**Board of Governors of the Federal Reserve System**

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# Annual Report of Holding Companies—FR Y-6

## Report at the close of business as of the end of fiscal year

This Report is required by law: Section 5(c)(1)(A) of the Bank Holding Company Act (12 U.S.C. § 1844(c)(1)(A)); sections 8(a) and 13(a) of the International Banking Act (12 U.S.C. §§ 3106(a) and 3108(a)); sections 11(a)(1), 25, and 25A of the Federal Reserve Act (12 U.S.C. §§ 248(a)(1), 602, and 611a); and sections 113, 165, 312, 618, and 809 of the Dodd-Frank Act (12 U.S.C. §§ 5361, 5365, 5412, 1850a(c)(1), and 5468(b)(1)). Return to the appropriate Federal Reserve Bank the original and the number of copies specified.

This report form is to be filed by all top-tier bank holding companies, top-tier savings and loan holding companies, and U.S. intermediate holding companies organized under U.S. law, and by any foreign banking organization that does not meet the requirements of and is not treated as a qualifying foreign banking organization under Section 211.23 of Regulation K (12 C.F.R. § 211.23). (See page one of the general instructions for more detail of who must file.) The Federal Reserve may not conduct or sponsor, and an organization (or a person) is not required to respond to, an information collection unless it displays a currently valid OMB control number.

NOTE: The *Annual Report of Holding Companies* must be signed by one director of the top-tier holding company. This individual should also be a senior official of the top-tier holding company. In the event that the top-tier holding company does not have an individual who is a senior official and is also a director, the chairman of the board must sign the report. If the holding company is an ESOP/ESOT formed as a corporation or is an LLC, see the General Instructions for the authorized individual who must sign the report.

I, A. C. Evans, Jr.
Name of the Holding Company Director and Official

President/CEO
Title of the Holding Company Director and Official

attest that the *Annual Report of Holding Companies* (including the supporting attachments) for this report date has been prepared in conformance with the instructions issued by the Federal Reserve System and are true and correct to the best of my knowledge and belief.

*With respect to information regarding individuals contained in this report, the Reporter certifies that it has the authority to provide this information to the Federal Reserve. The Reporter also certifies that it has the authority, on behalf of each individual, to consent or object to public release of information regarding that individual. The Federal Reserve may assume, in the absence of a request for confidential treatment submitted in accordance with the Board's "Rules Regarding Availability of Information," 12 C.F.R. Part 261, that the Reporter* and *individual consent to public release of all details in the report concerning that individual.*

Signature of Holding Company Director and Official

2/14/18
Date of Signature

*For holding companies* not *registered with the SEC–*
Indicate status of Annual Report to Shareholders:
- [x] is included with the FR Y-6 report
- [ ] will be sent under separate cover
- [ ] is not prepared

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RSSD ID 2504285
C.I.

**Date of Report** (top-tier holding company's fiscal year-end):
**December 31, 2017**
Month / Day / Year

LEI: None
Reporter's Legal Entity Identifier (LEI) (20-Character LEI Code)

Reporter's Name, Street, and Mailing Address

FNB Company
Legal Title of Holding Company

P O Box 671
(Mailing Address of the Holding Company) Street / P.O. Box

| Livingston | TX | 77351 |
|---|---|---|
| City | State | Zip Code |

2121 Hwy 190 West
Physical Location (if different from mailing address)

Person to whom questions about this report should be directed:

| Danielle Marsh | VP/CFO First National Bank |
|---|---|
| Name | Title |

936-328-5581
Area Code / Phone Number / Extension

936-328-5497
Area Code / FAX Number

dmarsh@fnblivingston.com
E-mail Address

n/a
Address (URL) for the Holding Company's web page

Is confidential treatment requested for any portion of this report submission? .................................. 0=No 1=Yes **0**

In accordance with the General Instructions for this report (check only one),

1. a letter justifying this request is being provided along with the report ..................................................... [ ]
2. a letter justifying this request has been provided separately ... [ ]

NOTE: Information for which confidential treatment is being requested must be provided separately and labeled as "confidential."

Public reporting burden for this information collection is estimated to vary from 1.3 to 101 hours per response, with an average of 5.50 hours per response, including time to gather and maintain data in the required form and to review instructions and complete the information collection. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551, and to the Office of Management and Budget, Paperwork Reduction Project (7100-0297), Washington, DC 20503.

FINANCIAL STATEMENTS WITH
INDEPENDENT AUDITORS' REPORT

FNB COMPANY AND SUBSIDIARIES
Livingston, Texas

December 31, 2017 and 2016

AXLEY & RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

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AXLEY&RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

# INDEPENDENT AUDITORS' REPORT

Board of Directors
FNB Company and Subsidiaries
Livingston, Texas

We have audited the accompanying consolidated financial statements of FNB Company and Subsidiaries (an S corporation), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

## 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 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks 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 purpose 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 FNB Company and Subsidiaries as of December 31, 2017 and 2016, and the consolidated results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Axley & Rode LLP
CERTIFIED PUBLIC ACCOUNTANTS

Lufkin, Texas
February 7, 2018



www.axleyrode.com

FNB COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 4 497 848 | $ 3 223 847 |
| Interest bearing deposits in banks | 13 213 573 | 7 551 035 |
| CASH AND CASH EQUIVALENTS | 17 711 421 | 10 774 882 |
| Interest-bearing time deposits in banks | 69 436 000 | 66 124 000 |
| Securities available for sale | 156 727 876 | 146 259 596 |
| Securities held-to-maturity | 1 937 187 | - |
| Restricted equity securities | 571 520 | 570 220 |
| Loans, net of allowance for loan losses of $2,145,687 in 2017 and $2,148,346 in 2016 | 121 021 481 | 115 886 163 |
| Bank premises and equipment, net | 8 791 247 | 9 049 097 |
| Accrued interest receivable | 1 494 819 | 1 381 731 |
| Goodwill, net | 3 031 499 | 3 031 499 |
| Residential real estate acquired in settlement of loans | 90 000 | - |
| Other assets | 1 049 903 | 1 031 933 |
| TOTAL ASSETS | $ 381 862 953 | $ 354 109 121 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Liabilities: | | |
| Deposits: | | |
| Noninterest-bearing deposits | $ 136 237 620 | $ 114 613 290 |
| Interest-bearing deposits | 192 299 633 | 185 862 587 |
| TOTAL DEPOSITS | 328 537 253 | 300 475 877 |
| | | |
| Federal funds purchased | - | 2 440 000 |
| Accrued interest and other liabilities | 1 152 390 | 1 123 207 |
| TOTAL LIABILITIES | 329 689 643 | 304 039 084 |
| | | |
| Stockholders' Equity: | | |
| Common stock, $1 par value; 5,000,000 shares authorized; 130,028 issued, 128,498 outstanding | 130 028 | 130 028 |
| Surplus | 21 401 004 | 21 401 004 |
| Retained earnings | 32 860 055 | 30 879 335 |
| Treasury stock (1,530 shares at cost) | (435 938) | (435 938) |
| Accumulated other comprehensive income | (1 781 839) | (1 904 392) |
| TOTAL STOCKHOLDERS' EQUITY | 52 173 310 | 50 070 037 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 381 862 953 | $ 354 109 121 |

The accompanying notes are an integral part of these financial statements.

FNB COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| Interest Income: | | |
| Interest and fees on loans | $ 6 224 701 | $ 6 231 374 |
| Interest on Investment Securities: | | |
| Taxable | 2 179 662 | 1 905 446 |
| Exempt from Federal income tax | 1 089 678 | 1 141 816 |
| Interest on deposits in banks | 1 167 528 | 976 797 |
| TOTAL INTEREST INCOME | 10 661 569 | 10 255 433 |
| Interest expense on deposits | 442 102 | 441 118 |
| Interest on Federal funds purchased | 1 018 | 1 205 |
| NET INTEREST INCOME | 10 218 449 | 9 813 110 |
| Provision for loan losses | 240 000 | 287 500 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 9 978 449 | 9 525 610 |
| Other Income: | | |
| Service charges on deposit accounts | 1 909 860 | 2 004 564 |
| Other service charges and fees | 1 741 283 | 1 574 871 |
| Insurance commissions | 639 906 | 453 074 |
| Brokerage commissions (net) | 1 755 992 | 1 615 549 |
| Gain/(loss) other | (1 130) | - |
| Other income | 50 858 | 75 497 |
| TOTAL OTHER INCOME | 6 096 769 | 5 723 555 |
| Other Expenses: | | |
| Salaries and employee benefits | 6 365 471 | 5 883 560 |
| Occupancy, insurance and equipment expense | 1 427 688 | 1 339 360 |
| ATM processing | 737 766 | 631 549 |
| Deposit insurance expense | 159 995 | 113 500 |
| Data processing | 831 786 | 841 430 |
| Directors fees | 185 819 | 190 473 |
| Postage and freight | 134 066 | 116 361 |
| Printing and office supplies | 216 107 | 184 732 |
| Legal and professional services | 248 716 | 226 055 |
| Telephone | 111 764 | 119 713 |
| Marketing | 90 665 | 116 435 |
| Other operating expenses | 937 596 | 823 460 |
| TOTAL OTHER EXPENSES | 11 447 439 | 10 586 628 |
| INCOME FROM OPERATIONS BEFORE FEDERAL INCOME TAXES | 4 627 779 | 4 662 537 |
| Federal income taxes (benefit) | - | (19 494) |
| NET INCOME | $ 4 627 779 | $ 4 682 031 |

The accompanying notes are an integral part of these financial statements.

FNB COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended December 31, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| Net income | $ 4 627 779 | $ 4 682 031 |
| Other Comprehensive Income: | | |
| Unrealized gains (losses) on available for sale securities arising during the period | 122 553 | (3 162 869) |
| TOTAL OTHER COMPREHENSIVE INCOME | 122 553 | (3 162 869) |
| COMPREHENSIVE INCOME | $ 4 750 332 | $ 1 519 162 |

The accompanying notes are an integral part of these financial statements.

FNB COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For the Years Ended December 31, 2017 and 2016

| | COMMON STOCK | | | | | ACCUMULATED | |
|---|---|---|---|---|---|---|---|
| | SHARES | AMOUNT | CAPITAL SURPLUS | RETAINED EARNINGS | TREASURY STOCK | COMPREHENSIVE INCOME/(LOSS) | TOTAL EQUITY |
| Balance, December 31, 2015 | 130 028 | $ 130 028 | $ 21 401 004 | $ 28 905 356 | $ (375 168) | $ 1 258 477 | $ 51 319 697 |
| Net income | - | - | - | 4 682 031 | - | - | 4 682 031 |
| Other comprehensive loss | - | - | - | - | - | (3 162 869) | (3 162 869) |
| Purchase of treasury stock (200 shares) | - | - | - | - | (60 770) | - | (60 770) |
| Cash distributions | - | - | - | (2 708 052) | - | - | (2 708 052) |
| Balance, December 31, 2016 | 130 028 | 130 028 | 21 401 004 | 30 879 335 | (435 938) | (1 904 392) | 50 070 037 |
| Net income | - | - | - | 4 627 779 | - | - | 4 627 779 |
| Other comprehensive income | - | - | - | - | - | 122 553 | 122 553 |
| Cash distributions | - | - | - | (2 647 059) | - | - | (2 647 059) |
| Balance, December 31, 2017 | 130 028 | $ 130 028 | $ 21 401 004 | $ 32 860 055 | $ (435 938) | $ (1 781 839) | $ 52 173 310 |

The accompanying notes are an integral part of these financial statements.



AXLEY & RODE LLP CERTIFIED PUBLIC ACCOUNTANTS

## FNB COMPANY AND SUBSIDIARIES
## CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2017 and 2016

| | | 2017 | | 2016 |
|---|---|---|---|---|
| Cash Flows from Operating Activities: | | | | |
| Net income | $ | 4 627 779 | $ | 4 682 031 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: | | | | |
| Provision for loan losses | | 240 000 | | 287 500 |
| Provision for depreciation | | 643 782 | | 566 733 |
| Provision (benefit) for deferred taxes | | - | | (12 397) |
| (Gain)/loss on retirement of premises and equipment | | 1 130 | | - |
| FHLB dividends paid in stock | | (1 200) | | (400) |
| Net amortization (accretion) on investment securities | | 690 118 | | 616 472 |
| (Increase) decrease in accrued interest receivable | | (113 088) | | (80 713) |
| (Increase) decrease in other assets | | (17 970) | | (5 467) |
| Increase (decrease) in accrued interest and other liabilities | | 35 608 | | (119 353) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | | 6 106 159 | | 5 934 406 |
| Cash Flows from Investing Activities: | | | | |
| Purchases of interest-bearing time deposit in banks | | (19 164 000) | | (24 239 000) |
| Maturities of interest-bearing time deposit in banks | | 15 852 000 | | 17 684 000 |
| Purchases of available-for-sale securities | | (31 680 839) | | (94 119 554) |
| Payments received on mortgage backed securities | | 5 284 033 | | 6 457 298 |
| Proceeds from maturities/calls/sales of available-for-sale securities | | 15 375 000 | | 78 560 000 |
| Proceeds from maturities/calls of held-to-maturity securities | | 20 000 | | - |
| Purchases of held-to-maturity securities | | (1 971 226) | | - |
| Net decrease/(increase) in loans | | (5 465 318) | | 3 854 818 |
| Purchases of premises and equipment | | (391 099) | | (706 687) |
| Proceeds from sale of premises and equipment | | 4 037 | | - |
| Purchases of Federal Home Loan Bank Stock | | (100) | | (4 900) |
| Proceeds from sale of other real estate | | - | | 150 000 |
| NET CASH USED BY INVESTING ACTIVITIES | | (22 137 512) | | (12 364 025) |
| Cash Flows from Financing Activities: | | | | |
| Net increase (decrease) in noninterest-bearing deposits | | 21 624 330 | | 2 047 475 |
| Net (decrease) increase in interest bearing deposits | | 6 437 046 | | (1 590 065) |
| Purchase of treasury stock | | - | | (60 770) |
| Purchase of Federal funds sold (net) | | (2 440 000) | | 2 440 000 |
| Distributions paid | | (2 653 484) | | (2 715 528) |
| NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES | | 22 967 892 | | 121 112 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | | 6 936 539 | | (6 308 507) |
| Cash and cash equivalents at beginning of year | | 10 774 882 | | 17 083 389 |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | $ | 17 711 421 | $ | 10 774 882 |
| Supplemental Information: | | | | |
| Cash Paid During the Year for: | | | | |
| Interest | $ | 443 157 | $ | 442 755 |
| Non-Cash Investing and Financing Activities: | | | | |
| Distributions declared but not paid | $ | 661 765 | $ | 668 190 |
| Increase (decrease) in securities available for sale due to unrealized gains/losses | $ | 122 553 | $ | (3 162 869) |
| Transfer of loans to other real estate | $ | 90 000 | $ | - |

The accompanying notes are an integral part of these financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

FNB Company (the "Company"), is a holding company that owns all of the capital stock of The First National Bank of Livingston (the "Bank"), which in turn owns all the capital stock of Church Street Financial, ("Church") and Polk County Title Company, Inc., ("Polk") (Note 15). "Bank", "Church" and "Polk" are referred to as the subsidiaries in these statements. The Bank's main office is located in Livingston, Texas with branches located in Livingston, Texas, and Onalaska, Texas. The Bank represents approximately 88% of the total gross revenues on the consolidated statements of income at December 31, 2017 and 2016.

The accounting and reporting policies of the Company and its subsidiaries conform significantly to accounting principles generally accepted in the United States of American (GAAP) and practices within the banking industry. The following is a description of the more significant of those policies.

Principles of Consolidation:

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Nature of Operations:

The Company provides a variety of financial services to individuals and corporate customers through its subsidiaries in Polk County, Texas. The subsidiary Bank's primary deposit products are demand deposits and certificates of deposit. Its primary lending products are consumer, commercial, real estate and single family residential loans. Church provides investment services through its location in Livingston Texas.

Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the fair value of securities available for sale, the allowance for losses on loans and the valuation of other real estate owned. In connection with the determination of the allowances for losses on loans and valuation of other real estate owned, management may obtain independent appraisals.

While management uses available information to recognize losses on loans and other real estate owned, future additions to the allowances may be necessary based on changes in local economic conditions, other risk characteristics applicable to portfolio segments or borrowers' circumstances. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowances for losses on loans and foreclosed real estate. Such agencies may require the Bank to recognize additions to the allowances based on their judgments about information available to them at the time of their examination.

As a result of the changes inherent in the estimation process, management's estimate of the fair value of securities available for sale, the allowance for losses on loans and the valuation of other real estate owned may change in the near term.

Cash and Cash Equivalents:

Cash and cash equivalents, for purposes of the statement of cash flows, include cash and due from banks, Federal funds sold and certain investment securities and interest bearing deposits in banks with original maturities of three months or less.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Investment Securities:

Securities classified as held-to-maturity are those debt securities the Company has both the intent and ability to hold to maturity regardless of changes in market conditions, liquidity needs or changes in general economic conditions. These securities are carried at cost, adjusted for amortization of premium and accretion of discount, computed using the interest method, over their contractual lives.

Securities classified as available-for-sale are equity securities with readily determinable fair values and those debt securities that the Company intends to hold for an indefinite period of time but not necessarily to maturity. Any decision to sell a security classified as available-for-sale would be based on various factors, including significant movement in interest rates, changes in the maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. These securities are carried at estimated fair value based on information provided by a third party pricing service with an unrealized gains or losses excluded from net income and reported in accumulated other comprehensive income (loss), which is reported as a separate component of stockholders' equity.

Dividend and interest income, including amortization of premium and accretion of discount arising at acquisition, from all categories of investment securities are included in interest income in the consolidated statements of income.

Gains and losses realized on sales of investments securities, determined using the adjusted cost basis of the specific securities sold, are included in noninterest income in the consolidated statements of income. Additionally, declines in the estimated fair value of individual investment securities below their cost that are other-than-temporary are reflected as realized losses in the statements of income. Factor affecting the determination of whether an other-than-temporary impairment has occurred include, among other things, (i) the length of time and extent to which the fair value has been less than cost, (ii) the financial condition and near term prospects of the issuer, (iii) that the Company does not intend to sell these securities, and (iv) it is more likely than not that the Company will not be required to sell before a period of time sufficient to allow for any anticipated recovery in fair value.

Restricted stock consists of stock from the Federal Reserve Bank, Texas Independent Bank and the Federal Home Loan Bank, which are restricted as to their marketability. Because no ready market exists for these investments and they have no quoted market value, the Bank's investment in these stocks are carried at cost. The Bank is required to maintain certain stock balances in the Federal Reserve Bank and the Federal Home Loan Bank.

Loans:

Loans are stated at the amount of unpaid principal, reduced by the undisbursed portion of construction loans (construction loans in process), unearned discount and an allowance for loan losses. The major loan portfolio segments include Commercial, Real Estate, Installment, Overdrafts, Consumer and Other. Within these categories, loans are secured most significantly by real estate, but are also secured by account receivables, inventory, income producing commercial properties, personal properties such as vehicles and boats and other items of property, plant and equipment. A small segment of consumer loans are unsecured.

Interest on loans is calculated by using the simple interest method on the daily balances of the principal amounts outstanding. The recognition of income on a loan is discontinued, and previously accrued interest is reversed when, in the opinion of management, it is probable that the borrower will be unable to meet payments as they become due. This generally occurs when the loan becomes 90 days delinquent, but may occur sooner should borrower circumstance dictate.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loan origination and commitment fees are recognized as income when received. Direct loan origination costs are expensed when paid. Financial Accounting Standards Board Codification Section 310.20 *Non-Refundable Fees and Costs* requires the net effect of loan origination and commitment fees and certain direct loan origination costs to be deferred and recognized over the life of the related loan as an adjustment of yield. FNB Company and Subsidiaries do not feel the application of this standard would have a material effect on the Bank's financial position or results of operations.

Allowance for Loan Losses:

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance is based on two basic principles of accounting: (i) FASB ASC 450, *Contingencies*, which requires that losses be accrued when they are probable of occurring and estimable and (ii) FASB ASC 310, *Receivables*, which requires that losses or impaired loans be accrued based on the differences between the loan balance and either the value of collateral, if such loans are considered to be collateral dependent and in the process of collection, or the present value of future cash flows, or the loan's value as observable in the secondary market. A loan is considered impaired when, based on current information and events, the Company has concerns about the ability to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines that significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all the circumstances surrounding the loan and borrower, including the length of delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owned.

The Company's allowance for loan losses has three basic components: the specific allowance, the formula allowance and the pooled allowance. Each of these components is determined based upon estimates that can and do change when the actual events occur. As a result of the uncertainties inherent in the estimation process, management's estimate of loan losses and the related allowance could change in the near term.

The specific allowance component is used to individually establish an allowance for loans identified for impairment testing. When impairment is identified, a specific reserve may be established based on the Company's calculation of the estimated loss embedded in the individual loan. Impairment testing includes consideration of the borrower's overall financial condition, resources and payment record, support available form financial guarantors and the fair value of collateral. These factors are combined to estimate the probability and severity of inherent losses. Large groups of smaller balance, homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately evaluate individual consumer and residential loans for impairment.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

The formula allowance component is used for estimating the loss on internally risk rated loans exclusive of those identified as impaired. The loans meeting the Company's internal criteria for classification, such as special mention, substandard, doubtful and loss, as well as specifically identified impaired loans, are segregated from performing loans within the portfolio. These internally classified loans are then grouped by loan type (commercial, real estate, installment, overdrafts, and consumer and other). Each loan type is assigned an allowance factor based on management's estimate of the associated risk, complexity, and size of the individual loans within the particular loan category. Classified loans are assigned higher allowance factor than non-classified loans due to management's concerns regarding collectability or management's knowledge of particular elements surrounding the borrower. Allowance factors increase with the worsening of the internal risk rating.

The pooled formula component is used to estimate the losses inherent in the pools of non-classified loans. These loans are then also segregated by loan type and allowance factors are assigned by management based on delinquencies, loss history, trends in volume and terms of loans, effects of changes in lending policy, the experience and depth of management, national and local economic trends, concentration of credit, results of the loan review system and the effect of external factors (i.e. competition and regulatory requirements).

Allowance factors and overall size of the allowance may change from period to period based on management's assessment of the above-described factors and the relative weights given to each factor. In addition, various regulatory agencies periodically review the allowance for loan losses. These agencies may require the Bank to make additions to the allowance for loan losses based on their judgements of collectability based on information available to them at the time of their examination.

Management considers loans impaired when, based on current information, it is probable that the Company will not collect all principal and interest payments according to contractual terms. Loans are evaluated for impairment in accordance with the Company's portfolio monitoring and ongoing risk assessment procedures. Management considers the financial condition of the borrower, cash flow of the borrower, payment status of the loan, and the value of the collateral, if any, securing the loan. Generally, impaired loans do not include large groups of smaller balance homogenous loans such as residential real estate and consumer type loans which are evaluated collectively for impairment and are generally placed on nonaccrual when loan becomes 90 days past due as to principal or interest. Loans specifically reviewed for impairment are not considered impaired during periods of "minimal delay" in payment (90 or less) provided eventual collection of all amounts due is expected. The impairment of a loan is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, or the fair value of the collateral if repayment is expected to be provided solely by the collateral. In appropriate circumstances, interest income on impaired loans may be recognized on a cash basis.

The Company's charge-off policy states after all collection efforts have been exhausted and the loan is deemed to be a loss, it will be charged to the Company's established allowance for loan losses. Consumer loans subject to the Uniform Retail Credit Classification are charged off as follows: (a) closed end loans are charged-off no later than 120 days after becoming delinquent, (b) consumer loans to borrowers who subsequently declare bankruptcy, where the Company is an unsecured creditor, are charged-off within 60 days of receipt of notification from the bankruptcy court, (c) fraudulent loans are charged-off within 90 days of discovery and (d) death of borrower will cause a charge-off to be incurred at such time an actual loss is determined. All other types of loans are generally evaluated for loss potential at the 90th day past due threshold, and any loss is recognized no later than the 120th day past due threshold; each loss is evaluated on its specific facts regarding the appropriate timing to recognized loss.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Other Real Estate Owned and Other Assets Acquired in Settlement of Loans:

Other real estate owned and other assets acquired in settlement of loans are recorded at the balance of the loan or at estimated fair value less cost of sale, at the date acquired, plus capital improvements made thereafter to facilitate sale. Adjustments are made to reflect declines, if any, in fair values below the recorded amounts at the date of foreclosure and charged to the allowance for losses on loans. Declines in value subsequent to repossession are charged to a loss provision which is included in other expenses on the consolidated statements of income. Costs of holding real estate and other assets acquired in settlement of loans are reflected in income currently. Gains on sales of such assets are taken into income based on the buyer's initial and continuing investment in the property and reflected as part of other income on the consolidated statements of income. Other assets acquired in settlement of loans consist primarily of reacquired personal property.

During 2017, one property (and related improvements) was acquired through foreclosure. The property had an approximate book value of $112,200. Subsequent to repossession, the valuation of the property declined to $90,000. The $22,200 reduction in valuation was charged against the allowance for loan and lease losses reserve. The property was not sold during the year and is carried on the balance sheet at $90,000.

During the years ended December 31, 2017 and 2016, investments in mortgage loans secured by residential real estate properties where formal foreclosure procedures were in process totaled $-0- and $112,200, respectively.

Insignificant amounts of other assets acquired in settlement of loans were repossessed during 2017 and 2016.

Bank Premises and Equipment:

Bank premises and equipment are stated at cost less accumulated depreciation. The provision for depreciation is computed using the straight-line method based on estimated useful lives of the assets. Expenditures for improvements, which extend the life of an asset, are capitalized and depreciated over asset's remaining useful life. Gains or losses realized on the disposition of properties and equipment are reflected in the statements of income. Expenditures for repairs and maintenance are charged to operating expenses as incurred.

Off-Balance Sheet Financial Instruments:

In the ordinary course of business the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit, standby letters of credit and overdraft lines of credit. Such financial instruments are recorded in the financial statements when they are funded and at that time become subject to management's evaluation related to collectability.

Self-Insurance:

The Company is primarily self-insured for costs related to employee health care benefits, of which a portion is paid by the employees. Liabilities associated with these risks are estimated in part by considering historical claims experience and other assumptions. The Company has purchased stop loss coverage to limit exposure to claims. At December 31, 2017 and 2016, the Company had recorded approximately $24,000 and $-0-, respectively, as an accrual for this liability.

The assumptions underlying the ultimate costs of existing claim losses are unpredictable, which can affect the liability recorded for such claims. Although the Company's estimates of liabilities incurred do not anticipate significant changes in historical trends for these variables, any changes could have a significant impact on future claim costs and current recorded liabilities.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Income Taxes:

Effective January 1, 2010, the Company elected to become a subchapter S corporation. Under subchapter S guidelines, all federal taxable income is attributable to the Company shareholders individually. (See Note 8)

The Company is required to pay tax to the State of Texas based on gross margin (as defined). This tax has been deemed an income tax by the Financial Accounting Standards Board and consequently requires accrual in the year the taxable gross margin is earned. For the years presented, the Consolidated Statements of Income reflects approximately $11,000 and $(4,000) as state income tax expense (benefit) included in "Other Operating Expenses".

Sales Taxes:

Sales and use taxes and other such pass through state taxes are not recorded in the consolidated statements of income, but are instead collected and remitted through a liability account.

Goodwill:

The Company does not amortize goodwill, but instead, evaluates goodwill for impairment at least annually and adjusts accordingly in accordance with GAAP. The Company does not believe any impairment of goodwill exists at December 31, 2017, based on its evaluation.

Brokerage Commissions:

Brokerage commissions paid to Bank from its broker-dealer are net of various fees (see Note 17).

Fair Values of Financial Instruments:

The Company follows the guidance of FASB ASC 825, *Financial Instruments*, and FASB ASC 820, *Fair Value Measurement*. This guidance permits entities to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This guidance clarifies the fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Under this guidance, fair value measurements are not adjusted for transaction costs. This guidance established a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and lowest priority to unobservable inputs (Level 3 measurements).

Comprehensive Income:

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Uncertain Tax Positions:

FASB Codification Section 740 requires recognition, measurement and disclosure of uncertain tax positions. The Company currently accounts for uncertain tax positions based on the estimated likelihood of assessment and has determined that no tax positions (for interest, penalties or otherwise) require an accrual based on current standards of accounting. The Company is generally no longer subject to Federal tax examinations for tax years before 2014.

Advertising:

The Company expenses all advertising costs as incurred. These are included on the Consolidated Statements of Income as marketing expenses.

Reclassifications:

Certain reclassifications have been made to the prior period's financial statements in order to conform to the classifications used for the current year. These reclassifications had no effect on the capital, net income or net cash flows of the Bank.

Subsequent Events:

Management has evaluated subsequent events through February 7, 2018, the date the financial statements were available to be issued.

New Authoritative Accounting Guidance:

The Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASC) 201-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.* The amendments in this Update make targeted improvements to GAAP as follows: (1) Require equity investments to be measured at fair value with changes in fair value recognized in net income. (2) Simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value. (3) Eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheets. (4) Require public business entities to use the exit price notion when measuring fair value of financial instruments for disclosure purposes. (5) Clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. This ASU will be effective for financial institutions other than public business entities for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The Company does not expect the guidance to have a material impact on its financial statements.

The FASB issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* Current GAAP requires and *incurred loss* methodology for recognizing credit losses that delays recognition until it is probable a loss has been incurred. Users of financial statements expressed concern that current GAAP restricts the ability to record credit losses that are expected, but do not yet meet the *probable* threshold. The main objective of the ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by reporting entity at each reporting date. To achieve this objective, the amendments in this Update replace the incurred loss impairment methodology in current GAAP with methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. This ASU will be effective for financial institutions other than public entities for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. At this time, the Company has not determined the impact on its financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

The FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, which made the following changes that may affect the Company: (1) Debt Prepayment or Debt Extinguishment Costs: Cash payments for debt prepayment or debt extinguishment costs should be classified as cash flows from financing activities. (2) Proceeds from Settlement of Bank-Owned Life Insurance Policies: Cash proceeds received from the settlement of bank-owned life insurance policies should be classified as cash flows from investing activities. The cash payments for premiums on bank-owned policies may be classified as cash flows for investing activities, operating activities, or a combination of investing and operating. The amendments in the ASU will be effective for entities other than public business entities for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The Company does not expect the guidance to have a material impact on its financial statements.

NOTE 2 - INVESTMENT SECURITIES

The carrying amount of investment securities as shown in the consolidated balance sheets of the Company and their fair values at December 31, 2017 and 2016, were as follows:

| | AMORTIZED COST | GROSS UNREALIZED GAIN | GROSS UNREALIZED LOSSES | FAIR VALUE |
|---|---|---|---|---|
| Securities Available for Sale: | | | | |
| December 31, 2017: | | | | |
| U.S. agency securities | $ 92 534 293 | $ 2 720 | $ (1 571 735) | $ 90 965 278 |
| State and municipal securities | 44 758 826 | 371 873 | (365 026) | 44 765 673 |
| Residential mortgage backed securities | 21 216 595 | 139 979 | (359 649) | 20 996 925 |
| Other securities | - | - | - | - |
| | $ 158 509 714 | $ 514 572 | $ (2 296 410) | $ 156 727 876 |
| December 31, 2016: | | | | |
| U.S. agency securities | $ 70 946 741 | $ 49 511 | $ (1 964 624) | $ 69 031 628 |
| State and municipal securities | 51 541 223 | 772 003 | (508 551) | 51 804 675 |
| Residential mortgage backed securities | 25 676 024 | 222 703 | (475 434) | 25 423 293 |
| Other securities | - | - | - | - |
| | $ 148 163 988 | $ 1 044 217 | $ (2 948 609) | $ 146 259 596 |

| | AMORTIZED COST | GROSS UNREALIZED GAIN | GROSS UNREALIZED LOSSES | FAIR VALUE |
|---|---|---|---|---|
| Held-to-Maturity: | | | | |
| December 31, 2017: | | | | |
| State and municipal securities | $ 1 937 187 | $ 3 200 | $ (30 964) | $ 1 909 423 |
| | $ 1 937 187 | $ 3 200 | $ (30 964) | $ 1 909 423 |

No securities were sold in either period presented.

The carrying amount and fair value of investment securities at December 31, 2017, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

NOTE 2 - INVESTMENT SECURITIES - CONTINUED

The scheduled maturities of debt securities at December 31, 2017, were as follows:

| | AVAILABLE-FOR-SALE SECURITIES | | HELD-TO-MATURITY SECURITIES | |
|---|---|---|---|---|
| | AMORTIZED COST | FAIR VALUE | AMORTIZED COST | FAIR VALUE |
| Due in one year or less | $ 17 223 878 | $ 17 279 990 | $ - | $ - |
| Due from one to five years | 53 978 424 | 53 334 444 | 1 056 950 | 1 053 200 |
| Due from five to ten years | 64 987 752 | 64 027 754 | 880 237 | 856 223 |
| Over ten years | 1 103 064 | 1 088 762 | - | - |
| Mortgage-backed securities | 21 216 596 | 20 996 926 | - | - |
| | $ 158 509 714 | $ 156 727 876 | $ 1 937 187 | $ 1 909 423 |

Investment securities with a fair value of approximately $35,392,000 and $34,799,000 at December 31, 2017 and 2016, respectively, were pledged to secure public deposits and for other purposes required or permitted by law.

Information pertaining to securities with gross unrealized losses at December 31, 2017 and 2016, aggregated by investment category and length of time that individual securities have been in a continuous loss position follows:

| | LESS THAN 12 MONTHS | | 12 MONTHS OR GREATER | | TOTAL | |
|---|---|---|---|---|---|---|
| Description of Securities: | FAIR VALUE | UNREALIZED LOSSES | FAIR VALUE | UNREALIZED LOSSES | FAIR VALUE | UNREALIZED LOSSES |
| December 31, 2017 | | | | | | |
| **Available-for-Sale Securities:** | | | | | | |
| U.S. Agency Securities | $ 28 611 223 | $ (173 796) | $ 57 352 962 | $ (1 397 939) | $ 85 964 185 | $ (1 571 735) |
| State and municipal | $ 13 375 504 | $ (98 156) | $ 13 441 425 | $ (266 870) | $ 26 816 929 | $ (365 026) |
| Mortgage-backed securities | $ 6 263 923 | $ (57 867) | $ 10 542 434 | $ (301 782) | $ 16 806 357 | $ (359 649) |
| **Held-to-Maturity Securities:** | | | | | | |
| State and municipal | $ 1 377 248 | $ (30 964) | $ - | $ - | $ 1 377 248 | $ (30 964) |
| December 31, 2016 | | | | | | |
| **Available-for-Sale Securities:** | | | | | | |
| U.S. Agency Securities | $ 57 561 298 | $ (1 964 624) | $ - | $ - | $ 57 561 298 | $ (1 964 624) |
| State and municipal | $ 23 838 284 | $ (499 571) | $ 1 959 726 | $ (8 980) | $ 25 798 010 | $ (508 551) |
| Mortgage-backed securities | $ 18 934 713 | $ (475 434) | $ - | $ - | $ 18 934 713 | $ (475 434) |

Management evaluates securities for other-than-temporary impairment on a periodic basis. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Debt securities with unrealized losses have depreciated 1.75% and 2.80% from the Company's amortized cost basis at December 31, 2017 and 2016, respectively. These securities are guaranteed by the U.S. Government, agencies thereof or municipalities. These unrealized losses relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the Federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other-than-temporary.

## NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES

The Company's goal is to mitigate risk from an unforeseen threat to the loan portfolio as a result of an economic downturn or other negative influences. Plans that aid in mitigating these potential risks in managing the loan portfolio include: enforcing loan policies and procedures, evaluating the borrower's business plan through the loan term, identifying and monitoring primary and alternative sources of repayment, and obtaining adequate collateral to mitigate loss in the event of liquidation. Specific reserves are established based on credit and/or collateral risks on an individual loan basis. A risk rating system is used to estimate potential loss exposure and to provide a measuring system for setting general and specific reserve allocations.

As of December 31, 2017, the real estate loan portfolio constituted 78% of the total loan portfolio. This can be broken down further into the following categories: 54.74% residential real estate, 17.57% commercial real estate, and 5.09% land development loans, as a percentage of total loans.

The Company's construction and land development loans are secured by real property where the loans funds will be used to acquire land and to construct or improve appropriately zoned real property for the creation of income producing or owner occupied commercial properties. Borrowers are generally required to put equity into the project at levels determined by the loan committee and usually are underwritten with a maximum term of 24 months.

Commercial real estate loans are secured by improved real property which is generating income in the normal course of business. Debt service coverage, assuming stabilized occupancy, must be satisfied to support a permanent loan. The debt service coverage ratio is ordinarily at 1.20 to 1.00. These loans are generally underwritten with a term not greater than 20 years or the remaining useful life of the property, whichever is lower.

Residential real estate loans are secured by improved real property of the borrower and are underwritten with terms up to 30 years.

The Company also makes commercial and industrial loans for a variety of purposes, which include working capital, equipment and account receivable financing. This category represents 10% of the loan portfolio at December 31, 2017. Loans in this category generally carry a variable interest rate. Commercial loans meet reasonable underwriting standards, including appropriate collateral and cash flow necessary to support debt service. Personal guarantees are generally required, but may be limited.

Outstanding Loans:

The tables below present an aged analysis of the Bank's loan portfolio by major loan classification as of December 31, 2017 and December 31, 2016.

| | 0-59 DAYS PAST DUE | 60-89 DAYS PAST DUE | GREATER THAN 90 DAYS PAST DUE | TOTAL PAST DUE | CURRENT | BALANCE DECEMBER 31, 2017 |
|---|---|---|---|---|---|---|
| Commercial | $ 311 289 | $ - | $ - | $ 311 289 | $ 11 451 630 | $ 11 762 919 |
| Real estate | 2 617 530 | 8 188 | - | 2 625 718 | 96 911 904 | 99 537 622 |
| Installment | - | - | - | - | - | - |
| Overdrafts | - | - | - | - | 279 371 | 279 371 |
| Consumer and other | 985 726 | 22 182 | 913 | 1 008 821 | 13 856 282 | 14 865 103 |
| | $ 3 914 545 | $ 30 370 | $ 913 | $ 3 945 828 | $ 122 499 187 | 126 445 015 |
| Construction loans in process | | | | | | (3 277 847) |
| | | | | | | 123 167 168 |
| Allowance for loan losses | | | | | | (2 145 687) |
| | | | | | | $ 121 021 481 |

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES - CONTINUED

| | 0-59 DAYS PAST DUE | 60-89 DAYS PAST DUE | GREATER THAN 90 DAYS PAST DUE | TOTAL PAST DUE | CURRENT | BALANCE DECEMBER 31, 2016 |
|---|---|---|---|---|---|---|
| Commercial | $ 428 711 | $ - | $ - | $ 428 711 | $ 12 134 528 | $ 12 563 239 |
| Real estate | 4 521 393 | 86 925 | 120 367 | 4 728 685 | 85 278 587 | 90 007 272 |
| Installment | - | - | - | - | 1 985 | 1 985 |
| Overdrafts | - | - | - | - | 262 598 | 262 598 |
| Consumer and other | 1 095 879 | 18 750 | - | 1 114 629 | 16 464 301 | 17 578 930 |
| | $ 6 045 983 | $ 105 675 | $ 120 367 | $ 6 272 025 | $ 114 141 999 | 120 414 024 |
| Construction loans in process | | | | | | (2 379 490) |
| Unearned discount | | | | | | (25) |
| | | | | | | 118 034 509 |
| Allowance for loan losses | | | | | | (2 148 346) |
| | | | | | | $ 115 886 163 |

Nonaccrual Loans:

The table below includes the Bank's nonaccrual loans, including nonperforming trouble debt restructures and loans past due 90 days, or more at December 31, 2017 and 2016.

| | NONACCRUAL LOANS DECEMBER 31, 2017 | NONACCRUAL LOANS DECEMBER 31, 2016 | ACCRUING PAST DUE 90 DAYS OR MORE DECEMBER 31, 2017 | ACCRUING PAST DUE 90 DAYS OR MORE DECEMBER 31, 2016 |
|---|---|---|---|---|
| Commercial | $ 94 751 | $ - | $ - | $ - |
| Real estate | 319 669 | 203 357 | - | - |
| Consumer | 54 793 | 81 559 | - | - |
| TOTAL | $ 469 213 | $ 284 916 | $ - | $ - |

The difference between interest income that would have been recorded under the original terms of such loans and that which was recorded is not significant to these financial statements.

Real estate loans consist of residential (78% in 2017 and 74% in 2016) and commercial (22% in 2017 and 26% in 2016). All past due real estate loans are in the residential category at December 31, 2017 and 2016.

Credit Quality Indicators:

The Bank monitors credit quality within its major loan classifications. The results of this classification process is a factor in the risk characteristics used in establishing the allowance for loan losses. These loans are evaluated and internally classified by the Bank as pass, special mention, substandard, doubtful or loss.

*Pass* - An asset classified pass is one that does not possess any weaknesses by management sufficient to warrant a more adverse classification.

*Special Mention* - A *special mention* asset has 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 an institution to sufficient risk to warrant adverse classification.

*Substandard* - A *substandard* asset is inadequately protected by the current sound worth and paying capacity of the obligor or of 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 bank will sustain some loss if the deficiencies are not corrected.

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES - CONTINUED

*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.

*Loss* - Assets classified *loss* are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be effected in the future. Amounts classified as loss are generally charged off to the allowance for loan losses upon such classification.

The remaining loans are classified as pass. The following presents the Bank's loan classification as of December 31, 2017 and 2016 by its major loan classifications.

| | 2017 | | | | | |
|---|---|---|---|---|---|---|
| | PASS | SPECIAL MENTION | SUBSTANDARD | DOUBTFUL | LOSS | TOTAL |
| Commercial | $ 11 114 807 | $ - | $ 561 043 | $ 87 069 | $ - | $ 11 762 919 |
| Real estate | 93 922 904 | 21 828 | 2 229 336 | 85 707 | - | 96 259 775 |
| Installment | - | - | - | - | - | - |
| Overdrafts | 279 371 | - | - | - | - | 279 371 |
| Consumer and other | 14 360 215 | 5 724 | 481 003 | 18 161 | - | 14 865 103 |
| TOTAL | $ 119 677 297 | $ 27 552 | $ 3 271 382 | $ 190 937 | $ - | $ 123 167 168 |

| | 2016 | | | | | |
|---|---|---|---|---|---|---|
| | PASS | SPECIAL MENTION | SUBSTANDARD | DOUBTFUL | LOSS | TOTAL |
| Commercial | $ 10 626 709 | $ 27 179 | $ 1 909 351 | $ - | $ - | $ 12 563 239 |
| Real estate | 87 442 557 | - | 185 225 | - | - | 87 627 782 |
| Installment | 1 960 | - | - | - | - | 1 960 |
| Overdrafts | 262 598 | - | - | - | - | 262 598 |
| Consumer and other | 17 032 199 | 35 862 | 496 018 | 14 851 | - | 17 578 930 |
| TOTAL | $ 115 366 023 | $ 63 041 | $ 2 590 594 | $ 14 851 | $ - | $ 118 034 509 |

Allowance for Credit Loss:

The detail below reflects the changes in the allowance for loan losses by the Bank's major loan classifications for the years ended December 31, 2017 and 2016:

| | COMMERCIAL | REAL ESTATE | OVERDRAFTS | CONSUMER AND OTHER | UNALLOCATED | TOTAL |
|---|---|---|---|---|---|---|
| ALLOWANCE FOR LOAN LOSSES DECEMBER 31, 2015 | $ 146 095 | $ 1 073 349 | $ 101 686 | $ 324 920 | $ 425 870 | $ 2 071 920 |
| Loans charged off | (36 607) | - | (133 456) | (91 121) | - | (261 184) |
| Recoveries of loans previously charged off | - | - | 38 357 | 11 753 | - | 50 110 |
| NET CHARGE OFFS | (36 607) | - | (95 099) | (79 368) | - | (211 074) |
| Provision for loan and lease losses | 65 826 | 10 284 | 90 751 | 129 316 | (8 677) | 287 500 |
| ALLOWANCE FOR LOAN LOSSES DECEMBER 31, 2016 | 175 314 | 1 083 633 | 97 338 | 374 868 | 417 193 | 2 148 346 |
| Loans charged off | (18 825) | (22 200) | (145 432) | (111 454) | - | (297 911) |
| Recoveries of loans previously charged off | - | - | 41 628 | 13 624 | - | 55 252 |
| NET CHARGE OFFS | (18 825) | (22 200) | (103 804) | (97 830) | - | (242 659) |
| Provision for loan and lease losses | 67 029 | 204 484 | 132 239 | 85 425 | (249 177) | 240 000 |
| ALLOWANCE FOR LOAN LOSSES DECEMBER 31, 2017 | $ 223 518 | $ 1 265 917 | $ 125 773 | $ 362 463 | $ 168 016 | $ 2 145 687 |

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES - CONTINUED

The table below represents the allowance and the carrying value of outstanding loans and leases by portfolio segment at December 31, 2017 and 2016:

| DECEMBER 31, 2017 | COM-MERCIAL | REAL ESTATE | INSTALL-MENT | CONSUMER AND OTHER | OVER-DRAFTS | TOTAL |
|---|---|---|---|---|---|---|
| Impaired Loans and Trouble Debt Restructurings: | | | | | | |
| Allowance for loans and lease losses | $ 64 719 | $ 91 548 | $ - | $ 105 297 | $ - | $ 261 564 |
| Unpaid principal balance | $ 163 895 | $ 714 272 | $ - | $ 228 422 | $ - | $ 1 106 589 |
| Allowance as a percentage of unpaid principal balance | 39.49% | 12.82% | - % | 46.10% | - % | 23.64% |
| Collectively Evaluated for Impairment: | | | | | | |
| Allowance for loans and lease losses | $ 158 799 | $ 1 174 369 | $ - | $ 257 166 | $ 125 773 | $ 1 716 107 |
| Unpaid principal balance | $ 11 599 024 | $ 95 545 503 | $ - | $ 14 636 681 | $ 279 371 | $ 122 060 579 |
| Allowance as a percentage of unpaid principal balance | 1.37% | 1.23% | - % | 1.76% | 45.02% | 1.41% |
| Total: | | | | | | |
| Allowance for loans and lease losses | $ 223 518 | $ 1 265 917 | $ - | $ 362 463 | $ 125 773 | $ 1 977 671 |
| Unpaid principal balance | $ 11 762 919 | $ 96 259 775 | $ - | $ 14 865 103 | $ 279 371 | $ 123 167 168 |
| Allowance as a percentage of unpaid principal balance | 1.90% | 1.32% | - % | 2.44% | 45.02% | 1.61% |

| DECEMBER 31, 2016 | COM-MERCIAL | REAL ESTATE | INSTALL-MENT | CONSUMER AND OTHER | OVER-DRAFTS | TOTAL |
|---|---|---|---|---|---|---|
| Impaired Loans and Trouble Debt Restructurings: | | | | | | |
| Allowance for loans and lease losses | $ 22 690 | $ 52 995 | $ - | $ 93 504 | $ - | $ 169 189 |
| Unpaid principal balance | $ 117 690 | $ 449 043 | $ - | $ 253 993 | $ - | $ 820 724 |
| Allowance as a percentage of unpaid principal balance | 19.28% | 20.86% | - % | 36.81% | - % | 27.04% |
| Collectively Evaluated for Impairment: | | | | | | |
| Allowance for loans and lease losses | $ 152 624 | $ 1 030 638 | $ - | $ 281 364 | $ 97 338 | $ 1 561 964 |
| Unpaid principal balance | $ 12 445 549 | $ 87 373 789 | $ 1 960 | $ 17 324 937 | $ 262 598 | $ 117 408 833 |
| Allowance as a percentage of unpaid principal balance | 1.23% | 1.18% | - % | 1.62% | 37.07% | 1.33% |
| Total: | | | | | | |
| Allowance for loans and lease losses | $ 175 314 | $ 1 083 633 | $ - | $ 374 868 | $ 97 338 | $ 1 731 153 |
| Unpaid principal balance | $ 12 563 239 | $ 87 627 782 | $ 1 960 | $ 17 578 930 | $ 262 598 | $ 118 034 509 |
| Allowance as a percentage of unpaid principal balance | 1.40% | 1.24% | - % | 2.13% | 37.07% | 1.47% |

## NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES - CONTINUED

### Impaired Loans and Trouble Debt Restructurings:

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Information on impaired loans for the years ended December 31, 2017 and 2016 are as follows:

| | DECEMBER 31, 2017 | | | |
|---|---|---|---|---|
| | UNPAID PRINCIPAL BALANCE | CARRYING VALUE | RELATED ALLOWANCE | AVERAGE CARRYING AMOUNT |
| With no Related Allowance Recorded: | | | | |
| Commercial | $ - | $ - | $ - | $ - |
| Real estate | 170 158 | 170 158 | - | 130 658 |
| Consumer and other | 27 861 | 27 861 | - | 32 049 |
| TOTAL | 198 019 | 198 019 | - | 162 707 |
| With an Allowance Recorded: | | | | |
| Commercial | 163 895 | 99 176 | 64 719 | 97 088 |
| Real estate | 544 113 | 452 565 | 91 548 | 378 728 |
| Consumer and other | 200 561 | 95 264 | 105 297 | 109 758 |
| TOTAL | 908 569 | 647 005 | 261 564 | 585 574 |
| Total: | | | | |
| Commercial | 163 895 | 99 176 | 64 719 | 97 088 |
| Real estate | 714 271 | 622 723 | 91 548 | 509 386 |
| Consumer and other | 228 422 | 123 125 | 105 297 | 141 807 |
| TOTAL | $ 1 106 588 | $ 845 024 | $ 261 564 | $ 748 281 |

| | DECEMBER 31, 2016 | | | |
|---|---|---|---|---|
| | UNPAID PRINCIPAL BALANCE | CARRYING VALUE | RELATED ALLOWANCE | AVERAGE CARRYING AMOUNT |
| With no Related Allowance Recorded: | | | | |
| Commercial | $ - | $ - | $ - | $ - |
| Real estate | 91 157 | 91 157 | - | 49 682 |
| Consumer and other | 36 237 | 36 237 | - | 40 566 |
| TOTAL | 127 394 | 127 394 | - | 90 248 |
| With an Allowance Recorded: | | | | |
| Commercial | 117 690 | 95 000 | 22 690 | 47 500 |
| Real estate | 357 885 | 304 890 | 52 995 | 152 445 |
| Consumer and other | 217 755 | 124 251 | 93 504 | 69 780 |
| TOTAL | 693 330 | 524 141 | 169 189 | 269 725 |
| Total: | | | | |
| Commercial | 117 690 | 95 000 | 22 690 | 47 500 |
| Real estate | 449 042 | 396 047 | 52 995 | 202 127 |
| Consumer and other | 253 992 | 160 488 | 93 504 | 110 346 |
| TOTAL | $ 820 724 | $ 651 535 | $ 169 189 | $ 359 973 |

Income recognized during the periods presented related to impaired loans is not considered significant for separate disclosure.

The Bank is not committed to lend additional funds to debtors whose loans have been modified.

The aggregate amount of loans owed to the Bank by employees, directors and executive officers of the Bank and its subsidiaries and directors, executive officers and principal holders of the Company and their related entities totaled approximately $4,137,000 and $4,154,000 at December 31, 2017 and 2016, respectively. Activity during the years presented for these loans are approximately as follows:

| | 2017 | 2016 |
|---|---|---|
| Balance, beginning of year | $ 4 154 000 | $ 3 760 000 |
| Advances | 1 857 000 | 1 660 000 |
| Repayments | (2 119 000) | (1 175 000) |
| Additions - Hires with existing loans | 279 000 | - |
| Reductions - No longer employed | (34 000) | (91 000) |
| BALANCE END OF YEAR | $ 4 137 000 | $ 4 154 000 |

## NOTE 4 - BANK PREMISES AND EQUIPMENT

Major classifications of these assets as of December 31 are summarized as follows:

| | 2017 | 2016 | USEFUL LIVES IN YEARS |
|---|---|---|---|
| Land | $ 2 959 635 | $ 2 959 635 | - |
| Building and improvements | 9 558 495 | 9 478 137 | 5-40 |
| Furniture and equipment | 2 851 719 | 3 316 143 | 3-10 |
| Computer software | 455 162 | 365 914 | 3-5 |
| Automobiles | 115 936 | 105 906 | 3-4 |
| Equipment in process | 70 434 | 95 927 | |
| TOTAL COST | 16 011 381 | 16 321 662 | |
| Accumulated depreciation | (7 220 134) | (7 272 565) | |
| NET BOOK VALUE | $ 8 791 247 | $ 9 049 097 | |

Depreciation expense amounted to $643,782 and $566,733 in 2017 and 2016, respectively and is included as a component of occupancy and equipment expense on the consolidated statements of income.

## NOTE 5 - DEPOSITS

The aggregate amount of time deposits with a minimum denomination of $100,000, was approximately $17,783,000 and $18,847,000 at December 31, 2017 and 2016. Total time deposits in excess of the Federal insurance amount of $250,000 totaled approximately $3,636,000 and $4,245,000 at December 31, 2017 and 2016, respectively.

Time deposits maturing in years ending December 31, are as follows:

| | |
|---|---|
| 2018 | $ 35 890 495 |
| 2019 | 3 739 502 |
| 2020 | 1 912 586 |
| 2021 | 774 940 |
| 2022 | 1 980 890 |
| Thereafter | - |
| TOTAL | $ 44 298 413 |

Deposits due to directors, officers, significant shareholders and their affiliates approximated $9,705,000 and $9,929,000 at December 31, 2017 and 2016, respectively.

Overdraft demand deposits of $279,371 and $262,598 respectively have been classified as loans in the accompanying financial statements.

## NOTE 6 - LINE OF CREDIT

The Bank has two lines of credit to purchase Federal funds in the amount of $11,000,000 unsecured and $9,000,000 secured by certain investment securities that expires upon cancellation. The Bank had $-0- and $2,440,000 of Federal funds purchased drawn at December 31, 2017 and 2016, respectively.

## NOTE 7 - RETIREMENT PLANS

The Company sponsors a 401(k) Retirement Plan ("Plan") for the Company and its subsidiaries, which is in effect for substantially all full-time employees (if they elect to be covered). The Company, at its discretion, may match a portion of each employee's contribution. The Company, at its discretion, may make an additional contribution as of each December 31. Contributions to the plan amounted to approximately $398,000 and $372,000 for 2017 and 2016, respectively and are included in salaries and employee benefits on the consolidated statements of income.

## NOTE 8 - FEDERAL INCOME TAXES

Effective January 1, 2010, the Company elected to become a subchapter S corporation. Under subchapter S guidelines, all federal taxable income is attributable to the Company shareholders individually. The Company has passed the five year built-in gains tax period.

## NOTE 9 - FINANCIAL INSTRUMENTS

The Company 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 and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

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

The Company had financial instruments whose contract or notional amounts represent credit risk of approximately the following:

| | DECEMBER 31, | |
|---|---|---|
| | 2017 | 2016 |
| Commitments to extend credit | $ 2 350 000 | $ 4 830 000 |
| Standby letters of credit | $ 573 000 | $ 1 037 000 |
| Overdraft lines of credit (unfunded) | $ 5 777 000 | $ 5 939 000 |
| Unfunded portion of construction loans | $ 3 278 000 | $ 2 379 000 |

NOTE 9 - FINANCIAL INSTRUMENTS - CONTINUED

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses, are generally variable rate in nature and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include real estate; accounts receivable; inventory; property, plant, and equipment; and income-producing commercial properties. Of the commitments to extend credit, approximately $151,000 and $490,000 were to related party borrowers at December 31, 2017 and 2016, respectively.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. Standby letters of credit generally have fixed expiration dates and may require payment of a fee. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held for the standby letters of credit primarily consists of certificates of deposit.

Overdraft lines of credit represent amounts available for deposit customers to overdraft deposit accounts. Outstanding overdrafts as of December 31, 2017 and 2016 were approximately $279,000 and $263,000, respectively. Of these outstanding overdrafts, approximately $188,000 and $184,000 were amounts drawn on overdraft lines of credit as of December 31, 2017 and 2016.

FASB ASC 820, *Fair Value Measurement*, clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Under this guidance, fair value measurement are not adjusted for transaction costs. This guidance establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under this guidance are described below:

- Level 1 - Valuations for assets and liabilities traded in active exchange markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.
- Level 2 - Valuations for assets or liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable asset or liabilities which use observable inputs other than Level 1 prices, such as quoted prices from similar assets or liabilities; quoted prices in active 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 9 - FINANCIAL INSTRUMENTS - CONTINUED

Fair values of assets and liabilities are presented on the consolidated balances sheets measured on a recurring basis at December 31, 2017 and 2016 are as follows:

| | FAIR VALUE MEASUREMENTS AT REPORTING DATE USING | | | |
|---|---|---|---|---|
| | FAIR VALUE | QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS/ LIABILITIES (LEVEL 1) | SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2) | SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3) |
| **December 31, 2017** | | | | |
| Available-for-Sale Securities: | | | | |
| U. S. agency securities | $ 90 965 278 | $ - | $ 90 965 278 | $ - |
| State and municipal securities | 44 765 673 | - | 44 765 673 | - |
| Residential mortgage backed securities | 20 996 925 | - | 20 996 925 | - |
| | $ 156 727 876 | $ - | $ 156 727 876 | $ - |
| **December 31, 2016** | | | | |
| Available-for-Sale Securities: | | | | |
| U. S. agency securities | $ 69 031 628 | $ - | $ 69 031 628 | $ - |
| State and municipal securities | 51 804 675 | - | 51 804 675 | - |
| Residential mortgage backed securities | 25 423 293 | - | 25 423 293 | - |
| | $ 146 259 596 | $ - | $ 146 259 596 | $ - |

Fair value of available for sale securities is based on discounted cash flow analysis based on observable inputs reflective of Level 2 inputs. These inputs include market quotes for similar instruments, current market yields and offering sheets.

The following tables set forth the Company's financial assets and liabilities that were accounted for or disclosed at fair value on a nonrecurring basis as of December 31, 2017 and 2016:

| | | FAIR VALUE MEASUREMENTS USING | | |
|---|---|---|---|---|
| | DECEMBER 31, 2017 | QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1) | SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2) | SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3) |
| Impaired Loans: | | | | |
| Commercial | $ 163 895 | $ - | $ - | $ 163 895 |
| Real estate | 714 272 | - | - | 714 272 |
| Consumer | 228 422 | - | - | 228 422 |
| TOTAL IMPAIRED LOANS | $ 1 106 589 | $ - | $ - | $ 1 106 589 |
| Other Real Estate Owned: | | | | |
| Residential real estate | $ 90 000 | $ - | $ - | $ 90 000 |
| TOTAL OTHER REAL ESTATE OWNED | $ 90 000 | $ - | $ - | $ 90 000 |
| Goodwill | $ 3 031 499 | $ - | $ - | $ 3 031 499 |

NOTE 9 - FINANCIAL INSTRUMENTS - CONTINUED

| | | FAIR VALUE MEASUREMENTS USING | | |
|---|---|---|---|---|
| | DECEMBER 31, 2016 | QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1) | SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2) | SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3) |
| Impaired Loans: | | | | |
| Commercial | $ 117 690 | $ - | $ - | $ 117 690 |
| Real estate | 449 043 | - | - | 449 043 |
| Consumer | 253 993 | - | - | 253 993 |
| TOTAL IMPAIRED LOANS | $ 820 726 | $ - | $ - | $ 820 726 |
| Other Real Estate Owned: | | | | |
| Residential real estate | $ - | $ - | $ - | $ - |
| TOTAL OTHER REAL ESTATE OWNED | $ - | $ - | $ - | $ - |
| Goodwill | $ 3 031 499 | $ - | $ - | $ 3 031 499 |

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances. Financial assets and liabilities measured at fair value on nonrecurring basis include the following:

**Goodwill**

Fair market value of goodwill is determined on a nonrecurring basis in order to determine if any impairment exists. In order to estimate the fair value of goodwill the Company uses inputs such as values of similar entities.

**Impaired Loans**

Certain impaired loans are reported at fair value of underlying collateral if repayment is expected solely from the collateral. The impaired loans are reported at fair value through a specific valuation allowance allocation of the allowance for possible loan losses. Collateral values are estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria.

**Other Real Estate Owned**

OREO acquired by foreclosure is recorded at the fair value of the property, less any selling costs, as applicable, at the time of foreclosure. If necessary, carrying amounts are reduced to reflect this value through charges to the allowance for possible credit losses upon foreclosure. Subsequent to foreclosure, real estate is carried at the lower of its new cost basis or fair value, less estimated costs to sell. OREO is fair valued under Level 3 at the lower of cost or fair value based on property appraisals less estimated costs, which include both observable and unobservable inputs, at the time of transfer and as appropriate thereafter.

NOTE 9 - FINANCIAL INSTRUMENTS - CONTINUED

In accordance with the disclosure requirements of FASB ASC 825, *Financial Instruments*, the estimated fair values of the Company's financial instruments are as follows:

| | | | | | FAIR VALUE MEASUREMENTS AT REPORTING DATE USING | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| DECEMBER 31, 2017 | | CARRYING AMOUNT | | FAIR VALUE | | QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS/ LIABILITIES (LEVEL 1) | | SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2) | | SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3) |
| Cash and due from banks | $ | 17 711 421 | $ | 17 711 421 | $ | 17 711 421 | $ | - | $ | - |
| Interest bearing time deposits in banks | $ | 69 436 000 | $ | 68 834 406 | $ | - | $ | 68 834 406 | $ | - |
| Securities available-for-sale | $ | 156 727 876 | $ | 156 727 876 | $ | - | $ | 156 727 876 | $ | - |
| Securities held-to-maturity | $ | 1 937 187 | $ | 1 909 422 | $ | - | $ | 1 909 422 | $ | - |
| Restricted equity securities | $ | 571 520 | $ | N/A | $ | - | $ | - | $ | - |
| Loans receivable | $ | 121 021 481 | $ | 120 367 730 | $ | - | $ | - | $ | 120 367 730 |
| Accrued interest receivable | $ | 1 494 819 | $ | 1 494 819 | $ | 1 494 819 | $ | - | $ | - |
| Financial Liabilities: | | | | | | | | | | |
| Deposit liabilities | $ | 328 537 253 | $ | 323 853 158 | $ | - | $ | - | $ | 323 853 158 |
| Accrued interest payable | $ | 16 640 | $ | 16 640 | $ | 16 640 | $ | - | $ | - |

| | | | | | FAIR VALUE MEASUREMENTS AT REPORTING DATE USING | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| DECEMBER 31, 2016 | | CARRYING AMOUNT | | FAIR VALUE | | QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS/ LIABILITIES (LEVEL 1) | | SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2) | | SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3) |
| Cash and due from banks | $ | 10 774 882 | $ | 10 774 882 | $ | 10 774 882 | $ | - | $ | - |
| Interest bearing time deposits in banks | $ | 66 124 000 | $ | 65 824 624 | $ | - | $ | 65 824 624 | $ | - |
| Securities available-for-sale | $ | 146 259 596 | $ | 146 259 596 | $ | - | $ | 146 259 596 | $ | - |
| Securities held-to-maturity | $ | - | $ | - | $ | - | $ | - | $ | - |
| Restricted equity securities | $ | 570 220 | $ | N/A | $ | - | $ | - | $ | - |
| Loans receivable | $ | 115 886 163 | $ | 116 028 334 | $ | - | $ | - | $ | 116 028 334 |
| Accrued interest receivable | $ | 1 381 731 | $ | 1 381 731 | $ | - | $ | - | $ | - |
| Financial Liabilities: | | | | | | | | | | |
| Deposit liabilities | $ | 300 475 877 | $ | 300 561 184 | $ | - | $ | - | $ | 300 561 184 |
| Accrued interest payable | $ | 16 677 | $ | 16 677 | $ | 16 677 | $ | - | $ | - |
| Federal funds purchased | $ | 2 440 000 | $ | 2 440 000 | $ | 2 440 000 | $ | - | $ | - |

The following methodologies and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

**Cash and Cash Equivalents**

The carrying amounts report in the consolidated balance sheets for cash and cash equivalents approximate those assets' fair values.

**Interest Bearing Time Deposits in Banks**

Fair values of interest bearing deposits in banks are estimated using discounted cash flow analysis, based on rates currently being offered on certificates with terms approximating the remaining term of the certificates in the portfolio.

**Investment Securities and Restricted Equity Securities**

Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on discounted cash flow analysis based on observable inputs, except for restricted securities where fair value equals par value based on redemption value.

NOTE 9 - FINANCIAL INSTRUMENTS - CONTINUED

**Loans, Net**

For both fixed and variable rate loans in 2017 and 2016, fair values are estimated using discounted cash flow analysis and current interest rates charged for the types of loans in the portfolio.

**Accrued Interest Receivable**

The carrying amount of accrued interest receivable approximates fair value.

**Deposits**

The fair values of transactional deposits accounts (interest and noninterest checking, savings and money market accounts) are considered to be their carrying amounts. Fair values for fixed rate certificates of deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of the aggregate expected monthly maturities on time deposits.

**Accrued Interest Payable**

The carrying amount of accrued interest payable approximates fair value.

**Federal Fund Purchased**

Fair value of overnight borrowings approximate those liabilities' carrying amount.

**Commitments to Extend Credit**

There is not material difference between the notional amount and the estimated fair value of off-balance-sheet unfunded loan commitments which are generally priced at market at the time of funding. Letters of credit have an estimated fair value based on fees currently charged for similar agreements. Fees related to the unexpired term of the letters of credit are not significant. The Company has not incurred any losses on its commitments to extend credit or standby letters of credit during the years presented.

NOTE 10 - CONCENTRATION OF CREDIT RISK

The Company periodically carries certain assets with other financial institutions which are subject to credit risk by the amount such assets exceed Federal deposit insurance limits. From time to time, the Bank is also due amounts in excess of FDIC insurance limits for checks and transit items. The Federal Deposit Insurance Corporation (FDIC) provides deposit insurance coverage for amounts up to $250,000 for substantially all depository accounts. Management monitors the financial stability of correspondent banks and considers amounts advanced in excess of FDIC insurance limits to present no significant additional risk to the Bank.

NOTE 11 - REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the Federal banking agencies. 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 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 assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of Total, Common and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2017, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2017 and 2016, the most recent notification from the Office of the Comptroller of Currency categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, minimum total risk-based, Tier I risk based common equity Tier I risk based and Tier I leverage ratios as set forth in the table must be maintained. There are no conditions or events since that notification that management believes have changed the Bank's categories.

Actual capital amounts and ratios are presented in the table for the Bank (in thousands). Bank only amounts and percentages are presented as they do not differ materially from bank holding company amounts and percentages.

| | ACTUAL | | FOR CAPITAL ADEQUACY PURPOSES | | TO BE WELL CAPITALIZED UNDER PROMPT CORRECTIVE ACTION PROVISIONS | |
|---|---|---|---|---|---|---|
| | AMOUNT | RATIO | AMOUNT | RATIO | AMOUNT | RATIO |
| As of December 31, 2017: | | | | | | |
| Total Risk Based Capital (to Risk Weighted Assets) | $ 52 495 | 41.42% | $ ≥ 11 724 | ≥ 9.250% | $ ≥ 12 675 | ≥ 10.0% |
| Tier I Capital (to Risk Weighted Assets) | $ 50 904 | 40.16% | $ ≥ 9 189 | ≥ 7.250% | $ ≥ 10 140 | ≥ 8.0% |
| Common Equity Tier I Capital Ratio (to Risk Weighted Assets) | $ 50 904 | 40.16% | $ ≥ 7 288 | ≥ 5.750% | $ ≥ 8 239 | ≥ 6.5% |
| Tier I Leverage Capital (to Average Assets) | $ 50 904 | 13.29% | $ ≥ 15 316 | ≥ 4.000% | $ ≥ 19 145 | ≥ 5.0% |
| As of December 31, 2016: | | | | | | |
| Total Risk Based Capital (to Risk Weighted Assets) | $ 50 470 | 40.91% | $ ≥ 10 640 | ≥ 8.625% | $ ≥ 12 336 | ≥ 10.0% |
| Tier I Capital (to Risk Weighted Assets) | $ 48 921 | 39.66% | $ ≥ 8 173 | ≥ 6.625% | $ ≥ 9 869 | ≥ 8.0% |
| Common Equity Tier I Capital Ratio (to Risk Weighted Assets) | $ 48 921 | 39.66% | $ ≥ 6 322 | ≥ 5.125% | $ ≥ 8 018 | ≥ 6.5% |
| Tier I Leverage Capital (to Average Assets) | $ 48 921 | 13.67% | $ ≥ 14 315 | ≥ 4.000% | $ ≥ 17 894 | ≥ 5.0% |

The above 2017 risk-weighted capital ratios for capital adequacy purposes include a .625% capital conservation buffer. The capital conservation buffer will be phased in over four years to 2.50%. Financial institutions with a buffer greater than .625% (2017) are not subject to limits on capital distributions or discretionary bonus payments beyond those currently included in regulations. As reflected above, the Bank's capital was sufficient to exceed its minimum capital requirements including the required capital conservation buffer.

## NOTE 11 - REGULATORY MATTERS - CONTINUED

Although Federal Reserve regulations regarding specific capital requirements do not generally apply to Bank Holding Companies with consolidated assets of less than $500 million, the Federal Reserve may apply capital guidelines to the Company on a consolidated basis, regardless of asset size, if such action is warranted for supervisory purposes.

## NOTE 12 - RESTRICTIONS ON DISTRIBUTIONS (DIVIDENDS)

The Bank is subject to certain restrictions on the amount of distributions that it may pay without prior regulatory approval. The Bank normally restricts distributions to a lesser amount. At December 31, 2017, retained earnings of approximately $5,900,000, were available to the Bank for the payment of distributions without prior regulatory approval. This amount available is reduced subsequent to December 31, 2017 to approximately $3,900,000 since it is based on the current year to date earnings retained plus the previous two years retained income. In addition, distributions may not be paid by the Bank without regulatory approval if capital requirements will not be met subsequent to the dividend.

As a subchapter S corporation, the Company may also be limited as to distributions based on previous retained subchapter S earnings or bank capital requirements as noted above.

## NOTE 13 - RESTRICTION ON CASH AND DUE FROM BANKS

The Bank is required to maintain reserve funds in cash or on deposit with the Federal Reserve Bank. The required reserve at December 31, 2017, was approximately $4,467,000.

## NOTE 14 - DISCONTINUED OPERATIONS

Effective December 31, 2010, the physical assets and related title and abstract business of Polk County Title Company, Inc. were sold. Polk County Title Company, Inc. will remain in existence for a period of years in accordance with certain legal requirements and may generate or expend insignificant amounts of cash flow during the remaining years of its existence.

## NOTE 15 - COMPONENTS OF OTHER COMPREHENSIVE INCOME

The following table presents the components of other comprehensive income (loss) for the years ended December 31, 2017 and 2016.

| | YEARS ENDED | | | | | |
|---|---|---|---|---|---|---|
| | DECEMBER 31, 2017 | | | DECEMBER 31, 2016 | | |
| (DOLLARS IN THOUSANDS) | BEFORE TAX | TAX EFFECT | NET OF TAX | BEFORE TAX | TAX EFFECT | NET OF TAX |
| Changes in net unrealized gains on securities available for sale | $ 122 553 | $ - | $ 122 553 | $ (3 162 869) | $ - | $ (3 162 869) |
| Reclassification adjustment for gains realized | - | - | - | - | - | - |
| OTHER COMPREHENSIVE INCOME (LOSS) | $ 122 553 | $ - | $ 122 553 | $ (3 162 869) | $ - | $ (3 162 869) |

## NOTE 15 - COMPONENTS OF OTHER COMPREHENSIVE INCOME - CONTINUED

The following table presents the changes in each component of accumulated other comprehensive income, net of tax, for the years ended December 31, 2017 and 2016.

| (DOLLARS IN THOUSANDS) | | SECURITIES AVAILABLE FOR SALE | | ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) |
|---|---|---|---|---|
| Balance at January 1, 2016 | $ | 1 258 477 | $ | 1 258 477 |
| Other comprehensive income before reclassifications | | (3 162 869) | | (3 162 869 ) |
| Amounts reclassified from accumulated other comprehensive income | | - | | - |
| Balance at December 31, 2016 | | (1 904 392) | | (1 904 392) |
| Other comprehensive income before reclassifications | | 122 553 | | 122 553 |
| Amounts reclassified from accumulated other comprehensive income | | - | | - |
| Balance at December 31, 2017 | $ | (1 781 839) | $ | (1 781 839) |

## NOTE 16 - BROKERAGE COMMISSION

Net brokerage commission consists of the following for the years ended December 31, 2017 and 2016:

| | | 2016 | 2017 |
|---|---|---|---|
| Gross brokerage commissions | $ | 1 895 601 | 2 076 409 |
| Expenses | | (280 052) | (320 417) |
| NET BROKERAGE COMMISSIONS | $ | 1 615 549 | 1 755 992 |

AXLEY&RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT ON SUPPLEMENTARY INFORMATION

Board of Directors
FNB Company and Subsidiaries
Livingston, Texas

We have audited the consolidated financial statements of FNB Company and Subsidiaries as of and for the years ended December 31, 2017 and 2016, and our report thereon dated February 7, 2018 which expressed an unmodified opinion on those financial statements appears on page 3. Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Axley & Rode LLP
CERTIFIED PUBLIC ACCOUNTANTS

Lufkin, Texas
February 7, 2018



www.axleyrode.com

CONSOLIDATING SUPPLEMENTARY INFORMATION

FNB COMPANY AND SUBSIDIARIES

FNB COMPANY AND SUBSIDIARIES
CONSOLIDATING BALANCE SHEET
December 31, 2017

| | FNB COMPANY | THE FIRST NATIONAL BANK OF LIVINGSTON |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 19 162 | $ 17 711 421 |
| Interest bearing deposits in banks | - | 69 436 000 |
| Securities available-for-sale | - | 156 727 876 |
| Securities held-to-maturity | - | 1 937 187 |
| Restricted equity securities | - | 571 520 |
| Investment in subsidiaries | 52 154 201 | - |
| Loans, less allowance for loan losses | - | 121 021 481 |
| Bank premises and equipment, net | - | 8 791 247 |
| Accrued interest receivable | - | 1 494 819 |
| Goodwill, net | - | 3 031 499 |
| Residential real estate acquired in settlement of loans | - | 90 000 |
| Other assets | 661 712 | 1 049 956 |
| TOTAL ASSETS | $ 52 835 075 | $ 381 863 006 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Deposits: | | |
| Noninterest-bearing deposits | $ - | $ 136 256 782 |
| Interest-bearing deposits | - | 192 299 633 |
| TOTAL DEPOSITS | - | 328 556 415 |
| | | |
| Accrued interest and other liabilities | 661 765 | 1 152 390 |
| TOTAL LIABILITIES | 661 765 | 329 708 805 |
| | | |
| Stockholders' Equity: | | |
| Common stock | 130 028 | 479 000 |
| Surplus | 21 401 004 | 12 612 340 |
| Retained earnings | 32 860 055 | 40 844 700 |
| Treasury stock | (435 938) | - |
| Accumulated other comprehensive income | (1 781 839) | (1 781 839) |
| TOTAL STOCKHOLDERS' EQUITY | 52 173 310 | 52 154 201 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 52 835 075 | $ 381 863 006 |

See independent auditors' report on supplementary information.

| ELIMINATING ENTRIES | CONSOLIDATED TOTALS |
|---|---|
| $ (19 162) | $ 17 711 421 |
| - | 69 436 000 |
| - | 156 727 876 |
| - | 1 937 187 |
| - | 571 520 |
| (52 154 201) | - |
| - | 121 021 481 |
| - | 8 791 247 |
| - | 1 494 819 |
| - | 3 031 499 |
| - | 90 000 |
| (661 765) | 1 049 903 |
| $ (52 835 128) | $ 381 862 953 |
| | |
| $ (19 162) | $ 136 237 620 |
| - | 192 299 633 |
| (19 162) | 328 537 253 |
| | |
| (661 765) | 1 152 390 |
| (680 927) | 329 689 643 |
| | |
| (479 000) | 130 028 |
| (12 612 340) | 21 401 004 |
| (40 844 700) | 32 860 055 |
| - | (435 938) |
| 1 781 839 | (1 781 839) |
| (52 154 201) | 52 173 310 |
| | |
| $ (52 835 128) | $ 381 862 953 |

FNB COMPANY AND SUBSIDIARIES
CONSOLIDATING BALANCE SHEET
December 31, 2016

| | FNB COMPANY | THE FIRST NATIONAL BANK OF LIVINGSTON |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 16 781 | $ 10 774 882 |
| Interest bearing deposits in banks | - | 66 124 000 |
| Securities available for sale | - | 146 259 596 |
| Restricted equity securities | - | 570 220 |
| Investment in subsidiaries | 50 053 310 | - |
| Loans, less allowance for loan losses | - | 115 886 163 |
| Bank premises and equipment, net | - | 9 049 097 |
| Accrued interest receivable | - | 1 381 731 |
| Goodwill, net | - | 3 031 500 |
| Other assets | 668 136 | 1 031 986 |
| TOTAL ASSETS | $ 50 738 227 | $ 354 109 175 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Deposits: | | |
| Noninterest-bearing deposits | $ - | $ 114 630 071 |
| Interest-bearing deposits | - | 185 862 587 |
| TOTAL DEPOSITS | - | 300 492 658 |
| Federal funds purchased | - | 2 440 000 |
| Accrued interest and other liabilities | 668 190 | 1 123 207 |
| TOTAL LIABILITIES | 668 190 | 304 055 865 |
| Stockholders' Equity: | | |
| Common stock | 130 028 | 479 000 |
| Surplus | 21 401 004 | 12 612 340 |
| Retained earnings | 30 879 335 | 38 866 362 |
| Treasury stock | (435 938) | - |
| Accumulated other comprehensive income | (1 904 392) | (1 904 392) |
| TOTAL STOCKHOLDERS' EQUITY | 50 070 037 | 50 053 310 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 50 738 227 | $ 354 109 175 |

See independent auditors' report on supplementary information.

| ELIMINATING ENTRIES | CONSOLIDATED TOTALS |
|---|---|
| $ (16 781) | $ 10 774 882 |
| - | 66 124 000 |
| - | 146 259 596 |
| - | 570 220 |
| (50 053 310) | - |
| - | 115 886 163 |
| - | 9 049 097 |
| - | 1 381 731 |
| - | 3 031 500 |
| (668 190) | 1 031 932 |
| $ (50 738 281) | $ 354 109 121 |
| | |
| $ (16 781) | $ 114 613 290 |
| - | 185 862 587 |
| (16 781) | 300 475 877 |
| | |
| - | 2 440 000 |
| (668 190) | 1 123 207 |
| (684 971) | 304 039 084 |
| | |
| (479 000) | 130 028 |
| (12 612 340) | 21 401 004 |
| (38 866 362) | 30 879 335 |
| - | (435 938) |
| 1 904 392 | (1 904 392) |
| (50 053 310) | 50 070 037 |
| | |
| $ (50 738 281) | $ 354 109 121 |

FNB COMPANY AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF INCOME
For the Year Ended December 31, 2017

| | FNB COMPANY | THE FIRST NATIONAL BANK OF LIVINGSTON |
|---|---|---|
| Interest Income: | | |
| Interest and fees on loans | $ - | $ 6 224 701 |
| Interest on Investment Securities: | | |
| Taxable | - | 2 179 662 |
| Exempt from Federal income tax | - | 1 089 678 |
| Interest on deposits in banks | - | 1 167 528 |
| TOTAL INTEREST INCOME | - | 10 661 569 |
| Interest expense on deposits | - | 442 102 |
| Interest on Federal funds purchased | - | 1 018 |
| NET INTEREST INCOME | - | 10 218 449 |
| Provision for loan losses | - | 240 000 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | - | 9 978 449 |
| Other Income: | | |
| Service charges on deposit accounts | - | 1 909 860 |
| Other service charges and fees | - | 1 741 283 |
| Equity in earnings of subsidiaries | 4 625 398 | - |
| Insurance commissions | - | 639 906 |
| Brokerage commissions (net) | - | 1 755 992 |
| Gain/(loss) other | - | (1 130) |
| Other income | 4 592 | 46 266 |
| TOTAL OTHER INCOME | 4 629 990 | 6 092 177 |
| Other Expenses: | | |
| Salaries and employee benefits | - | 6 365 471 |
| Occupancy, insurance and equipment expense | - | 1 427 688 |
| ATM processing | - | 737 766 |
| Deposit insurance expense | - | 159 995 |
| Data processing | - | 831 786 |
| Directors fees | - | 185 819 |
| Postage and freight | - | 134 066 |
| Printing and office supplies | - | 216 107 |
| Legal and professional services | 1 086 | 247 630 |
| Telephone | - | 111 764 |
| Marketing | - | 90 665 |
| Other operating expenses | 1 125 | 936 471 |
| TOTAL OTHER EXPENSES | 2 211 | 11 445 228 |
| NET INCOME | $ 4 627 779 | $ 4 625 398 |

See independent auditors' report on supplementary information.

| ELIMINATING ENTRIES | CONSOLIDATED TOTALS |
|---|---|
| $ - | $ 6 224 701 |
| - | 2 179 662 |
| - | 1 089 678 |
| - | 1 167 528 |
| - | 10 661 569 |
| - | 442 102 |
| - | 1 018 |
| - | 10 218 449 |
| - | 240 000 |
| - | 9 978 449 |
| - | 1 909 860 |
| - | 1 741 283 |
| (4 625 398) | - |
| - | 639 906 |
| - | 1 755 992 |
| - | (1 130) |
| - | 50 858 |
| (4 625 398) | 6 096 769 |
| - | 6 365 471 |
| - | 1 427 688 |
| - | 737 766 |
| - | 159 995 |
| - | 831 786 |
| - | 185 819 |
| - | 134 066 |
| - | 216 107 |
| - | 248 716 |
| - | 111 764 |
| - | 90 665 |
| - | 937 596 |
| - | 11 447 439 |
| $ (4 625 398) | $ 4 627 779 |

FNB COMPANY AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF INCOME
For the Year Ended December 31, 2016

| | FNB COMPANY | THE FIRST NATIONAL BANK OF LIVINGSTON |
|---|---|---|
| Interest Income: | | |
| Interest and fees on loans | $ - | $ 6 231 374 |
| Interest on Investment Securities: | | |
| Taxable | - | 1 905 446 |
| Exempt from Federal income tax | - | 1 141 816 |
| Interest on deposits in banks | - | 976 797 |
| TOTAL INTEREST INCOME | - | 10 255 433 |
| Interest expense on deposits | - | 441 118 |
| Interest on Federal funds purchased | - | 1 205 |
| NET INTEREST INCOME | - | 9 813 110 |
| Provision for loan losses | - | 287 500 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | - | 9 525 610 |
| Other Income: | | |
| Service charges on deposit accounts | - | 2 004 564 |
| Other service charges and fees | - | 1 574 871 |
| Equity in earnings of subsidiaries | 4 674 568 | - |
| Insurance commissions | - | 453 074 |
| Brokerage commissions (net) | - | 1 615 549 |
| Other income | 17 441 | 58 056 |
| TOTAL OTHER INCOME | 4 692 009 | 5 706 114 |
| Other Expenses: | | |
| Salaries and employee benefits | - | 5 883 560 |
| Occupancy, insurance and equipment expense | - | 1 339 360 |
| ATM processing | - | 631 549 |
| Deposit insurance expense | - | 113 500 |
| Data processing | - | 841 430 |
| Directors fees | - | 190 473 |
| Postage and freight | - | 116 361 |
| Printing and office supplies | - | 184 732 |
| Legal and professional services | 1 056 | 224 999 |
| Telephone | - | 119 713 |
| Marketing | - | 116 435 |
| Other operating expenses | 8 921 | 814 539 |
| TOTAL OTHER EXPENSES | 9 977 | 10 576 651 |
| INCOME FROM OPERATIONS BEFORE FEDERAL INCOME TAXES | 4 682 032 | 4 655 073 |
| Federal income taxes (benefit) | - | (19 494) |
| NET INCOME | 4 682 032 | 4 674 567 |

See independent auditors' report on supplementary information.

| ELIMINATING ENTRIES | CONSOLIDATED TOTALS |
|---|---|
| $ - | $ 6 231 374 |
| | |
| - | 1 905 446 |
| - | 1 141 816 |
| - | 976 797 |
| - | 10 255 433 |
| - | 441 118 |
| - | 1 205 |
| - | 9 813 110 |
| - | 287 500 |
| | |
| - | 9 525 610 |
| | |
| - | 2 004 564 |
| - | 1 574 871 |
| (4 674 568) | - |
| - | 453 074 |
| - | 1 615 549 |
| - | 75 497 |
| (4 674 568) | 5 723 555 |
| | |
| - | 5 883 560 |
| - | 1 339 360 |
| - | 631 549 |
| - | 113 500 |
| - | 841 430 |
| - | 190 473 |
| - | 116 361 |
| - | 184 732 |
| - | 226 055 |
| - | 119 713 |
| - | 116 435 |
| - | 823 460 |
| - | 10 586 628 |
| | |
| (4 674 568) | 4 662 537 |
| - | (19 494) |
| (4 674 568) | 4 682 031 |

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CONSOLIDATING SUPPLEMENTARY INFORMATION

THE FIRST NATIONAL BANK OF LIVINGSTON AND SUBSIDIARIES

THE FIRST NATIONAL BANK OF LIVINGSTON AND SUBSIDIARIES
CONSOLIDATING BALANCE SHEET
December 31, 2017

| | | THE FIRST NATIONAL BANK OF LIVINGSTON |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ | 17 711 421 |
| Interest bearing deposits in banks | | 69 436 000 |
| Securities available-for-sale | | 156 727 876 |
| Securities held-to-maturity | | 1 937 187 |
| Restricted equity securities | | 571 520 |
| Investment in subsidiaries | | 435 930 |
| Loans, less allowance for loan losses | | 121 021 481 |
| Bank premises and equipment, net | | 8 784 230 |
| Accrued interest receivable | | 1 494 819 |
| Goodwill, net | | 3 031 499 |
| Residential real estate in settlement of loans | | 90 000 |
| Other assets | | 1 025 106 |
| TOTAL ASSETS | $ | 382 267 069 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Deposits: | | |
| Noninterest-bearing deposits | $ | 136 728 724 |
| Interest-bearing deposits | | 192 299 633 |
| TOTAL DEPOSITS | | 329 028 357 |
| Accrued interest and other liabilities | | 1 084 511 |
| TOTAL LIABILITIES | | 330 112 868 |
| Stockholders' Equity: | | |
| Common stock | | 479 000 |
| Surplus | | 12 612 340 |
| Retained earnings | | 40 844 700 |
| Accumulated other comprehensive income | | (1 781 839) |
| TOTAL STOCKHOLDERS' EQUITY | | 52 154 201 |
| | | |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ | 382 267 069 |

See independent auditors' report on supplementary information.

| CHURCH STREET FINANCIAL | POLK COUNTY TITLE COMPANY, INC. | ELIMINATING ENTRIES | CONSOLIDATED TOTALS |
|---|---|---|---|
| $ 298 865 | $ 36 172 | $ (335 037) | $ 17 711 421 |
| - | - | - | 69 436 000 |
| - | - | - | 156 727 876 |
| - | - | - | 1 937 187 |
| - | - | - | 571 520 |
| - | - | (435 930) | - |
| - | - | - | 121 021 481 |
| 7 017 | - | - | 8 791 247 |
| - | - | - | 1 494 819 |
| - | - | - | 3 031 499 |
| - | - | - | 90 000 |
| 160 924 | - | (136 074) | 1 049 956 |
| $ 466 806 | $ 36 172 | $ (907 041) | $ 381 863 006 |
| | | | |
| $ - | $ - | $ (471 942) | $ 136 256 782 |
| - | - | - | 192 299 633 |
| - | - | (471 942) | 328 556 415 |
| 67 879 | - | - | 1 152 390 |
| 67 879 | - | (471 942) | 329 708 805 |
| | | | |
| 350 000 | 2 000 | (352 000) | 479 000 |
| - | 111 795 | (111 795) | 12 612 340 |
| 48 927 | (77 623) | 28 696 | 40 844 700 |
| - | - | - | (1 781 839) |
| 398 927 | 36 172 | (435 099) | 52 154 201 |
| | | | |
| $ 466 806 | $ 36 172 | $ (907 041) | $ 381 863 006 |

THE FIRST NATIONAL BANK OF LIVINGSTON AND SUBSIDIARIES
CONSOLIDATING BALANCE SHEET
December 31, 2016

| | | THE FIRST NATIONAL BANK OF LIVINGSTON |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ | 10 774 882 |
| Interest bearing deposits in banks | | 66 124 000 |
| Securities available for sale | | 146 259 596 |
| Restricted equity securities | | 570 220 |
| Investment in subsidiaries | | 420 974 |
| Loans, less allowance for loan losses | | 115 886 163 |
| Bank premises and equipment, net | | 9 030 249 |
| Accrued interest receivable | | 1 381 731 |
| Goodwill, net | | 3 031 500 |
| Other assets | | 1 015 708 |
| TOTAL ASSETS | $ | 354 495 023 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Deposits: | | |
| Noninterest-bearing deposits | $ | 115 083 821 |
| Interest-bearing deposits | | 185 862 587 |
| TOTAL DEPOSITS | | 300 946 408 |
| Federal funds purchased | | 2 440 000 |
| Accrued interest and other liabilities | | 1 055 305 |
| TOTAL LIABILITIES | | 304 441 713 |
| Stockholders' Equity: | | |
| Common stock | | 479 000 |
| Surplus | | 12 612 340 |
| Retained earnings | | 38 866 362 |
| Accumulated other comprehensive income | | (1 904 392) |
| TOTAL STOCKHOLDERS' EQUITY | | 50 053 310 |
| | | |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ | 354 495 023 |

See independent auditors' report on supplementary information.

| CHURCH STREET FINANCIAL | POLK COUNTY TITLE COMPANY, INC. | ELIMINATING ENTRIES | CONSOLIDATED TOTALS |
|---|---|---|---|
| $ 276 429 | $ 36 172 | $ (312 601) | $ 10 774 882 |
| - | - | - | 66 124 000 |
| - | - | - | 146 259 596 |
| - | - | - | 570 220 |
| - | - | (420 974) | - |
| - | - | - | 115 886 163 |
| 18 848 | - | - | 9 049 097 |
| - | - | - | 1 381 731 |
| - | - | - | 3 031 500 |
| 156 597 | - | (140 319) | 1 031 986 |
| $ 451 874 | $ 36 172 | $ (873 894) | $ 354 109 175 |
| | | | |
| $ - | $ - | $ (453 750) | $ 114 630 071 |
| - | - | - | 185 862 587 |
| - | - | (453 750) | 300 492 658 |
| - | - | - | 2 440 000 |
| 67 902 | - | - | 1 123 207 |
| 67 902 | - | (453 750) | 304 055 865 |
| | | | |
| 350 000 | 2 000 | (352 000) | 479 000 |
| - | 111 795 | (111 795) | 12 612 340 |
| 33 972 | (77 623) | 43 651 | 38 866 362 |
| - | - | - | (1 904 392) |
| 383 972 | 36 172 | (420 144) | 50 053 310 |
| | | | |
| $ 451 874 | $ 36 172 | $ (873 894) | $ 354 109 175 |

THE FIRST NATIONAL BANK OF LIVINGSTON AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF INCOME
For the Year Ended December 31, 2017

| | | THE FIRST NATIONAL BANK OF LIVINGSTON |
|---|---|---|
| Interest Income: | | |
| Interest and fees on loans | $ | 6 224 701 |
| Interest on Investment Securities: | | |
| Taxable | | 2 179 662 |
| Exempt from Federal income tax | | 1 089 678 |
| Interest on deposits in banks | | 1 167 528 |
| TOTAL INTEREST INCOME | | 10 661 569 |
| Interest expense on deposits | | 442 102 |
| Interest on Federal funds purchased | | 1 018 |
| NET INTEREST INCOME | | 10 218 449 |
| Provision for loan losses | | 240 000 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | | 9 978 449 |
| Other Income: | | |
| Service charges on deposit accounts | | 1 909 860 |
| Other service charges and fees | | 1 741 283 |
| Equity in earnings of subsidiaries | | 639 955 |
| Insurance commissions | | - |
| Brokerage commissions (net) | | 1 755 992 |
| Management fee | | - |
| Gain/(loss) other | | (1 130) |
| Other income | | 190 266 |
| TOTAL OTHER INCOME | | 6 236 226 |
| Other Expenses: | | |
| Salaries and employee benefits | | 5 172 535 |
| Occupancy, insurance and equipment expense | | 1 393 233 |
| ATM processing | | 737 766 |
| Deposit insurance expense | | 159 995 |
| Data processing | | 807 481 |
| Directors fees | | 173 819 |
| Postage and freight | | 130 591 |
| Printing and office supplies | | 202 909 |
| Legal and professional services | | 235 517 |
| Telephone | | 102 624 |
| Marketing | | 79 254 |
| Management fee paid | | 1 571 046 |
| Other operating expenses | | 822 507 |
| TOTAL OTHER EXPENSES | | 11 589 277 |
| NET INCOME | $ | 4 625 398 |

See independent auditors' report on supplementary information.

| CHURCH STREET FINANCIAL | POLK CO. TITLE COMPANY, INC. | ELIMINATING ENTRIES | CONSOLIDATED TOTALS |
|---|---|---|---|
| $ - | $ - | $ - | $ 6 224 701 |
| - | - | - | 2 179 662 |
| - | - | - | 1 089 678 |
| - | - | - | 1 167 528 |
| - | - | - | 10 661 569 |
| - | - | - | 442 102 |
| - | - | - | 1 018 |
| - | - | - | 10 218 449 |
| - | - | - | 240 000 |
| - | - | - | 9 978 449 |
| - | - | - | 1 909 860 |
| - | - | - | 1 741 283 |
| - | - | (639 955) | - |
| 639 906 | - | - | 639 906 |
| - | - | - | 1 755 992 |
| 1 571 046 | - | (1 571 046) | - |
| - | - | - | (1 130) |
| - | - | (144 000) | 46 266 |
| 2 210 952 | - | (2 355 001) | 6 092 177 |
| 1 192 936 | - | - | 6 365 471 |
| 178 455 | - | (144 000) | 1 427 688 |
| - | - | - | 737 766 |
| - | - | - | 159 995 |
| 24 305 | - | - | 831 786 |
| 12 000 | - | - | 185 819 |
| 3 475 | - | - | 134 066 |
| 13 198 | - | - | 216 107 |
| 12 113 | - | - | 247 630 |
| 9 140 | - | - | 111 764 |
| 11 411 | - | - | 90 665 |
| - | - | (1 571 046) | - |
| 113 964 | - | - | 936 471 |
| 1 570 997 | - | (1 715 046) | 11 445 228 |
| $ 639 955 | $ - | $ (639 955) | $ 4 625 398 |

THE FIRST NATIONAL BANK OF LIVINGSTON AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF INCOME
For the Year Ended December 31, 2016

| | | THE FIRST NATIONAL BANK OF LIVINGSTON |
|---|---|---|
| Interest Income: | | |
| Interest and fees on loans | $ | 6 231 374 |
| Interest on Investment Securities: | | |
| Taxable | | 1 905 446 |
| Exempt from Federal income tax | | 1 141 816 |
| Interest on deposits in banks | | 976 797 |
| TOTAL INTEREST INCOME | | 10 255 433 |
| Interest expense on deposits | | 441 118 |
| Interest on Federal funds purchased | | 1 205 |
| NET INTEREST INCOME | | 9 813 110 |
| Provision for loan losses | | 287 500 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | | 9 525 610 |
| Other Income: | | |
| Service charges on deposit accounts | | 2 004 564 |
| Other service charges and fees | | 1 574 871 |
| Equity in earnings of subsidiaries | | 553 505 |
| Insurance commissions | | - |
| Brokerage commissions (net) | | 833 369 |
| Management fee | | - |
| Other income | | 188 056 |
| TOTAL OTHER INCOME | | 5 154 365 |
| Other Expenses: | | |
| Salaries and employee benefits | | 4 842 093 |
| Occupancy, insurance and equipment expense | | 1 298 615 |
| ATM processing | | 631 549 |
| Deposit insurance expense | | 113 500 |
| Data processing | | 802 934 |
| Directors fees | | 178 473 |
| Postage and freight | | 112 768 |
| Printing and office supplies | | 175 365 |
| Legal and professional services | | 211 965 |
| Telephone | | 107 051 |
| Marketing | | 100 895 |
| Management fee paid | | 721 918 |
| Other operating expenses | | 727 776 |
| TOTAL OTHER EXPENSES | | 10 024 902 |
| INCOME FROM OPERATIONS BEFORE FEDERAL INCOME TAXES | | 4 655 073 |
| Federal income taxes (benefits) | | (19 494) |
| NET INCOME | $ | 4 674 567 |

See independent auditors' report on supplementary information.

| CHURCH STREET FINANCIAL | POLK CO. TITLE COMPANY, INC. | ELIMINATING ENTRIES | CONSOLIDATED TOTALS |
|---|---|---|---|
| $ - | $ - | $ - | $ 6 231 374 |
| - | - | - | 1 905 446 |
| - | - | - | 1 141 816 |
| - | - | - | 976 797 |
| - | - | - | 10 255 433 |
| - | - | - | 441 118 |
| - | - | - | 1 205 |
| - | - | - | 9 813 110 |
| - | - | - | 287 500 |
| - | - | - | 9 525 610 |
| - | - | - | 2 004 564 |
| - | - | - | 1 574 871 |
| - | - | (553 505) | - |
| 453 074 | - | - | 453 074 |
| 782 181 | - | - | 1 615 550 |
| 721 918 | - | (721 918) | - |
| - | - | (130 000) | 58 056 |
| 1 957 173 | - | (1 405 423) | 5 706 115 |
| 1 041 467 | - | - | 5 883 560 |
| 170 745 | - | (130 000) | 1 339 360 |
| - | - | - | 631 549 |
| - | - | - | 113 500 |
| 38 496 | - | - | 841 430 |
| 12 000 | - | - | 190 473 |
| 3 593 | - | - | 116 361 |
| 9 367 | - | - | 184 732 |
| 13 034 | - | - | 224 999 |
| 12 662 | - | - | 119 713 |
| 15 540 | - | - | 116 435 |
| - | - | (721 918) | - |
| 86 764 | - | - | 814 540 |
| 1 403 668 | - | (851 918) | 10 576 652 |
| 553 505 | - | (553 505) | 4 655 073 |
| - | - | - | (19 494) |
| $ 553 505 | $ - | $ (553 505) | $ 4 674 567 |

FINANCIAL STATEMENTS WITH
INDEPENDENT AUDITORS' REPORT

FNB COMPANY AND SUBSIDIARIES
Livingston, Texas

December 31, 2017 and 2016

A&R | AXLEY&RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

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AXLEY & RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

# INDEPENDENT AUDITORS' REPORT

Board of Directors
FNB Company and Subsidiaries
Livingston, Texas

We have audited the accompanying consolidated financial statements of FNB Company and Subsidiaries (an S corporation), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

## 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 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks 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 purpose 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 FNB Company and Subsidiaries as of December 31, 2017 and 2016, and the consolidated results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Axley & Rode LLP
CERTIFIED PUBLIC ACCOUNTANTS

Lufkin, Texas
February 7, 2018



www.axleyrode.com

FNB COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 4 497 848 | $ 3 223 847 |
| Interest bearing deposits in banks | 13 213 573 | 7 551 035 |
| CASH AND CASH EQUIVALENTS | 17 711 421 | 10 774 882 |
| Interest-bearing time deposits in banks | 69 436 000 | 66 124 000 |
| Securities available for sale | 156 727 876 | 146 259 596 |
| Securities held-to-maturity | 1 937 187 | - |
| Restricted equity securities | 571 520 | 570 220 |
| Loans, net of allowance for loan losses of $2,145,687 in 2017 and $2,148,346 in 2016 | 121 021 481 | 115 886 163 |
| Bank premises and equipment, net | 8 791 247 | 9 049 097 |
| Accrued interest receivable | 1 494 819 | 1 381 731 |
| Goodwill, net | 3 031 499 | 3 031 499 |
| Residential real estate acquired in settlement of loans | 90 000 | - |
| Other assets | 1 049 903 | 1 031 933 |
| TOTAL ASSETS | $ 381 862 953 | $ 354 109 121 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Liabilities: | | |
| Deposits: | | |
| Noninterest-bearing deposits | $ 136 237 620 | $ 114 613 290 |
| Interest-bearing deposits | 192 299 633 | 185 862 587 |
| TOTAL DEPOSITS | 328 537 253 | 300 475 877 |
| Federal funds purchased | - | 2 440 000 |
| Accrued interest and other liabilities | 1 152 390 | 1 123 207 |
| TOTAL LIABILITIES | 329 689 643 | 304 039 084 |
| Stockholders' Equity: | | |
| Common stock, $1 par value; 5,000,000 shares authorized; 130,028 issued, 128,498 outstanding | 130 028 | 130 028 |
| Surplus | 21 401 004 | 21 401 004 |
| Retained earnings | 32 860 055 | 30 879 335 |
| Treasury stock (1,530 shares at cost) | (435 938) | (435 938) |
| Accumulated other comprehensive income | (1 781 839) | (1 904 392) |
| TOTAL STOCKHOLDERS' EQUITY | 52 173 310 | 50 070 037 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 381 862 953 | $ 354 109 121 |

The accompanying notes are an integral part of these financial statements.

FNB COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| Interest Income: | | |
| Interest and fees on loans | $ 6 224 701 | $ 6 231 374 |
| Interest on Investment Securities: | | |
| Taxable | 2 179 662 | 1 905 446 |
| Exempt from Federal income tax | 1 089 678 | 1 141 816 |
| Interest on deposits in banks | 1 167 528 | 976 797 |
| TOTAL INTEREST INCOME | 10 661 569 | 10 255 433 |
| Interest expense on deposits | 442 102 | 441 118 |
| Interest on Federal funds purchased | 1 018 | 1 205 |
| NET INTEREST INCOME | 10 218 449 | 9 813 110 |
| Provision for loan losses | 240 000 | 287 500 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 9 978 449 | 9 525 610 |
| Other Income: | | |
| Service charges on deposit accounts | 1 909 860 | 2 004 564 |
| Other service charges and fees | 1 741 283 | 1 574 871 |
| Insurance commissions | 639 906 | 453 074 |
| Brokerage commissions (net) | 1 755 992 | 1 615 549 |
| Gain/(loss) other | (1 130) | - |
| Other income | 50 858 | 75 497 |
| TOTAL OTHER INCOME | 6 096 769 | 5 723 555 |
| Other Expenses: | | |
| Salaries and employee benefits | 6 365 471 | 5 883 560 |
| Occupancy, insurance and equipment expense | 1 427 688 | 1 339 360 |
| ATM processing | 737 766 | 631 549 |
| Deposit insurance expense | 159 995 | 113 500 |
| Data processing | 831 786 | 841 430 |
| Directors fees | 185 819 | 190 473 |
| Postage and freight | 134 066 | 116 361 |
| Printing and office supplies | 216 107 | 184 732 |
| Legal and professional services | 248 716 | 226 055 |
| Telephone | 111 764 | 119 713 |
| Marketing | 90 665 | 116 435 |
| Other operating expenses | 937 596 | 823 460 |
| TOTAL OTHER EXPENSES | 11 447 439 | 10 586 628 |
| INCOME FROM OPERATIONS BEFORE FEDERAL INCOME TAXES | 4 627 779 | 4 662 537 |
| Federal income taxes (benefit) | - | (19 494) |
| NET INCOME | $ 4 627 779 | $ 4 682 031 |

The accompanying notes are an integral part of these financial statements.

FNB COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended December 31, 2017 and 2016

| | 2017 | 2016 |
|---|---|---|
| Net income | $ 4 627 779 | $ 4 682 031 |
| Other Comprehensive Income: | | |
| Unrealized gains (losses) on available for sale securities arising during the period | 122 553 | (3 162 869) |
| TOTAL OTHER COMPREHENSIVE INCOME | 122 553 | (3 162 869) |
| COMPREHENSIVE INCOME | $ 4 750 332 | $ 1 519 162 |

The accompanying notes are an integral part of these financial statements.

FNB COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For the Years Ended December 31, 2017 and 2016

| | COMMON STOCK SHARES | COMMON STOCK AMOUNT | CAPITAL SURPLUS | RETAINED EARNINGS | TREASURY STOCK | ACCUMULATED COMPREHENSIVE INCOME/(LOSS) | TOTAL EQUITY |
|---|---|---|---|---|---|---|---|
| Balance, December 31, 2015 | 130 028 | $ 130 028 | $ 21 401 004 | $ 28 905 356 | $ (375 168) | $ 1 258 477 | $ 51 319 697 |
| Net income | - | - | - | 4 682 031 | - | - | 4 682 031 |
| Other comprehensive loss | - | - | - | - | - | (3 162 869) | (3 162 869) |
| Purchase of treasury stock (200 shares) | - | - | - | - | (60 770) | - | (60 770) |
| Cash distributions | - | - | - | (2 708 052) | - | - | (2 708 052) |
| Balance, December 31, 2016 | 130 028 | 130 028 | 21 401 004 | 30 879 335 | (435 938) | (1 904 392) | 50 070 037 |
| Net income | - | - | - | 4 627 779 | - | - | 4 627 779 |
| Other comprehensive income | - | - | - | - | - | 122 553 | 122 553 |
| Cash distributions | - | - | - | (2 647 059) | - | - | (2 647 059) |
| Balance, December 31, 2017 | 130 028 | $ 130 028 | $ 21 401 004 | $ 32 860 055 | $ (435 938) | $ (1 781 839) | $ 52 173 310 |

The accompanying notes are an integral part of these financial statements.

FNB COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2017 and 2016

| | | 2017 | | 2016 |
|---|---|---|---|---|
| Cash Flows from Operating Activities: | | | | |
| Net income | $ | 4 627 779 | $ | 4 682 031 |
| Adjustments to Reconcile Net Income to Net | | | | |
| Cash Provided by Operating Activities: | | | | |
| Provision for loan losses | | 240 000 | | 287 500 |
| Provision for depreciation | | 643 782 | | 566 733 |
| Provision (benefit) for deferred taxes | | - | | (12 397) |
| (Gain)/loss on retirement of premises and equipment | | 1 130 | | - |
| FHLB dividends paid in stock | | (1 200) | | (400) |
| Net amortization (accretion) on investment securities | | 690 118 | | 616 472 |
| (Increase) decrease in accrued interest receivable | | (113 088) | | (80 713) |
| (Increase) decrease in other assets | | (17 970) | | (5 467) |
| Increase (decrease) in accrued interest and other liabilities | | 35 608 | | (119 353) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | | 6 106 159 | | 5 934 406 |
| | | | | |
| Cash Flows from Investing Activities: | | | | |
| Purchases of interest-bearing time deposit in banks | | (19 164 000) | | (24 239 000) |
| Maturities of interest-bearing time deposit in banks | | 15 852 000 | | 17 684 000 |
| Purchases of available-for-sale securities | | (31 680 839) | | (94 119 554) |
| Payments received on mortgage backed securities | | 5 284 033 | | 6 457 298 |
| Proceeds from maturities/calls/sales of available-for-sale securities | | 15 375 000 | | 78 560 000 |
| Proceeds from maturities/calls of held-to-maturity securities | | 20 000 | | - |
| Purchases of held-to-maturity securities | | (1 971 226) | | - |
| Net decrease/(increase) in loans | | (5 465 318) | | 3 854 818 |
| Purchases of premises and equipment | | (391 099) | | (706 687) |
| Proceeds from sale of premises and equipment | | 4 037 | | - |
| Purchases of Federal Home Loan Bank Stock | | (100) | | (4 900) |
| Proceeds from sale of other real estate | | - | | 150 000 |
| NET CASH USED BY INVESTING ACTIVITIES | | (22 137 512) | | (12 364 025) |
| | | | | |
| Cash Flows from Financing Activities: | | | | |
| Net increase (decrease) in noninterest-bearing deposits | | 21 624 330 | | 2 047 475 |
| Net (decrease) increase in interest bearing deposits | | 6 437 046 | | (1 590 065) |
| Purchase of treasury stock | | - | | (60 770) |
| Purchase of Federal funds sold (net) | | (2 440 000) | | 2 440 000 |
| Distributions paid | | (2 653 484) | | (2 715 528) |
| NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES | | 22 967 892 | | 121 112 |
| | | | | |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | | 6 936 539 | | (6 308 507) |
| Cash and cash equivalents at beginning of year | | 10 774 882 | | 17 083 389 |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | $ | 17 711 421 | $ | 10 774 882 |
| | | | | |
| Supplemental Information: | | | | |
| Cash Paid During the Year for: | | | | |
| Interest | $ | 443 157 | $ | 442 755 |
| Non-Cash Investing and Financing Activities: | | | | |
| Distributions declared but not paid | $ | 661 765 | $ | 668 190 |
| Increase (decrease) in securities available for sale due to unrealized gains/losses | $ | 122 553 | $ | (3 162 869) |
| Transfer of loans to other real estate | $ | 90 000 | $ | - |

The accompanying notes are an integral part of these financial statements.

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

FNB Company (the "Company"), is a holding company that owns all of the capital stock of The First National Bank of Livingston (the "Bank"), which in turn owns all the capital stock of Church Street Financial, ("Church") and Polk County Title Company, Inc., ("Polk") (Note 15). "Bank", "Church" and "Polk" are referred to as the subsidiaries in these statements. The Bank's main office is located in Livingston, Texas with branches located in Livingston, Texas, and Onalaska, Texas. The Bank represents approximately 88% of the total gross revenues on the consolidated statements of income at December 31, 2017 and 2016.

The accounting and reporting policies of the Company and its subsidiaries conform significantly to accounting principles generally accepted in the United States of American (GAAP) and practices within the banking industry. The following is a description of the more significant of those policies.

### Principles of Consolidation:

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

### Nature of Operations:

The Company provides a variety of financial services to individuals and corporate customers through its subsidiaries in Polk County, Texas. The subsidiary Bank's primary deposit products are demand deposits and certificates of deposit. Its primary lending products are consumer, commercial, real estate and single family residential loans. Church provides investment services through its location in Livingston Texas.

### Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the fair value of securities available for sale, the allowance for losses on loans and the valuation of other real estate owned. In connection with the determination of the allowances for losses on loans and valuation of other real estate owned, management may obtain independent appraisals.

While management uses available information to recognize losses on loans and other real estate owned, future additions to the allowances may be necessary based on changes in local economic conditions, other risk characteristics applicable to portfolio segments or borrowers' circumstances. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowances for losses on loans and foreclosed real estate. Such agencies may require the Bank to recognize additions to the allowances based on their judgments about information available to them at the time of their examination.

As a result of the changes inherent in the estimation process, management's estimate of the fair value of securities available for sale, the allowance for losses on loans and the valuation of other real estate owned may change in the near term.

### Cash and Cash Equivalents:

Cash and cash equivalents, for purposes of the statement of cash flows, include cash and due from banks, Federal funds sold and certain investment securities and interest bearing deposits in banks with original maturities of three months or less.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Investment Securities:

Securities classified as held-to-maturity are those debt securities the Company has both the intent and ability to hold to maturity regardless of changes in market conditions, liquidity needs or changes in general economic conditions. These securities are carried at cost, adjusted for amortization of premium and accretion of discount, computed using the interest method, over their contractual lives.

Securities classified as available-for-sale are equity securities with readily determinable fair values and those debt securities that the Company intends to hold for an indefinite period of time but not necessarily to maturity. Any decision to sell a security classified as available-for-sale would be based on various factors, including significant movement in interest rates, changes in the maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. These securities are carried at estimated fair value based on information provided by a third party pricing service with an unrealized gains or losses excluded from net income and reported in accumulated other comprehensive income (loss), which is reported as a separate component of stockholders' equity.

Dividend and interest income, including amortization of premium and accretion of discount arising at acquisition, from all categories of investment securities are included in interest income in the consolidated statements of income.

Gains and losses realized on sales of investments securities, determined using the adjusted cost basis of the specific securities sold, are included in noninterest income in the consolidated statements of income. Additionally, declines in the estimated fair value of individual investment securities below their cost that are other-than-temporary are reflected as realized losses in the statements of income. Factor affecting the determination of whether an other-than-temporary impairment has occurred include, among other things, (i) the length of time and extent to which the fair value has been less than cost, (ii) the financial condition and near term prospects of the issuer, (iii) that the Company does not intend to sell these securities, and (iv) it is more likely than not that the Company will not be required to sell before a period of time sufficient to allow for any anticipated recovery in fair value.

Restricted stock consists of stock from the Federal Reserve Bank, Texas Independent Bank and the Federal Home Loan Bank, which are restricted as to their marketability. Because no ready market exists for these investments and they have no quoted market value, the Bank's investment in these stocks are carried at cost. The Bank is required to maintain certain stock balances in the Federal Reserve Bank and the Federal Home Loan Bank.

Loans:

Loans are stated at the amount of unpaid principal, reduced by the undisbursed portion of construction loans (construction loans in process), unearned discount and an allowance for loan losses. The major loan portfolio segments include Commercial, Real Estate, Installment, Overdrafts, Consumer and Other. Within these categories, loans are secured most significantly by real estate, but are also secured by account receivables, inventory, income producing commercial properties, personal properties such as vehicles and boats and other items of property, plant and equipment. A small segment of consumer loans are unsecured.

Interest on loans is calculated by using the simple interest method on the daily balances of the principal amounts outstanding. The recognition of income on a loan is discontinued, and previously accrued interest is reversed when, in the opinion of management, it is probable that the borrower will be unable to meet payments as they become due. This generally occurs when the loan becomes 90 days delinquent, but may occur sooner should borrower circumstance dictate.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loan origination and commitment fees are recognized as income when received. Direct loan origination costs are expensed when paid. Financial Accounting Standards Board Codification Section 310.20 *Non-Refundable Fees and Costs* requires the net effect of loan origination and commitment fees and certain direct loan origination costs to be deferred and recognized over the life of the related loan as an adjustment of yield. FNB Company and Subsidiaries do not feel the application of this standard would have a material effect on the Bank's financial position or results of operations.

Allowance for Loan Losses:

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance is based on two basic principles of accounting: (i) FASB ASC 450, *Contingencies*, which requires that losses be accrued when they are probable of occurring and estimable and (ii) FASB ASC 310, *Receivables*, which requires that losses or impaired loans be accrued based on the differences between the loan balance and either the value of collateral, if such loans are considered to be collateral dependent and in the process of collection, or the present value of future cash flows, or the loan's value as observable in the secondary market. A loan is considered impaired when, based on current information and events, the Company has concerns about the ability to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines that significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all the circumstances surrounding the loan and borrower, including the length of delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owned.

The Company's allowance for loan losses has three basic components: the specific allowance, the formula allowance and the pooled allowance. Each of these components is determined based upon estimates that can and do change when the actual events occur. As a result of the uncertainties inherent in the estimation process, management's estimate of loan losses and the related allowance could change in the near term.

The specific allowance component is used to individually establish an allowance for loans identified for impairment testing. When impairment is identified, a specific reserve may be established based on the Company's calculation of the estimated loss embedded in the individual loan. Impairment testing includes consideration of the borrower's overall financial condition, resources and payment record, support available form financial guarantors and the fair value of collateral. These factors are combined to estimate the probability and severity of inherent losses. Large groups of smaller balance, homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately evaluate individual consumer and residential loans for impairment.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

The formula allowance component is used for estimating the loss on internally risk rated loans exclusive of those identified as impaired. The loans meeting the Company's internal criteria for classification, such as special mention, substandard, doubtful and loss, as well as specifically identified impaired loans, are segregated from performing loans within the portfolio. These internally classified loans are then grouped by loan type (commercial, real estate, installment, overdrafts, and consumer and other). Each loan type is assigned an allowance factor based on management's estimate of the associated risk, complexity, and size of the individual loans within the particular loan category. Classified loans are assigned higher allowance factor than non-classified loans due to management's concerns regarding collectability or management's knowledge of particular elements surrounding the borrower. Allowance factors increase with the worsening of the internal risk rating.

The pooled formula component is used to estimate the losses inherent in the pools of non-classified loans. These loans are then also segregated by loan type and allowance factors are assigned by management based on delinquencies, loss history, trends in volume and terms of loans, effects of changes in lending policy, the experience and depth of management, national and local economic trends, concentration of credit, results of the loan review system and the effect of external factors (i.e. competition and regulatory requirements).

Allowance factors and overall size of the allowance may change from period to period based on management's assessment of the above-described factors and the relative weights given to each factor. In addition, various regulatory agencies periodically review the allowance for loan losses. These agencies may require the Bank to make additions to the allowance for loan losses based on their judgements of collectability based on information available to them at the time of their examination.

Management considers loans impaired when, based on current information, it is probable that the Company will not collect all principal and interest payments according to contractual terms. Loans are evaluated for impairment in accordance with the Company's portfolio monitoring and ongoing risk assessment procedures. Management considers the financial condition of the borrower, cash flow of the borrower, payment status of the loan, and the value of the collateral, if any, securing the loan. Generally, impaired loans do not include large groups of smaller balance homogenous loans such as residential real estate and consumer type loans which are evaluated collectively for impairment and are generally placed on nonaccrual when loan becomes 90 days past due as to principal or interest. Loans specifically reviewed for impairment are not considered impaired during periods of "minimal delay" in payment (90 or less) provided eventual collection of all amounts due is expected. The impairment of a loan is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, or the fair value of the collateral if repayment is expected to be provided solely by the collateral. In appropriate circumstances, interest income on impaired loans may be recognized on a cash basis.

The Company's charge-off policy states after all collection efforts have been exhausted and the loan is deemed to be a loss, it will be charged to the Company's established allowance for loan losses. Consumer loans subject to the Uniform Retail Credit Classification are charged off as follows: (a) closed end loans are charged-off no later than 120 days after becoming delinquent, (b) consumer loans to borrowers who subsequently declare bankruptcy, where the Company is an unsecured creditor, are charged-off within 60 days of receipt of notification from the bankruptcy court, (c) fraudulent loans are charged-off within 90 days of discovery and (d) death of borrower will cause a charge-off to be incurred at such time an actual loss is determined. All other types of loans are generally evaluated for loss potential at the 90th day past due threshold, and any loss is recognized no later than the 120th day past due threshold; each loss is evaluated on its specific facts regarding the appropriate timing to recognized loss.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Other Real Estate Owned and Other Assets Acquired in Settlement of Loans:

Other real estate owned and other assets acquired in settlement of loans are recorded at the balance of the loan or at estimated fair value less cost of sale, at the date acquired, plus capital improvements made thereafter to facilitate sale. Adjustments are made to reflect declines, if any, in fair values below the recorded amounts at the date of foreclosure and charged to the allowance for losses on loans. Declines in value subsequent to repossession are charged to a loss provision which is included in other expenses on the consolidated statements of income. Costs of holding real estate and other assets acquired in settlement of loans are reflected in income currently. Gains on sales of such assets are taken into income based on the buyer's initial and continuing investment in the property and reflected as part of other income on the consolidated statements of income. Other assets acquired in settlement of loans consist primarily of reacquired personal property.

During 2017, one property (and related improvements) was acquired through foreclosure. The property had an approximate book value of $112,200. Subsequent to repossession, the valuation of the property declined to $90,000. The $22,200 reduction in valuation was charged against the allowance for loan and lease losses reserve. The property was not sold during the year and is carried on the balance sheet at $90,000.

During the years ended December 31, 2017 and 2016, investments in mortgage loans secured by residential real estate properties where formal foreclosure procedures were in process totaled $-0- and $112,200, respectively.

Insignificant amounts of other assets acquired in settlement of loans were repossessed during 2017 and 2016.

Bank Premises and Equipment:

Bank premises and equipment are stated at cost less accumulated depreciation. The provision for depreciation is computed using the straight-line method based on estimated useful lives of the assets. Expenditures for improvements, which extend the life of an asset, are capitalized and depreciated over asset's remaining useful life. Gains or losses realized on the disposition of properties and equipment are reflected in the statements of income. Expenditures for repairs and maintenance are charged to operating expenses as incurred.

Off-Balance Sheet Financial Instruments:

In the ordinary course of business the Bank has entered into off-balance sheet financial instruments consisting of commitments to extend credit, standby letters of credit and overdraft lines of credit. Such financial instruments are recorded in the financial statements when they are funded and at that time become subject to management's evaluation related to collectability.

Self-Insurance:

The Company is primarily self-insured for costs related to employee health care benefits, of which a portion is paid by the employees. Liabilities associated with these risks are estimated in part by considering historical claims experience and other assumptions. The Company has purchased stop loss coverage to limit exposure to claims. At December 31, 2017 and 2016, the Company had recorded approximately $24,000 and $-0-, respectively, as an accrual for this liability.

The assumptions underlying the ultimate costs of existing claim losses are unpredictable, which can affect the liability recorded for such claims. Although the Company's estimates of liabilities incurred do not anticipate significant changes in historical trends for these variables, any changes could have a significant impact on future claim costs and current recorded liabilities.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Income Taxes:

Effective January 1, 2010, the Company elected to become a subchapter S corporation. Under subchapter S guidelines, all federal taxable income is attributable to the Company shareholders individually. (See Note 8)

The Company is required to pay tax to the State of Texas based on gross margin (as defined). This tax has been deemed an income tax by the Financial Accounting Standards Board and consequently requires accrual in the year the taxable gross margin is earned. For the years presented, the Consolidated Statements of Income reflects approximately $11,000 and $(4,000) as state income tax expense (benefit) included in "Other Operating Expenses".

Sales Taxes:

Sales and use taxes and other such pass through state taxes are not recorded in the consolidated statements of income, but are instead collected and remitted through a liability account.

Goodwill:

The Company does not amortize goodwill, but instead, evaluates goodwill for impairment at least annually and adjusts accordingly in accordance with GAAP. The Company does not believe any impairment of goodwill exists at December 31, 2017, based on its evaluation.

Brokerage Commissions:

Brokerage commissions paid to Bank from its broker-dealer are net of various fees (see Note 17).

Fair Values of Financial Instruments:

The Company follows the guidance of FASB ASC 825, *Financial Instruments*, and FASB ASC 820, *Fair Value Measurement*. This guidance permits entities to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This guidance clarifies the fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Under this guidance, fair value measurements are not adjusted for transaction costs. This guidance established a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and lowest priority to unobservable inputs (Level 3 measurements).

Comprehensive Income:

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Uncertain Tax Positions:

FASB Codification Section 740 requires recognition, measurement and disclosure of uncertain tax positions. The Company currently accounts for uncertain tax positions based on the estimated likelihood of assessment and has determined that no tax positions (for interest, penalties or otherwise) require an accrual based on current standards of accounting. The Company is generally no longer subject to Federal tax examinations for tax years before 2014.

Advertising:

The Company expenses all advertising costs as incurred. These are included on the Consolidated Statements of Income as marketing expenses.

Reclassifications:

Certain reclassifications have been made to the prior period's financial statements in order to conform to the classifications used for the current year. These reclassifications had no effect on the capital, net income or net cash flows of the Bank.

Subsequent Events:

Management has evaluated subsequent events through February 7, 2018, the date the financial statements were available to be issued.

New Authoritative Accounting Guidance:

The Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASC) 201-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.* The amendments in this Update make targeted improvements to GAAP as follows: (1) Require equity investments to be measured at fair value with changes in fair value recognized in net income. (2) Simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value. (3) Eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheets. (4) Require public business entities to use the exit price notion when measuring fair value of financial instruments for disclosure purposes. (5) Clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. This ASU will be effective for financial institutions other than public business entities for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The Company does not expect the guidance to have a material impact on its financial statements.

The FASB issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* Current GAAP requires and *incurred loss* methodology for recognizing credit losses that delays recognition until it is probable a loss has been incurred. Users of financial statements expressed concern that current GAAP restricts the ability to record credit losses that are expected, but do not yet meet the *probable* threshold. The main objective of the ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by reporting entity at each reporting date. To achieve this objective, the amendments in this Update replace the incurred loss impairment methodology in current GAAP with methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. This ASU will be effective for financial institutions other than public entities for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. At this time, the Company has not determined the impact on its financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

The FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, which made the following changes that may affect the Company: (1) Debt Prepayment or Debt Extinguishment Costs: Cash payments for debt prepayment or debt extinguishment costs should be classified as cash flows from financing activities. (2) Proceeds from Settlement of Bank-Owned Life Insurance Policies: Cash proceeds received from the settlement of bank-owned life insurance policies should be classified as cash flows from investing activities. The cash payments for premiums on bank-owned policies may be classified as cash flows for investing activities, operating activities, or a combination of investing and operating. The amendments in the ASU will be effective for entities other than public business entities for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The Company does not expect the guidance to have a material impact on its financial statements.

NOTE 2 - INVESTMENT SECURITIES

The carrying amount of investment securities as shown in the consolidated balance sheets of the Company and their fair values at December 31, 2017 and 2016, were as follows:

| | AMORTIZED COST | GROSS UNREALIZED GAIN | GROSS UNREALIZED LOSSES | FAIR VALUE |
|---|---|---|---|---|
| Securities Available for Sale: | | | | |
| December 31, 2017: | | | | |
| U.S. agency securities | $ 92 534 293 | $ 2 720 | $ (1 571 735) | $ 90 965 278 |
| State and municipal securities | 44 758 826 | 371 873 | (365 026) | 44 765 673 |
| Residential mortgage backed securities | 21 216 595 | 139 979 | (359 649) | 20 996 925 |
| Other securities | - | - | - | - |
| | $ 158 509 714 | $ 514 572 | $ (2 296 410) | $ 156 727 876 |
| December 31, 2016: | | | | |
| U.S. agency securities | $ 70 946 741 | $ 49 511 | $ (1 964 624) | $ 69 031 628 |
| State and municipal securities | 51 541 223 | 772 003 | (508 551) | 51 804 675 |
| Residential mortgage backed securities | 25 676 024 | 222 703 | (475 434) | 25 423 293 |
| Other securities | - | - | - | - |
| | $ 148 163 988 | $ 1 044 217 | $ (2 948 609) | $ 146 259 596 |

| | AMORTIZED COST | GROSS UNREALIZED GAIN | GROSS UNREALIZED LOSSES | FAIR VALUE |
|---|---|---|---|---|
| Held-to-Maturity: | | | | |
| December 31, 2017: | | | | |
| State and municipal securities | $ 1 937 187 | $ 3 200 | $ (30 964) | $ 1 909 423 |
| | $ 1 937 187 | $ 3 200 | $ (30 964) | $ 1 909 423 |

No securities were sold in either period presented.

The carrying amount and fair value of investment securities at December 31, 2017, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

## NOTE 2 - INVESTMENT SECURITIES - CONTINUED

The scheduled maturities of debt securities at December 31, 2017, were as follows:

| | AVAILABLE-FOR-SALE SECURITIES | | HELD-TO-MATURITY SECURITIES | |
|---|---|---|---|---|
| | AMORTIZED COST | FAIR VALUE | AMORTIZED COST | FAIR VALUE |
| Due in one year or less | $ 17 223 878 | $ 17 279 990 | $ - | $ - |
| Due from one to five years | 53 978 424 | 53 334 444 | 1 056 950 | 1 053 200 |
| Due from five to ten years | 64 987 752 | 64 027 754 | 880 237 | 856 223 |
| Over ten years | 1 103 064 | 1 088 762 | - | - |
| Mortgage-backed securities | 21 216 596 | 20 996 926 | - | - |
| | $ 158 509 714 | $ 156 727 876 | $ 1 937 187 | $ 1 909 423 |

Investment securities with a fair value of approximately $35,392,000 and $34,799,000 at December 31, 2017 and 2016, respectively, were pledged to secure public deposits and for other purposes required or permitted by law.

Information pertaining to securities with gross unrealized losses at December 31, 2017 and 2016, aggregated by investment category and length of time that individual securities have been in a continuous loss position follows:

| | LESS THAN 12 MONTHS | | 12 MONTHS OR GREATER | | TOTAL | |
|---|---|---|---|---|---|---|
| Description of Securities: | FAIR VALUE | UNREALIZED LOSSES | FAIR VALUE | UNREALIZED LOSSES | FAIR VALUE | UNREALIZED LOSSES |
| December 31, 2017 | | | | | | |
| **Available-for-Sale Securities:** | | | | | | |
| U.S. Agency Securities | $ 28 611 223 | $ (173 796) | $ 57 352 962 | $ (1 397 939) | $ 85 964 185 | $ (1 571 735) |
| State and municipal | $ 13 375 504 | $ (98 156) | $ 13 441 425 | $ (266 870) | $ 26 816 929 | $ (365 026) |
| Mortgage-backed securities | $ 6 263 923 | $ (57 867) | $ 10 542 434 | $ (301 782) | $ 16 806 357 | $ (359 649) |
| **Held-to-Maturity Securities:** | | | | | | |
| State and municipal | $ 1 377 248 | $ (30 964) | $ - | $ - | $ 1 377 248 | $ (30 964) |
| December 31, 2016 | | | | | | |
| **Available-for-Sale Securities:** | | | | | | |
| U.S. Agency Securities | $ 57 561 298 | $ (1 964 624) | $ - | $ - | $ 57 561 298 | $ (1 964 624) |
| State and municipal | $ 23 838 284 | $ (499 571) | $ 1 959 726 | $ (8 980) | $ 25 798 010 | $ (508 551) |
| Mortgage-backed securities | $ 18 934 713 | $ (475 434) | $ - | $ - | $ 18 934 713 | $ (475 434) |

Management evaluates securities for other-than-temporary impairment on a periodic basis. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Debt securities with unrealized losses have depreciated 1.75% and 2.80% from the Company's amortized cost basis at December 31, 2017 and 2016, respectively. These securities are guaranteed by the U.S. Government, agencies thereof or municipalities. These unrealized losses relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the Federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other-than-temporary.

## NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES

The Company's goal is to mitigate risk from an unforeseen threat to the loan portfolio as a result of an economic downturn or other negative influences. Plans that aid in mitigating these potential risks in managing the loan portfolio include: enforcing loan policies and procedures, evaluating the borrower's business plan through the loan term, identifying and monitoring primary and alternative sources of repayment, and obtaining adequate collateral to mitigate loss in the event of liquidation. Specific reserves are established based on credit and/or collateral risks on an individual loan basis. A risk rating system is used to estimate potential loss exposure and to provide a measuring system for setting general and specific reserve allocations.

As of December 31, 2017, the real estate loan portfolio constituted 78% of the total loan portfolio. This can be broken down further into the following categories: 54.74% residential real estate, 17.57% commercial real estate, and 5.09% land development loans, as a percentage of total loans.

The Company's construction and land development loans are secured by real property where the loans funds will be used to acquire land and to construct or improve appropriately zoned real property for the creation of income producing or owner occupied commercial properties. Borrowers are generally required to put equity into the project at levels determined by the loan committee and usually are underwritten with a maximum term of 24 months.

Commercial real estate loans are secured by improved real property which is generating income in the normal course of business. Debt service coverage, assuming stabilized occupancy, must be satisfied to support a permanent loan. The debt service coverage ratio is ordinarily at 1.20 to 1.00. These loans are generally underwritten with a term not greater than 20 years or the remaining useful life of the property, whichever is lower.

Residential real estate loans are secured by improved real property of the borrower and are underwritten with terms up to 30 years.

The Company also makes commercial and industrial loans for a variety of purposes, which include working capital, equipment and account receivable financing. This category represents 10% of the loan portfolio at December 31, 2017. Loans in this category generally carry a variable interest rate. Commercial loans meet reasonable underwriting standards, including appropriate collateral and cash flow necessary to support debt service. Personal guarantees are generally required, but may be limited.

Outstanding Loans:

The tables below present an aged analysis of the Bank's loan portfolio by major loan classification as of December 31, 2017 and December 31, 2016.

| | 0-59 DAYS PAST DUE | 60-89 DAYS PAST DUE | GREATER THAN 90 DAYS PAST DUE | TOTAL PAST DUE | CURRENT | BALANCE DECEMBER 31, 2017 |
|---|---|---|---|---|---|---|
| Commercial | $ 311 289 | $ - | $ - | $ 311 289 | $ 11 451 630 | $ 11 762 919 |
| Real estate | 2 617 530 | 8 188 | - | 2 625 718 | 96 911 904 | 99 537 622 |
| Installment | - | - | - | - | - | - |
| Overdrafts | - | - | - | - | 279 371 | 279 371 |
| Consumer and other | 985 726 | 22 182 | 913 | 1 008 821 | 13 856 282 | 14 865 103 |
| | $ 3 914 545 | $ 30 370 | $ 913 | $ 3 945 828 | $ 122 499 187 | 126 445 015 |
| Construction loans in process | | | | | | (3 277 847) |
| | | | | | | 123 167 168 |
| Allowance for loan losses | | | | | | (2 145 687) |
| | | | | | | $ 121 021 481 |

## NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES - CONTINUED

| | 0-59 DAYS PAST DUE | 60-89 DAYS PAST DUE | GREATER THAN 90 DAYS PAST DUE | TOTAL PAST DUE | CURRENT | BALANCE DECEMBER 31, 2016 |
|---|---|---|---|---|---|---|
| Commercial | $ 428 711 | $ - | $ - | $ 428 711 | $ 12 134 528 | $ 12 563 239 |
| Real estate | 4 521 393 | 86 925 | 120 367 | 4 728 685 | 85 278 587 | 90 007 272 |
| Installment | - | - | - | - | 1 985 | 1 985 |
| Overdrafts | - | - | - | - | 262 598 | 262 598 |
| Consumer and other | 1 095 879 | 18 750 | - | 1 114 629 | 16 464 301 | 17 578 930 |
| | $ 6 045 983 | $ 105 675 | $ 120 367 | $ 6 272 025 | $ 114 141 999 | 120 414 024 |
| Construction loans in process | | | | | | (2 379 490) |
| Unearned discount | | | | | | (25) |
| | | | | | | 118 034 509 |
| Allowance for loan losses | | | | | | (2 148 346) |
| | | | | | | $ 115 886 163 |

Nonaccrual Loans:

The table below includes the Bank's nonaccrual loans, including nonperforming trouble debt restructures and loans past due 90 days, or more at December 31, 2017 and 2016.

| | NONACCRUAL LOANS DECEMBER 31, 2017 | NONACCRUAL LOANS DECEMBER 31, 2016 | ACCRUING PAST DUE 90 DAYS OR MORE DECEMBER 31, 2017 | ACCRUING PAST DUE 90 DAYS OR MORE DECEMBER 31, 2016 |
|---|---|---|---|---|
| Commercial | $ 94 751 | $ - | $ - | $ - |
| Real estate | 319 669 | 203 357 | - | - |
| Consumer | 54 793 | 81 559 | - | - |
| TOTAL | $ 469 213 | $ 284 916 | $ - | $ - |

The difference between interest income that would have been recorded under the original terms of such loans and that which was recorded is not significant to these financial statements.

Real estate loans consist of residential (78% in 2017 and 74% in 2016) and commercial (22% in 2017 and 26% in 2016). All past due real estate loans are in the residential category at December 31, 2017 and 2016.

Credit Quality Indicators:

The Bank monitors credit quality within its major loan classifications. The results of this classification process is a factor in the risk characteristics used in establishing the allowance for loan losses. These loans are evaluated and internally classified by the Bank as pass, special mention, substandard, doubtful or loss.

*Pass* - An asset classified pass is one that does not possess any weaknesses by management sufficient to warrant a more adverse classification.

*Special Mention* - A *special mention* asset has 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 an institution to sufficient risk to warrant adverse classification.

*Substandard* - A *substandard* asset is inadequately protected by the current sound worth and paying capacity of the obligor or of 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 bank will sustain some loss if the deficiencies are not corrected.

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES - CONTINUED

*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.

*Loss* - Assets classified *loss* are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be effected in the future. Amounts classified as loss are generally charged off to the allowance for loan losses upon such classification.

The remaining loans are classified as pass. The following presents the Bank's loan classification as of December 31, 2017 and 2016 by its major loan classifications.

| | 2017 | | | | | |
|---|---|---|---|---|---|---|
| | PASS | SPECIAL MENTION | SUBSTANDARD | DOUBTFUL | LOSS | TOTAL |
| Commercial | $ 11 114 807 | $ - | $ 561 043 | $ 87 069 | $ - | $ 11 762 919 |
| Real estate | 93 922 904 | 21 828 | 2 229 336 | 85 707 | - | 96 259 775 |
| Installment | - | - | - | - | - | - |
| Overdrafts | 279 371 | - | - | - | - | 279 371 |
| Consumer and other | 14 360 215 | 5 724 | 481 003 | 18 161 | - | 14 865 103 |
| TOTAL | $ 119 677 297 | $ 27 552 | $ 3 271 382 | $ 190 937 | $ - | $ 123 167 168 |

| | 2016 | | | | | |
|---|---|---|---|---|---|---|
| | PASS | SPECIAL MENTION | SUBSTANDARD | DOUBTFUL | LOSS | TOTAL |
| Commercial | $ 10 626 709 | $ 27 179 | $ 1 909 351 | $ - | $ - | $ 12 563 239 |
| Real estate | 87 442 557 | - | 185 225 | - | - | 87 627 782 |
| Installment | 1 960 | - | - | - | - | 1 960 |
| Overdrafts | 262 598 | - | - | - | - | 262 598 |
| Consumer and other | 17 032 199 | 35 862 | 496 018 | 14 851 | - | 17 578 930 |
| TOTAL | $ 115 366 023 | $ 63 041 | $ 2 590 594 | $ 14 851 | $ - | $ 118 034 509 |

Allowance for Credit Loss:

The detail below reflects the changes in the allowance for loan losses by the Bank's major loan classifications for the years ended December 31, 2017 and 2016:

| | COM-MERCIAL | REAL ESTATE | OVER-DRAFTS | CONSUMER AND OTHER | UN-ALLOCATED | TOTAL |
|---|---|---|---|---|---|---|
| ALLOWANCE FOR LOAN LOSSES DECEMBER 31, 2015 | $ 146 095 | $ 1 073 349 | $ 101 686 | $ 324 920 | $ 425 870 | $ 2 071 920 |
| Loans charged off | (36 607) | - | (133 456) | (91 121) | - | (261 184) |
| Recoveries of loans previously charged off | - | - | 38 357 | 11 753 | - | 50 110 |
| NET CHARGE OFFS | (36 607) | - | (95 099) | (79 368) | - | (211 074) |
| Provision for loan and lease losses | 65 826 | 10 284 | 90 751 | 129 316 | (8 677) | 287 500 |
| ALLOWANCE FOR LOAN LOSSES DECEMBER 31, 2016 | 175 314 | 1 083 633 | 97 338 | 374 868 | 417 193 | 2 148 346 |
| Loans charged off | (18 825) | (22 200) | (145 432) | (111 454) | - | (297 911) |
| Recoveries of loans previously charged off | - | - | 41 628 | 13 624 | - | 55 252 |
| NET CHARGE OFFS | (18 825) | (22 200) | (103 804) | (97 830) | - | (242 659) |
| Provision for loan and lease losses | 67 029 | 204 484 | 132 239 | 85 425 | (249 177) | 240 000 |
| ALLOWANCE FOR LOAN LOSSES DECEMBER 31, 2017 | $ 223 518 | $ 1 265 917 | $ 125 773 | $ 362 463 | $ 168 016 | $ 2 145 687 |

## NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES - CONTINUED

The table below represents the allowance and the carrying value of outstanding loans and leases by portfolio segment at December 31, 2017 and 2016:

| DECEMBER 31, 2017 | COMMERCIAL | REAL ESTATE | INSTALLMENT | CONSUMER AND OTHER | OVERDRAFTS | TOTAL |
|---|---|---|---|---|---|---|
| Impaired Loans and Trouble Debt Restructurings: | | | | | | |
| Allowance for loans and lease losses | $ 64 719 | $ 91 548 | $ - | $ 105 297 | $ - | $ 261 564 |
| Unpaid principal balance | $ 163 895 | $ 714 272 | $ - | $ 228 422 | $ - | $ 1 106 589 |
| Allowance as a percentage of unpaid principal balance | 39.49% | 12.82% | - % | 46.10% | - % | 23.64% |
| Collectively Evaluated for Impairment: | | | | | | |
| Allowance for loans and lease losses | $ 158 799 | $ 1 174 369 | $ - | $ 257 166 | $ 125 773 | $ 1 716 107 |
| Unpaid principal balance | $ 11 599 024 | $ 95 545 503 | $ - | $ 14 636 681 | $ 279 371 | $ 122 060 579 |
| Allowance as a percentage of unpaid principal balance | 1.37% | 1.23% | - % | 1.76% | 45.02% | 1.41% |
| Total: | | | | | | |
| Allowance for loans and lease losses | $ 223 518 | $ 1 265 917 | $ - | $ 362 463 | $ 125 773 | $ 1 977 671 |
| Unpaid principal balance | $ 11 762 919 | $ 96 259 775 | $ - | $ 14 865 103 | $ 279 371 | $ 123 167 168 |
| Allowance as a percentage of unpaid principal balance | 1.90% | 1.32% | - % | 2.44% | 45.02% | 1.61% |

| DECEMBER 31, 2016 | COMMERCIAL | REAL ESTATE | INSTALLMENT | CONSUMER AND OTHER | OVERDRAFTS | TOTAL |
|---|---|---|---|---|---|---|
| Impaired Loans and Trouble Debt Restructurings: | | | | | | |
| Allowance for loans and lease losses | $ 22 690 | $ 52 995 | $ - | $ 93 504 | $ - | $ 169 189 |
| Unpaid principal balance | $ 117 690 | $ 449 043 | $ - | $ 253 993 | $ - | $ 820 724 |
| Allowance as a percentage of unpaid principal balance | 19.28% | 20.86% | - % | 36.81% | - % | 27.04% |
| Collectively Evaluated for Impairment: | | | | | | |
| Allowance for loans and lease losses | $ 152 624 | $ 1 030 638 | $ - | $ 281 364 | $ 97 338 | $ 1 561 964 |
| Unpaid principal balance | $ 12 445 549 | $ 87 373 789 | $ 1 960 | $ 17 324 937 | $ 262 598 | $ 117 408 833 |
| Allowance as a percentage of unpaid principal balance | 1.23% | 1.18% | - % | 1.62% | 37.07% | 1.33% |
| Total: | | | | | | |
| Allowance for loans and lease losses | $ 175 314 | $ 1 083 633 | $ - | $ 374 868 | $ 97 338 | $ 1 731 153 |
| Unpaid principal balance | $ 12 563 239 | $ 87 627 782 | $ 1 960 | $ 17 578 930 | $ 262 598 | $ 118 034 509 |
| Allowance as a percentage of unpaid principal balance | 1.40% | 1.24% | - % | 2.13% | 37.07% | 1.47% |

NOTE 3 - LOANS AND ALLOWANCE FOR LOAN LOSSES - CONTINUED

Impaired Loans and Trouble Debt Restructurings:

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Information on impaired loans for the years ended December 31, 2017 and 2016 are as follows:

| | DECEMBER 31, 2017 | | | |
|---|---|---|---|---|
| | UNPAID PRINCIPAL BALANCE | CARRYING VALUE | RELATED ALLOWANCE | AVERAGE CARRYING AMOUNT |
| With no Related Allowance Recorded: | | | | |
| Commercial | $ - | $ - | $ - | $ - |
| Real estate | 170 158 | 170 158 | - | 130 658 |
| Consumer and other | 27 861 | 27 861 | - | 32 049 |
| TOTAL | 198 019 | 198 019 | - | 162 707 |
| With an Allowance Recorded: | | | | |
| Commercial | 163 895 | 99 176 | 64 719 | 97 088 |
| Real estate | 544 113 | 452 565 | 91 548 | 378 728 |
| Consumer and other | 200 561 | 95 264 | 105 297 | 109 758 |
| TOTAL | 908 569 | 647 005 | 261 564 | 585 574 |
| Total: | | | | |
| Commercial | 163 895 | 99 176 | 64 719 | 97 088 |
| Real estate | 714 271 | 622 723 | 91 548 | 509 386 |
| Consumer and other | 228 422 | 123 125 | 105 297 | 141 807 |
| TOTAL | $ 1 106 588 | $ 845 024 | $ 261 564 | $ 748 281 |

| | DECEMBER 31, 2016 | | | |
|---|---|---|---|---|
| | UNPAID PRINCIPAL BALANCE | CARRYING VALUE | RELATED ALLOWANCE | AVERAGE CARRYING AMOUNT |
| With no Related Allowance Recorded: | | | | |
| Commercial | $ - | $ - | $ - | $ - |
| Real estate | 91 157 | 91 157 | - | 49 682 |
| Consumer and other | 36 237 | 36 237 | - | 40 566 |
| TOTAL | 127 394 | 127 394 | - | 90 248 |
| With an Allowance Recorded: | | | | |
| Commercial | 117 690 | 95 000 | 22 690 | 47 500 |
| Real estate | 357 885 | 304 890 | 52 995 | 152 445 |
| Consumer and other | 217 755 | 124 251 | 93 504 | 69 780 |
| TOTAL | 693 330 | 524 141 | 169 189 | 269 725 |
| Total: | | | | |
| Commercial | 117 690 | 95 000 | 22 690 | 47 500 |
| Real estate | 449 042 | 396 047 | 52 995 | 202 127 |
| Consumer and other | 253 992 | 160 488 | 93 504 | 110 346 |
| TOTAL | $ 820 724 | $ 651 535 | $ 169 189 | $ 359 973 |

Income recognized during the periods presented related to impaired loans is not considered significant for separate disclosure.

The Bank is not committed to lend additional funds to debtors whose loans have been modified.

The aggregate amount of loans owed to the Bank by employees, directors and executive officers of the Bank and its subsidiaries and directors, executive officers and principal holders of the Company and their related entities totaled approximately $4,137,000 and $4,154,000 at December 31, 2017 and 2016, respectively. Activity during the years presented for these loans are approximately as follows:

| | 2017 | 2016 |
|---|---|---|
| Balance, beginning of year | $ 4 154 000 | $ 3 760 000 |
| Advances | 1 857 000 | 1 660 000 |
| Repayments | (2 119 000) | (1 175 000) |
| Additions - Hires with existing loans | 279 000 | - |
| Reductions - No longer employed | (34 000) | (91 000) |
| BALANCE END OF YEAR | $ 4 137 000 | $ 4 154 000 |

NOTE 4 - BANK PREMISES AND EQUIPMENT

Major classifications of these assets as of December 31 are summarized as follows:

| | 2017 | 2016 | USEFUL LIVES IN YEARS |
|---|---|---|---|
| Land | $ 2 959 635 | $ 2 959 635 | - |
| Building and improvements | 9 558 495 | 9 478 137 | 5-40 |
| Furniture and equipment | 2 851 719 | 3 316 143 | 3-10 |
| Computer software | 455 162 | 365 914 | 3-5 |
| Automobiles | 115 936 | 105 906 | 3-4 |
| Equipment in process | 70 434 | 95 927 | |
| TOTAL COST | 16 011 381 | 16 321 662 | |
| Accumulated depreciation | (7 220 134) | (7 272 565) | |
| NET BOOK VALUE | $ 8 791 247 | $ 9 049 097 | |

Depreciation expense amounted to $643,782 and $566,733 in 2017 and 2016, respectively and is included as a component of occupancy and equipment expense on the consolidated statements of income.

NOTE 5 - DEPOSITS

The aggregate amount of time deposits with a minimum denomination of $100,000, was approximately $17,783,000 and $18,847,000 at December 31, 2017 and 2016. Total time deposits in excess of the Federal insurance amount of $250,000 totaled approximately $3,636,000 and $4,245,000 at December 31, 2017 and 2016, respectively.

Time deposits maturing in years ending December 31, are as follows:

| | |
|---|---|
| 2018 | $ 35 890 495 |
| 2019 | 3 739 502 |
| 2020 | 1 912 586 |
| 2021 | 774 940 |
| 2022 | 1 980 890 |
| Thereafter | - |
| TOTAL | $ 44 298 413 |

Deposits due to directors, officers, significant shareholders and their affiliates approximated $9,705,000 and $9,929,000 at December 31, 2017 and 2016, respectively.

Overdraft demand deposits of $279,371 and $262,598 respectively have been classified as loans in the accompanying financial statements.

NOTE 6 - LINE OF CREDIT

The Bank has two lines of credit to purchase Federal funds in the amount of $11,000,000 unsecured and $9,000,000 secured by certain investment securities that expires upon cancellation. The Bank had $-0- and $2,440,000 of Federal funds purchased drawn at December 31, 2017 and 2016, respectively.

## NOTE 7 - RETIREMENT PLANS

The Company sponsors a 401(k) Retirement Plan ("Plan") for the Company and its subsidiaries, which is in effect for substantially all full-time employees (if they elect to be covered). The Company, at its discretion, may match a portion of each employee's contribution. The Company, at its discretion, may make an additional contribution as of each December 31. Contributions to the plan amounted to approximately $398,000 and $372,000 for 2017 and 2016, respectively and are included in salaries and employee benefits on the consolidated statements of income.

## NOTE 8 - FEDERAL INCOME TAXES

Effective January 1, 2010, the Company elected to become a subchapter S corporation. Under subchapter S guidelines, all federal taxable income is attributable to the Company shareholders individually. The Company has passed the five year built-in gains tax period.

## NOTE 9 - FINANCIAL INSTRUMENTS

The Company 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 and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

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

The Company had financial instruments whose contract or notional amounts represent credit risk of approximately the following:

| | DECEMBER 31, | |
|---|---|---|
| | 2017 | 2016 |
| Commitments to extend credit | $ 2 350 000 | $ 4 830 000 |
| Standby letters of credit | $ 573 000 | $ 1 037 000 |
| Overdraft lines of credit (unfunded) | $ 5 777 000 | $ 5 939 000 |
| Unfunded portion of construction loans | $ 3 278 000 | $ 2 379 000 |

NOTE 9 - FINANCIAL INSTRUMENTS - CONTINUED

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses, are generally variable rate in nature and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include real estate; accounts receivable; inventory; property, plant, and equipment; and income-producing commercial properties. Of the commitments to extend credit, approximately $151,000 and $490,000 were to related party borrowers at December 31, 2017 and 2016, respectively.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. Standby letters of credit generally have fixed expiration dates and may require payment of a fee. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held for the standby letters of credit primarily consists of certificates of deposit.

Overdraft lines of credit represent amounts available for deposit customers to overdraft deposit accounts. Outstanding overdrafts as of December 31, 2017 and 2016 were approximately $279,000 and $263,000, respectively. Of these outstanding overdrafts, approximately $188,000 and $184,000 were amounts drawn on overdraft lines of credit as of December 31, 2017 and 2016.

FASB ASC 820, *Fair Value Measurement*, clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Under this guidance, fair value measurement are not adjusted for transaction costs. This guidance establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under this guidance are described below:

- Level 1 - Valuations for assets and liabilities traded in active exchange markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.
- Level 2 - Valuations for assets or liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable asset or liabilities which use observable inputs other than Level 1 prices, such as quoted prices from similar assets or liabilities; quoted prices in active 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 9 - FINANCIAL INSTRUMENTS - CONTINUED

Fair values of assets and liabilities are presented on the consolidated balances sheets measured on a recurring basis at December 31, 2017 and 2016 are as follows:

| | FAIR VALUE MEASUREMENTS AT REPORTING DATE USING | | | |
|---|---|---|---|---|
| | FAIR VALUE | QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS/ LIABILITIES (LEVEL 1) | SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2) | SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3) |
| **December 31, 2017** | | | | |
| Available-for-Sale Securities: | | | | |
| U. S. agency securities | $ 90 965 278 | $ - | $ 90 965 278 | $ - |
| State and municipal securities | 44 765 673 | - | 44 765 673 | - |
| Residential mortgage backed securities | 20 996 925 | - | 20 996 925 | - |
| | $ 156 727 876 | $ - | $ 156 727 876 | $ - |
| **December 31, 2016** | | | | |
| Available-for-Sale Securities: | | | | |
| U. S. agency securities | $ 69 031 628 | $ - | $ 69 031 628 | $ - |
| State and municipal securities | 51 804 675 | - | 51 804 675 | - |
| Residential mortgage backed securities | 25 423 293 | - | 25 423 293 | - |
| | $ 146 259 596 | $ - | $ 146 259 596 | $ - |

Fair value of available for sale securities is based on discounted cash flow analysis based on observable inputs reflective of Level 2 inputs. These inputs include market quotes for similar instruments, current market yields and offering sheets.

The following tables set forth the Company's financial assets and liabilities that were accounted for or disclosed at fair value on a nonrecurring basis as of December 31, 2017 and 2016:

| | | FAIR VALUE MEASUREMENTS USING | | |
|---|---|---|---|---|
| | DECEMBER 31, 2017 | QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1) | SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2) | SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3) |
| Impaired Loans: | | | | |
| Commercial | $ 163 895 | $ - | $ - | $ 163 895 |
| Real estate | 714 272 | - | - | 714 272 |
| Consumer | 228 422 | - | - | 228 422 |
| TOTAL IMPAIRED LOANS | $ 1 106 589 | $ - | $ - | $ 1 106 589 |
| Other Real Estate Owned: | | | | |
| Residential real estate | $ 90 000 | $ - | $ - | $ 90 000 |
| TOTAL OTHER REAL ESTATE OWNED | $ 90 000 | $ - | $ - | $ 90 000 |
| Goodwill | $ 3 031 499 | $ - | $ - | $ 3 031 499 |

NOTE 9 - FINANCIAL INSTRUMENTS - CONTINUED

| | DECEMBER 31, 2016 | FAIR VALUE MEASUREMENTS USING: QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1) | SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2) | SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3) |
|---|---|---|---|---|
| Impaired Loans: | | | | |
| Commercial | $ 117 690 | $ - | $ - | $ 117 690 |
| Real estate | 449 043 | - | - | 449 043 |
| Consumer | 253 993 | - | - | 253 993 |
| TOTAL IMPAIRED LOANS | $ 820 726 | $ - | $ - | $ 820 726 |
| Other Real Estate Owned: | | | | |
| Residential real estate | $ - | $ - | $ - | $ - |
| TOTAL OTHER REAL ESTATE OWNED | $ - | $ - | $ - | $ - |
| Goodwill | $ 3 031 499 | $ - | $ - | $ 3 031 499 |

Certain financial assets and financial liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances. Financial assets and liabilities measured at fair value on nonrecurring basis include the following:

**Goodwill**

Fair market value of goodwill is determined on a nonrecurring basis in order to determine if any impairment exists. In order to estimate the fair value of goodwill the Company uses inputs such as values of similar entities.

**Impaired Loans**

Certain impaired loans are reported at fair value of underlying collateral if repayment is expected solely from the collateral. The impaired loans are reported at fair value through a specific valuation allowance allocation of the allowance for possible loan losses. Collateral values are estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria.

**Other Real Estate Owned**

OREO acquired by foreclosure is recorded at the fair value of the property, less any selling costs, as applicable, at the time of foreclosure. If necessary, carrying amounts are reduced to reflect this value through charges to the allowance for possible credit losses upon foreclosure. Subsequent to foreclosure, real estate is carried at the lower of its new cost basis or fair value, less estimated costs to sell. OREO is fair valued under Level 3 at the lower of cost or fair value based on property appraisals less estimated costs, which include both observable and unobservable inputs, at the time of transfer and as appropriate thereafter.

NOTE 9 - FINANCIAL INSTRUMENTS - CONTINUED

In accordance with the disclosure requirements of FASB ASC 825, *Financial Instruments*, the estimated fair values of the Company's financial instruments are as follows:

| DECEMBER 31, 2017 | CARRYING AMOUNT | FAIR VALUE | FAIR VALUE MEASUREMENTS AT REPORTING DATE USING: QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS/ LIABILITIES (LEVEL 1) | SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2) | SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3) |
|---|---|---|---|---|---|
| Cash and due from banks | $ 17 711 421 | $ 17 711 421 | $ 17 711 421 | $ - | $ - |
| Interest bearing time deposits in banks | $ 69 436 000 | $ 68 834 406 | $ - | $ 68 834 406 | $ - |
| Securities available-for-sale | $ 156 727 876 | $ 156 727 876 | $ - | $ 156 727 876 | $ - |
| Securities held-to-maturity | $ 1 937 187 | $ 1 909 422 | $ - | $ 1 909 422 | $ - |
| Restricted equity securities | $ 571 520 | $ N/A | $ - | $ - | $ - |
| Loans receivable | $ 121 021 481 | $ 120 367 730 | $ - | $ - | $ 120 367 730 |
| Accrued interest receivable | $ 1 494 819 | $ 1 494 819 | $ 1 494 819 | $ - | $ - |
| Financial Liabilities: | | | | | |
| Deposit liabilities | $ 328 537 253 | $ 323 853 158 | $ - | $ - | $ 323 853 158 |
| Accrued interest payable | $ 16 640 | $ 16 640 | $ 16 640 | $ - | $ - |

| DECEMBER 31, 2016 | CARRYING AMOUNT | FAIR VALUE | FAIR VALUE MEASUREMENTS AT REPORTING DATE USING: QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS/ LIABILITIES (LEVEL 1) | SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2) | SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3) |
|---|---|---|---|---|---|
| Cash and due from banks | $ 10 774 882 | $ 10 774 882 | $ 10 774 882 | $ - | $ - |
| Interest bearing time deposits in banks | $ 66 124 000 | $ 65 824 624 | $ - | $ 65 824 624 | $ - |
| Securities available-for-sale | $ 146 259 596 | $ 146 259 596 | $ - | $ 146 259 596 | $ - |
| Securities held-to-maturity | $ - | $ - | $ - | $ - | $ - |
| Restricted equity securities | $ 570 220 | $ N/A | $ - | $ - | $ - |
| Loans receivable | $ 115 886 163 | $ 116 028 334 | $ - | $ - | $ 116 028 334 |
| Accrued interest receivable | $ 1 381 731 | $ 1 381 731 | $ - | $ - | $ - |
| Financial Liabilities: | | | | | |
| Deposit liabilities | $ 300 475 877 | $ 300 561 184 | $ - | $ - | $ 300 561 184 |
| Accrued interest payable | $ 16 677 | $ 16 677 | $ 16 677 | $ - | $ - |
| Federal funds purchased | $ 2 440 000 | $ 2 440 000 | $ 2 440 000 | $ - | $ - |

The following methodologies and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

**Cash and Cash Equivalents**

The carrying amounts report in the consolidated balance sheets for cash and cash equivalents approximate those assets' fair values.

**Interest Bearing Time Deposits in Banks**

Fair values of interest bearing deposits in banks are estimated using discounted cash flow analysis, based on rates currently being offered on certificates with terms approximating the remaining term of the certificates in the portfolio.

**Investment Securities and Restricted Equity Securities**

Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on discounted cash flow analysis based on observable inputs, except for restricted securities where fair value equals par value based on redemption value.

NOTE 9 - FINANCIAL INSTRUMENTS - CONTINUED

**Loans, Net**

For both fixed and variable rate loans in 2017 and 2016, fair values are estimated using discounted cash flow analysis and current interest rates charged for the types of loans in the portfolio.

**Accrued Interest Receivable**

The carrying amount of accrued interest receivable approximates fair value.

**Deposits**

The fair values of transactional deposits accounts (interest and noninterest checking, savings and money market accounts) are considered to be their carrying amounts. Fair values for fixed rate certificates of deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of the aggregate expected monthly maturities on time deposits.

**Accrued Interest Payable**

The carrying amount of accrued interest payable approximates fair value.

**Federal Fund Purchased**

Fair value of overnight borrowings approximate those liabilities' carrying amount.

**Commitments to Extend Credit**

There is not material difference between the notional amount and the estimated fair value of off-balance-sheet unfunded loan commitments which are generally priced at market at the time of funding. Letters of credit have an estimated fair value based on fees currently charged for similar agreements. Fees related to the unexpired term of the letters of credit are not significant. The Company has not incurred any losses on its commitments to extend credit or standby letters of credit during the years presented.

NOTE 10 - CONCENTRATION OF CREDIT RISK

The Company periodically carries certain assets with other financial institutions which are subject to credit risk by the amount such assets exceed Federal deposit insurance limits. From time to time, the Bank is also due amounts in excess of FDIC insurance limits for checks and transit items. The Federal Deposit Insurance Corporation (FDIC) provides deposit insurance coverage for amounts up to $250,000 for substantially all depository accounts. Management monitors the financial stability of correspondent banks and considers amounts advanced in excess of FDIC insurance limits to present no significant additional risk to the Bank.

## NOTE 11 - REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the Federal banking agencies. 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 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 assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of Total, Common and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2017, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2017 and 2016, the most recent notification from the Office of the Comptroller of Currency categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, minimum total risk-based, Tier I risk based common equity Tier I risk based and Tier I leverage ratios as set forth in the table must be maintained. There are no conditions or events since that notification that management believes have changed the Bank's categories.

Actual capital amounts and ratios are presented in the table for the Bank (in thousands). Bank only amounts and percentages are presented as they do not differ materially from bank holding company amounts and percentages.

| | ACTUAL | | FOR CAPITAL ADEQUACY PURPOSES | | TO BE WELL CAPITALIZED UNDER PROMPT CORRECTIVE ACTION PROVISIONS | |
|---|---|---|---|---|---|---|
| | AMOUNT | RATIO | AMOUNT | RATIO | AMOUNT | RATIO |
| As of December 31, 2017: | | | | | | |
| Total Risk Based Capital (to Risk Weighted Assets) | $ 52 495 | 41.42% | $ ≥ 11 724 | ≥ 9.250% | $ ≥ 12 675 | ≥ 10.0% |
| Tier I Capital (to Risk Weighted Assets) | $ 50 904 | 40.16% | $ ≥ 9 189 | ≥ 7.250% | $ ≥ 10 140 | ≥ 8.0% |
| Common Equity Tier I Capital Ratio (to Risk Weighted Assets) | $ 50 904 | 40.16% | $ ≥ 7 288 | ≥ 5.750% | $ ≥ 8 239 | ≥ 6.5% |
| Tier I Leverage Capital (to Average Assets) | $ 50 904 | 13.29% | $ ≥ 15 316 | ≥ 4.000% | $ ≥ 19 145 | ≥ 5.0% |
| As of December 31, 2016: | | | | | | |
| Total Risk Based Capital (to Risk Weighted Assets) | $ 50 470 | 40.91% | $ ≥ 10 640 | ≥ 8.625% | $ ≥ 12 336 | ≥ 10.0% |
| Tier I Capital (to Risk Weighted Assets) | $ 48 921 | 39.66% | $ ≥ 8 173 | ≥ 6.625% | $ ≥ 9 869 | ≥ 8.0% |
| Common Equity Tier I Capital Ratio (to Risk Weighted Assets) | $ 48 921 | 39.66% | $ ≥ 6 322 | ≥ 5.125% | $ ≥ 8 018 | ≥ 6.5% |
| Tier I Leverage Capital (to Average Assets) | $ 48 921 | 13.67% | $ ≥ 14 315 | ≥ 4.000% | $ ≥ 17 894 | ≥ 5.0% |

The above 2017 risk-weighted capital ratios for capital adequacy purposes include a .625% capital conservation buffer. The capital conservation buffer will be phased in over four years to 2.50%. Financial institutions with a buffer greater than .625% (2017) are not subject to limits on capital distributions or discretionary bonus payments beyond those currently included in regulations. As reflected above, the Bank's capital was sufficient to exceed its minimum capital requirements including the required capital conservation buffer.

NOTE 11 - REGULATORY MATTERS - CONTINUED

Although Federal Reserve regulations regarding specific capital requirements do not generally apply to Bank Holding Companies with consolidated assets of less than $500 million, the Federal Reserve may apply capital guidelines to the Company on a consolidated basis, regardless of asset size, if such action is warranted for supervisory purposes.

NOTE 12 - RESTRICTIONS ON DISTRIBUTIONS (DIVIDENDS)

The Bank is subject to certain restrictions on the amount of distributions that it may pay without prior regulatory approval. The Bank normally restricts distributions to a lesser amount. At December 31, 2017, retained earnings of approximately $5,900,000, were available to the Bank for the payment of distributions without prior regulatory approval. This amount available is reduced subsequent to December 31, 2017 to approximately $3,900,000 since it is based on the current year to date earnings retained plus the previous two years retained income. In addition, distributions may not be paid by the Bank without regulatory approval if capital requirements will not be met subsequent to the dividend.

As a subchapter S corporation, the Company may also be limited as to distributions based on previous retained subchapter S earnings or bank capital requirements as noted above.

NOTE 13 - RESTRICTION ON CASH AND DUE FROM BANKS

The Bank is required to maintain reserve funds in cash or on deposit with the Federal Reserve Bank. The required reserve at December 31, 2017, was approximately $4,467,000.

NOTE 14 - DISCONTINUED OPERATIONS

Effective December 31, 2010, the physical assets and related title and abstract business of Polk County Title Company, Inc. were sold. Polk County Title Company, Inc. will remain in existence for a period of years in accordance with certain legal requirements and may generate or expend insignificant amounts of cash flow during the remaining years of its existence.

NOTE 15 - COMPONENTS OF OTHER COMPREHENSIVE INCOME

The following table presents the components of other comprehensive income (loss) for the years ended December 31, 2017 and 2016.

| | YEARS ENDED | | | | | |
|---|---|---|---|---|---|---|
| | DECEMBER 31, 2017 | | | DECEMBER 31, 2016 | | |
| (DOLLARS IN THOUSANDS) | BEFORE TAX | TAX EFFECT | NET OF TAX | BEFORE TAX | TAX EFFECT | NET OF TAX |
| Changes in net unrealized gains on securities available for sale | $ 122 553 | $ - | $ 122 553 | $ (3 162 869) | $ - | $ (3 162 869) |
| Reclassification adjustment for gains realized | - | - | - | - | - | - |
| OTHER COMPREHENSIVE INCOME (LOSS) | $ 122 553 | $ - | $ 122 553 | $ (3 162 869) | $ - | $ (3 162 869) |

## NOTE 15 - COMPONENTS OF OTHER COMPREHENSIVE INCOME - CONTINUED

The following table presents the changes in each component of accumulated other comprehensive income, net of tax, for the years ended December 31, 2017 and 2016.

| (DOLLARS IN THOUSANDS) | SECURITIES AVAILABLE FOR SALE | ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) |
|---|---|---|
| Balance at January 1, 2016 | $ 1 258 477 | $ 1 258 477 |
| Other comprehensive income before reclassifications | (3 162 869) | (3 162 869 ) |
| Amounts reclassified from accumulated other comprehensive income | - | - |
| Balance at December 31, 2016 | (1 904 392) | (1 904 392) |
| Other comprehensive income before reclassifications | 122 553 | 122 553 |
| Amounts reclassified from accumulated other comprehensive income | - | - |
| Balance at December 31, 2017 | $ (1 781 839) | $ (1 781 839) |

## NOTE 16 - BROKERAGE COMMISSION

Net brokerage commission consists of the following for the years ended December 31, 2017 and 2016:

| | 2016 | 2017 |
|---|---|---|
| Gross brokerage commissions | $ 1 895 601 | 2 076 409 |
| Expenses | (280 052) | (320 417) |
| NET BROKERAGE COMMISSIONS | $ 1 615 549 | 1 755 992 |

AXLEY & RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT ON SUPPLEMENTARY INFORMATION

Board of Directors
FNB Company and Subsidiaries
Livingston, Texas

We have audited the consolidated financial statements of FNB Company and Subsidiaries as of and for the years ended December 31, 2017 and 2016, and our report thereon dated February 7, 2018 which expressed an unmodified opinion on those financial statements appears on page 3. Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Axley & Rode LLP
CERTIFIED PUBLIC ACCOUNTANTS

Lufkin, Texas
February 7, 2018

CONSOLIDATING SUPPLEMENTARY INFORMATION

FNB COMPANY AND SUBSIDIARIES

FNB COMPANY AND SUBSIDIARIES
CONSOLIDATING BALANCE SHEET
December 31, 2017

| | FNB COMPANY | THE FIRST NATIONAL BANK OF LIVINGSTON |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 19 162 | $ 17 711 421 |
| Interest bearing deposits in banks | - | 69 436 000 |
| Securities available-for-sale | - | 156 727 876 |
| Securities held-to-maturity | - | 1 937 187 |
| Restricted equity securities | - | 571 520 |
| Investment in subsidiaries | 52 154 201 | - |
| Loans, less allowance for loan losses | - | 121 021 481 |
| Bank premises and equipment, net | - | 8 791 247 |
| Accrued interest receivable | - | 1 494 819 |
| Goodwill, net | - | 3 031 499 |
| Residential real estate acquired in settlement of loans | - | 90 000 |
| Other assets | 661 712 | 1 049 956 |
| TOTAL ASSETS | $ 52 835 075 | $ 381 863 006 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Deposits: | | |
| Noninterest-bearing deposits | $ - | $ 136 256 782 |
| Interest-bearing deposits | - | 192 299 633 |
| TOTAL DEPOSITS | - | 328 556 415 |
| | | |
| Accrued interest and other liabilities | 661 765 | 1 152 390 |
| TOTAL LIABILITIES | 661 765 | 329 708 805 |
| | | |
| Stockholders' Equity: | | |
| Common stock | 130 028 | 479 000 |
| Surplus | 21 401 004 | 12 612 340 |
| Retained earnings | 32 860 055 | 40 844 700 |
| Treasury stock | (435 938) | - |
| Accumulated other comprehensive income | (1 781 839) | (1 781 839) |
| TOTAL STOCKHOLDERS' EQUITY | 52 173 310 | 52 154 201 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 52 835 075 | $ 381 863 006 |

See independent auditors' report on supplementary information.

| ELIMINATING ENTRIES | CONSOLIDATED TOTALS |
|---|---|
| $ (19 162) | $ 17 711 421 |
| - | 69 436 000 |
| - | 156 727 876 |
| - | 1 937 187 |
| - | 571 520 |
| (52 154 201) | - |
| - | 121 021 481 |
| - | 8 791 247 |
| - | 1 494 819 |
| - | 3 031 499 |
| - | 90 000 |
| (661 765) | 1 049 903 |
| $ (52 835 128) | $ 381 862 953 |
| | |
| $ (19 162) | $ 136 237 620 |
| - | 192 299 633 |
| (19 162) | 328 537 253 |
| | |
| (661 765) | 1 152 390 |
| (680 927) | 329 689 643 |
| | |
| (479 000) | 130 028 |
| (12 612 340) | 21 401 004 |
| (40 844 700) | 32 860 055 |
| - | (435 938) |
| 1 781 839 | (1 781 839) |
| (52 154 201) | 52 173 310 |
| | |
| $ (52 835 128) | $ 381 862 953 |

FNB COMPANY AND SUBSIDIARIES
CONSOLIDATING BALANCE SHEET
December 31, 2016

| | FNB COMPANY | THE FIRST NATIONAL BANK OF LIVINGSTON |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 16 781 | $ 10 774 882 |
| Interest bearing deposits in banks | - | 66 124 000 |
| Securities available for sale | - | 146 259 596 |
| Restricted equity securities | - | 570 220 |
| Investment in subsidiaries | 50 053 310 | - |
| Loans, less allowance for loan losses | - | 115 886 163 |
| Bank premises and equipment, net | - | 9 049 097 |
| Accrued interest receivable | - | 1 381 731 |
| Goodwill, net | - | 3 031 500 |
| Other assets | 668 136 | 1 031 986 |
| TOTAL ASSETS | $ 50 738 227 | $ 354 109 175 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Deposits: | | |
| Noninterest-bearing deposits | $ - | $ 114 630 071 |
| Interest-bearing deposits | - | 185 862 587 |
| TOTAL DEPOSITS | - | 300 492 658 |
| | | |
| Federal funds purchased | - | 2 440 000 |
| Accrued interest and other liabilities | 668 190 | 1 123 207 |
| TOTAL LIABILITIES | 668 190 | 304 055 865 |
| | | |
| Stockholders' Equity: | | |
| Common stock | 130 028 | 479 000 |
| Surplus | 21 401 004 | 12 612 340 |
| Retained earnings | 30 879 335 | 38 866 362 |
| Treasury stock | (435 938) | - |
| Accumulated other comprehensive income | (1 904 392) | (1 904 392) |
| TOTAL STOCKHOLDERS' EQUITY | 50 070 037 | 50 053 310 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 50 738 227 | $ 354 109 175 |

See independent auditors' report on supplementary information.

| ELIMINATING ENTRIES | CONSOLIDATED TOTALS |
|---|---|
| $ (16 781) | $ 10 774 882 |
| - | 66 124 000 |
| - | 146 259 596 |
| - | 570 220 |
| (50 053 310) | - |
| - | 115 886 163 |
| - | 9 049 097 |
| - | 1 381 731 |
| - | 3 031 500 |
| (668 190) | 1 031 932 |
| $ (50 738 281) | $ 354 109 121 |
| | |
| $ (16 781) | $ 114 613 290 |
| - | 185 862 587 |
| (16 781) | 300 475 877 |
| | |
| - | 2 440 000 |
| (668 190) | 1 123 207 |
| (684 971) | 304 039 084 |
| | |
| (479 000) | 130 028 |
| (12 612 340) | 21 401 004 |
| (38 866 362) | 30 879 335 |
| - | (435 938) |
| 1 904 392 | (1 904 392) |
| (50 053 310) | 50 070 037 |
| | |
| $ (50 738 281) | $ 354 109 121 |

FNB COMPANY AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF INCOME
For the Year Ended December 31, 2017

| | FNB COMPANY | THE FIRST NATIONAL BANK OF LIVINGSTON |
|---|---|---|
| Interest Income: | | |
| Interest and fees on loans | $ - | $ 6 224 701 |
| Interest on Investment Securities: | | |
| Taxable | - | 2 179 662 |
| Exempt from Federal income tax | - | 1 089 678 |
| Interest on deposits in banks | - | 1 167 528 |
| TOTAL INTEREST INCOME | - | 10 661 569 |
| Interest expense on deposits | - | 442 102 |
| Interest on Federal funds purchased | - | 1 018 |
| NET INTEREST INCOME | - | 10 218 449 |
| Provision for loan losses | - | 240 000 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | - | 9 978 449 |
| Other Income: | | |
| Service charges on deposit accounts | - | 1 909 860 |
| Other service charges and fees | - | 1 741 283 |
| Equity in earnings of subsidiaries | 4 625 398 | - |
| Insurance commissions | - | 639 906 |
| Brokerage commissions (net) | - | 1 755 992 |
| Gain/(loss) other | - | (1 130) |
| Other income | 4 592 | 46 266 |
| TOTAL OTHER INCOME | 4 629 990 | 6 092 177 |
| Other Expenses: | | |
| Salaries and employee benefits | - | 6 365 471 |
| Occupancy, insurance and equipment expense | - | 1 427 688 |
| ATM processing | - | 737 766 |
| Deposit insurance expense | - | 159 995 |
| Data processing | - | 831 786 |
| Directors fees | - | 185 819 |
| Postage and freight | - | 134 066 |
| Printing and office supplies | - | 216 107 |
| Legal and professional services | 1 086 | 247 630 |
| Telephone | - | 111 764 |
| Marketing | - | 90 665 |
| Other operating expenses | 1 125 | 936 471 |
| TOTAL OTHER EXPENSES | 2 211 | 11 445 228 |
| NET INCOME | $ 4 627 779 | $ 4 625 398 |

See independent auditors' report on supplementary information.

| ELIMINATING ENTRIES | CONSOLIDATED TOTALS |
| --- | --- |
| $ - | $ 6 224 701 |
| - | 2 179 662 |
| - | 1 089 678 |
| - | 1 167 528 |
| - | 10 661 569 |
| - | 442 102 |
| - | 1 018 |
| - | 10 218 449 |
| - | 240 000 |
| - | 9 978 449 |
| - | 1 909 860 |
| - | 1 741 283 |
| (4 625 398) | - |
| - | 639 906 |
| - | 1 755 992 |
| - | (1 130) |
| - | 50 858 |
| (4 625 398) | 6 096 769 |
| - | 6 365 471 |
| - | 1 427 688 |
| - | 737 766 |
| - | 159 995 |
| - | 831 786 |
| - | 185 819 |
| - | 134 066 |
| - | 216 107 |
| - | 248 716 |
| - | 111 764 |
| - | 90 665 |
| - | 937 596 |
| - | 11 447 439 |
| $ (4 625 398) | $ 4 627 779 |

FNB COMPANY AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF INCOME
For the Year Ended December 31, 2016

| | FNB COMPANY | THE FIRST NATIONAL BANK OF LIVINGSTON |
|---|---|---|
| Interest Income: | | |
| Interest and fees on loans | $ - | $ 6 231 374 |
| Interest on Investment Securities: | | |
| Taxable | - | 1 905 446 |
| Exempt from Federal income tax | - | 1 141 816 |
| Interest on deposits in banks | - | 976 797 |
| TOTAL INTEREST INCOME | - | 10 255 433 |
| Interest expense on deposits | - | 441 118 |
| Interest on Federal funds purchased | - | 1 205 |
| NET INTEREST INCOME | - | 9 813 110 |
| Provision for loan losses | - | 287 500 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | - | 9 525 610 |
| Other Income: | | |
| Service charges on deposit accounts | - | 2 004 564 |
| Other service charges and fees | - | 1 574 871 |
| Equity in earnings of subsidiaries | 4 674 568 | - |
| Insurance commissions | - | 453 074 |
| Brokerage commissions (net) | - | 1 615 549 |
| Other income | 17 441 | 58 056 |
| TOTAL OTHER INCOME | 4 692 009 | 5 706 114 |
| Other Expenses: | | |
| Salaries and employee benefits | - | 5 883 560 |
| Occupancy, insurance and equipment expense | - | 1 339 360 |
| ATM processing | - | 631 549 |
| Deposit insurance expense | - | 113 500 |
| Data processing | - | 841 430 |
| Directors fees | - | 190 473 |
| Postage and freight | - | 116 361 |
| Printing and office supplies | - | 184 732 |
| Legal and professional services | 1 056 | 224 999 |
| Telephone | - | 119 713 |
| Marketing | - | 116 435 |
| Other operating expenses | 8 921 | 814 539 |
| TOTAL OTHER EXPENSES | 9 977 | 10 576 651 |
| INCOME FROM OPERATIONS BEFORE FEDERAL INCOME TAXES | 4 682 032 | 4 655 073 |
| Federal income taxes (benefit) | - | (19 494) |
| NET INCOME | 4 682 032 | 4 674 567 |

See independent auditors' report on supplementary information.

| ELIMINATING ENTRIES | CONSOLIDATED TOTALS |
|---|---|
| $ - | $ 6 231 374 |
| | |
| - | 1 905 446 |
| - | 1 141 816 |
| - | 976 797 |
| - | 10 255 433 |
| - | 441 118 |
| - | 1 205 |
| - | 9 813 110 |
| - | 287 500 |
| | |
| - | 9 525 610 |
| | |
| - | 2 004 564 |
| - | 1 574 871 |
| (4 674 568) | - |
| - | 453 074 |
| - | 1 615 549 |
| - | 75 497 |
| (4 674 568) | 5 723 555 |
| | |
| - | 5 883 560 |
| - | 1 339 360 |
| - | 631 549 |
| - | 113 500 |
| - | 841 430 |
| - | 190 473 |
| - | 116 361 |
| - | 184 732 |
| - | 226 055 |
| - | 119 713 |
| - | 116 435 |
| - | 823 460 |
| - | 10 586 628 |
| | |
| (4 674 568) | 4 662 537 |
| - | (19 494) |
| (4 674 568) | 4 682 031 |

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CONSOLIDATING SUPPLEMENTARY INFORMATION

THE FIRST NATIONAL BANK OF LIVINGSTON AND SUBSIDIARIES

THE FIRST NATIONAL BANK OF LIVINGSTON AND SUBSIDIARIES
CONSOLIDATING BALANCE SHEET
December 31, 2017

| | | THE FIRST NATIONAL BANK OF LIVINGSTON |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ | 17 711 421 |
| Interest bearing deposits in banks | | 69 436 000 |
| Securities available-for-sale | | 156 727 876 |
| Securities held-to-maturity | | 1 937 187 |
| Restricted equity securities | | 571 520 |
| Investment in subsidiaries | | 435 930 |
| Loans, less allowance for loan losses | | 121 021 481 |
| Bank premises and equipment, net | | 8 784 230 |
| Accrued interest receivable | | 1 494 819 |
| Goodwill, net | | 3 031 499 |
| Residential real estate in settlement of loans | | 90 000 |
| Other assets | | 1 025 106 |
| TOTAL ASSETS | $ | 382 267 069 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Deposits: | | |
| Noninterest-bearing deposits | $ | 136 728 724 |
| Interest-bearing deposits | | 192 299 633 |
| TOTAL DEPOSITS | | 329 028 357 |
| Accrued interest and other liabilities | | 1 084 511 |
| TOTAL LIABILITIES | | 330 112 868 |
| Stockholders' Equity: | | |
| Common stock | | 479 000 |
| Surplus | | 12 612 340 |
| Retained earnings | | 40 844 700 |
| Accumulated other comprehensive income | | (1 781 839) |
| TOTAL STOCKHOLDERS' EQUITY | | 52 154 201 |
| | | |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ | 382 267 069 |

See independent auditors' report on supplementary information.

| CHURCH STREET FINANCIAL | POLK COUNTY TITLE COMPANY, INC. | ELIMINATING ENTRIES | CONSOLIDATED TOTALS |
|---|---|---|---|
| $ 298 865 | $ 36 172 | $ (335 037) | $ 17 711 421 |
| - | - | - | 69 436 000 |
| - | - | - | 156 727 876 |
| - | - | - | 1 937 187 |
| - | - | - | 571 520 |
| - | - | (435 930) | - |
| - | - | - | 121 021 481 |
| 7 017 | - | - | 8 791 247 |
| - | - | - | 1 494 819 |
| - | - | - | 3 031 499 |
| - | - | - | 90 000 |
| 160 924 | - | (136 074) | 1 049 956 |
| $ 466 806 | $ 36 172 | $ (907 041) | $ 381 863 006 |
| | | | |
| $ - | $ - | $ (471 942) | $ 136 256 782 |
| - | - | - | 192 299 633 |
| - | - | (471 942) | 328 556 415 |
| 67 879 | - | - | 1 152 390 |
| 67 879 | - | (471 942) | 329 708 805 |
| | | | |
| 350 000 | 2 000 | (352 000) | 479 000 |
| - | 111 795 | (111 795) | 12 612 340 |
| 48 927 | (77 623) | 28 696 | 40 844 700 |
| - | - | - | (1 781 839) |
| 398 927 | 36 172 | (435 099) | 52 154 201 |
| | | | |
| $ 466 806 | $ 36 172 | $ (907 041) | $ 381 863 006 |

THE FIRST NATIONAL BANK OF LIVINGSTON AND SUBSIDIARIES
CONSOLIDATING BALANCE SHEET
December 31, 2016

| | | THE FIRST NATIONAL BANK OF LIVINGSTON |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ | 10 774 882 |
| Interest bearing deposits in banks | | 66 124 000 |
| Securities available for sale | | 146 259 596 |
| Restricted equity securities | | 570 220 |
| Investment in subsidiaries | | 420 974 |
| Loans, less allowance for loan losses | | 115 886 163 |
| Bank premises and equipment, net | | 9 030 249 |
| Accrued interest receivable | | 1 381 731 |
| Goodwill, net | | 3 031 500 |
| Other assets | | 1 015 708 |
| TOTAL ASSETS | $ | 354 495 023 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Deposits: | | |
| Noninterest-bearing deposits | $ | 115 083 821 |
| Interest-bearing deposits | | 185 862 587 |
| TOTAL DEPOSITS | | 300 946 408 |
| Federal funds purchased | | 2 440 000 |
| Accrued interest and other liabilities | | 1 055 305 |
| TOTAL LIABILITIES | | 304 441 713 |
| Stockholders' Equity: | | |
| Common stock | | 479 000 |
| Surplus | | 12 612 340 |
| Retained earnings | | 38 866 362 |
| Accumulated other comprehensive income | | (1 904 392) |
| TOTAL STOCKHOLDERS' EQUITY | | 50 053 310 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ | 354 495 023 |

See independent auditors' report on supplementary information.

| CHURCH STREET FINANCIAL | POLK COUNTY TITLE COMPANY, INC. | ELIMINATING ENTRIES | CONSOLIDATED TOTALS |
|---|---|---|---|
| $ 276 429 | $ 36 172 | $ (312 601) | $ 10 774 882 |
| - | - | - | 66 124 000 |
| - | - | - | 146 259 596 |
| - | - | - | 570 220 |
| - | - | (420 974) | - |
| - | - | - | 115 886 163 |
| 18 848 | - | - | 9 049 097 |
| - | - | - | 1 381 731 |
| - | - | - | 3 031 500 |
| 156 597 | - | (140 319) | 1 031 986 |
| $ 451 874 | $ 36 172 | $ (873 894) | $ 354 109 175 |

| | | | |
|---|---|---|---|
| $ - | $ - | $ (453 750) | $ 114 630 071 |
| - | - | - | 185 862 587 |
| - | - | (453 750) | 300 492 658 |
| - | - | - | 2 440 000 |
| 67 902 | - | - | 1 123 207 |
| 67 902 | - | (453 750) | 304 055 865 |
| 350 000 | 2 000 | (352 000) | 479 000 |
| - | 111 795 | (111 795) | 12 612 340 |
| 33 972 | (77 623) | 43 651 | 38 866 362 |
| - | - | - | (1 904 392) |
| 383 972 | 36 172 | (420 144) | 50 053 310 |
| $ 451 874 | $ 36 172 | $ (873 894) | $ 354 109 175 |

THE FIRST NATIONAL BANK OF LIVINGSTON AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF INCOME
For the Year Ended December 31, 2017

| | THE FIRST NATIONAL BANK OF LIVINGSTON |
|---|---|
| Interest Income: | |
| Interest and fees on loans | $ 6 224 701 |
| Interest on Investment Securities: | |
| Taxable | 2 179 662 |
| Exempt from Federal income tax | 1 089 678 |
| Interest on deposits in banks | 1 167 528 |
| TOTAL INTEREST INCOME | 10 661 569 |
| Interest expense on deposits | 442 102 |
| Interest on Federal funds purchased | 1 018 |
| NET INTEREST INCOME | 10 218 449 |
| Provision for loan losses | 240 000 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 9 978 449 |
| Other Income: | |
| Service charges on deposit accounts | 1 909 860 |
| Other service charges and fees | 1 741 283 |
| Equity in earnings of subsidiaries | 639 955 |
| Insurance commissions | - |
| Brokerage commissions (net) | 1 755 992 |
| Management fee | - |
| Gain/(loss) other | (1 130) |
| Other income | 190 266 |
| TOTAL OTHER INCOME | 6 236 226 |
| Other Expenses: | |
| Salaries and employee benefits | 5 172 535 |
| Occupancy, insurance and equipment expense | 1 393 233 |
| ATM processing | 737 766 |
| Deposit insurance expense | 159 995 |
| Data processing | 807 481 |
| Directors fees | 173 819 |
| Postage and freight | 130 591 |
| Printing and office supplies | 202 909 |
| Legal and professional services | 235 517 |
| Telephone | 102 624 |
| Marketing | 79 254 |
| Management fee paid | 1 571 046 |
| Other operating expenses | 822 507 |
| TOTAL OTHER EXPENSES | 11 589 277 |
| NET INCOME | $ 4 625 398 |

See independent auditors' report on supplementary information.

| CHURCH STREET FINANCIAL | POLK CO. TITLE COMPANY, INC. | ELIMINATING ENTRIES | CONSOLIDATED TOTALS |
|---|---|---|---|
| $ - | $ - | $ - | $ 6 224 701 |
| - | - | - | 2 179 662 |
| - | - | - | 1 089 678 |
| - | - | - | 1 167 528 |
| - | - | - | 10 661 569 |
| - | - | - | 442 102 |
| - | - | - | 1 018 |
| - | - | - | 10 218 449 |
| - | - | - | 240 000 |
| - | - | - | 9 978 449 |
| - | - | - | 1 909 860 |
| - | - | - | 1 741 283 |
| - | - | (639 955) | - |
| 639 906 | - | - | 639 906 |
| - | - | - | 1 755 992 |
| 1 571 046 | - | (1 571 046) | - |
| - | - | - | (1 130) |
| - | - | (144 000) | 46 266 |
| 2 210 952 | - | (2 355 001) | 6 092 177 |
| 1 192 936 | - | - | 6 365 471 |
| 178 455 | - | (144 000) | 1 427 688 |
| - | - | - | 737 766 |
| - | - | - | 159 995 |
| 24 305 | - | - | 831 786 |
| 12 000 | - | - | 185 819 |
| 3 475 | - | - | 134 066 |
| 13 198 | - | - | 216 107 |
| 12 113 | - | - | 247 630 |
| 9 140 | - | - | 111 764 |
| 11 411 | - | - | 90 665 |
| - | - | (1 571 046) | - |
| 113 964 | - | - | 936 471 |
| 1 570 997 | - | (1 715 046) | 11 445 228 |
| $ 639 955 | $ - | $ (639 955) | $ 4 625 398 |



AXLEY&RODE LLP
CERTIFIED PUBLIC ACCOUNTANTS

THE FIRST NATIONAL BANK OF LIVINGSTON AND SUBSIDIARIES
CONSOLIDATING STATEMENT OF INCOME
For the Year Ended December 31, 2016

| | THE FIRST NATIONAL BANK OF LIVINGSTON |
|---|---|
| Interest Income: | |
| Interest and fees on loans | $ 6 231 374 |
| Interest on Investment Securities: | |
| Taxable | 1 905 446 |
| Exempt from Federal income tax | 1 141 816 |
| Interest on deposits in banks | 976 797 |
| TOTAL INTEREST INCOME | 10 255 433 |
| Interest expense on deposits | 441 118 |
| Interest on Federal funds purchased | 1 205 |
| NET INTEREST INCOME | 9 813 110 |
| Provision for loan losses | 287 500 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 9 525 610 |
| Other Income: | |
| Service charges on deposit accounts | 2 004 564 |
| Other service charges and fees | 1 574 871 |
| Equity in earnings of subsidiaries | 553 505 |
| Insurance commissions | - |
| Brokerage commissions (net) | 833 369 |
| Management fee | - |
| Other income | 188 056 |
| TOTAL OTHER INCOME | 5 154 365 |
| Other Expenses: | |
| Salaries and employee benefits | 4 842 093 |
| Occupancy, insurance and equipment expense | 1 298 615 |
| ATM processing | 631 549 |
| Deposit insurance expense | 113 500 |
| Data processing | 802 934 |
| Directors fees | 178 473 |
| Postage and freight | 112 768 |
| Printing and office supplies | 175 365 |
| Legal and professional services | 211 965 |
| Telephone | 107 051 |
| Marketing | 100 895 |
| Management fee paid | 721 918 |
| Other operating expenses | 727 776 |
| TOTAL OTHER EXPENSES | 10 024 902 |
| INCOME FROM OPERATIONS BEFORE FEDERAL INCOME TAXES | 4 655 073 |
| Federal income taxes (benefits) | (19 494) |
| NET INCOME | $ 4 674 567 |

See independent auditors' report on supplementary information.

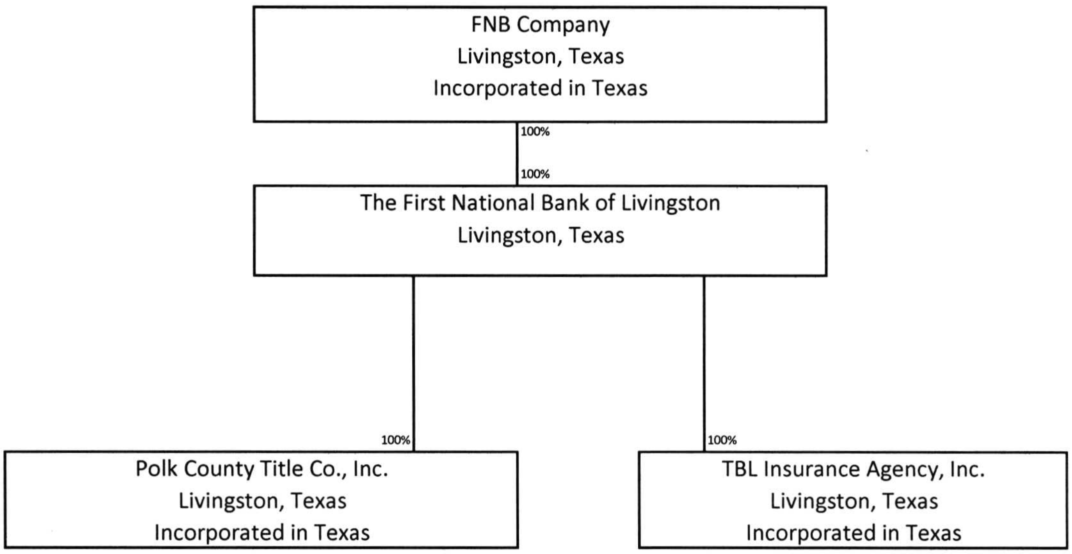
| CHURCH STREET FINANCIAL | POLK CO. TITLE COMPANY, INC. | ELIMINATING ENTRIES | CONSOLIDATED TOTALS |
|---|---|---|---|
| $ - | $ - | $ - | $ 6 231 374 |
| - | - | - | 1 905 446 |
| - | - | - | 1 141 816 |
| - | - | - | 976 797 |
| - | - | - | 10 255 433 |
| - | - | - | 441 118 |
| - | - | - | 1 205 |
| - | - | - | 9 813 110 |
| - | - | - | 287 500 |
| - | - | - | 9 525 610 |
| - | - | - | 2 004 564 |
| - | - | - | 1 574 871 |
| - | - | (553 505) | - |
| 453 074 | - | - | 453 074 |
| 782 181 | - | - | 1 615 550 |
| 721 918 | - | (721 918) | - |
| - | - | (130 000) | 58 056 |
| 1 957 173 | - | (1 405 423) | 5 706 115 |
| 1 041 467 | - | - | 5 883 560 |
| 170 745 | - | (130 000) | 1 339 360 |
| - | - | - | 631 549 |
| - | - | - | 113 500 |
| 38 496 | - | - | 841 430 |
| 12 000 | - | - | 190 473 |
| 3 593 | - | - | 116 361 |
| 9 367 | - | - | 184 732 |
| 13 034 | - | - | 224 999 |
| 12 662 | - | - | 119 713 |
| 15 540 | - | - | 116 435 |
| - | - | (721 918) | - |
| 86 764 | - | - | 814 540 |
| 1 403 668 | - | (851 918) | 10 576 652 |
| 553 505 | - | (553 505) | 4 655 073 |
| - | - | - | (19 494) |
| $ 553 505 | $ - | $ (553 505) | $ 4 674 567 |

Form FR Y-6
FNB Company
Livingston, Texas
Fiscal Year Ending December 31, 2017

Report Item

1: The BHC does prepare an annual report for its shareholders. Enclosed are two copies of the annual report.

2a: Organization Chart




No LEI is available for any entity listed above.

Report Item 2b: Domestic Branch Listing
FNB Company ID# 630658

| Data Action | Effective Date | Branch Service Type | Branch ID_RSSD* | Popular Name | Street Address | City | State | Zip Code | County | Country | FDIC UNINUM* | Office Number* | Head Office | Head Office ID_RSSD* | Comments |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Ok | | Full Service (Head Office) | 630658 | FIRST NATIONAL BANK OF LIVINGSTON, THE | 2121 HWY 190 WEST | LIVINGSTON | TX | 77351 | POLK | UNITED STATES | Not Required | Not Required | FIRST NATIONAL BANK OF LIVINGSTON, THE | 630658 | |
| Ok | | Full Service | 2114796 | DOWNTOWN BRANCH | 308 WEST CHURCH STREET | LIVINGSTON | TX | 77351 | POLK | UNITED STATES | Not Required | Not Required | FIRST NATIONAL BANK OF LIVINGSTON, THE | 630658 | |
| Ok | | Full Service | 1464234 | ONALASKA BRANCH | 14114 US HIGHWAY 190 WEST | ONALASKA | TX | 77360 | POLK | UNITED STATES | Not Required | Not Required | FIRST NATIONAL BANK OF LIVINGSTON, THE | 630658 | |

**Form FR Y-6**

**FNB Company**
**Livingston, TX**
**Fiscal Year Ending December 31, 2017**

**Report Item 3: Securities Holders**

| Current Securities Holders with ownership, control or holdings of 5% or more with power to vote as of fiscal year ending 12-31-2017 | | | Securities Holders not listed in 3(1)(a) through (3)(1)(c) that had ownership, control or holdings of 5% or more with power to vote during the fiscal year ending 12-31-2017 | | |
|---|---|---|---|---|---|
| **(1)(a)** Name & Address (City, State, Country) | **(1)(b)** Country of Citizenship or Incorporation | **(1)(c)** Number and Percentage of Each Class of Voting Securities | **(2)(a)** Name & Address (City, State, Country) | **(2)(b)** Country of Citizenship or Incorporation | **(2)(c)** Number and Percentage of Each Class of Voting Securities |
| Carey L. Cochran, Jr.<br>Livingston, TX | USA | 21,208 common 16.50% | N/A | | |
| Ernest H. Cochran<br>Bypass Trust B<br>Judy Cochran & Malcolm Jones, Trustees<br>Livingston, TX | USA | 8,610 common 6.70% | | | |
| Ernest H Cochran<br>Residuary Trust C<br>Judy Cochran & Malcolm Jones, Trustees<br>Livingston, TX | USA | 11,124 common 8.66% | | | |
| The John Guy Slocomb<br>Family Trust<br>Connie Slocomb, Trustee<br>Livingston, TX | USA | 14,335 common 11.16% | | | |
| Constance Slocomb<br>Livingston, TX | USA | 19,421** common 15.11% | | | |
| Judy Cochran<br>Livingston, TX | USA | 21,354* common 16.62% | | | |
| Malcolm Jones<br>Livingston, TX | USA | 19,934* common 15.51% | | | |

* Includes 19,734 shares common reported under Ernest H Cochran Trusts of which Mrs. Cochran & Mr. Jones are trustees.

** Includes 14,335 shares common reported under The John Guy Slocomb Family Trust of which Mrs. Slocomb is trustee.

Form FR Y-6

**FNB Company**
**Livingston, TX**
**Fiscal Year Ending December 31, 2017**

**Report Item 4: Insiders**
(1)(a)(b)(c) and (2)(a)(b)(c)

| (1) Names & Address (City, State, Country) | (2) Principal Occupation if other than with holding company | (3)(a) Title & Position with holding company | (3)(b) Title & Position with Subsidiaries (include names of subsidiaries) | (3)(c) Title & Position with Other Businesses (include names of other businesses) | (4)(a) Percentage of Voting Securities in holding company | (4)(b) Percentage of Voting Securities in Subsidiaries (include names of subsidiaries) | (4)(c) List names of other companies (includes partnerships) if 25% or more of voting securities are held (List names of companies and percentage of voting securities held) |
|---|---|---|---|---|---|---|---|
| Judy Cochran<br>Livingston, Texas, USA | Investments | Director | Director-FNB | Pres-Livingston Lands, Inc.<br>Director-JAR Partnership | 16.62% | NONE | 25% Livingston Lands, Inc. |
| C.L. Cochran, Jr.<br>Livingston, Texas, USA | Merchant | Director | Director-FNB | Pres-Cochran Funeral Home | 16.50% | NONE | 100% Cochran Funeral Home |
| R. Malcolm Jones<br>Livingston, Texas, USA | Attorney | Sr. Chm | Sr. Chm-FNB<br>Director-TBL Ins. | N/A | 15.51% | NONE | N/A |
| The John Guy Slocomb Family Trust<br>Connie Slocomb, Trustee<br>Livingston, Texas, USA | N/A | N/A | N/A | N/A | 11.16% | NONE | N/A |
| Constance T. Slocomb<br>Livingston, Texas, USA | Attorney/CPA | Director | Director-FNB | N/A | 3.96% | NONE | N/A |
| Richard L. Gilbert<br>Livingston, Texas, USA | Safety Advisor | Director | Director-FNB | N/A | 3.98% | NONE | N/A |
| Linda Nadolski<br>Livingston, Texas, USA | Retired/Interior Designer | Director | Director-FNB | N/A | 3.33% | NONE | N/A |
| John Thompson<br>Livingston, Texas, USA | Consultant | Director | Director-FNB | N/A | 2.06% | NONE | N/A |
| Zonna Craig<br>Livingston, Texas, USA | Retired/Banking | Director | Director-FNB | N/A | 1.72% | NONE | N/A |
| John Haynes<br>Livingston, Texas, USA | Equipment Manufacturing | Director | Director-FNB | Pres-L.B. Equipment, Inc.<br>V.P.-Little Beaver, Inc. | 1.48% | NONE | 50% H & H Leasing; 50% L.B. Equipment, Inc; 50% Little Beaver |
| J.E. Peters, Jr.<br>Livingston, Texas, USA | Investments/Ranching | Director | Director-FNB | Director-Peters Tractor & Equipment | 1.15% | NONE | N/A |

**FNB Company**
**Livingston, TX**
**Fiscal Year Ending December 31, 2017**

**Report Item 4: Insiders**
(1)(a)(b)(c) and (2)(a)(b)(c)

| (1) Names & Address (City, State, Country) | (2) Principal Occupation if other than with holding company | (3)(a) Title & Position with holding company | (3)(b) Title & Position with Subsidiaries (include names of subsidiaries) | (3)(c) Title & Position with Other Businesses (include names of other businesses) | (4)(a) Percentage of Voting Securities in holding company | (4)(b) Percentage of Voting Securities in Subsidiaries (include names of subsidiaries) | (4)(c) List names of other companies (includes partnerships) if 25% or more of voting securities are held (List names of companies and percentage of voting securities held) |
|---|---|---|---|---|---|---|---|
| A.C. Evans, Jr.<br>Livingston, Texas, USA | Banker | President<br>CEO/Director<br>Treasurer | President<br>CEO/Director-FNB<br>Director-TBL Ins | N/A | 0.97% | NONE | N/A |
| Claud Thomas<br>Livingston, Texas, USA | Building Materials | Director | Director-FNB | Pres-Thomas Supply, Inc. | 0.86% | NONE | Thomas Supply, Inc.-52% |
| Craig Anderson Evans<br>Livingston, Texas, USA | Insurance/Investments | Director | Director/Vice President-TBL Ins. | N/A | 0.60% | NONE | N/A |
| John Allen Slocomb<br>Livingston, Texas, USA | Banker | Director | Director/Sr. Vice President-FNB | N/A | 0.16% | NONE | N/A |
| Cindy Snook<br>Livingston, Texas, USA | Banker | Director | Director/Sr. Vice President-FNB | N/A | 0.16% | NONE | 50% Snook Roofing and Sheet Metal, LLC |
| Kyle J. Kuntz<br>Livingston, Texas, USA | Electric Power Distribution | Director | Director-FNB | CEO-Sam Houston Electric Co-op | 0.16% | NONE | N/A |
| Russell Thomas<br>Livingston, Texas, USA | Building Materials | Director | Director-FNB | Director-Thomas Supply | 0.16% | NONE | Thomas Supply Inc- 48% |