was charged to occupancy and equipment expense under terms of this lease, respectively. The following table summarizes minimum aggregate payments due under the lease agreement by year:

| Year ending December 31, | (In thousands) |
|---|---|
| 2018 | $ 149 |
| 2019 | 149 |
| 2020 | 149 |
| 2021 | 149 |
| 2022 | 167 |
| 2023 and thereafter | 711 |
| | $1,474 |

## NOTE F - DEPOSITS

Deposits consist of the following major classifications at December 31:

| **Deposit type and weighted-average interest rate** | 2017 | 2016 |
|---|---|---|
| | (In thousands) | |
| Interest-bearing demand accounts | | |
| 2017 – 0.89% | $139,990 | $140,332 |
| 2016 – 0.61% | | |
| Savings accounts | | |
| 2017 – 0.59% | 79,226 | 73,109 |
| 2016 – 0.40% | | |
| Non-interest bearing accounts | 72,475 | 63,694 |
| Total demand and savings accounts | 291,691 | 277,135 |

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE F - DEPOSITS (CONTINUED)**

| | | |
|---|---|---|
| Certificates of deposit, including individual retirement accounts: | | |
| Original maturities of: | | |
| 12 months and less | | |
| 2017 – 0.31% | 11,637 | 12,802 |
| 2016 – 0.32% | | |
| 15 months to 18 months | | |
| 2017 – 0.52% | 4,144 | 4,783 |
| 2016 – 0.40% | | |
| 21 months to 30 months | | |
| 2017 – 0.52% | 8,066 | 9,741 |
| 2016 – 0.50% | | |
| More than 30 months | | |
| 2017 – 1.39 % | 68,511 | 72,725 |
| 2016 – 1.41 % | | |
| Total certificates of deposit | 92,358 | 100,051 |
| Total deposits | **$384,049** | **$377,186** |

**NOTE F - DEPOSITS (CONTINUED)**

The Dodd-Frank Wall Street Reform and Consumer Protection Act permanently raised the standard maximum deposit insurance amount to $250,000. Certain deposits with balances greater than $250,000 are not federally insured. At December 31, 2017 and 2016, the Bank had certificate of deposit accounts with balances greater than $250,000 totaling approximately $8.4 million and $9.3 million, respectively.

In the ordinary course of business, the Bank maintains deposit accounts for some officers, directors, and other related interests. Related party deposit accounts were made on the same terms as those prevailing at the time for comparable transactions with unrelated persons. The aggregate dollar amount of related party deposits totaled $3.3 million and $3.7 million at December 31, 2017 and 2016, respectively.

Interest expense on deposits for the year ended December 31 is summarized as follows:

| | 2017 | 2016 |
|---|---|---|
| | (In thousands) | |
| Interest-bearing demand accounts | $ 427 | $ 416 |
| Savings accounts | 152 | 144 |
| Certificates of deposit | 1,073 | 1,169 |
| | **$1,652** | **$1,729** |

Maturities of outstanding certificates of deposit at December 31 are summarized as follows:

| | 2017 |
|---|---|
| | (In thousands) |
| 2018 | $ 32,090 |
| 2019 | 21,152 |
| 2020 | 15,993 |
| 2021 | 13,897 |
| 2022 | 9,223 |
| 2023 and thereafter | 3 |
| | **$92,358** |

**NOTE G - SHORT-TERM BORROWINGS**

Short-term borrowings are comprised of the following at December 31:

| | 2017 | 2016 |
|---|---|---|
| | (In thousands) | |
| Securities sold under repurchase agreements | $9,307 | $8,775 |
| Total short-term borrowings | **$9,307** | **$8,775** |

Securities sold under agreements to repurchase consist of obligations of the Bank to other parties. The maximum month-end amount of outstanding agreements during the years ended December 31, 2017 and 2016 totaled $9,307,000 and $10,952,000 respectively, and the average of such agreements totaled approximately $8,832,000 and $6,821,000 for the years ended December 31, 2017 and 2016, respectively. The average interest rates were .80% and .87% for the years ended December 31, 2017 and 2016. The agreements at December 31, 2017, are secured by pledges of investment securities totaling approximately $12,483,000. These agreements may be terminated by either the Bank or other party on terms ranging from one to five days.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE H - INCOME TAXES**

The provision for income taxes differs from that computed at the statutory corporate tax rate for the year ended December 31 as follows:

| | 2017 | 2016 |
|---|---|---|
| | (In thousands) | |
| Federal income taxes computed at the statutory rate | $1,729 | $1,768 |
| Increase (decrease) in taxes resulting from: | | |
| Tax-exempt interest | (324) | (315) |
| Non-taxable income on bank owned life insurance | (88) | (92) |
| State income taxes, net of federal benefits | 114 | 71 |
| Deferred tax impact of change in federal tax rate | 353 | - |
| Other | (41) | (33) |
| Income tax provision per consolidated financial statements | **$1,743** | **$1,399** |

Income tax expense for 2017 includes a downward adjustment of net deferred tax assets in the amount of $353,000, recorded as a result of the enactment of H.R.1 Tax Cuts and Jobs Act on December 22, 2017. The Act reduced the corporate federal tax rate from 34% to 21% effective January 1, 2018.

The composition of the Corporation's net deferred tax asset at December 31 is as follows:

| | 2017 | 2016 |
|---|---|---|
| | (In thousands) | |
| Deferred tax assets: | | |
| Retirement expense | $ 25 | $ 47 |
| General loan loss allowance | 1,094 | 1,718 |
| Unrealized losses on AFS Securities | - | 75 |
| Goodwill | 47 | 165 |
| Deferred loan fees | 70 | 103 |
| Total deferred tax assets | 1,236 | 2,108 |
| Deferred tax liabilities: | | |
| FHLB stock dividends | (18) | (29) |
| Captive insurance | (163) | (275) |
| Mortgage servicing rights | (175) | (280) |
| Unrealized gains on AFS securities | (47) | - |
| Book versus tax depreciation | (110) | (226) |
| Other | (1) | - |
| Total deferred tax liabilities | (514) | (810) |
| Net deferred income tax asset | **$ 722** | **$ 1,298** |

Management believes that it is more likely than not that the results of future operations will generate sufficient taxable income to realize reported deferred tax assets.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE I - COMMITMENTS**

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers, including commitments to extend credit. Such commitments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the consolidated statement of financial condition. The contract or notional amounts of the commitments reflect the extent of the Bank's involvement in such financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as those utilized for on-balance-sheet instruments.

At December 31, 2017, the Bank had outstanding commitments of approximately $4,013,000 to originate residential real estate loans. Additionally, the Bank had unused overdraft protection of approximately $673,000 and unused lines of credit under residential loans and commercial loans of approximately $22.2 million and $28.6 million, respectively, at December 31, 2017. Of the approximately $55.5 million in commitments, approximately $46.4 million and $9.1 million were variable and fixed, respectively.

The Bank had no commitments under financial standby letters of credit at December 31, 2017. Financial standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. In the opinion of management, all loan commitments equaled or exceeded prevalent market interest rates as of December 31, 2017, and will be funded from normal cash flow from operations.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE J - REGULATORY CAPITAL**

The Bank is subject to the regulatory capital requirements of the Federal Deposit Insurance Corporation (the "FDIC"). Failure to meet minimum capital requirements can initiate certain mandatory – and possibly additional discretionary – actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The FDIC has adopted risk-based capital ratio guidelines to which the Bank is subject. The guidelines establish a systematic analytical framework that makes regulatory capital requirements more sensitive to differences in risk profiles among banking organizations. Risk-based capital ratios are determined by allocating assets and specified off-balance sheet commitments to four risk-weighting categories, with higher levels of capital being required for the categories perceived as representing greater risk.

During the current calendar year, the Bank was notified by its primary regulator that it was categorized as "well-capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well-capitalized" the Bank must maintain minimum capital ratios as set forth in the table that follows.

As of December 31, 2017 and 2016, management believed that the Bank met all capital adequacy requirements to which it was subject.

| **2017:** | **Actual** | | **For capital adequacy purposes** | | **To be "well-capitalized" under prompt corrective action provisions** | |
|---|---|---|---|---|---|---|
| | **Amount** | **Ratio** | **Amount** | **Ratio** | **Amount** | **Ratio** |
| | | | (Dollars in thousands) | | | |
| Common Equity tier 1 (to risk-based capital) | $43,399 | 16.95% | ≥$11,525 | ≥4.5% | ≥$16,647 | ≥ 6.5% |
| Total capital (to risk-weighted assets) | $46,619 | 18.20% | ≥$20,488 | ≥ 8.0% | ≥$25,610 | ≥ 10.0% |
| Tier I capital (to risk-weighted assets) | $43,399 | 16.95% | ≥$15,366 | ≥ 6.0% | ≥$20,488 | ≥ 8.0% |
| Tier I leverage | $43,399 | 9.79% | ≥$17,734 | ≥ 4.0% | ≥$22,168 | ≥5.0% |

**NOTE J - REGULATORY CAPITAL (CONTINUED)**

**2016:**

| | Actual | | For capital adequacy purposes | | To be "well-capitalized" under prompt corrective action provisions | |
|---|---|---|---|---|---|---|
| | **Amount** | **Ratio** | **Amount** | **Ratio** | **Amount** | **Ratio** |
| | | | (Dollars in thousands) | | | |
| Common Equity tier 1 (to risk-based capital) | $41,822 | 16.66% | ≥$11,297 | ≥4.5% | ≥$16,137 | ≥ 6.5% |
| Total capital (to risk-weighted assets) | $44,981 | 17.92% | ≥$20,083 | ≥ 8.0% | ≥$25,104 | ≥ 10.0% |
| Tier I capital (to risk-weighted assets) | $41,822 | 16.66% | ≥$15,062 | ≥ 6.0% | ≥$20,083 | ≥ 8.0% |
| Tier I leverage | $41,822 | 9.65% | ≥$17,328 | ≥ 4.0% | ≥$21,660 | ≥5.0% |

The Bank's management believes that, under the current regulatory capital regulations, the Bank will continue to meet its minimum capital requirements in the foreseeable future. However, events beyond the control of the Bank, such as increased interest rates or a downturn in the economy in the Bank's primary market area, could adversely affect future earnings and, consequently, the ability to meet future minimum regulatory capital requirements.

**NOTE K – COMPREHENSIVE INCOME RECLASSIFICATION ADJUSTMENT**

The following information discloses the reclassification adjustments for each component of accumulated other comprehensive income, including the income statement line items that affected, as of December 31, 2017 and 2016:

| Accumulated Other Comprehensive Income Components | Reclassification Amount (in thousands) | Affected Line Item in the Consolidated Statements of Income |
|---|---|---|
| **December 31, 2017:** | | |
| Unrealized losses on available for sale securities | (56) | Gain (loss) on sale of investments and mortgage-backed securities |
| | 19 | Income taxes |
| Total reclassifications | $(37) | |
| **December 31, 2016:** | | |
| Unrealized gains on available for sale securities | 18 | Gain (loss) on sale of investments and mortgage-backed securities |
| | (6) | Income taxes |
| Total reclassifications | $12 | |

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2017 and 2016

**NOTE L - CONDENSED FINANCIAL STATEMENTS OF FCN BANC CORP.**

The following condensed financial statements summarize the financial position of FCN Banc Corp. as of December 31, 2017 and 2016, and the results of its operations and cash flows for the years ended December 31, 2017 and 2016.

**FCN Banc Corp.**
**STATEMENTS OF FINANCIAL CONDITION**
December 31, 2017 and 2016
(In thousands)

| **ASSETS** | **2017** | **2016** |
|---|---|---|
| Cash and cash equivalents | $ 1,529 | $ 981 |
| Investment in FCN Bank | 45,692 | 43,780 |
| Prepaid expenses | 462 | 400 |
| Dividend receivable from FCN Bank | 421 | 406 |
| Total assets | **$48,104** | **$45,567** |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Dividends payable | $ 421 | $ 406 |
| Other liabilities | 986 | 1,066 |
| Total liabilities | 1,407 | 1,472 |
| Shareholders' equity | | |
| Common stock | 9,856 | 9,856 |
| Additional paid-in capital | 620 | 620 |
| Retained earnings | 37,299 | 35,016 |
| Treasury stock | (1,251) | (1,251) |
| Unrealized gains on securities designated as available for sale, net | 173 | (146) |
| Total shareholders' equity | 46,697 | 44,095 |
| Total liabilities and shareholders' equity | **$48,104** | **$45,567** |

**FCN Banc Corp.**
**STATEMENTS OF EARNINGS**
December 31, 2017 and 2016
(In thousands)

| | **2017** | **2016** |
|---|---|---|
| Equity in earnings of FCN Bank | $3,478 | $3,986 |
| Fee income from subsidiary | 663 | - |
| General and administrative expenses | (216) | (41) |
| Earnings before income tax benefit | 3,925 | 3,945 |
| Income tax benefit | 70 | 17 |
| NET EARNINGS | **$3,995** | **$3,962** |

**NOTE L - CONDENSED FINANCIAL STATEMENTS OF FCN BANC CORP. (CONTINUED)**

**FCN Banc Corp.**
**STATEMENTS OF CASH FLOWS**
Year ended December 31, 2017 and 2016
(In thousands)

| | 2017 | 2016 |
|---|---|---|
| **Cash flows provided by operating activities:** | | |
| Net earnings for the year | $3,995 | $3,962 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Undistributed earnings of consolidated subsidiary | (1,637) | (1,976) |
| Effect of changes in operating assets and liabilities | | |
| Prepaid expenses | (62) | (400) |
| Other liabilities | (80) | 1,066 |
| Net cash provided by operating activities | 2,216 | 2,652 |
| **Cash flows used in financing activities:** | | |
| Dividends on common stock | (1,668) | (1,610) |
| Repurchase of common stock | - | (77) |
| Net cash used in financing activities | (1,668) | (1,687) |
| Net decrease in cash and cash equivalents | 548 | 965 |
| Cash and cash equivalents at beginning of year | 981 | 16 |
| Cash and cash equivalents at end of year | **$ 1,529** | **$ 981** |

# NOTES

# LOCATIONS

**MAIN OFFICE**
501 Main St.
Brookville, IN 47012
765-647-4116

**BROOKVILLE DRIVE-UP**
400 Main St.
Brookville, IN 47012
765-647-4116

**CONNERSVILLE**
105 West 3rd St.
Connersville, IN 47331
765-825-7251

**BATESVILLE**
1060 State Rd. 229 N.
Batesville, IN 47006
812-934-9078

**SUNMAN**
226 N. Meridian St.
Sunman, IN 47041
812-623-8900

**HARRISON**
590 Ring Rd.
Harrison, OH 45030
513-367-6111

FCN
BANC CORP

fcnbank.com