FIRST COMMUNITY BANKSHARES INC /VA/
Form 10-Q
November 02, 2018

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended **September 30, 2018**
or

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

Commission file number: **000-19297**

FIRST COMMUNITY BANKSHARES, INC.
(Exact name of registrant as specified in its charter)

Virginia	**55-0694814**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
P.O. Box 989 Bluefield, Virginia	**24605-0989**
(Address of principal executive offices)	(Zip Code)

(276) 326-9000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to

such filing requirements for the past 90 days.
Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes No

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

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

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

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

As of October 26, 2018, there were 16,285,370 shares outstanding of the registrant's Common Stock, $1.00 par value.

FIRST COMMUNITY BANKSHARES, INC.
FORM 10-Q
INDEX

Table of Contents

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Forward-looking statements in filings with the Securities and Exchange Commission, including this Quarterly Report on Form 10-Q and the accompanying Exhibits, filings incorporated by reference, reports to shareholders, and other communications that represent the Company's beliefs, plans, objectives, goals, guidelines, expectations, anticipations, estimates, and intentions are made in good faith pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict. The words "may," "could," "should," "would," "believe," "anticipat "estimate," "expect," "intend," "plan," and other similar expressions identify forward-looking statements. The following factors, among others, could cause financial performance to differ materially from that expressed in such forward-looking statements:

- the strength of the U.S. economy in general and the strength of the local economies in which we conduct operations;
- the effects of, and changes in, trade, monetary, and fiscal policies and laws, including interest rate policies of the Federal Reserve System;
- inflation, interest rate, market and monetary fluctuations;
- timely development of competitive new products and services and the acceptance of these products and services by new and existing customers;
- the willingness of customers to substitute competitors' products and services for the Company's products and services and vice versa;
- the impact of changes in financial services laws and regulations, including laws about taxes, banking, securities, and insurance, and the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act;
- the impact of the U.S. Department of the Treasury and federal banking regulators' continued implementation of programs to address capital and liquidity in the banking system;
- further, future, and proposed rules, including those that are part of the process outlined in the Basel Committee on Banking Supervision's "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems," which require banking institutions to increase levels of capital;
- technological changes;
- the effect of acquisitions, including, without limitation, the failure to achieve the expected revenue growth and/or expense savings from such acquisitions;
- the growth and profitability of noninterest, or fee, income being less than expected;
- unanticipated regulatory or judicial proceedings;
- changes in consumer spending and saving habits; and
- the Company's success at managing the risks mentioned above.

This list of important factors is not exclusive. If one or more of the factors affecting these forward-looking statements proves incorrect, actual results, performance, or achievements could differ materially from those expressed in, or implied by, forward-looking statements contained in this Quarterly Report on Form 10-Q and other reports we file with the Securities and Exchange Commission. Therefore, the Company cautions you not to place undue reliance on forward-looking information and statements. The Company does not intend to update any forward-looking statements, whether written or oral, to reflect changes. These cautionary statements expressly qualify all forward-looking statements that apply to the Company including the risk factors presented in Part II, Item 1A, "Risk Factors," of this report and Part I, Item 1A, “Risk Factors,” of the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

FIRST COMMUNITY BANKSHARES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except share and per share data)	**September 30, 2018** (Unaudited)	**December 31, 2017**[(1)]
Assets		
Cash and due from banks	$44,719	$37,115
Federal funds sold	27,965	119,891
Interest-bearing deposits in banks	995	945
Total cash and cash equivalents	73,679	157,951
Debt securities available for sale	163,593	165,525
Debt securities held to maturity	25,047	25,149
Loans held for investment, net of unearned income (including covered loans of $20,483 and $27,948)	1,790,909	1,817,184
Allowance for loan losses	(18,256)	(19,276)
Loans held for investment, net	1,772,653	1,797,908
FDIC indemnification asset	5,653	7,161
Premises and equipment, net	45,537	48,126
Other real estate owned (including covered OREO of $44 and $105)	4,798	2,514
Interest receivable	5,374	5,778
Goodwill	94,287	95,779
Other intangible assets	5,366	6,151
Other assets	73,701	76,418
Total assets	$2,269,688	$2,388,460
Liabilities		
Deposits		
Noninterest-bearing	$463,945	$454,143
Interest-bearing	1,411,906	1,475,748
Total deposits	1,875,851	1,929,891
Securities sold under agreements to repurchase	30,151	30,086
FHLB borrowings	-	50,000

Interest, taxes, and other liabilities	25,284	27,769
Total liabilities	1,931,286	2,037,746
Stockholders' equity		
Preferred stock, undesignated par value; 1,000,000 shares authorized; Series A Noncumulative Convertible Preferred Stock, $0.01 par value; 25,000 shares authorized; none outstanding	-	-
Common stock, $1 par value; 50,000,000 shares authorized; 21,381,779 shares issued at September 30, 2018, and December 31, 2017; 4,991,277 and 4,383,553 shares in treasury at September 30, 2018, and December 31, 2017, respectively	21,382	21,382
Additional paid-in capital	229,182	228,750
Retained earnings	189,902	180,543
Treasury stock, at cost	(99,247)	(79,121)
Accumulated other comprehensive loss	(2,817)	(840)
Total stockholders' equity	338,402	350,714
Total liabilities and stockholders' equity	$2,269,688	$2,388,460

(1) Derived from audited financial statements

See Notes to Condensed Consolidated Financial Statements.

4

Table of Contents

FIRST COMMUNITY BANKSHARES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(Amounts in thousands, except share and per share data)	**Three Months Ended September 30, 2018**	**2017**	**Nine Months Ended September 30, 2018**	**2017**
Interest income				
Interest and fees on loans	$22,556	$22,694	$67,733	$67,435
Interest on securities -- taxable	666	341	1,704	1,157
Interest on securities -- tax-exempt	706	739	2,133	2,299
Interest on deposits in banks	358	275	1,343	655
Total interest income	24,286	24,049	72,913	71,546
Interest expense				
Interest on deposits	1,269	1,275	3,847	3,674
Interest on short-term borrowings	204	213	606	634
Interest on long-term debt	488	511	1,494	1,753
Total interest expense	1,961	1,999	5,947	6,061
Net interest income	22,325	22,050	66,966	65,485
Provision for loan losses	495	730	1,485	2,156
Net interest income after provision for loan losses	21,830	21,320	65,481	63,329
Noninterest income				
Wealth management	791	758	2,408	2,339
Service charges on deposits	3,803	3,605	10,883	10,078
Other service charges and fees	1,925	1,709	5,716	5,156
Insurance commissions	299	306	966	1,004
Net loss on sale of securities	(618)	-	(618)	(657)
Net FDIC indemnification asset amortization	(645)	(268)	(1,602)	(3,186)
Other operating income	964	593	2,393	2,336
Total noninterest income	6,519	6,703	20,146	17,070
Noninterest expense				
Salaries and employee benefits	8,983	9,001	27,417	26,771
Occupancy expense	1,075	1,082	3,408	3,671
Furniture and equipment expense	985	1,133	2,976	3,311
Service fees	1,134	705	2,813	2,645
Advertising and public relations	478	551	1,461	1,700
Professional fees	337	339	1,074	1,978
Amortization of intangibles	261	266	785	790
FDIC premiums and assessments	234	227	697	698
Loss on extinguishment of debt	1,096	-	1,096	-

Goodwill impairment	1,492	-	1,492	-
Other operating expense	2,056	3,173	9,188	8,655
Total noninterest expense	18,131	16,477	52,407	50,219
Income before income taxes	10,218	11,546	33,220	30,180
Income tax expense	1,118	3,894	6,186	9,908
Net income	9,100	7,652	27,034	20,272
Earnings per common share				
Basic	$0.55	$0.45	$1.62	$1.19
Diluted	0.55	0.45	1.61	1.19
Cash dividends per common share	0.21	0.18	1.05	0.50
Weighted average shares outstanding				
Basic	16,512,823	17,005,654	16,717,704	17,005,350
Diluted	16,612,416	17,082,729	16,810,425	17,076,958

See Notes to Condensed Consolidated Financial Statements.

5

Table of Contents

FIRST COMMUNITY BANKSHARES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	**2017**	**2018**	**2017**
(Amounts in thousands)				
Net income	$9,100	$7,652	$27,034	$20,272
Other comprehensive income, before tax				
Available-for-sale debt securities:				
Change in net unrealized (losses) gains on debt securities without other-than-temporary impairment	(983)	(169)	(3,426)	2,127
Reclassification adjustment for net losses recognized in net income	618	-	618	657
Net unrealized (losses) gains on available-for-sale debt securities	(365)	(169)	(2,808)	2,784
Employee benefit plans:				
Net actuarial (loss) gain	(1)	(1)	91	133
Reclassification adjustment for amortization of prior service cost and net actuarial loss recognized in net income	72	65	214	194
Net unrealized gains on employee benefit plans	71	64	305	327
Other comprehensive (loss) income, before tax	(294)	(105)	(2,503)	3,111
Income tax (benefit) expense	(62)	(39)	(526)	1,167
Other comprehensive (loss) income, net of tax	(232)	(66)	(1,977)	1,944
Total comprehensive income	$8,868	$7,586	$25,057	$22,216

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

FIRST COMMUNITY BANKSHARES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)

(Amounts in thousands, except share and per share data)	Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Balance January 1, 2017	$ -	$ 21,382	$ 228,142	$ 170,377	$ (78,833)	$ (2,011)	$ 339,057
Net income	-	-	-	20,272	-	-	20,272
Other comprehensive income	-	-	-	-	-	1,944	1,944
Common dividends declared -- $0.50 per share	-	-	-	(8,504)	-	-	(8,504)
Equity-based compensation expense	-	-	250	-	387	-	637
Common stock options exercised -- 8,036 shares	-	-	6	-	145	-	151
Issuance of treasury stock to 401(k) plan -- 12,834 shares	-	-	112	-	231	-	343
Purchase of treasury shares -- 50,118 shares at $25.20 per share	-	-	-	-	(1,263)	-	(1,263)
Balance September 30, 2017	$ -	$ 21,382	$ 228,510	$ 182,145	$ (79,333)	$ (67)	$ 352,637
Balance January 1, 2018	$ -	$ 21,382	$ 228,750	$ 180,543	$ (79,121)	$ (840)	$ 350,714
Net income	-	-	-	27,034	-	-	27,034
Other comprehensive loss	-	-	-	-	-	(1,977)	(1,977)
Common dividends declared -- $0.57 per share	-	-	-	(9,541)	-	-	(9,541)
Special common dividend declared -- $0.48 per share	-	-	-	(8,134)	-	-	(8,134)
Equity-based compensation expense	-	-	345	-	602	-	947
Common stock options exercised -- 18,979 shares	-	-	(41)	-	362	-	321
	-	-	128	-	197	-	325

Issuance of treasury stock to 401(k) plan -- 10,543 shares							
Purchase of treasury shares -- 670,016 shares at $31.77 per share	-	-	-	-	(21,287)	-	(21,287)
Balance September 30, 2018	$ -	$ 21,382	$ 229,182	$ 189,902	$ (99,247)	$ (2,817)	$ 338,402

See Notes to Condensed Consolidated Financial Statements.

7

Table of Contents

FIRST COMMUNITY BANKSHARES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine Months Ended September 30,	
(Amounts in thousands)	**2018**	**2017**
Operating activities		
Net income	$27,034	$20,272
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	1,485	2,156
Depreciation and amortization of premises and equipment	2,221	2,688
Amortization (accretion) of premiums on investments, net	26	63
Amortization of FDIC indemnification asset, net	1,602	3,186
Amortization of intangible assets	785	790
Goodwill impairment	1,492	-
Accretion on acquired loans	(4,257)	(4,257)
Equity-based compensation expense	947	637
Issuance of treasury stock to 401(k) plan	325	343
(Gain) loss on sale of premises and equipment, net	(8)	13
Loss on sale of other real estate owned	833	940
Loss on sale of securities	618	657
Loss on extinguishment of debt	1,096	-
Decrease in accrued interest receivable	404	397
Decrease (increase) in other operating activities	2,543	(4,647)
Net cash provided by operating activities	37,146	23,238
Investing activities		
Proceeds from sale of securities available for sale	8,937	12,273
Proceeds from maturities, prepayments, and calls of securities available for sale	57,056	18,022
Proceeds from maturities and calls of securities held to maturity	-	21,840
Payments to acquire securities available for sale	(67,355)	(36,966)
Proceeds from loans, net	23,929	17,304
Proceeds from bank owned life insurance	458	2,639
(Redemption of) proceeds from FHLB stock, net	(2,122)	694
(Payments to) proceeds from the FDIC	(117)	1,701
Proceeds from sale of premises and equipment	507	29
Payments to acquire premises and equipment	(1,076)	(2,028)
Proceeds from sale of other real estate owned	981	2,130
Net cash provided by investing activities	21,198	37,638
Financing activities		

Increase in noninterest-bearing deposits, net	9,802	25,235
Decrease in interest-bearing deposits, net	(63,842)	(2,753)
Proceeds from (repayments of) securities sold under agreements to repurchase, net	65	(14,222)
Repayments of FHLB and other borrowings, net	(50,000)	(30,708)
Proceeds from stock options exercised	321	151
Payments for repurchase of treasury stock	(21,287)	(1,263)
Payments of common dividends	(17,675)	(8,504)
Net cash used in financing activities	(142,616)	(32,064)
Net (decrease) increase in cash and cash equivalents	(84,272)	28,812
Cash and cash equivalents at beginning of period	157,951	76,307
Cash and cash equivalents at end of period	$73,679	$105,119
Supplemental disclosure -- cash flow information		
Cash paid for interest	$6,447	$6,257
Cash paid for income taxes	4,800	12,942
Supplemental transactions -- noncash items		
Transfer of loans to other real estate owned	4,135	1,282
Loans originated to finance other real estate owned	92	-
(Increase) decrease in accumulated other comprehensive loss	(1,977)	1,944

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1. Basis of Presentation

General

First Community Bankshares, Inc. (the “Company”), a financial holding company, was incorporated under the laws of the Commonwealth of Virginia in 2018. The Company is the successor to First Community Bancshares, Inc., a Nevada corporation, pursuant to an Agreement and Plan of Reincorporation and Merger, the sole purpose of which was to change the Company’s state of incorporation from Nevada to Virginia. The reincorporation was completed on October 2, 2018. The Company’s principal executive office is located at One Community Place, Bluefield, Virginia. The Company provides banking products and services to individual and commercial customers through its wholly owned subsidiary First Community Bank (the “Bank”), a Virginia-chartered banking institution founded in 1874. The Bank operates as First Community Bank in Virginia, West Virginia, and North Carolina and People’s Community Bank, a Division of First Community Bank, in Tennessee. The Bank provides insurance services through its wholly owned subsidiary First Community Insurance Services (“FCIS”) and offers wealth management and investment advice through its Trust Division and wholly owned subsidiary First Community Wealth Management (“FCWM”). Unless the context suggests otherwise, the terms “First Community,” “Company,” “we,” “our,” and “us” refer to First Community Bankshares, Inc. and its subsidiaries as a consolidated entity.

On September 17, 2018, the Company announced its intention to sell its remaining insurance agency assets to Bankers Insurance, LLC (“BI”) of Glen Allen, Virginia in exchange for an equity interest in BI. The sale, which closed October 1, 2018, strategically allows the Company to continue offering insurance products to its customers through a larger, more diversified insurance agency. In connection with the decision to divest the insurance agency assets, the Company recognized a one-time goodwill impairment charge of $1.49 million during the third quarter of 2018. The Company used the fair value of the equity interest in BI as the basis for determining the goodwill impairment.

Principles of Consolidation

The Company’s accounting and reporting policies conform with U.S. generally accepted accounting principles (“GAAP”) and prevailing practices in the banking industry. The consolidated financial statements include all accounts of the Company and its wholly owned subsidiaries and eliminate all intercompany balances and transactions. The Company operates in one business segment, Community Banking, which consists of all operations, including commercial and consumer banking, lending activities, wealth management, and insurance services. Operating results for interim periods are not necessarily indicative of results that may be expected for other interim periods or for the full year. In management's opinion, the accompanying unaudited interim condensed consolidated financial statements contain all necessary adjustments, including normal recurring accruals, and disclosures for a fair presentation.

These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 (the "2017 Form 10-K"), as filed with the Securities and Exchange Commission (the "SEC") on March 5, 2018. The condensed consolidated balance sheet as of December 31, 2017, has been derived from the audited consolidated financial statements.

Reclassifications

Certain amounts reported in prior years have been reclassified to conform to the current year's presentation. These reclassifications had no effect on the Company's results of operations, financial position, or net cash flow.

Use of Estimates

Preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that require the most subjective or complex judgments relate to fair value measurements, investment securities, the allowance for loan losses, goodwill and other intangible assets, and income taxes. A discussion of the Company's application of critical accounting estimates is included in "Critical Accounting Estimates" in Item 2 of this report.

Table of Contents

Significant Accounting Policies

A complete and detailed description of the Company's significant accounting policies is included in Note 1, "Basis of Presentation," of the Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2018, and in Note 1, "Basis of Presentation and Significant Accounting Policies," of the Notes to Consolidated Financial Statements in Part II, Item 8 of the Company's 2017 Form 10-K.

Recent Accounting Standards

Standards Adopted in 2018

In May 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Updated ("ASU") 2017-09, "Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting." This ASU clarifies when to account for a change to the terms or conditions of a share-based payment award as a modification. Under the new guidance, modification accounting is required only if the fair value, the vesting conditions, or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions. The Company adopted ASU 2017-09 in the first quarter of 2018. The adoption of the standard did not have a material effect on the Company's financial statements.

In March 2017, the FASB issued ASU 2017-08, "Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Securities." This ASU amends the amortization period for certain purchased callable debt securities. The Company early adopted ASU 2017-08 in the first quarter of 2018. The adoption of the standard did not have a material effect on the Company's financial statements since securities held at a premium were already being amortized to the earliest call date.

In March 2017, the FASB issued ASU 2017-07, "Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." This ASU intends to improve the presentation of net periodic pension cost and net periodic postretirement benefit costs in the income statement and to narrow the amounts eligible for capitalization in assets. The Company adopted ASU 2017-07 in the first quarter of 2018. The adoption of the standard did not have a material effect on the Company's financial statements. In accordance with the standard, the Company reclassified the non-service components of the net periodic benefit costs from salaries and employee benefits to other expense on a retrospective basis, which totaled $136 thousand for the three months ended September 30, 2017, and $407 thousand for the nine months ended September 30, 2017.

In November 2016, the FASB issued ASU 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash." This ASU requires that a statement of cash flows explains the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The Company adopted ASU 2016-18 in the first quarter of 2018. The adoption of the standard did not have a material effect on the Company's financial statements.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments." This ASU makes eight targeted changes to how cash receipts and cash payments are presented and classified in the statement of cash flows. The update should be applied on a retrospective basis, if practicable. The Company adopted ASU 2016-15 in the first quarter of 2018. The adoption of the standard did not have a material effect on the Company's financial statements. In accordance with the standard, the Company reclassified proceeds from bank owned life insurance from operating activities to investing activities on a retrospective basis, which totaled $2.64 million for the nine months ended September 30, 2017.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." This ASU significantly revises how entities account and disclose financial assets and liabilities. The guidance (1) requires most equity investments to be measured at fair value with changes in fair value recognized in net income; (2) simplifies the impairment assessment of equity investments without a readily determinable fair value; (3) eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost on the balance sheet; (4) requires public business entities to use exit price notion, rather than entry prices, when measuring fair value of financial instruments for disclosure purposes; (5) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial assets on the balance sheet or the accompanying notes to the financial statements; (6) requires separate presentation in other comprehensive income of the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; and (7) states that a valuation allowance on deferred tax assets related to available-for-sale securities should be evaluated in combination with other deferred tax assets. In February 2018, the FASB issued ASU 2018-03, which included technical corrections and improvements to clarify the guidance in ASU 2016-01. The Company adopted ASU 2016-01 in the first quarter of 2018. The adoption of the standard did not have a material effect on the Company's financial statements. In accordance with the prospective application of the standard, the Company measured the fair value of loans using an exit price notion as of March 31, 2018. For additional information, see Note 13, "Fair Value" to the Condensed Consolidated Financial Statements of this report.

Table of Contents

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers (Topic 606).” This ASU’s core principle is that an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under existing guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. In August 2015, the FASB issued ASU 2015-14, “Revenue from Contracts with Customers” deferring the effective date of ASU 2014-09 for the Company until fiscal years beginning after December 15, 2017, with early adoption permitted for fiscal years beginning after December 15, 2016. The Company adopted Topic 606, and related updates, in the first quarter of 2018 using the modified retrospective method. The Company’s primary source of revenue is interest income, which is excluded from the scope of this guidance; however, the Company evaluated the impact on other income; which includes fees for services, commissions on sales, and various deposit service charges; revenue contracts; and disclosures and determined that no cumulative-effect adjustment to retained earnings was necessary. The adoption of the standard did not have a material effect on the Company’s financial statements.

Revenue Recognition

Accounting Standards Codification Topic 606 (“ASC 606”), “Revenue from Contracts with Customers,” establishes principles for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the Company's contracts to provide goods or services to customers. The core principle requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it expects to be entitled to receive in exchange for those goods or services recognized as performance obligations are satisfied.

The great majority of the Company’s revenue-generating transactions are not subject to ASC 606, including revenue generated from financial instruments, such as loans, letters of credit, and derivatives and investment securities, as these activities are subject to other GAAP discussed elsewhere within our disclosures. Descriptions of the Company’s revenue-generating activities that are within the scope of ASC 606, which are discussed below, are presented in the Company’s consolidated statements of income as components of noninterest income.

Wealth management. Wealth management income represents monthly fees due from wealth management customers as consideration for managing the customers' assets. Wealth management and trust services include custody of assets, investment management, escrow services, fees for trust services and similar fiduciary activities. Revenue is recognized when the performance obligation is completed each month, which is generally the time that payment is received. Income also includes fees received from a third party broker-dealer as part of a revenue-sharing agreement for fees earned from customers that are referred to the third party. These fees are paid to the Company by the third party on a quarterly basis and recognized ratably throughout the quarter as the performance obligation is satisfied.

Service charges on deposits and other service charges and fees. Service charges on deposits and other service charges and fees represent general service fees for account maintenance and activity and transaction-based fees that consist of transaction-based revenue, time-based revenue (service period), item-based revenue, or some other individual attribute-based revenue. Revenue is recognized when the performance obligation is completed, which is generally monthly for account maintenance services or when a transaction has been completed. Payment for such performance obligations is generally received at the time the performance obligations are satisfied. Other service charges and fees include interchange income from debit and credit card transaction fees. In accordance with the adoption of ASC 606, the Company reclassified interchange expense, which was previously a component of noninterest expense, to net against interchange income on a retrospective basis, which totaled $432 thousand for the three months ended September 30, 2017, and $1.23 million for the nine months ended September 30, 2017.

Other operating income. Other operating income consists primarily of third-party incentive payments, income on life insurance contracts, and dividends received, which are not subject to the requirements of ASC 606.

Standards Not Yet Adopted

In July 2018, the FASB issued ASU 2018-09, "Codification Improvements." This ASU makes changes to a variety of topics to clarify, correct errors in, or make minor improvements to the Accounting Standards Codification. The majority of the amendments in ASU 2018-09 will be effective for the Company for fiscal years beginning after December 15, 2018. The Company expects to adopt ASU 2018-09 in the first quarter of 2019. The Company is evaluating the impact of the standard and does not expect the guidance to have a material effect on its financial statements.

In August 2017, the FASB issued ASU 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities." This ASU intends to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements and simplify the application of hedge accounting guidance. ASU 2017-12 will be effective for the Company for fiscal years beginning after December 15, 2018. The Company expects to adopt ASU 2017-12 in the first quarter of 2019. The Company is evaluating the impact of the standard and does not expect the guidance to have a material effect on its financial statements.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." This ASU intends to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. This ASU requires an organization to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. In addition, the update amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 will be effective for the Company for fiscal years beginning after December 15, 2019, with early adoption permitted for fiscal years beginning after December 15, 2018. The Company expects to adopt ASU 2016-13 in the first quarter of 2020 and recognize a cumulative adjustment to retained earnings as of the beginning of the year of adoption. The Company is evaluating the impact of the standard.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." This ASU increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and requiring more disclosures related to leasing transactions. In July 2018, the FASB issued ASU 2018-10, "Codification Improvements to Topic 842, Leases," which updates narrow aspects of the guidance issued in ASU 2016-02. ASU 2016-02 will be effective for the Company for fiscal years beginning after December 15, 2018, with early adoption permitted. The Company expects to adopt ASU 2016-02 in the first quarter of 2019. The Company leases certain banking offices under lease agreements it classifies as operating leases. The Company is evaluating the impact of the standard and expects an increase in assets and liabilities; however, the Company does not expect the guidance to have a material effect on its financial statements or resulting operations.

The Company does not expect other recent accounting standards issued by the FASB or other standards-setting bodies to have a material impact on the consolidated financial statements.

Note 2. Debt Securities

The following tables present the amortized cost and fair value of available-for-sale debt securities, including gross unrealized gains and losses, as of the dates indicated:

	September 30, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
(Amounts in thousands)				
U.S. Agency securities	$1,137	$ 4	$ -	$1,141
U.S. Treasury securities	29,910	-	(22)	29,888
Municipal securities	97,857	766	(1,112)	97,511
Mortgage-backed Agency securities	36,263	15	(1,225)	35,053
Total	$165,167	$ 785	$ (2,359)	$163,593

	December 31, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
(Amounts in thousands)				
U.S. Agency securities	$11,289	$ 17	$ (10)	$11,296
U.S. Treasury securities	19,987	-	(16)	19,971
Municipal securities	101,552	2,203	(107)	103,648
Single issue trust preferred securities	9,367	-	(483)	8,884
Mortgage-backed Agency securities	22,095	46	(415)	21,726
Total	$164,290	$ 2,266	$ (1,031)	$165,525

Table of Contents

The following tables present the amortized cost and fair value of held-to-maturity debt securities, including gross unrealized gains and losses, as of the dates indicated:

	September 30, 2018			
	Amortized Cost	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**
(Amounts in thousands)				
U.S. Agency securities	$17,900	$ -	$ (53)	$17,847
Corporate securities	7,147	-	(15)	7,132
Total	$25,047	$ -	$ (68)	$24,979

	December 31, 2017			
	Amortized Cost	**Unrealized Gains**	**Unrealized Losses**	**Fair Value**
(Amounts in thousands)				
U.S. Agency securities	$17,937	$ -	$ (49)	$17,888
Corporate securities	7,212	-	(16)	7,196
Total	$25,149	$ -	$ (65)	$25,084

The following table presents the amortized cost and aggregate fair value of available-for-sale debt securities and held-to-maturity debt securities, by contractual maturity, as of the date indicated. Actual maturities could differ from contractual maturities because issuers may have the right to call or prepay obligations with or without penalties.

	September 30, 2018	
(Amounts in thousands)	**Amortized Cost**	**Fair Value**
Available-for-sale debt securities		
Due within one year	$29,910	$29,888
Due after one year but within five years	11,547	11,644
Due after five years but within ten years	86,662	86,226
Due after ten years	785	782
	128,904	128,540
Mortgage-backed securities	36,263	35,053
Total debt securities available for sale	$165,167	$163,593
Held-to-maturity debt securities		
Due within one year	$25,047	$24,979
Due after one year but within five years	-	-
Due after five years but within ten years	-	-
Due after ten years	-	-
Total debt securities held to maturity	$25,047	$24,979

The following tables present the fair values and unrealized losses for available-for-sale debt securities in a continuous unrealized loss position for less than 12 months and for 12 months or longer as of the dates indicated:

	September 30, 2018					
	Less than 12 Months		**12 Months or Longer**		**Total**	
	Fair Value	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
(Amounts in thousands)						
U.S. Treasury securities	$29,888	$ (22)	$-	$ -	$29,888	$ (22)
Municipal securities	26,034	(720)	6,938	(392)	32,972	(1,112)
Mortgage-backed Agency securities	20,213	(369)	13,062	(856)	33,275	(1,225)
Total	$76,135	$ (1,111)	$20,000	$ (1,248)	$96,135	$ (2,359)

Table of Contents

	December 31, 2017					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(Amounts in thousands)						
U.S. Agency securities	$10,054	$ (10)	$-	$ -	$10,054	$ (10)
U.S. Treasury securities	19,972	(16)	-	-	19,972	(16)
Municipal securities	8,047	(55)	2,314	(52)	10,361	(107)
Single issue trust preferred securities	-	-	8,884	(483)	8,884	(483)
Mortgage-backed Agency securities	4,276	(25)	14,069	(390)	18,345	(415)
Total	$42,349	$ (106)	$25,267	$ (925)	$67,616	$ (1,031)

The following tables present the fair values and unrealized losses for held-to-maturity debt securities in a continuous unrealized loss position for less than 12 months and for 12 months or longer as of the dates indicated:

	September 30, 2018					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(Amounts in thousands)						
U.S. Agency securities	$14,104	$ (41)	$3,743	$ (12)	$17,847	$ (53)
Corporate securities	3,746	(5)	3,386	(10)	7,132	(15)
Total	$17,850	$ (46)	$7,129	$ (22)	$24,979	$ (68)

	December 31, 2017					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(Amounts in thousands)						
U.S. Agency securities	$17,888	$ (49)	$ -	$ -	$17,888	$ (49)
Corporate securities	7,196	(16)	-	-	7,196	(16)
Total	$25,084	$ (65)	$ -	$ -	$25,084	$ (65)

There were 116 individual debt securities in an unrealized loss position as of September 30, 2018, and their combined depreciation in value represented 1.29% of the debt securities portfolio. There were 45 individual debt securities in an unrealized loss position as of December 31, 2017, and their combined depreciation in value represented 0.57% of the debt securities portfolio.

The Company reviews its investment portfolio quarterly for indications of other-than-temporary impairment ("OTTI"). The initial indicator of OTTI for debt securities is a decline in fair value below book value and the severity and duration of the decline. The credit-related OTTI is recognized as a charge to noninterest income and the noncredit-related OTTI is recognized in other comprehensive income ("OCI"). During the three and nine months ended September 30, 2018 and 2017, the Company incurred no OTTI charges on debt securities. Temporary impairment on debt securities is primarily related to changes in benchmark interest rates, changes in pricing in the credit markets, and other current economic factors.

The following table presents gross realized gains and losses from the sale of available-for-sale debt securities for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
(Amounts in thousands)				
Gross realized gains	$ -	$ -	$ -	$ -
Gross realized losses	(618)	-	(618)	(657)
Net loss on sale of securities	$ (618)	$ -	$ (618)	$ (657)

The carrying amount of securities pledged for various purposes totaled $37.79 million as of September 30, 2018, and $51.34 million as of December 31, 2017.

Table of Contents

Note 3. Loans

The Company groups loans held for investment into three segments (commercial loans, consumer real estate loans, and consumer and other loans) with each segment divided into various classes. Covered loans are those loans acquired in Federal Deposit Insurance Corporation ("FDIC") assisted transactions that are covered by loss share agreements. Customer overdrafts reclassified as loans totaled $1.83 million as of September 30, 2018, and $1.71 million as of December 31, 2017. Deferred loan fees, net of loan costs, totaled $4.64 million as of September 30, 2018, and $4.44 million as of December 31, 2017. For information about off-balance sheet financing, see Note 14, "Litigation, Commitments, and Contingencies," to the Condensed Consolidated Financial Statements of this report.

The following table presents loans, net of unearned income, with the non-covered portfolio by loan class, as of the dates indicated:

	September 30, 2018		**December 31, 2017**	
(Amounts in thousands)	**Amount**	**Percent**	**Amount**	**Percent**
Non-covered loans held for investment				
Commercial loans				
Construction, development, and other land	$62,657	3.50 %	$60,017	3.30 %
Commercial and industrial	105,603	5.90 %	92,188	5.07 %
Multi-family residential	112,710	6.29 %	125,202	6.89 %
Single family non-owner occupied	142,591	7.96 %	141,670	7.80 %
Non-farm, non-residential	606,800	33.88 %	616,633	33.93 %
Agricultural	9,016	0.50 %	7,035	0.39 %
Farmland	20,872	1.17 %	25,649	1.41 %
Total commercial loans	1,060,249	59.20 %	1,068,394	58.79 %
Consumer real estate loans				
Home equity lines	96,819	5.41 %	103,205	5.68 %
Single family owner occupied	520,363	29.05 %	502,686	27.66 %
Owner occupied construction	17,889	1.00 %	39,178	2.16 %
Total consumer real estate loans	635,071	35.46 %	645,069	35.50 %
Consumer and other loans				
Consumer loans	69,974	3.91 %	70,772	3.89 %
Other	5,132	0.29 %	5,001	0.28 %
Total consumer and other loans	75,106	4.20 %	75,773	4.17 %
Total non-covered loans	1,770,426	98.86 %	1,789,236	98.46 %
Total covered loans	20,483	1.14 %	27,948	1.54 %
Total loans held for investment, net of unearned income	$1,790,909	100.00 %	$1,817,184	100.00 %

The following table presents the covered loan portfolio, by loan class, as of the dates indicated:

	September 30, 2018	**December 31, 2017**
(Amounts in thousands)		
Covered loans		
Commercial loans		
Construction, development, and other land	$ 35	$ 39
Single family non-owner occupied	245	284
Non-farm, non-residential	7	9
Total commercial loans	287	332
Consumer real estate loans		
Home equity lines	16,804	23,720
Single family owner occupied	3,392	3,896
Total consumer real estate loans	20,196	27,616
Total covered loans	$ 20,483	$ 27,948

The Company identifies certain purchased loans as impaired when fair values are established at acquisition and groups those purchased credit impaired (“PCI”) loans into loan pools with common risk characteristics. The Company estimates cash flows to be collected on PCI loans and discounts those cash flows at a market rate of interest.

Table of Contents

The following table presents the recorded investment and contractual unpaid principal balance of PCI loans, by acquisition, as of the dates indicated:

	September 30, 2018		December 31, 2017	
(Amounts in thousands)	**Recorded Investment**	**Unpaid Principal Balance**	**Recorded Investment**	**Unpaid Principal Balance**
PCI Loans, by acquisition				
Peoples	$5,420	$ 7,546	$5,278	$ 8,111
Waccamaw	7,354	22,930	12,176	31,335
Other acquired	899	925	986	1,012
Total PCI Loans	$13,673	$ 31,401	$18,440	$ 40,458

The following table presents the changes in the accretable yield on PCI loans, by acquisition, during the periods indicated:

	Peoples	**Waccamaw**	**Total**
(Amounts in thousands)			
Balance January 1, 2017	$4,392	$ 21,834	$26,226
Accretion	(969)	(4,690)	(5,659)
Reclassifications from nonaccretable difference[1]	782	2,525	3,307
Other changes, net	(375)	(311)	(686)
Balance September 30, 2017	$3,830	$ 19,358	$23,188
Balance January 1, 2018	$3,388	$ 19,465	$22,853
Accretion	(986)	(4,157)	(5,143)
Reclassifications (to) from nonaccretable difference[1]	(5)	1,416	1,411
Other changes, net	354	(302)	52
Balance September 30, 2018	$2,751	$ 16,422	$19,173

(1) Represents changes attributable to expected loss assumptions

Note 4. Credit Quality

The Company uses a risk grading matrix to assign a risk grade to each loan in its portfolio. Loan risk ratings may be upgraded or downgraded to reflect current information identified during the loan review process. The general characteristics of each risk grade are as follows:

Pass -- This grade is assigned to loans with acceptable credit quality and risk. The Company further segments this grade based on borrower characteristics that include capital strength, earnings stability, liquidity, leverage, and industry conditions.
Special Mention -- This grade is assigned to loans that require an above average degree of supervision and attention. These loans have the characteristics of an asset with acceptable credit quality and risk; however, adverse economic or financial conditions exist that create potential weaknesses deserving of management's close attention. If potential weaknesses are not corrected, the prospect of repayment may worsen.
Substandard -- This grade is assigned to loans that have well defined weaknesses that may make payment default, or principal exposure, possible. These loans will likely be dependent on collateral liquidation, secondary repayment sources, or events outside the normal course of business to meet repayment terms.
Doubtful -- This grade is assigned to loans that have the weaknesses inherent in substandard loans; however, the weaknesses are so severe that collection or liquidation in full is unlikely based on current facts, conditions, and values. Due to certain specific pending factors, the amount of loss cannot yet be determined.
Loss -- This grade is assigned to loans that will be charged off or charged down when payments, including the timing and value of payments, are uncertain. This risk grade does not imply that the asset has no recovery or salvage value, but simply means that it is not practical or desirable to defer writing off, either all or a portion of, the loan balance even though partial recovery may be realized in the future.

Table of Contents

The following tables present the recorded investment of the loan portfolio, by loan class and credit quality, as of the dates indicated. Losses on covered loans are generally reimbursable by the FDIC at the applicable loss share percentage, 80%; therefore, covered loans are disclosed separately.

	September 30, 2018					
(Amounts in thousands)	**Pass**	**Special Mention**	**Substandard**	**Doubtful**	**Loss**	**Total**
Non-covered loans						
Commercial loans						
Construction, development, and other land	$60,665	$800	$ 1,192	$ -	$ -	$62,657
Commercial and industrial	102,590	2,187	826	-	-	105,603
Multi-family residential	106,488	4,077	2,145	-	-	112,710
Single family non-owner occupied	133,820	4,500	4,271	-	-	142,591
Non-farm, non-residential	588,273	8,556	9,825	146	-	606,800
Agricultural	8,716	198	102	-	-	9,016
Farmland	18,427	626	1,819	-	-	20,872
Consumer real estate loans						
Home equity lines	94,401	648	1,770	-	-	96,819
Single family owner occupied	491,179	4,562	24,622	-	-	520,363
Owner occupied construction	17,588	-	301	-	-	17,889
Consumer and other loans						
Consumer loans	69,611	5	354	-	4	69,974
Other	5,132	-	-	-	-	5,132
Total non-covered loans	1,696,890	26,159	47,227	146	4	1,770,426
Covered loans						
Commercial loans						
Construction, development, and other land	-	35	-	-	-	35
Single family non-owner occupied	230	-	15	-	-	245
Non-farm, non-residential	-	-	7	-	-	7
Consumer real estate loans						
Home equity lines	9,864	6,329	611	-	-	16,804
Single family owner occupied	2,610	372	410	-	-	3,392
Total covered loans	12,704	6,736	1,043	-	-	20,483
Total loans	$1,709,594	$32,895	$ 48,270	$ 146	$ 4	$1,790,909

Table of Contents

	December 31, 2017					
(Amounts in thousands)	**Pass**	**Special Mention**	**Substandard**	**Doubtful**	**Loss**	**Total**
Non-covered loans						
Commercial loans						
Construction, development, and other land	$57,768	$1,367	$ 882	$ -	$ -	$60,017
Commercial and industrial	87,181	3,721	1,286	-	-	92,188
Multi-family residential	118,509	5,663	1,030	-	-	125,202
Single family non-owner occupied	130,689	7,271	3,710	-	-	141,670
Non-farm, non-residential	596,616	12,493	7,351	173	-	616,633
Agricultural	6,639	294	102	-	-	7,035
Farmland	22,875	210	2,564	-	-	25,649
Consumer real estate loans						
Home equity lines	100,833	618	1,754	-	-	103,205
Single family owner occupied	471,382	5,480	25,824	-	-	502,686
Owner occupied construction	38,947	-	231	-	-	39,178
Consumer and other loans						
Consumer loans	70,448	13	311	-	-	70,772
Other	5,001	-	-	-	-	5,001
Total non-covered loans	1,706,888	37,130	45,045	173	-	1,789,236
Covered loans						
Commercial loans						
Construction, development, and other land	1	38	-	-	-	39
Single family non-owner occupied	265	-	19	-	-	284
Non-farm, non-residential	-	-	9	-	-	9
Consumer real estate loans						
Home equity lines	11,338	11,685	697	-	-	23,720
Single family owner occupied	2,996	411	489	-	-	3,896
Total covered loans	14,600	12,134	1,214	-	-	27,948
Total loans	$1,721,488	$49,264	$ 46,259	$ 173	$ -	$1,817,184

The Company identifies loans for potential impairment through a variety of means, including, but not limited to, ongoing loan review, renewal processes, delinquency data, market communications, and public information. If the Company determines that it is probable all principal and interest amounts contractually due will not be collected, the loan is generally deemed impaired.

Table of Contents

The following table presents the recorded investment, unpaid principal balance, and related allowance for loan losses for impaired loans, excluding PCI loans, as of the dates indicated:

	September 30, 2018			December 31, 2017		
(Amounts in thousands)	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**
Impaired loans with no related allowance						
Commercial loans						
Construction, development, and other land	$ 903	$ 918	$ -	$ 727	$ 988	$ -
Commercial and industrial	300	321	-	315	1,142	-
Multi-family residential	1,380	1,445	-	499	1,010	-
Single family non-owner occupied	2,448	2,782	-	2,042	3,521	-
Non-farm, non-residential	3,859	4,759	-	3,022	5,955	-
Agricultural	102	107	-	102	107	-
Farmland	1,404	1,478	-	395	414	-
Consumer real estate loans						
Home equity lines	1,451	1,589	-	1,621	1,770	-
Single family owner occupied	14,963	17,868	-	16,633	18,964	-
Owner occupied construction	227	227	-	231	231	-
Consumer and other loans						
Consumer loans	203	209	-	141	144	-
Total impaired loans with no allowance	27,240	31,703	-	25,728	34,246	-
Impaired loans with a related allowance						
Commercial loans						
Commercial and industrial	-	-	-	343	343	270
Multi-family residential	536	536	235	-	-	-
Single family non-owner occupied	842	842	238	446	446	62
Non-farm, non-residential	-	-	-	262	263	15
Farmland	410	418	158	936	974	233
Consumer real estate loans						
Home equity lines	65	68	66	-	-	-
Single family owner occupied	4,907	4,951	1,017	5,586	5,606	1,978
Total impaired loans with an allowance	6,760	6,815	1,714	7,573	7,632	2,558
Total impaired loans[1]	$ 34,000	$ 38,518	$ 1,714	$ 33,301	$ 41,878	$ 2,558

(1) Total impaired loans include loans totaling $25.42 million as of September 30, 2018, and $20.13 million as of December 31, 2017, that do not meet the Company's evaluation threshold for individual impairment and are therefore collectively evaluated for impairment. During the first quarter of 2018, the Company changed the threshold for quarterly reviews of individual loans that are deemed to be impaired from $250 thousand to $500 thousand or greater.

Table of Contents

The following table presents the average recorded investment and interest income recognized on impaired loans, excluding PCI loans, for the periods indicated:

(Amounts in thousands)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2018		2017		2018		2017	
	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment
Impaired loans with no related allowance:								
Commercial loans								
Construction, development, and other land	$ -	$ 910	$ 32	$ 907	$ 14	$ 950	$ 32	$ 309
Commercial and industrial	3	311	5	754	6	378	8	468
Multi-family residential	5	1,402	-	509	15	832	3	474
Single family non-owner occupied	8	2,529	11	3,304	56	2,599	88	3,313
Non-farm, non-residential	-	3,926	68	5,244	39	5,028	93	3,766
Agricultural	-	103	4	127	-	187	4	127
Farmland	23	1,425	17	1,003	38	1,066	17	1,004
Consumer real estate loans								
Home equity lines	3	1,514	15	1,683	20	1,719	35	1,259
Single family owner occupied	15	15,832	137	17,478	208	15,222	317	15,209
Owner occupied construction	-	229	1	235	6	249	6	234
Consumer and other loans								
Consumer loans	-	210	1	62	6	164	3	52
Total impaired loans with no related allowance	57	28,391	291	31,306	408	28,394	606	26,215
Impaired loans with a related allowance:								
Commercial loans								
Construction, development, and other land	-	-	-	-	-	-	-	143
Commercial and industrial	-	-	50	2,516	-	-	103	1,727
Multi-family residential	-	541	-	-	-	271	-	-
Single family non-owner occupied	-	849	8	778	7	644	21	488
Non-farm, non-residential	-	-	-	872	-	770	15	964
Farmland	-	413	-	413	-	409	-	275
Consumer real estate loans								
Home equity lines	1	67	-	-	3	69	-	139
Single family owner occupied	35	4,999	24	3,814	126	5,838	92	4,527
Owner occupied construction	-	-	-	-	-	-	-	1
Total impaired loans with a related allowance	36	6,869	82	8,393	136	8,001	231	8,264
Total impaired loans	$ 93	$ 35,260	$ 373	$ 39,699	$ 544	$ 36,395	$ 837	$ 34,479

There were no impaired PCI loan pools as of September 30, 2018, or December 31, 2017. The following table provides information on impaired PCI loan pools for the dates indicated:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2018	**2017**	**2018**	**2017**
(Amounts in thousands)				
Interest income recognized	$ -	$ -	$ -	$ 20
Average recorded investment	-	-	-	705

Table of Contents

The Company generally places a loan on nonaccrual status when it is 90 days or more past due. PCI loans are generally not classified as nonaccrual due to the accrual of interest income under the accretion method of accounting. The following table presents nonaccrual loans, by loan class, as of the dates indicated:

	September 30, 2018			**December 31, 2017**		
(Amounts in thousands)	**Non-covered**	**Covered**	**Total**	**Non-covered**	**Covered**	**Total**
Commercial loans						
Construction, development, and other land	$485	$ -	$485	$-	$ -	$-
Commercial and industrial	284	-	284	211	-	211
Multi-family residential	1,861	-	1,861	498	-	498
Single family non-owner occupied	1,328	15	1,343	851	19	870
Non-farm, non-residential	3,960	-	3,960	2,448	-	2,448
Agricultural	102	-	102	102	-	102
Farmland	1,055	-	1,055	805	-	805
Consumer real estate loans						
Home equity lines	758	277	1,035	882	306	1,188
Single family owner occupied	10,574	38	10,612	13,108	17	13,125
Consumer and other loans						
Consumer loans	135	-	135	92	-	92
Total nonaccrual loans	$20,542	$ 330	$20,872	$18,997	$ 342	$19,339

The following tables present the aging of past due loans, by loan class, as of the dates indicated. Nonaccrual loans 30 days or more past due are included in the applicable delinquency category. Loans acquired with credit deterioration, with a discount, continue to accrue interest based on expected cash flows; therefore, PCI loans are not generally considered nonaccrual. Non-covered accruing loans contractually past due 90 days or more totaled $46 thousand as of September 30, 2018, compared to $1 thousand as of December 31, 2017.

	September 30, 2018					
(Amounts in thousands)	**30 - 59 Days Past Due**	**60 - 89 Days Past Due**	**90+ Days Past Due**	**Total Past Due**	**Current Loans**	**Total Loans**
Non-covered loans						
Commercial loans						
Construction, development, and other land	$87	$-	$478	$565	$62,092	$62,657
Commercial and industrial	174	260	216	650	104,953	105,603
Multi-family residential	148	-	1,515	1,663	111,047	112,710
Single family non-owner occupied	762	281	881	1,924	140,667	142,591
Non-farm, non-residential	795	74	2,559	3,428	603,372	606,800
Agricultural	-	-	-	-	9,016	9,016
Farmland	201	321	410	932	19,940	20,872
Consumer real estate loans						
Home equity lines	379	199	499	1,077	95,742	96,819

Single family owner occupied	3,247	1,802	3,938	8,987	511,376	520,363
Owner occupied construction	90	-	-	90	17,799	17,889
Consumer and other loans						
Consumer loans	484	169	117	770	69,204	69,974
Other	-	-	-	-	5,132	5,132
Total non-covered loans	6,367	3,106	10,613	20,086	1,750,340	1,770,426
Covered loans						
Commercial loans						
Construction, development, and other land	-	-	-	-	35	35
Single family non-owner occupied	-	-	-	-	245	245
Non-farm, non-residential	-	-	-	-	7	7
Consumer real estate loans						
Home equity lines	184	239	26	449	16,355	16,804
Single family owner occupied	59	-	30	89	3,303	3,392
Total covered loans	243	239	56	538	19,945	20,483
Total loans	$6,610	$3,345	$10,669	$20,624	$1,770,285	$1,790,909

Table of Contents

	December 31, 2017					
(Amounts in thousands)	30 - 59 Days Past Due	60 - 89 Days Past Due	90+ Days Past Due	Total Past Due	Current Loans	Total Loans
Non-covered loans						
Commercial loans						
Construction, development, and other land	$20	$365	$-	$385	$59,632	$60,017
Commercial and industrial	232	40	142	414	91,774	92,188
Multi-family residential	544	-	185	729	124,473	125,202
Single family non-owner occupied	223	302	331	856	140,814	141,670
Non-farm, non-residential	2,433	383	1,536	4,352	612,281	616,633
Agricultural	123	-	-	123	6,912	7,035
Farmland	113	-	692	805	24,844	25,649
Consumer real estate loans						
Home equity lines	226	198	485	909	102,296	103,205
Single family owner occupied	6,959	2,418	8,186	17,563	485,123	502,686
Owner occupied construction	326	79	-	405	38,773	39,178
Consumer and other loans						
Consumer loans	439	97	17	553	70,219	70,772
Other	-	-	-	-	5,001	5,001
Total non-covered loans	11,638	3,882	11,574	27,094	1,762,142	1,789,236
Covered loans						
Commercial loans						
Construction, development, and other land	-	-	-	-	39	39
Single family non-owner occupied	-	-	-	-	284	284
Non-farm, non-residential	-	-	-	-	9	9
Consumer real estate loans						
Home equity lines	402	-	173	575	23,145	23,720
Single family owner occupied	70	-	-	70	3,826	3,896
Total covered loans	472	-	173	645	27,303	27,948
Total loans	$12,110	$3,882	$11,747	$27,739	$1,789,445	$1,817,184

The Company may make concessions in interest rates, loan terms and/or amortization terms when restructuring loans for borrowers experiencing financial difficulty. Restructured loans in excess of $250 thousand are evaluated for a specific reserve based on either the collateral or net present value method, whichever is most applicable. Restructured loans under $250 thousand are subject to the reserve calculation at the historical loss rate for classified loans. Certain TDRs are classified as nonperforming at the time of restructuring and are returned to performing status after six months of satisfactory payment performance; however, these loans remain identified as impaired until full payment or other satisfaction of the obligation occurs. PCI loans are generally not considered TDRs as long as the loans remain in the assigned loan pool. No covered loans were recorded as TDRs as of September 30, 2018, or December 31, 2017.

The following table presents loans modified as TDRs, by loan class and accrual status, as of the dates indicated:

(Amounts in thousands)	**September 30, 2018**			**December 31, 2017**		
	Nonaccrual (1)	**Accruing**	**Total**	**Nonaccrual (1)**	**Accruing**	**Total**
Commercial loans						
Single family non-owner occupied	$332	$ 311	$643	$364	$ 528	$892
Non-farm, non-residential	-	315	315	-	295	295
Consumer real estate loans						
Home equity lines	-	130	130	-	145	145
Single family owner occupied	1,881	6,124	8,005	1,565	6,496	8,061
Owner occupied construction	-	227	227	-	233	233
Consumer and other loans						
Consumer loans	-	35	35	-	37	37
Total TDRs	$2,213	$ 7,142	$9,355	$1,929	$ 7,734	$9,663
Allowance for loan losses related to TDRs			$632			$642

(1) Nonaccrual TDRs are included in total nonaccrual loans disclosed in the nonaccrual table above.

Table of Contents

The following table presents interest income recognized on TDRs for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
(Amounts in thousands)				
Interest income recognized	$ 73	$ 74	$ 207	$ 159

The following tables present loans modified as TDRs, by type of concession made and loan class, that were restructured during the periods indicated:

	Three Months Ended September 30,					
	2018			2017		
(Amounts in thousands)	Total Contracts	Pre-modification Recorded Investment	Post-modification Recorded Investment[1]	Total Contracts	Pre-modification Recorded Investment	Post-modification Recorded Investment[1]
Below market interest rate						
Single family owner occupied	1	$ 11	$ 11	-	$ -	$ -
Below market interest rate and extended payment term						
Single family owner occupied	-	-	-	1	42	42
Total	1	$ 11	$ 11	1	$ 42	$ 42

(1) Represents the loan balance immediately following modification

	Nine Months Ended September 30,					
	2018			2017		
(Amounts in thousands)	Total Contracts	Pre-modification Recorded	Post-modification Recorded	Total Contracts	Pre-modification Recorded	Post-modification Recorded

		Investment	Investment[1]		Investment	Investment[1]
Below market interest rate						
Single family owner occupied	1	$ 11	$ 11	-	$ -	$ -
Below market interest rate and extended payment term						
Single family owner occupied	1	41	41	3	141	141
Total	2	$ 52	$ 52	3	$ 141	$ 141

(1) Represents the loan balance immediately following modification

There were no payment defaults on loans modified as TDRs that were restructured within the previous 12 months as of September 30, 2018 or 2017.

The following table provides information about other real estate owned ("OREO"), which consists of properties acquired through foreclosure, as of the dates indicated:

	September 30, 2018	December 31, 2017
(Amounts in thousands)		
Non-covered OREO	$ 4,754	$ 2,409
Covered OREO	44	105
Total OREO	$ 4,798	$ 2,514
Non-covered OREO secured by residential real estate	$ 3,331	$ 2,209
Residential real estate loans in the foreclosure process[1]	7,129	9,921

(1) The recorded investment in consumer mortgage loans collateralized by residential real estate that are in the process of foreclosure according to local requirements of the applicable jurisdiction

23

Table of Contents

Note 5. Allowance for Loan Losses

The following tables present the changes in the allowance for loan losses, by loan segment, during the periods indicated. There was no allowance related to PCI loans as of September 30, 2018, or December 31, 2017.

	Three Months Ended September 30, 2018			
(Amounts in thousands)	Commercial	Consumer Real Estate	Consumer and Other	Total Allowance
Total allowance				
Beginning balance	$10,902	$ 7,867	$ 814	$ 19,583
(Recovery of) provision for loan losses charged to operations	(300)	376	419	495
Charge-offs	(201)	(1,598)	(378)	(2,177)
Recoveries	88	187	80	355
Net charge-offs	(113)	(1,411)	(298)	(1,822)
Ending balance	$10,489	$ 6,832	$ 935	$ 18,256

	Three Months Ended September 30, 2017			
(Amounts in thousands)	Commercial	Consumer Real Estate	Consumer and Other	Total Allowance
Allowance, excluding PCI				
Beginning balance	$12,283	$ 5,802	$ 793	$ 18,878
Provision for loan losses charged to operations	358	75	305	738
Charge-offs	(207)	(137)	(373)	(717)
Recoveries	170	67	70	307
Net charge-offs	(37)	(70)	(303)	(410)
Ending balance	$12,604	$ 5,807	$ 795	$ 19,206
PCI allowance				
Beginning balance	$-	$ 8	$ -	$ 8
Recovery of loan losses	-	(8)	-	(8)
Benefit attributable to the FDIC indemnification asset	-	-	-	-
Recovery of loan losses charged to operations	-	(8)	-	(8)
Recovery of loan losses recorded through the FDIC indemnification asset	-	-	-	-
Ending balance	$-	$ -	$ -	$ -
Total allowance				
Beginning balance	$12,283	$ 5,810	$ 793	$ 18,886

Provision for loan losses	358	67	305	730
Benefit attributable to the FDIC indemnification asset	-	-	-	-
Provision for loan losses charged to operations	358	67	305	730
Recovery of loan losses recorded through the FDIC indemnification asset	-	-	-	-
Charge-offs	(207)	(137)	(373)	(717)
Recoveries	170	67	70	307
Net charge-offs	(37)	(70)	(303)	(410)
Ending balance	$ 12,604	$ 5,807	$ 795	$ 19,206

24

Table of Contents

	Nine Months Ended September 30, 2018			
(Amounts in thousands)	Commercial	Consumer Real Estate	Consumer and Other	Total Allowance
Total allowance				
Beginning balance	$11,672	$ 6,810	$ 794	$ 19,276
(Recovery of) provision for loan losses charged to operations	(1,025)	1,519	991	1,485
Charge-offs	(670)	(1,853)	(1,102)	(3,625)
Recoveries	512	356	252	1,120
Net charge-offs	(158)	(1,497)	(850)	(2,505)
Ending balance	$10,489	$ 6,832	$ 935	$ 18,256

	Nine Months Ended September 30, 2017			
(Amounts in thousands)	Commercial	Consumer Real Estate	Consumer and Other	Total Allowance
Allowance, excluding PCI				
Beginning balance	$11,690	$ 5,487	$ 759	$ 17,936
Provision for loan losses charged to operations	822	561	785	2,168
Charge-offs	(493)	(535)	(948)	(1,976)
Recoveries	585	294	199	1,078
Net recoveries (charge-offs)	92	(241)	(749)	(898)
Ending balance	$12,604	$ 5,807	$ 795	$ 19,206
PCI allowance				
Beginning balance	$-	$ 12	$ -	$ 12
Recovery of loan losses	-	(12)	-	(12)
Benefit attributable to the FDIC indemnification asset	-	-	-	-
Recovery of loan losses charged to operations	-	(12)	-	(12)
Recovery of loan losses recorded through the FDIC indemnification asset	-	-	-	-
Ending balance	$-	$ -	$ -	$ -
Total allowance				
Beginning balance	$11,690	$ 5,499	$ 759	$ 17,948
Provision for loan losses	822	549	785	2,156
Benefit attributable to the FDIC indemnification asset	-	-	-	-
Provision for loan losses charged to operations	822	549	785	2,156
Recovery of loan losses recorded through the FDIC indemnification asset	-	-	-	-
Charge-offs	(493)	(535)	(948)	(1,976)
Recoveries	585	294	199	1,078
Net recoveries (charge-offs)	92	(241)	(749)	(898)
Ending balance	$12,604	$ 5,807	$ 795	$ 19,206

25

Table of Contents

The following tables present the allowance for loan losses and recorded investment in loans evaluated for impairment, excluding PCI loans, by loan class, as of the dates indicated:

	September 30, 2018			
(Amounts in thousands)	**Loans Individually Evaluated for Impairment**	**Allowance for Loans Individually Evaluated**	**Loans Collectively Evaluated for Impairment**	**Allowance for Loans Collectively Evaluated**
Commercial loans				
Construction, development, and other land	$ -	$ -	$ 62,053	$ 394
Commercial and industrial	-	-	105,597	587
Multi-family residential	536	235	112,174	987
Single family non-owner occupied	842	238	139,958	6,296
Non-farm, non-residential	582	-	602,017	1,363
Agricultural	-	-	9,016	89
Farmland	925	158	19,947	142
Total commercial loans	2,885	631	1,050,762	9,858
Consumer real estate loans				
Home equity lines	65	66	107,452	687
Single family owner occupied	5,627	1,017	517,450	4,938
Owner occupied construction	-	-	17,889	124
Total consumer real estate loans	5,692	1,083	642,791	5,749
Consumer and other loans				
Consumer loans	-	-	69,974	935
Other	-	-	5,132	-
Total consumer and other loans	-	-	75,106	935
Total loans, excluding PCI loans	$ 8,577	$ 1,714	$ 1,768,659	$ 16,542

	December 31, 2017			
(Amounts in thousands)	**Loans Individually Evaluated for Impairment**	**Allowance for Loans Individually Evaluated**	**Loans Collectively Evaluated for Impairment**	**Allowance for Loans Collectively Evaluated**
Commercial loans				
Construction, development, and other land	$ -	$ -	$ 59,386	$ 830
Commercial and industrial	343	270	91,845	492
Multi-family residential	-	-	125,202	1,094
Single family non-owner occupied	770	62	139,093	1,914
Non-farm, non-residential	1,367	15	611,477	6,582

Agricultural	-	-	7,035	51
Farmland	1,219	233	24,430	129
Total commercial loans	3,699	580	1,058,468	11,092
Consumer real estate loans				
Home equity lines	-	-	115,807	803
Single family owner occupied	9,471	1,978	496,348	3,732
Owner occupied construction	-	-	39,178	297
Total consumer real estate loans	9,471	1,978	651,333	4,832
Consumer and other loans				
Consumer loans	-	-	70,772	794
Other	-	-	5,001	-
Total consumer and other loans	-	-	75,773	794
Total loans, excluding PCI loans	$13,170	$ 2,558	$ 1,785,574	$ 16,718

Table of Contents

The following table presents the recorded investment in PCI loans and the allowance for loan losses on PCI loans, by loan pool, as of the dates indicated:

(Amounts in thousands)	September 30, 2018 Recorded Investment	September 30, 2018 Allowance for Loan Pools With Impairment	December 31, 2017 Recorded Investment	December 31, 2017 Allowance for Loan Pools With Impairment
Commercial loans				
Waccamaw commercial	$426	$ -	$64	$ -
Peoples commercial	4,476	-	4,279	-
Other	899	-	986	-
Total commercial loans	5,801	-	5,329	-
Consumer real estate loans				
Waccamaw serviced home equity lines	6,106	-	11,118	-
Waccamaw residential	822	-	994	-
Peoples residential	944	-	999	-
Total consumer real estate loans	7,872	-	13,111	-
Total PCI loans	$13,673	$ -	$18,440	$ -

Management believed the allowance was adequate to absorb probable loan losses inherent in the loan portfolio as of September 30, 2018.

Note 6. FDIC Indemnification Asset

In connection with the FDIC-assisted acquisition of Waccamaw Bank ("Waccamaw") in 2012, the Company entered into loss share agreements with the FDIC that covered $20.48 million of loans and $44 thousand of OREO as of September 30, 2018, compared to $27.95 million of loans and $105 thousand of OREO as of December 31, 2017. Under the loss share agreements, the FDIC agrees to cover 80% of most loan and foreclosed real estate losses and reimburse certain expenses incurred in relation to these covered assets. Loss share coverage expired June 30, 2017, for commercial loans, with recoveries continuing until June 30, 2019. Loss share coverage will expire June 30, 2022, for single family loans. The Company's consolidated statements of income include the expense on covered assets net of estimated reimbursements. The following table presents the changes in the FDIC indemnification asset during the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
(Amounts in thousands)				
Beginning balance	$6,390	$8,159	$7,161	$12,173
Increase in estimated losses on covered OREO	-	4	-	71
Reimbursable expenses (to) from the FDIC	(2)	47	(23)	108
Net amortization	(645)	(268)	(1,602)	(3,186)
(Reimbursements from) payments to the FDIC	(90)	(477)	117	(1,701)
Ending balance	$5,653	$7,465	$5,653	$7,465

27

Table of Contents

Note 7. Deposits

The following table presents the components of deposits as of the dates indicated:

	September 30, 2018	December 31, 2017
(Amounts in thousands)		
Noninterest-bearing demand deposits	$463,945	$454,143
Interest-bearing deposits:		
Interest-bearing demand deposits	459,376	465,407
Money market accounts	151,436	170,731
Savings deposits	343,685	342,064
Certificates of deposit	339,523	374,373
Individual retirement accounts	117,886	123,173
Total interest-bearing deposits	1,411,906	1,475,748
Total deposits	$1,875,851	$1,929,891

Note 8. Borrowings

The following table presents the components of borrowings as of the dates indicated:

	September 30, 2018		December 31, 2017	
(Amounts in thousands)	Balance	Weighted Average Rate	Balance	Weighted Average Rate
Short-term borrowings				