RIVIERA HOLDINGS CORP
Form 8-K
June 27, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934

Date of Report (Date of earliest event reported): June 27, 2002

RIVIERA HOLDINGS CORPORATION
(exact name of registrant as specified in its charter)

Nevada	000-21430	88-0296885
(State of Incorporation)	(Commission File Number)	(IRS Employer Identification No.)

2901 Las Vegas Boulevard Las Vegas, Nevada	89109
(Address of principal office)	(Zip code)
Registrant's Telephone number, including area code	(702) 794-9527

Item 5. Other Events

On June 27, 2002, Riviera Holdings Corporation (RHC) through a press release announced that the Commission of Jefferson County, Missouri has voted unanimously to endorse Riviera's application for a license to the Missouri Gaming Commission to construct and operate a casino in Jefferson County.

Item 7. Financial Statements, Pro Forma Financial Information and Exhibits

(a) Not Applicable

(b) Not Applicable

(c) Exhibits

Exhibit 99 Riviera Holdings Press Release dated June 27, 2002.

SIGNATURE

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

Dated: June 27, 2002 RIVIERA HOLDINGS CORPORATION

By: /s/ Duane Krohn
Treasurer and CFO

EXHIBIT INDEX

Exhibit Number	Description
99	Riviera Holdings Press Release dated June 27, 2002.

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Pass	$112,435	$323,300	$363,448	$47,254	$18,933	$23,308
Special Mention	1,413	12,147	21,088	764	-	-

Substandard

6,382 14,806 15,831 589 - -

Doubtful

- 42 - - - -

Total

$120,230 $350,295 $400,367 $48,607 $18,933 $23,308

The Company considers the performance of the loan portfolio and its impact on the allowance for loan losses. For consumer loan classes, the Company evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the consumer loans outstanding based on payment activity as of June 30, 2017 and December 31, 2016.

	June 30, 2017		December 31, 2016	
	Consumer		Consumer	
(In thousands)	Secured	Unsecured	Secured	Unsecured
Credit risk profile based on payment activity				
Performing	$4,173	$ 3,735	$4,550	$ 4,538
Nonperforming	11	307	4	143
Total	$4,184	$ 4,042	$4,554	$ 4,681

The Company evaluates the loan risk grading system definitions and allowance for loan loss methodology on an ongoing basis. During the first quarter of 2017, the Company shortened the look-back period it uses to determine historical loss rates to the previous twelve quarters from sixteen quarters. No other significant changes were made to the loan risk grading system definitions and allowance for loan loss methodology during the past year.

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8. Other Real Estate Owned

Other real estate owned ("OREO") was as follows for the dates indicated:

(In thousands)	June 30, 2017	December 31, 2016
Construction and land development	$4,808	$ 7,996
Residential real estate	460	871
Farmland and other commercial enterprises	919	1,806
Total	$6,187	$ 10,673

OREO activity for the six months ended June 30, 2017 and 2016 was as follows:

Six months ended June 30, (In thousands)	2017	2016
Beginning balance	$10,673	$21,843
Transfers from loans and other increases	345	1,474
Proceeds from sales	(4,553)	(5,527)
Gain (loss) on sales, net	72	(125)
Write downs and other decreases, net	(350)	(732)
Ending balance	$6,187	$16,933

At June 30, 2017, the Company had a total of $1.2 million of loans secured by residential real estate mortgages that were in the process of foreclosure.

9. Securities Sold under Agreements to Repurchase

Securities sold under agreements to repurchase represent transactions where the Company sells certain of its investment securities and agrees to repurchase them at a specific date in the future. Securities sold under agreements to repurchase are accounted for as secured borrowing and reflect the amount of cash received in connection with the transaction.

Securities sold under agreements to repurchase are collateralized by U.S. government agency securities, primarily mortgage-backed securities. The Company may be required to provide additional collateral securing the borrowings in the event of principal pay downs or a decrease in the market value of the pledged securities. The Company mitigates this risk by monitoring the market value and liquidity of the collateral and ensuring that it holds a sufficient level of eligible securities to cover potential increases in collateral requirements.

The following tables represent the remaining maturity of repurchase agreements disaggregated by the class of securities pledged as of the dates indicated.

	Remaining Contractual Maturity of the Agreements					
June 30, 2017 (In thousands)	Overnight/ Continuous	Less Than 30 Days	30-89 Days	90 Days to One Year	Over One Year to Three Years	Total
Obligations of U.S. government-sponsored entities	$-	$501	$-	$ -	$1,032	$1,533
Mortgage-backed securities – residential	30,134	702	200	-	-	31,036
Total	$30,134	$1,203	$200	$ -	$1,032	$32,569

	Remaining Contractual Maturity of the Agreements					
December 31, 2016 (In thousands)	Overnight/ Continuous	Less Than 30 Days	30-89 Days	90 Days to One Year	Over One Year to Three Years	Total
Obligations of U.S. government-sponsored entities	$5,596	$301	$ -	$258	$1,027	$7,182
Mortgage-backed securities – residential	28,086	902	-	200	-	29,188
Total	$33,682	$1,203	$ -	$458	$1,027	$36,370

10. Postretirement Medical Benefits

The Company provides lifetime medical and dental benefits upon retirement for certain employees meeting the eligibility requirements as of December 31, 1989 (“Plan 1”). Additional participants are not eligible to be included in Plan 1 unless they met the requirements on this date. During 2003, the Company implemented an additional postretirement health insurance program (“Plan 2”). Under Plan 2, any employee meeting the service requirement of 20 years of full time service to the Company and is at least age 55 upon retirement is eligible to continue their health insurance coverage. Under both plans, retirees not yet eligible for Medicare have coverage identical to the coverage offered to active employees. Under both plans, Medicare-eligible retirees are provided with a Medicare Advantage plan. The Company pays 100% of the cost of Plan 1. The Company and the retirees each pay 50% of the cost under Plan 2. Both plans are unfunded. Employees hired on or after January 1, 2016 are not eligible for benefits under Plan 2.

The following disclosures of the net periodic benefit cost components of Plan 1 and Plan 2 were measured at January 1, 2017 and 2016.

	Three months ended June 30,		Six months ended June 30,	
(In thousands)	2017	2016	2017	2016
Service cost	$137	$159	$283	$318
Interest cost	164	171	332	342
Curtailment gain recognized	-	-	(351)	-
Recognized prior service cost	-	12	8	25
Net periodic benefit cost	$301	$342	$272	$685

In connection with the merger of certain of its subsidiaries in February 2017, the Company recognized a curtailment gain of $351 thousand during the first quarter of 2017 as a result of revaluing its postretirement medical benefits plan liability due to a reduction in workforce. The gain is net of $67 thousand of prior service costs recognized due to the curtailment.

The Company expects benefit payments of $468 thousand for 2017, of which $172 thousand have been made during the first six months of 2017.

11. Regulatory Matters

The Company and its subsidiary bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements will initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, banks must meet specific capital guidelines that involve quantitative measures of the bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Company and its subsidiary bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The regulatory ratios of the consolidated Company and its subsidiary bank were as follows for the dates indicated:

	June 30, 2017				December 31, 2016			
	Common Equity Tier 1 Risk-based Capital[1]	Tier 1 Risk-based Capital[1]	Total Risk-based Capital[1]	Tier 1 Leverage[2]	Common Equity Tier 1 Risk-based Capital[1]	Tier 1 Risk-based Capital[1]	Total Risk-based Capital[1]	Tier 1 Leverage[2]
Consolidated	16.60 %	19.39 %	20.18 %	13.64 %	16.43 %	19.28 %	20.10 %	13.20 %
United Bank & Capital Trust Company	14.76	14.76	15.55	10.49	*	*	*	*
Farmers Bank & Capital Trust Company	*	*	*	*	16.53	16.53	17.23	9.80
United Bank & Trust Company	*	*	*	*	15.54	15.54	16.47	12.38
First Citizens Bank	*	*	*	*	13.56	13.56	14.16	9.76
Citizens Bank of Northern Kentucky, Inc.	*	*	*	*	15.24	15.24	16.40	10.68
Regulatory minimum	4.50	6.00	8.00	4.00	4.50	6.00	8.00	4.00
Well-capitalized status	6.50	8.00	10.00	5.00	6.50	8.00	10.00	5.00

[1]Common Equity Tier 1 Risked-based, Tier 1 Risk-based, and Total Risk-based Capital ratios are computed by dividing a bank's Common Equity Tier 1, Tier 1 or Total Capital, as defined by regulation, by a risk-weighted sum of the bank's assets, with the risk weighting determined by general standards established by regulation.

[2]Tier 1 Leverage ratio is computed by dividing a bank's Tier 1 Capital by its total quarterly average assets, as defined by regulation.

*In February 2017, the Company merged United Bank & Trust Company, First Citizens Bank, Inc., and Citizens Bank of Northern Kentucky, Inc. into Farmers Bank & Capital Trust Company in Frankfort, KY, the name of which was immediately changed to United Bank & Capital Trust Company.

12. Fair Value Measurements

ASC Topic 820, *"Fair Value Measurements and Disclosures,"* defines fair value, establishes a framework for measuring fair value, and sets forth disclosures about fair value measurements. ASC Topic 825, *"Financial*

Instruments," allows entities to choose to measure certain financial assets and liabilities at fair value. The Company has not elected the fair value option for any of its financial assets or liabilities.

ASC Topic 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. It also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. This Topic describes three levels of inputs that may be used to measure fair value:

Level 1:	Quoted prices for identical assets or liabilities in active markets that the entity has the ability to access at the measurement date.
Level 2:	Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
Level 3:	Significant unobservable inputs that reflect a reporting entity's own assumptions supported by little or no market activity, about the assumptions that market participants would use in pricing the asset or liability.

Following is a description of the valuation method used for financial instruments measured at fair value on a recurring basis. For this disclosure, the Company only has available for sale investment securities and money market mutual funds classified as cash equivalents that meet the requirement. The carrying value of the $27.7 million in money market mutual funds is equivalent to its fair value and based on Level 1 inputs.

Available for sale investment securities

Valued primarily by independent third party pricing services under the market valuation approach that include, but are not limited to, the following inputs:

- Mutual funds and equity securities are priced utilizing real-time data feeds from active market exchanges for identical securities and are considered Level 1 inputs.
- Government-sponsored agency debt securities, obligations of states and political subdivisions, mortgage-backed securities, corporate bonds, and other similar investment securities are priced with available market information through processes using benchmark yields, matrix pricing, prepayment speeds, cash flows, live trading data, and market spreads sourced from new issues, dealer quotes, and trade prices, among others sources and are considered Level 2 inputs.

Fair value disclosure for available for sale investment securities as of June 30, 2017 and December 31, 2016 are as follows:

(In thousands) Available For Sale Investment Securities	Fair Value	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)
June 30, 2017				
Obligations of U.S. government-sponsored entities	$79,517	$-	$ 79,517	$ -
Obligations of states and political subdivisions	126,573	-	126,573	-
Mortgage-backed securities – residential	202,163	-	202,163	-
Mortgage-backed securities – commercial	46,826	-	46,826	-
Corporate debt securities	7,666	-	7,666	-
Mutual funds and equity securities	875	875	-	-
Total	$463,620	$875	$ 462,745	$ -

(In thousands) Available For Sale Investment Securities	Fair Value	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)
December 31, 2016				
Obligations of U.S. government-sponsored entities	$71,694	$-	$ 71,694	$ -
Obligations of states and political subdivisions	132,292	-	132,292	-
Mortgage-backed securities – residential	224,307	-	224,307	-
Mortgage-backed securities – commercial	45,613	-	45,613	-
Corporate debt securities	6,125	-	6,125	-
Mutual funds and equity securities	833	833	-	-
Total	$480,864	$833	$ 480,031	$ -

The Company is required to measure and disclose certain other assets and liabilities at fair value on a nonrecurring basis in periods following their initial recognition. The Company's disclosure about assets and liabilities measured at fair value on a nonrecurring basis consists of collateral-dependent impaired loans and OREO. The carrying value of these assets are adjusted to fair value on a nonrecurring basis through impairment charges as described more fully below.

Impairment charges on collateral-dependent loans are recorded by either an increase to the provision for loan losses and related allowance or by direct loan charge-offs. The fair value of collateral-dependent impaired loans with specific allocations of the allowance for loan losses is measured based on recent appraisals of the underlying collateral. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Appraisers take absorption rates into consideration and adjustments are routinely made in the appraisal process to identify differences between the comparable sales and income data available. Such adjustments consist mainly of estimated costs to sell that are not included in certain appraisals or to update appraised collateral values as a result of market declines of similar properties for which a newer appraisal is available. These adjustments can be significant and typically result in a Level 3 classification of the inputs for determining fair value.

OREO includes properties acquired by the Company through, or in lieu of, actual loan foreclosures and is carried at fair value less estimated costs to sell. Fair value of OREO at acquisition is generally based on third party appraisals of the property that includes comparable sales data and is considered as Level 3 inputs. The carrying value of each OREO property is updated at least annually and more frequently when market conditions significantly impact the value of the property. If the carrying amount of the OREO exceeds fair value less estimated costs to sell, an impairment loss is recorded through noninterest expense.

The following table represents the carrying amount of assets measured at fair value on a nonrecurring basis and still held by the Company as of the dates indicated. The amounts in the table only represent assets whose carrying amount has been adjusted by impairment charges during the period in a manner as described above; therefore, these amounts will differ from the total amounts outstanding. With the exception of those calculated using the collateral valuation method, collateral-dependent impaired loan amounts in the tables below exclude restructured loans that are measured based on present value techniques, which are outside the scope of the fair value reporting framework.

(In thousands)		Fair Value Measurements Using		
Description	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

June 30, 2017				
Collateral-dependent Impaired Loans				
Real estate mortgage – construction and land development	$1,315	$-	$ -	$ 1,315
Real estate mortgage – residential	395	-	-	395
Commercial, financial, and agriculture	13	-	-	13
Total	$1,723	$-	$ -	$ 1,723
OREO				
Construction and land development	$2,588	$-	$ -	$ 2,588
Residential real estate	90	-	-	90
Farmland and other commercial enterprises	729	-	-	729
Total	$3,407	$-	$ -	$ 3,407

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(In thousands) Description	Fair Value	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)
December 31, 2016				
Collateral-dependent Impaired Loans				
Real estate mortgage – construction and land development	$2,909	$-	$ -	$ 2,909
Real estate mortgage – residential	3,137	-	-	3,137
Real estate mortgage – farmland and other commercial enterprises	351	-	-	351
Total	$6,397	$-	$ -	$ 6,397
OREO				
Construction and land development	$4,883	$-	$ -	$ 4,883
Residential real estate	234	-	-	234
Farmland and other commercial enterprises	1,070	-	-	1,070
Total	$6,187	$-	$ -	$ 6,187

The following table represents impairment charges recorded in earnings for the periods indicated on assets measured at fair value on a nonrecurring basis.

	Three months ended June 30,		Six months ended June 30,	
(In thousands)	2017	2016	2017	2016
Impairment charges:				
Collateral-dependent impaired loans	$25	$494	$27	$524
OREO	138	116	202	566
Total	$163	$610	$229	$1,090

The following table presents quantitative information about unobservable inputs for assets measured on a nonrecurring basis using Level 3 measurements. As described above, the fair value of real estate securing collateral-dependent impaired loans and OREO are based on current third party appraisals. It is sometimes necessary, however, for the Company to discount the appraisal amounts supporting its impaired loans and OREO. These discounts relate primarily to marketing and other holding costs that are not included in certain appraisals or to update values as a result of market declines of similar properties for which newer appraisals are available. Discounts may also result from contracts to sell properties entered into during the period. The range of discounts is presented in the table below for 2017 and 2016.

(In thousands)	Fair Value	Valuation Technique	Unobservable Inputs	Range	Average	
June 30, 2017						
Collateral-dependent impaired loans	$1,723	Discounted appraisals	Marketability discount	0%-10.7%	4.1	%
OREO	$3,407	Discounted appraisals	Marketability discount	0%-40.5%	20.2	%
December 31, 2016						
Collateral-dependent impaired loans	$6,397	Discounted appraisals	Marketability discount	0%-67.8%	3.5	%
OREO	$6,187	Discounted appraisals	Marketability discount	0%-50.0%	11.2	%

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Fair Value of Financial Instruments

The table that follows represents the estimated fair values of the Company's financial instruments made in accordance with the requirements of ASC Topic 825, *"Financial Instruments."* ASC Topic 825 requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet for which it is practicable to estimate that value. The estimated fair value amounts have been determined by the Company using available market information and present value or other valuation techniques. These derived fair values are subjective in nature, involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. ASC Topic 825 excludes certain financial instruments and all nonfinancial instruments from the disclosure requirements. Accordingly, the aggregate fair value amounts presented are not intended to represent the underlying value of the Company.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments not presented elsewhere for which it is practicable to estimate that value.

Cash and Cash Equivalents, Accrued Interest Receivable, and Accrued Interest Payable

The carrying amount is a reasonable estimate of fair value due to the relatively short time between the origination of the instrument and its expected realization or settlement.

Investment Securities Held to Maturity

Fair value is based on quoted market price, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities or with available market information through processes using benchmark yields, matrix pricing, prepayment speeds, cash flows, live trading data, and market spreads sourced from new issues, dealer quotes, and trade prices, among other sources.

Loans

The fair value of loans is estimated by discounting expected future cash flows using current discount rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Expected future cash flows are projected based on contractual cash flows adjusted for estimated prepayments.

Federal Home Loan Bank and Federal Reserve Bank Stock

The fair value of Federal Home Loan Bank and Federal Reserve Bank stock is estimated at book value due to restrictions that limit the sale or transfer of such securities.

Deposit Liabilities

The fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date and fair value approximates carrying value. The fair value of fixed maturity certificates of deposit is estimated by discounting the expected future cash flows using the rates currently offered for certificates of deposit with similar remaining maturities.

Federal Funds Purchased and Short-term Securities Sold Under Agreements to Repurchase

The carrying amount is the estimated fair value for these borrowings which reprice frequently in the near term.

Securities Sold Under Agreements to Repurchase, Subordinated Notes Payable, and Other Long-term Borrowings

The fair value of these borrowings is estimated by discounting the expected future cash flows using rates currently available for debt with similar terms and remaining maturities. For subordinated notes payable, the Company uses its best estimate to determine an appropriate discount rate since active markets for similar debt transactions are very limited.

Commitments to Extend Credit and Standby Letters of Credit

Pricing of these financial instruments is based on the credit quality and relationship, fees, interest rates, probability of funding, compensating balance, and other covenants or requirements. Loan commitments generally have fixed expiration dates, variable interest rates and contain termination and other clauses that provide for relief from funding in the event there is a significant deterioration in the credit quality of the customer. Many loan commitments are expected to, and typically do, expire without being drawn upon. The rates and terms of the Company's commitments to lend and standby letters of credit are competitive with others in the various markets in which the Company operates. There are no unamortized fees relating to these financial instruments, as such the carrying value and fair value are both zero.

The following table presents the estimated fair values of the Company's financial instruments and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2017 and December 31, 2016. Information for available for sale investment securities is presented within this footnote in greater detail above.

			Fair Value Measurements Using		
(In thousands)	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2017					
Assets					
Cash and cash equivalents	$98,014	$98,014	$98,014	$ -	$ -
Held to maturity investment securities	3,461	3,617	-	3,617	-
Loans, net	979,827	973,781	-	-	973,781
Accrued interest receivable	4,707	4,707	-	4,707	-
Federal Home Loan Bank and Federal Reserve Bank Stock	13,410	13,410	-	-	13,410
Liabilities					
Deposits	1,352,838	1,352,783	1,109,354	-	243,429
Securities sold under agreements to repurchase	32,569	32,576	-	32,576	-
Federal Home Loan Bank advances	13,562	13,855	-	13,855	-
Subordinated notes payable to unconsolidated trusts	33,506	21,110	-	-	21,110
Accrued interest payable	279	279	-	279	-

December 31, 2016					
Assets					
Cash and cash equivalents	$113,534	$113,534	$113,534	$ -	$ -
Held to maturity investment securities	3,488	3,597	-	3,597	-
Loans, net	961,631	962,437	-	-	962,437
Accrued interest receivable	5,019	5,019	-	5,019	-
Federal Home Loan Bank and Federal Reserve Bank Stock	9,840	9,840	-	-	9,840
Liabilities					
Deposits	1,369,907	1,369,567	1,099,211	-	270,356
Securities sold under agreements to repurchase	36,370	36,381	-	36,381	-
Federal Home Loan Bank advances	18,646	19,114	-	19,114	-
Subordinated notes payable to unconsolidated trusts	33,506	21,234	-	-	21,234
Accrued interest payable	321	321	-	321	-

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

FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements with the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), under the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties. Statements in this report that are not statements of historical fact are forward-looking statements. In general, forward-looking statements relate to a discussion of future financial results or projections, future economic performance, future operational plans and objectives, and statements regarding the underlying assumptions of such statements. Although management of Farmers Capital Bank Corporation (the "Company" or "Parent Company") believes that the assumptions underlying the forward-looking statements contained herein are reasonable, any of the assumptions could be inaccurate, and therefore, there can be no assurance that the forward-looking statements included herein will prove to be accurate.

Various risks and uncertainties may cause actual results to differ materially from those indicated by the Company's forward-looking statements. In addition to the risks described under Part 1, Item 1A *"Risk Factors"* in the Company's most recent annual report on Form 10-K, factors that could cause actual results to differ from the results discussed in the forward-looking statements include, but are not limited to: economic conditions (both generally and more specifically in the markets in which the Company and its subsidiaries operate) and lower interest margins; competition for the Company's customers from other providers of financial services; deposit outflows or reduced demand for financial services and loan products; government legislation, regulation, and changes in monetary and fiscal policies (which changes from time to time and over which the Company has no control); changes in interest rates; changes in prepayment speeds of loans or investment securities; inflation; material unforeseen changes in the liquidity, results of operations, or financial condition of the Company's customers; changes in the level of non-performing assets and charge-offs; changes in the number of common shares outstanding; the capability of the Company to successfully enter into a definitive agreement for, close, and realize the benefits of anticipated transactions; unexpected claims or litigation against the Company; expected insurance or other recoveries; technological or operational difficulties; the impact of new accounting pronouncements and changes in policies and practices that may be adopted by regulatory agencies; acts of war or terrorism; the ability of the Parent Company to receive dividends from its subsidiaries; the impact of larger or similar financial institutions encountering difficulties, which may adversely affect the banking industry or the Company; the Company or its subsidiary bank's ability to maintain required capital levels and adequate funding sources and liquidity; and other risks or uncertainties detailed in the Company's filings with the Securities and Exchange Commission, all of which are difficult to predict and many of which are beyond the control of the Company.

The Company's forward-looking statements are based on information available at the time such statements are made. The Company expressly disclaims any intent or obligation to update any forward-looking statements to reflect changes in underlying assumptions or factors, new information, future events, or other changes.

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RESULTS OF OPERATIONS

Second Quarter 2017 Compared to Second Quarter 2016

The Company reported net income of $4.5 million or $.60 per common share and $3.6 million or $.47 per common share for the quarters ended June 30, 2017 and 2016, respectively. This represents an increase of $926 thousand or 26.0%, and $.13 on a per common share basis in the comparison.

(In thousands except per share data)

Three Months Ended June 30,	2017	2016	Increase (Decrease)
Interest income	$14,830	$14,973	$ (143)
Interest expense	881	1,975	(1,094)
Net interest income	13,949	12,998	951
Provision for loan losses	(499)	(156)	(343)
Net interest income after provision for loan losses	14,448	13,154	1,294
Noninterest income	5,102	5,521	(419)
Noninterest expenses	13,346	13,884	(538)
Income before income taxes	6,204	4,791	1,413
Income tax expense	1,722	1,235	487
Net income	$4,482	$3,556	$ 926
Basic and diluted net income per common share	$.60	$.47	$ .13
Cash dividends declared per common share	.10	.07	.03
Weighted average common shares outstanding – basic and diluted	7,512	7,502	10
Return on average assets	1.09 %	.81 %	28 bp
Return on average equity	9.45 %	7.73 %	172 bp

bp – basis points.

The increase in net income is attributed primarily to higher net interest income of $951 thousand or 7.3% and a higher credit to the provision for loan losses of $343 thousand. Noninterest income declined $419 thousand or 7.6%, which was more than offset by a decrease in noninterest expense of $538 thousand or 3.9%. Further information related to the more significant components making up the decline in net income follows.

Net Interest Income

The overall interest rate environment at June 30, 2017, as measured by the Treasury yield curve, remained at very low levels when compared with historical trends. During the quarter, the shape of the yield curve flattened as a result of a decrease in yields on longer-term maturities and higher yields on shorter-term maturities. Yields for the ten and thirty-year maturity periods declined 8 and 17 basis points, respectively, while the three-month and two-year maturities were up 26 and 13 basis points, respectively. During June 2017, the Federal Reserve Board ("Federal Reserve") raised the short-term federal funds target interest rate to a range between 1.00% and 1.25%. This marks the second increase during 2017, up from a target range of 0.50% to 0.75% established in December 2016 and a range of 0.25% to 0.50% targeted in December 2015. The Federal Reserve has indicated that it will continue to assess realized and expected economic conditions relative to its objectives of maximum employment and two percent inflation when determining the timing and size of future adjustments to the target rate. At June 30, 2017, the national and Kentucky unemployment rates were 4.4% and 5.1%, respectively. The national inflation rate at June 30, 2017 was 1.6% based on the Consumer Price Index published by the Bureau of Labor Statistics, down from 2.1% at year-end 2016.

Net interest income was $13.9 million for the current quarter, an increase of $951 thousand or 7.3% compared to $13.0 million a year earlier. The increase in net interest income was driven by a decline in interest expense of $1.1 million or 55.4% partially offset by a decrease in interest income of $143 thousand or 1.0%. Interest expense on deposits and borrowed funds were down $76 thousand or 12.7% and $1.0 million or 74.0%, respectively. Interest income on loans was up $270 thousand or 2.3%. Interest on loans in the current quarter include the collection of a $73 thousand prepayment fee and the collection of $38 thousand related to a nonaccrual residential real estate loan that fully paid off during the quarter. Interest income on investments decreased $472 thousand or 15.6%.

The increase in interest income on loans was driven by a higher average loan balance outstanding, partially offset by a lower average rate earned of three basis points. For the current quarter, the prepayment fee and collection of interest on the nonaccrual loan identified above aided the average rate earned on loans by three basis points. Average loans for the current quarter increased $24.6 million or 2.6% compared to the prior-year quarter.

Interest income on investment securities is down primarily due to lower volume. Average investment securities for the quarter decreased $99.6 million or 16.9% from a year ago. Volume declines are mainly the result of the balance sheet deleverage transaction that was announced during the third quarter of 2016, which is more fully described below.

The decrease in interest expense on deposits was driven by rate declines and lower average outstanding balances related to time deposits. Interest expense on borrowed funds was down primarily due to the early repayment of $100 million of high fixed-rate borrowings during the third quarter of 2016 related to the deleveraging transaction discussed below.

Overall declines in the average rate earned from interest income on loans and average interest rate paid on deposits are the result of a slow growing economy and related low interest rate environment, competitive pressures, and the Company's ongoing strategy of being more selective in pricing its loans and deposits. The goal of this strategy is to improve credit quality, net interest income, overall profitability, and capital position.

The Company is generally earning and paying less interest from its earning assets and funding sources as the average rates earned and paid have decreased. This includes repricing of variable and floating rate assets and liabilities that have reset to overall lower amounts since their previous repricing date, as well as activity related to new earning assets and funding sources in a low interest rate environment. The Company continues to reprice its higher-rate maturing time deposits downward to lower market rates or to allow them to mature without renewal, as liquidity has been adequate.

To offset the overall decline in average rates earned and paid, the Company has improved its mix of earning assets and interest bearing liabilities through growth in the loan portfolio over the past year combined with a significant decrease in lower-yielding investment securities and higher-rate borrowings. On an average basis, loans represented 63.2% of earning assets for the second quarter of 2017, an increase of 481 basis points compared to 58.4% for the second quarter of 2016. Loans typically involve an increase in credit risk and higher yields when compared to investment securities.

As part of its strategy to improve net interest income and net interest margin, the Company completed a series of transactions during the last half of 2016 to deleverage its balance sheet and reposition its investment securities portfolio. The Company used a mixture of $10.4 million of excess cash and $93.4 million of proceeds from the sale of investment securities to prepay $100 million of high fixed-rate borrowings due to mature in November 2017. The Company incurred a prepayment fee of $3.8 million, which was offset by a gain in the same amount from the sale of investment securities. The average yield on the mix of cash and investment securities sold to fund the debt prepayment was 2.97%. The average cost of the fixed rate borrowings that were repaid was 3.95%. The Company also took action to reposition its investment securities portfolio by replacing approximately $78 million of certain lower-yielding, short-term investments with longer-term, higher-yielding investments consistent with a more normalized strategy and maturity periods. The lower-yielding, short-term investments were built up in anticipation of the November 2017 debt repayment. The average yield on the investments identified for the repositioning strategy was 0.85% compared to a targeted reinvestment yield of 1.85%. As a result, the average life of the securities portfolio at the time of the transaction increased to 4.0 years from 3.5 years.

The net interest margin on a taxable equivalent basis was 3.69% for the current quarter, an increase of 41 basis points compared with 3.28% a year earlier. Net interest spread increased 49 basis points to 3.60%, up from 3.11% a year ago. Net interest margin and spread for the current quarter were positively impacted three basis points from the prepayment fee and collection of interest on the nonaccrual residential real estate loan identified above. The Company expects its net interest margin to stay relatively flat in the near term according to internal modeling using expectations about future market interest rates, the maturity structure of the Company’s earning assets and liabilities, and other factors. Future results could be significantly different than current expectations.

The following tables present an analysis of net interest income for the quarterly periods ended June 30.

Distribution of Assets, Liabilities and Shareholders' Equity: Interest Rates and Interest Differential

Three Months Ended June 30,	2017				2016			
	Average		Average		Average		Average	
(In thousands)	Balance	Interest	Rate		Balance	Interest	Rate	
Earning Assets								
Investment securities[1]								
Taxable	$370,020	$1,984	2.15	%	$469,793	$2,429	2.08	%
Nontaxable[2]	119,640	871	2.92		119,483	903	3.04	
Interest bearing deposits in banks, federal funds sold and securities purchased under agreements to resell, and money market mutual funds	81,734	161	.79		92,618	102	.44	
Loans[2,3,4]	983,139	12,179	4.97		958,542	11,912	5.00	
Total earning assets	1,554,533	$15,195	3.92	%	1,640,436	$15,346	3.76	%
Allowance for loan losses	(9,499)				(9,674)			
Total earning assets, net of allowance for loan losses	1,545,034				1,630,762			
Nonearning Assets								
Cash and due from banks	21,005				22,170			
Premises and equipment, net	31,923				32,403			
Other assets	62,245				81,628			
Total assets	$1,660,207				$1,766,963			
Interest Bearing Liabilities								
Deposits								
Interest bearing demand	$345,206	$110	.13	%	$335,841	$65	.08	%
Savings	424,297	132	.12		405,986	130	.13	
Time	251,141	281	.45		302,807	404	.54	
Federal funds purchased	4	-	-		1	-	-	
Short-term securities sold under agreements to repurchase	31,712	14	.18		32,579	21	.26	
Long-term securities sold under agreements to repurchase	1,048	2	.77		101,280	1,000	3.97	
Federal Home Loan Bank advances	13,579	129	3.81		18,751	185	3.97	
Subordinated notes payable to unconsolidated trusts	33,506	213	2.55		33,506	170	2.04	
Total interest bearing liabilities	1,100,493	$881	.32	%	1,230,751	$1,975	.65	%
Noninterest Bearing Liabilities								
Demand deposits	341,535				322,817			
Other liabilities	27,421				28,299			
Total liabilities	1,469,449				1,581,867			
Shareholders' equity	190,758				185,096			
Total liabilities and shareholders' equity	$1,660,207				$1,766,963			
Net interest income		14,314				13,371		

TE basis adjustment	(365)		(373)	
Net interest income	$13,949		$12,998	
Net interest spread		3.60 %		3.11 %
Impact of noninterest bearing sources of funds		.09		.17
Net interest margin		3.69 %		3.28 %

[1]Average yields on securities available for sale have been calculated based on amortized cost.

[2]Income and yield stated at a fully tax equivalent basis using the marginal corporate Federal tax rate of 35%.

[3]Loan balances include principal balances on nonaccrual loans.

[4]Loan fees included in interest income amounted to $429 thousand and $364 thousand in 2017 and 2016, respectively.

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Analysis of Changes in Net Interest Income (tax equivalent basis)

(In thousands)	Variance	Variance Attributed to	
Three Months Ended June 30,	2017/2016[1]	Volume	Rate
Interest Income			
Taxable investment securities	$ (445)	$ (952)	$ 507
Nontaxable investment securities[2]	(32)	9	(41)
Interest bearing deposits in banks, federal funds sold and securities purchased under agreements to resell, and money market mutual funds	59	(76)	135
Loans[2]	267	683	(416)
Total interest income	(151)	(336)	185
Interest Expense			
Interest bearing demand deposits	45	2	43
Savings deposits	2	31	(29)
Time deposits	(123)	(62)	(61)
Federal funds purchased	-	-	-
Short-term securities sold under agreements to repurchase	(7)	-	(7)
Long-term securities sold under agreements to repurchase	(998)	(550)	(448)
Federal Home Loan Bank advances	(56)	(49)	(7)
Subordinated notes payable to unconsolidated trusts	43	-	43
Total interest expense	(1,094)	(628)	(466)
Net interest income	$ 943	$ 292	$ 651
Percentage change	100.0 %	31.0 %	69.0 %

[1]The changes that are not solely due to rate or volume are allocated on a percentage basis using the absolute values of rate and volume variances as a basis for allocation.

[2]Income stated at fully tax equivalent basis using the marginal corporate Federal tax rate of 35%.

Provision for Loan Losses

The provision for loan losses represents charges or credits to earnings that are necessary to maintain an allowance for loan losses at an adequate level to cover credit losses specifically identified in the loan portfolio, as well as management's best estimate of incurred probable loan losses in the remainder of the portfolio at the balance sheet date. The credit quality of the Company's loan portfolio continued recent trends of improvement during the current quarter, as certain credit quality metrics are at or near recent quarterly bests.

The Company recorded a credit to the provision for loan losses in the amount of $499 thousand and $156 thousand for the current and year-ago quarters, respectively. The allowance for loan losses as a percentage of outstanding loans was

0.93% at June 30, 2017 compared to 0.96% and 0.99% at year-end 2016 and June 30, 2016, respectively. The credit to the provision for the current quarter was driven by net recoveries of $214 thousand combined with a decline in specific reserves on impaired loans of $273 thousand. Net recoveries during the quarter include $371 thousand from a real estate development project. The Company recorded a total of $1.4 million in charge-offs between 2010 and 2012 related to the real estate development project and anticipates it could receive an additional $340 thousand in recoveries related to this credit during the remainder of 2017.

While historical loss rates continued to be low, the effect of the improvement in loss rates on the allowance for loan losses has diminished now that the higher levels experienced during 2008 through the first quarter of 2014 have already rolled out of the three year look-back period used when evaluating the allowance for loan losses. Overall credit quality metrics of the loan portfolio has continued to improve. Nonperforming loans, impaired loans, loans graded as substandard or below, and watch list loans have each declined when compared with a year earlier. For further information about improvements in the Company's overall credit quality, please refer to the discussion under the captions *"Allowance for Loan Losses"* and *"Nonperforming Loans"* that follows.

Noninterest Income

The components of noninterest income are as follows for the periods indicated:

Three Months Ended June 30, (In thousands)	2017	2016	Increase (Decrease)	%
Service charges and fees on deposits	$2,012	$1,927	$ 85	4.4 %
Allotment processing fees	651	820	(169)	(20.6)
Other service charges, commissions, and fees	1,328	1,432	(104)	(7.3)
Trust income	626	665	(39)	(5.9)
Investment securities (losses) gains, net	(1)	131	(132)	(100.8)
Gain on sale of mortgage loans, net	189	222	(33)	(14.9)
Income from company-owned life insurance	221	231	(10)	(4.3)
Other	76	93	(17)	(18.3)
Total noninterest income	$5,102	$5,521	$ (419)	(7.6)%

The decline in noninterest income is primarily attributable to lower allotment processing fees, a net loss on the sale of investment securities compared to a net gain a year-ago, and lower nondeposit charges, commissions, and fees.

Service charges and fees on deposits increased primarily due to higher service charges on savings accounts of $28 thousand or 125% and higher overdraft fees of $18 thousand or 1.9%. Contributing to the overall increase in service charges are higher average balances of demand deposits and savings account compared to the prior year. Additionally, during the second quarter of 2016, the Company standardized and reduced the number of its deposit account product offerings throughout the corporation, which has contributed to an overall increase in service charges since completion.

The decline in allotment processing fees is primarily a result of lower processing volume stemming from the U.S. Department of Defense policy that went into effect on January 1, 2015 which restricts the types of purchases that active duty service members are able to make using the military allotment system for payment. The Company is continuing its effort to mitigate these declines by diversifying its customer base beyond the historically strong level of military participants and by expanding its payment processing options.

The decrease in nondeposit service charges, commissions, and fees was driven by declines across multiple line items. Net losses on the sale of investment securities compared to net gains in the prior year is attributed to normal asset/liability management strategies, as the Company periodically sells investment securities to lock in gains, increase yield, restructure expected future cash flows, improve risk exposures, and/or enhance its capital position.

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Noninterest Expense

The components of noninterest expense are as follows for the periods indicated:

Three Months Ended June 30, (In thousands)	2017	2016	Increase (Decrease)	%
Salaries and employee benefits	$7,646	$7,655	$ (9)	(0.1)%
Occupancy expenses, net	1,135	1,179	(44)	(3.7)
Equipment expenses	599	639	(40)	(6.3)
Data processing and communication expenses	1,093	1,212	(119)	(9.8)
Bank franchise tax	609	611	(2)	(0.3)
Deposit insurance expenses	130	280	(150)	(53.6)
Other real estate expenses, net	326	373	(47)	(12.6)
Legal expenses	118	102	16	15.7
Other	1,690	1,833	(143)	(7.8)
Total noninterest expense	$13,346	$13,884	$ (538)	(3.9)%

The decline in noninterest expense in the comparison was driven by lower deposit insurance expenses and a decrease in data processing and communications expenses.

Salaries and employee benefits was relatively unchanged compared to the prior-year second quarter. Salaries and related payroll taxes increased $131 thousand or 2.1% in the comparison, partially offset by a decline in employee benefits of $130 thousand or 9.9%. Salaries and related payroll taxes in the current quarter includes incentive pay accruals of $359 thousand related to the Company's Board-approved incentive payment plans put in place for 2017. These plans include the Company's executive management team and certain other designated officers throughout the corporation. Salary expense also includes Board-approved retention payments during the second quarter of 2017 in the amount of $201 thousand to certain members of management. There were no such incentive accruals or retention payments in the comparable period. The decline in employee benefits was mainly due to lower claims activity related to the Company's self-funded health insurance plan of $138 thousand due to the reduced workforce. The Company had 433 full time equivalent employees at quarter-end, down from 489 a year ago.

Data processing and communication expense was down primarily due to a one-time accrual adjustment of $137 thousand included in the prior-year quarter related to a change in card vendor. The reduction in deposit insurance expense is due to a combination of further improvement in the risk rating at the Company's subsidiary bank and lower assessment rates. The decline in other expenses was across multiple line items, led by lower directors' fees of $63 thousand or 38.1%, mainly attributable to having fewer boards of directors due to the consolidation of subsidiaries during the first quarter of 2017.

Income Taxes

Income tax expense was $1.7 million for the current quarter, an increase of $487 thousand or 39.4% compared to $1.2 million for the same quarter of 2016. The effective income tax rates were 27.8% and 25.8% for the current and year-ago quarters, respectively.

First Six Months of 2017 Compared to First Six Months 2016

The Company reported net income of $7.8 million or $1.04 per common share and $9.7 million or $1.30 per common share for the six months ended June 30, 2017 and 2016, respectively. This represents a decrease of $1.9 million or 19.8%, and $.26 on a per common share basis in the comparison. The current six-months includes pre-tax expenses of $472 thousand ($307 thousand after tax) or $.04 per common share related to the Company's consolidation of its four bank subsidiaries and data processing subsidiary into one bank. This consolidation was completed in February 2017. Selected income statement amounts and related data are summarized in the table below.

(In thousands except per share data)

Six Months Ended June 30,	2017	2016	Increase (Decrease)
Interest income	$29,209	$30,303	$ (1,094)
Interest expense	1,797	4,018	(2,221)
Net interest income	27,412	26,285	1,127
Provision for loan losses	81	(629)	710
Net interest income after provision for loan losses	27,331	26,914	417
Noninterest income	10,353	15,063	(4,710)
Noninterest expenses	26,875	28,291	(1,416)
Income before income taxes	10,809	13,686	(2,877)
Income tax expense	2,998	3,950	(952)
Net income	$7,811	$9,736	$ (1,925)
Basic and diluted net income per common share	$1.04	$1.30	$ (.26)
Cash dividends declared per common share	.20	.14	.06
Weighted average common shares outstanding – basic and diluted	7,511	7,501	10
Return on average assets	.95 %	1.11 %	(16)bp
Return on average equity	8.37 %	10.69 %	(232)bp

bp – basis points.

The $1.9 million decline in net income is attributed primarily to a pretax gain during the first quarter of 2016 of $4.1 million related to the early extinguishment of $15.5 million of debt. Net interest income and the provision for loan losses increased $1.1 million or 4.3% and $710 thousand, respectively. Salaries and employee benefits and expenses related to repossessed real estate decreased $371 thousand and $612 thousand, respectively. Further information related to the more significant components making up the decline in net income follows.

Net Interest Income

Net interest income was $27.4 million for the first six months of 2017, an increase of $1.1 million or 4.3% compared to $26.3 million for the first six months of 2016. The increase in net interest income was driven by reductions of interest expense of $2.2 million or 55.3% partially offset by a decrease in interest income of $1.1 million or 3.6%. Interest expense on deposits and borrowed funds were down $189 thousand or 15.2% and $2.0 million or 73.3%, respectively. Interest income on loans declined $98 thousand or 0.4%. Interest on loans in the current six months includes a $73 thousand prepayment fee and the collection of $38 thousand related to a nonaccrual residential real estate loan that fully paid off during the period. The prior year was positively impacted by the collection of $236 thousand related to a nonaccrual commercial real estate loan that fully paid off during the year-ago first quarter. Interest income on investments decreased $1.1 million or 18.1%.

The decline in interest income on loans was driven by a lower average rate earned of 11 basis points, partially offset by a higher average loan balance outstanding. The average rate earned on loans during the current period was positively impacted two basis points from the prepayment fee and collection of interest on the nonaccrual loan identified above. For the first six months of 2016, the average rate earned on loans was boosted five basis points by the collection of interest on the nonaccrual loan identified above. Average loans increased $20.3 million or 2.1% from the year-ago comparable period.

Interest income on investment securities is down mainly due to lower volume. Average investment securities for the period decreased $93.9 million or 16.1% compared to the first six months of 2016. Volume declines are mainly the result of the balance sheet deleverage transaction that was announced during the third quarter of 2016, which is more fully described below.

The decrease in interest expense on deposits was driven by rate declines and lower average outstanding balances of time deposits. Interest expense on borrowed funds was down primarily due to the early repayment of $100 million of high fixed-rate borrowings during the third quarter of 2016 related to the deleveraging transaction discussed below.

Overall declines in the average rate earned from interest income on loans and average interest rate paid on deposits are the result of a slow growing economy and related low interest rate environment, competitive pressures, and the Company's ongoing strategy of being more selective in pricing its loans and deposits. The goal of this strategy is to improve credit quality, net interest income, overall profitability, and capital position.

The Company is generally earning and paying less interest from its earning assets and funding sources as the average rates earned and paid have decreased. This includes repricing of variable and floating rate assets and liabilities that have reset to overall lower amounts since their previous repricing date, as well as activity related to new earning assets and funding sources in a low interest rate environment. The Company continues to reprice its higher-rate maturing time deposits downward to lower market rates or to allow them to mature without renewal, as liquidity has been adequate.

To offset the overall decline in average rates earned and paid, the Company has improved its mix of earning assets and interest bearing liabilities through growth in the loan portfolio over the past year combined with a significant decrease in lower-yielding investment securities and higher-rate borrowings. On an average basis, loans represented 62.9% of earning assets for the first six months of 2017, an increase of 412 basis points compared to 58.7% for the first six months of 2016. Loans typically involve an increase in credit risk and higher yields when compared to investment securities.

As part of its strategy to improve net interest income and net interest margin, the Company completed a series of transactions during the second half of 2016 to deleverage its balance sheet and reposition its investment securities portfolio. The Company used a mixture of $10.4 million of excess cash and $93.4 million of proceeds from the sale of investment securities to prepay $100 million of high fixed-rate borrowings due to mature in November 2017. The Company incurred a prepayment fee of $3.8 million, which was offset by a gain in the same amount on the sale of investment securities. The average yield on the mix of cash and investment securities sold to fund the debt prepayment was 2.97%. The average cost of the fixed rate borrowings that were repaid was 3.95%. The Company also took action to reposition its investment securities portfolio by replacing approximately $78 million of certain lower-yielding, short-term investments with longer-term, higher-yielding investments consistent with a more normalized strategy and maturity periods. The lower-yielding, short-term investments were built up in anticipation of the November 2017 debt repayment. The average yield on the investments identified for the repositioning strategy was 0.85% compared to a targeted reinvestment yield of 1.85%. As a result, the average life of the securities portfolio at the time of the transaction increased to 4.0 years from 3.5 years.

The net interest margin on a taxable equivalent basis was 3.64% for the first six months of 2017, an increase of 31 basis points compared with 3.33% a year earlier. Net interest spread increased 37 basis points to 3.55%, up from 3.18% a year ago. The Company expects its net interest margin to remain relatively flat in the near term according to internal modeling using expectations about future market interest rates, the maturity structure of the Company's earning assets and liabilities, and other factors. Future results could be significantly different than current expectations.

The following tables present an analysis of net interest income for the six months ended June 30.

Distribution of Assets, Liabilities and Shareholders' Equity: Interest Rates and Interest Differential

Six Months Ended June 30,	2017				2016			
(In thousands)	Average Balance	Interest	Average Rate		Average Balance	Interest	Average Rate	
Earning Assets								
Investment securities[1]								
Taxable	$369,820	$3,884	2.12	%	$463,110	$4,936	2.14	%
Nontaxable[2]	121,407	1,758	2.92		122,045	1,842	3.04	
Interest bearing deposits in banks, federal funds sold and securities purchased under agreements to resell, and money market mutual funds	87,174	327	.76		88,277	205	.47	
Loans[2,3,4]	979,063	23,975	4.94		958,795	24,069	5.05	
Total earning assets	1,557,464	$29,944	3.88	%	1,632,227	$31,052	3.83	%
Allowance for loan losses	(9,473)				(9,940)			
Total earning assets, net of allowance for loan losses	1,547,991				1,622,287			
Nonearning Assets								
Cash and due from banks	23,234				22,538			
Premises and equipment, net	31,888				32,654			
Other assets	60,448				88,350			
Total assets	$1,663,561				$1,765,829			
Interest Bearing Liabilities								
Deposits								
Interest bearing demand	$347,209	$201	.12	%	$333,011	$131	.08	%
Savings	422,763	256	.12		404,852	261	.13	
Time	257,863	599	.47		310,206	853	.55	
Federal funds purchased	22	-	-		230	-	-	
Short-term securities sold under agreements to repurchase	32,717	37	.23		33,739	45	.27	
Long-term securities sold under agreements to repurchase	1,168	4	.69		101,308	2,000	3.97	
Federal Home Loan Bank advances	14,789	289	3.94		18,766	371	3.98	
Subordinated notes payable to unconsolidated trusts	33,506	411	2.47		35,585	357	2.02	
Total interest bearing liabilities	1,110,037	$1,797	.33	%	1,237,697	$4,018	.65	%
Noninterest Bearing Liabilities								
Demand deposits	339,276				317,135			
Other liabilities	25,981				27,914			
Total liabilities	1,475,294				1,582,746			
Shareholders' equity	188,267				183,083			
Total liabilities and shareholders' equity	$1,663,561				$1,765,829			
Net interest income		28,147				27,034		

TE basis adjustment	(735)		(749)	
Net interest income	$27,412		$26,285	
Net interest spread		3.55 %		3.18 %
Impact of noninterest bearing sources of funds		.09		.15
Net interest margin		3.64 %		3.33 %

[1]Average yields on securities available for sale have been calculated based on amortized cost.

[2]Income and yield stated at a fully tax equivalent basis using the marginal corporate Federal tax rate of 35%.

[3]Loan balances include principal balances on nonaccrual loans.

[4]Loan fees included in interest income amounted to $755 thousand and $682 thousand in 2017 and 2016, respectively.

Analysis of Changes in Net Interest Income (tax equivalent basis)

(In thousands)	Variance	Variance Attributed to	
Six Months Ended June 30,	2017/2016[1]	Volume	Rate
Interest Income			
Taxable investment securities	$ (1,052)	$ (1,005)	$ (47)
Nontaxable investment securities[2]	(84)	(10)	(74)
Interest bearing deposits in banks, federal funds sold and securities purchased under agreements to resell, and money market mutual funds	122	(7)	129
Loans[2]	(94)	993	(1,087)
Total interest income	(1,108)	(29)	(1,079)
Interest Expense			
Interest bearing demand deposits	70	5	65
Savings deposits	(5)	27	(32)
Time deposits	(254)	(136)	(118)
Federal funds purchased	-	-	-
Short-term securities sold under agreements to repurchase	(8)	(1)	(7)
Long-term securities sold under agreements to repurchase	(1,996)	(1,087)	(909)
Federal Home Loan Bank advances	(82)	(78)	(4)
Subordinated notes payable to unconsolidated trusts	54	(55)	109
Total interest expense	(2,221)	(1,325)	(896)
Net interest income	$ 1,113	$ 1,296	$ (183)
Percentage change	100.0 %	116.4 %	(16.4)%

[1] The changes that are not solely due to rate or volume are allocated on a percentage basis using the absolute values of rate and volume variances as a basis for allocation.

[2] Income stated at fully tax equivalent basis using the marginal corporate Federal tax rate of 35%.

Provision for Loan Losses

The Company recorded a provision for loan losses in the amount of $81 thousand and a credit to the provision of $629 thousand for the first six months of 2017 and 2016, respectively. The allowance for loan losses as a percentage of outstanding loans was 0.93% at June 30, 2017 compared to 0.96% and 0.99% at year-end 2016 and June 30, 2016, respectively. The provision for loan losses was driven by net charge-offs of $203 thousand for the current quarter.

Nonperforming loans, impaired loans, loans graded as substandard or below, and watch list loans have each declined when compared with a year earlier. While historical loss rates continued to improve, the rate of improvement has declined as the elevated levels of charge-offs experienced in prior years have already rolled out of the three year look-back period used when evaluating the allowance for loan losses. For further information about improvements in the Company’s overall credit quality, please refer to the discussion under the captions *“Allowance for Loan Losses”* and *“Nonperforming Loans”* that follows.

Noninterest Income

The components of noninterest income are as follows for the periods indicated:

Six Months Ended June 30, (In thousands)	2017	2016	Increase (Decrease)	%
Service charges and fees on deposits	$3,970	$3,794	$ 176	4.6 %
Allotment processing fees	1,366	1,694	(328)	(19.4)
Other service charges, commissions, and fees	2,700	2,714	(14)	(0.5)
Trust income	1,330	1,319	11	0.8
Investment securities (losses) gains, net	(10)	214	(224)	(104.7)
Gain on sale of mortgage loans, net	343	422	(79)	(18.7)
Income from company-owned life insurance	456	556	(100)	(18.0)
Gain on debt extinguishment	-	4,050	(4,050)	NM
Other	198	300	(102)	(34.0)
Total noninterest income	$10,353	$15,063	$ (4,710)	(31.3)%

NM – not meaningful.

The decline in noninterest income is mainly attributed to the $4.1 million pre-tax gain during the first quarter of 2016 related to the early extinguishment of debt. Noninterest income in the first six months of 2016 also includes a $100 thousand payment received related to a litigation settlement.

Service charges and fees on deposits increased primarily due to higher service charges related to demand deposits and savings accounts of $117 thousand or 28.6% and $35 thousand or 81.7%, respectively. Contributing to the overall increase in service charges are higher average balances of demand deposits and savings account compared to the prior year. Additionally, during the second quarter of 2016, the Company standardized and reduced the number of its deposit account product offerings throughout the corporation, which has contributed to an overall increase in service charges since completion.

The decrease in allotment processing fees is a result of lower processing volume resulting from the U.S. Department of Defense policy that went into effect on January 1, 2015 restricting the types of purchases that active duty service members are able to make using the military allotment system for payment. The Company continues its efforts to mitigate these declines by diversifying its customer base beyond the historically strong level of military participants and by expanding its payment processing options.

Net losses on the sale of investment securities compared to net gains in the prior year is attributed to normal asset/liability management strategies, as the Company periodically sells investment securities to lock in gains, increase yield, restructure expected future cash flows, improve risk exposures, and/or enhance its capital position. Net gains on the sale of mortgage loans were down mainly due to lower sales volume of $3.2 million or 19.2% compared to the prior year. The decline in income from company-owned life insurance is primarily due to a tax-free death benefit received in excess of the cash surrender value during the first quarter of 2016 of $81 thousand.

Noninterest Expense

The components of noninterest expense are as follows for the periods indicated:

Six Months Ended June 30, (In thousands)	2017	2016	Increase (Decrease)	%
Salaries and employee benefits	$15,263	$15,634	$ (371)	(2.4)%
Occupancy expenses, net	2,349	2,369	(20)	(0.8)
Equipment expenses	1,152	1,171	(19)	(1.6)
Data processing and communication expenses	2,386	2,326	60	2.6
Bank franchise tax	1,166	1,210	(44)	(3.6)
Deposit insurance expenses	267	578	(311)	(53.8)
Other real estate expenses, net	400	1,012	(612)	(60.5)
Legal expenses	203	269	(66)	(24.5)
Other	3,689	3,722	(33)	(0.9)
Total noninterest expense	$26,875	$28,291	$ (1,416)	(5.0)%

Noninterest expense for the current six months includes $472 thousand related to the consolidation of the Company's subsidiaries during the first quarter of 2017. The decline in noninterest expense in the comparison was led by lower expenses related to repossessed real estate. Write-downs on repossessed real estate were down $382 thousand or 52.2%, which include a write-down in the prior-year period of $352 thousand related to one larger-balance commercial real estate property resulting from an updated appraisal. Net gains on the sale of property in the current period were $72 thousand compared to a net loss of $125 thousand in the prior year. Maintenance and operating costs were down $33 thousand or 21.3% in the comparison.

The decrease in salaries and employee benefits is attributed to lower employee benefits of $734 thousand or 27.4% primarily related to a curtailment gain of $351 thousand in the first quarter. The curtailment gain resulted from revaluing the Company's postretirement medical benefits plan liability due to a reduction in workforce related to the subsidiary consolidation plan that was completed in the first quarter. Also contributing to the decline in employee benefits was lower claims activity related to the Company's self-funded health insurance plan of $338 thousand, also due to the reduced workforce. Salaries and related payroll taxes increased $74 thousand or 0.6%. Salaries and related payroll taxes for the current year include incentive pay accruals of $574 thousand, severance pay expense of $301 thousand, and retention payments to certain members of management of $201 thousand. There were no similar accruals or payments during the prior year period. The Company had 433 full time equivalent employees at June 30, 2017, down from 489 a year ago.

Data processing and communication expense during the current year includes $127 thousand related to the consolidation of subsidiaries. The reduction in deposit insurance expense is due to a combination of further improvement in the risk rating at the Company's subsidiary bank and lower assessment rates.

Income Taxes

Income tax expense was $3.0 million for the first six months of 2017, a decrease of $952 thousand or 24.1% compared to $4.0 million for 2016. The effective income tax rates were 27.7% and 28.9% for the current and year-ago periods, respectively. Income tax expense and the effective tax rate are down in the current period as a result of lower pretax income, made up by a higher mix of tax-exempt versus taxable sources of revenue that was driven by the $4.1 million pretax gain on extinguishment of debt in 2016.

FINANCIAL CONDITION

Total assets were $1.7 billion at June 30, 2017, a decrease of $18.7 million or 1.1% from year-end 2016, led by a decline in investment securities of $17.3 million. Liabilities were down $27.5 million or 1.8% and equity increased $8.8 million or 4.8% in the comparison. Selected balance sheet amounts and related data are presented in the table below and discussion that follows.

(Dollars in thousands, except per share data)	June 30, 2017	December 31, 2016	Increase (Decrease)	%
Cash and cash equivalents	$98,014	$113,534	$(15,520)	(13.7)%
Investment securities	467,081	484,352	(17,271)	(3.6)
Loans, net of allowance of $9,222 and $9,344	979,827	961,631	18,196	1.9
Other real estate owned	6,187	10,673	(4,486)	(42.0)
Other assets	101,231	100,840	391	0.4
Total assets	$1,652,340	$1,671,030	$(18,690)	(1.1)%
Deposits	$1,352,838	$1,369,907	$(17,069)	(1.2)%
Securities sold under agreements to repurchase	32,569	36,370	(3,801)	(10.5)
Other borrowings	47,068	52,152	(5,084)	(9.7)
Other liabilities	26,989	28,535	(1,546)	(5.4)
Total liabilities	1,459,464	1,486,964	(27,500)	(1.8)
Common stock	939	939	-	-
Capital surplus	52,034	51,885	149	0.3
Retained earnings	140,959	134,650	6,309	4.7
Accumulated other comprehensive loss	(1,056)	(3,408)	2,352	69.0
Total shareholders' equity	192,876	184,066	8,810	4.8
Total liabilities and shareholders' equity	$1,652,340	$1,671,030	$(18,690)	(1.1)%
End of period tangible book value per common share[1]	$25.67	$24.51	$1.16	4.7 %
End of period per common share closing price	38.55	42.05	(3.50)	(8.3)

[1]Represents total common equity less intangible assets divided by the number of common shares outstanding at the end of the period.

Cash and cash equivalents are down mainly as a result of funding new loans and the outflow of deposits. The increase in loans was driven mainly by loans secured by real estate, primarily commercial related lending, partially offset by lower construction and residential real estate lending. OREO decreased primarily due to property sales and impairment charges to adjust carrying amounts to their estimated fair value less cost to sell.

The decline in total liabilities was driven by lower deposits and a reduction in both securities sold under agreements to repurchase and other borrowings. Deposits were down primarily from lower time deposits and interest bearing demand deposits. The trend over the last several years has been for deposits in the first quarter of the year to exceed the prior year-end amount, then experiencing a decline in the second and third quarters before trending back up during the fourth quarter. These trends indicate a certain amount of seasonality in our customer deposit base particularly related to public funds. The decrease in other borrowings was driven by principal payments of $5.1 million related to Federal Home Loan Bank ("FHLB") advances during the period.

Shareholders' equity was up primarily due to net income of $7.8 million and other comprehensive income of $2.4 million, partially offset by dividends declared on common stock of $1.5 million. Other comprehensive income was driven by an increase in the after-tax unrealized gain of $2.3 million related to the available for sale investment securities portfolio.

Temporary Investments

Temporary investments consist of interest bearing deposits in other banks, federal funds sold and securities purchased under agreements to resell, and money market mutual funds. The Company uses these funds in the management of liquidity and interest rate sensitivity, as a short-term holding prior to subsequent movement into other investments with higher yields, or for other purposes. At June 30, 2017, temporary investments were $70.6 million, a decrease of $17.2 million or 19.6% from year-end 2016.

Investment Securities

The investment securities portfolio is comprised primarily of residential mortgage-backed securities, tax-exempt securities of states and political subdivisions, and debt securities issued by U.S. government-sponsored agencies. Substantially all of the Company's investment securities are designated as available for sale. Proceeds received from maturing or called investment securities not needed to fund higher-earning loans are either reinvested in similar investments or used to manage liquidity, such as for deposit outflows or other payment obligations. Total investment securities had a carrying amount of $467 million at June 30, 2017, a decrease of $17.3 million or 3.6% compared to $484 million at year-end 2016.

The decline in investment securities was driven by net maturities, calls, and sales totaling $18.9 million and net premium amortization of $1.7 million, partially offset by higher pre-tax market values related to the available for sale portfolio of $3.5 million.

Loans

Loans were $989 million at June 30, 2017, an increase of $18.1 million or 1.9% compared to year-end 2016. While recent loan demand and near term prospects are encouraging, the Company continues a conservative approach to loan originations as it strives to further reduce its level of nonperforming assets. The loan portfolio grew during the first quarter of 2017, then held relatively steady during the second quarter despite several early payoffs of larger-balance commercial real estate loans totaling $7.3 million in the aggregate.

From time to time the Company may purchase a limited amount of loans originated by otherwise nonaffiliated third parties. The Company performs its own risk assessment and makes the credit decision on each loan prior to purchase. The Company purchased smaller balance commercial loans totaling $1.8 million and $1.2 million in the aggregate during the first six months of 2017 and 2016, respectively. The average amount of the purchased loans was $150 thousand for 2017 and $124 thousand for 2016.

The composition of the loan portfolio is summarized in the table below.

	June 30, 2017		December 31, 2016	
(Dollars in thousands)	Amount	%	Amount	%
Real estate mortgage – construction and land development	$103,884	10.5 %	$120,230	12.4 %
Real estate mortgage – residential	340,213	34.4	350,295	36.1
Real estate mortgage – farmland and other commercial enterprises	438,945	44.4	400,367	41.2
Commercial, financial, and agriculture	97,781	9.9	90,848	9.4
Installment	8,226	.8	9,235	.9
Total	$989,049	100.0%	$970,975	100.0%

On an average basis, loans represented 62.9% of earning assets for the first six months of 2017, an increase of 357 basis points compared to 59.3% for the full year of 2016. The increase in the level of loans as a percentage of earning assets reflects the overall growth in the loan portfolio over the past year combined with a significant decrease in investment securities as a result of unwinding the balance sheet leverage transaction. The increase in loans in recent periods has been funded by cash flows from investment securities and temporary investments. Loans typically involve an increase in credit risk and higher yields when compared to investment securities and temporary investment alternatives.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level management believes is adequate to cover probable losses in the loan portfolio. The determination of the appropriate level of allowance for loan losses requires significant judgment in order to reflect credit losses specifically identified in the Company’s loan portfolio as well as management's best estimate of probable incurred credit losses in the loan portfolio at the balance sheet date. The allowance for loan losses is a valuation allowance increased by the provision for loan losses and decreased by net charge-offs. Loan losses are charged against the allowance when management believes the uncollectibility of a loan is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses and the related provision for loan losses generally fluctuate as the relative level of nonperforming and impaired loans vary. However, other factors impact the amount of the allowance such as the Company’s historical loss experience, the financial condition of its borrowers, general economic conditions, and other qualitative risk factors as described in greater detail in the Company’s most recent annual report on Form 10-K.

The allowance for loan losses was $9.2 million or 0.93% of outstanding loans at June 30, 2017. This compares to $9.3 million or 0.96% of net loans outstanding at year-end 2016. The decrease in the allowance as a percentage of net loans outstanding from the prior year-end is a result of net charge-offs of $203 thousand combined loan growth for the current six-month period, partially offset by a provision for loan losses of $81 thousand. As a percentage of nonperforming loans, the allowance for loan losses was 34.4% at June 30, 2017 compared to 31.8% at year-end 2016. The relatively low amount of the allowance for loan losses as a percentage of nonperforming loans is due mainly to the makeup of nonperforming loans as discussed further below.

Nonperforming loans include $22.4 million of accruing restructured loans, which represents 83.5% of total nonperforming loans at June 30, 2017. At year-end 2016, this amount was $22.9 million or 78.1%. The allowance attributed to credits that are restructured with lower interest rates generally represents the difference in the present value of future cash flows calculated at the loan’s original effective interest rate and the new lower rate resulting from the restructuring. This typically results in a reserve for loan losses that is less severe than for other loans that are collateral dependent. The allowance specifically allocated to impaired loans, which includes restructured loans, was $2.9 million or 7.3% and $2.9 million or 7.0% of such loans at June 30, 2017 and year-end 2016, respectively. As a percentage of nonaccrual loans and loans past due 90 days or more and still accruing, the allowance for loan losses was 208% and 145% for the current quarter-end and year-end 2016, respectively.

The overall improvement in the credit quality of the loan portfolio experienced during 2016 continued during the first six months of 2017. While the specific reserve on total impaired loans was relatively unchanged from year-end 2016, total impaired loans declined $2.7 million or 6.4%. This is due to the characteristics of the individual loans that are classified as impaired.

Certain credit quality measures are summarized in the table that follows for the periods indicated. Several of these measures are at or near the best level in the last three years.

(In thousands)	June 30, 2017	December 31, 2016	June 30, 2016	Three-year High[1]	Three-year Low[1]
Nonperforming loans	$26,844	$29,365	$29,843	$40,819	$26,844
Nonaccrual loans	4,427	6,423	6,397	15,530	4,427
Loans past due 30-89 days and still accruing	1,218	2,259	2,719	3,016	588
Loans graded substandard or below	35,325	37,650	39,826	66,185	35,325
Impaired loans	39,196	41,895	43,298	48,881	37,182
Loans, net of unearned income	989,049	970,975	957,426	989,833	927,389

[1]Based on quarter-end balances over the previous three years.

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Nonperforming Loans

Nonperforming loans consist of nonaccrual loans, accruing restructured loans, and loans 90 days or more past due and still accruing interest. The accrual of interest on loans is discontinued when it is determined that the collection of interest or principal is doubtful, or when a default of interest or principal has existed for 90 days or more, unless such loan is well secured and in the process of collection.

Restructured loans occur when a lender, because of economic or legal reasons related to a borrower's financial difficulty, grants a concession to the borrower that it would not otherwise consider. Restructured loans typically include a reduction of the stated interest rate or an extension of the maturity date, among other possible concessions. The Company gives careful consideration to identifying which of its challenged credits merit a restructuring of terms that it believes will result in maximum loan repayments and mitigation of possible losses. Cash flow projections are carefully scrutinized prior to restructuring any credits; past due credits are typically not granted concessions.

Nonperforming loans were $26.8 million at June 30, 2017, a decrease of $2.5 million or 8.6% compared to $29.4 million at year-end 2016. Nonaccrual loans and accruing restructured loans decreased $2.0 million or 31.1% and $527 thousand or 2.3%, respectively. Loan payments include $1.5 million related to nonaccrual loans during the first six months of 2017, which include two larger-balance credits totaling $712 thousand in the aggregate. One of these larger-balance credits also had a charge-off totaling $405 thousand and the remaining collateral securing the loan was repossessed and subsequently sold at a small gain. There are no further balances outstanding related to this credit. One larger-balance nonaccrual credit in the amount of $428 thousand secured by commercial real estate was upgraded to performing status during the second quarter of 2017. The credit was upgraded based on a detailed review and current expectation of full repayment during the third quarter.

Accruing restructured loans make up $22.4 million or 83.5% of the Company's nonperforming loans at June 30, 2017 compared with $4.4 million or 16.5% related to nonaccrual loans. Additionally, three larger balance credits account for $21.2 million or 94.7% of total restructured loans. Nonaccrual loans have decreased to the lowest level since the second quarter of 2007.

Nonperforming loans, presented by class, were as follows for the periods indicated:

Nonperforming Loans

(In thousands)	June 30, 2017	December 31, 2016
Nonaccrual Loans		
Real Estate		
Real estate mortgage – construction and land development	$381	$ 712
Real estate mortgage – residential	1,913	2,316
Real estate mortgage – farmland and other commercial enterprises	1,924	3,383
Commercial		
Other	25	-
Consumer		
Secured	11	4
Unsecured	173	8
Total nonaccrual loans	$4,427	$ 6,423
Restructured Loans		
Real Estate		
Real estate mortgage – construction and land development	$1,961	$ 3,637
Real estate mortgage – residential	5,402	4,006
Real estate mortgage – farmland and other commercial enterprises	14,546	14,787
Commercial		
Commercial and industrial	374	377
Consumer		
Unsecured	132	135
Total restructured loans	$22,415	$ 22,942
Past Due 90 Days or More and Still Accruing		
Consumer		
Unsecured	$2	$ -
Total past due 90 days or more and still accruing	$2	$ -
Total nonperforming loans	$26,844	$ 29,365
Ratio of total nonperforming loans to total loans	2.7 %	3.0 %

The most significant components of nonperforming loans include nonaccrual and restructured loans. Activity during 2017 related to these two components was as follows:

(In thousands)

	Nonaccrual Loans	Restructured Loans
Balance at December 31, 2016	$ 6,423	$ 22,942
Additions	742	-
Principal paydowns	(1,542)	(527)
Transfers to performing status	(428)	-
Transfers to other real estate owned	(187)	-
Charge-offs	(581)	-
Balance at June 30, 2017	$ 4,427	$ 22,415

The Company's comprehensive risk-grading and loan review program includes a review of loans to assess risk and assign a grade to those loans, a review of delinquencies, and an assessment of loans for needed charge-offs or placement on nonaccrual status. The Company had loans in the amount of $38.5 million and $44.0 million at June 30, 2017 and year-end 2016, respectively, which were performing but considered potential problem loans and are not included in the nonperforming loan totals in the table above. These loans, however, are considered in establishing an appropriate allowance for loan losses. The balance outstanding for potential problem credits is partially attributed to lingering strain from the recession on certain of the Company's customers. Potential problem loans include a variety of borrowers and are secured primarily by various types of real estate including commercial, construction properties, and residential real estate developments. At June 30, 2017, the five largest potential problem credits were $11.3 million in the aggregate compared to $11.5 million at year-end 2016.

Potential problem loans are identified on the Company's watch list and consist of loans that require close monitoring by management. Credits may be considered as a potential problem loan for reasons that are temporary or correctable, such as for a deficiency in loan documentation or absence of current financial statements of the borrower. Potential problem loans may also include credits where adverse circumstances are identified that may affect the borrower's ability to comply with the contractual terms of the loan. Other factors which might indicate the existence of a potential problem loan include the delinquency of a scheduled loan payment, deterioration in a borrower's financial condition identified in a review of periodic financial statements, a decrease in the value of the collateral securing the loan, or a change in the economic environment in which the borrower operates. Certain loans on the Company's watch list are also considered impaired and specific allowances related to these loans are established in accordance with the appropriate accounting guidance.

Other Real Estate

OREO includes real estate properties acquired by the Company through, or in lieu of, actual foreclosure. At June 30, 2017, OREO was $6.2 million, a decrease of $4.5 million or 42.0% compared to $10.7 million at year-end 2016. The decrease was driven by sales activity, including the sale of a residential real estate development property that sold for $2.0 million with a related gain of $147 thousand and three larger-balance commercial real estate development properties sold for $1.4 million with a related net loss of $62 thousand in the aggregate. OREO has declined $46.4 million or 88.2% from its peak of $52.6 million, which occurred at year-end 2012. A summary of OREO activity for 2017 follows.

(In thousands)	Amount
Balance at December 31, 2016	$10,673
Transfers from loans and other increases	345
Proceeds from sales	(4,553)
Gain on sales, net	72
Write-downs	(350)
Balance at June 30, 2017	$6,187

Deposits

A summary of the Company's deposits are as follows for the periods indicated:

(In thousands)	End of Period			Average		
	June 30, 2017	December 31, 2016	Increase (Decrease)	Six Months June 30, 2017	Twelve Months December 31, 2016	Increase (Decrease)
Noninterest Bearing	$349,572	$334,676	$14,896	$339,276	$324,596	$14,680
Interest Bearing						
Demand	337,688	348,197	(10,509)	347,209	334,818	12,391
Savings	422,094	416,611	5,483	422,763	407,353	15,410
Time	243,484	270,423	(26,939)	257,863	296,258	(38,395)
Total interest bearing	1,003,266	1,035,231	(31,965)	1,027,835	1,038,429	(10,594)
Total Deposits	$1,352,838	$1,369,907	$(17,069)	$1,367,111	$1,363,025	$4,086

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The decline in total end of period deposits was driven by lower time deposits and interest bearing demand deposits of $26.9 million or 10.0% and $10.5 million or 3.0%, respectively. Noninterest bearing demand deposits and savings deposits increased $14.9 million or 4.5% and $5.5 million or 1.3%. The decrease in time deposits is a result of the Company's overall high liquidity position and a strategy to lower overall funding costs, mainly by allowing higher-rate certificates of deposit to roll off or reprice at lower interest rates. Many of those balances have been rolled into interest and noninterest bearing demand accounts or savings accounts by the customer. As rates have generally decreased throughout the deposit portfolio, many customers have opted to transfer funds from maturing time deposits or investments from other sources into short-term demand or savings accounts. The Company has not sought out or accepted brokered deposits in the past nor does it have plans to do so in the future.

Borrowed Funds

Total borrowed funds were $79.6 million at June 30, 2017, down $8.9 million or 10.0% from year-end 2016. The decline in borrowed funds was driven by a principal payment to the FHLB of $5.0 million for borrowings that matured in February which carried a fixed interest rate of 4.45%. The Company has $10.0 million of FHLB debt outstanding with a fixed interest rate of 3.95% that matures during the third quarter of 2017.

Securities sold under agreements to repurchase were $32.6 million at quarter-end, down $3.8 million or 10.5% from year-end 2016. Securities sold under agreements to repurchase represent funds that have been swept out of the deposit accounts to facilitate the needs of certain qualifying customers, primarily commercial, into repurchase agreements. Such transactions are accounted for as secured borrowings by the Company.

LIQUIDITY

The primary source of funds for the Parent Company is the receipt of dividends from its subsidiary bank, United Bank & Capital Trust Company ("United Bank" or the "Bank"), balances of cash and cash equivalents maintained, and borrowings from nonaffiliated sources. Primary uses of cash include the payment of dividends to its shareholders, paying interest expense on borrowings, and payments to fund general operating expenses.

Payments of dividends to the Parent Company by the Bank are subject to certain regulatory restrictions as set forth in national and state banking laws and regulations. A depository institution may not pay any dividend if payment would cause it to become undercapitalized or if it is already undercapitalized. The federal banking agencies may prevent the payment of a dividend if they determine that the payment would be an unsafe and unsound banking practice. Moreover, the federal agencies have issued policy statements which provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings. Capital ratios at the Bank exceed regulatory established "well-capitalized" status at June 30, 2017 under the prompt corrective action regulatory framework.

The Parent Company had cash and cash equivalents of $52.4 million and $44.3 million at June 30, 2017 and year-end 2016, respectively. Significant cash receipts for 2017 include dividend payments from United Bank of $13 million and management fees from subsidiaries of $551 thousand. Significant cash payments include $1.5 million for the payment of dividends on common stock; $1.5 million to the Bank in connection with the transfer of Parent Company personnel and related liabilities resulting from the consolidation of its subsidiaries; $1.4 million for salaries, payroll taxes, and employee benefits incurred prior to the consolidation of subsidiaries; and $400 thousand for the payment of interest on subordinated notes payable.

The Company's objective as it relates to liquidity is to ensure that the Bank has funds available to meet deposit withdrawals and credit demands without unduly penalizing profitability. In order to maintain a proper level of liquidity, the Bank has several sources of funds available on a daily basis. For assets, those sources of funds include liquid assets that are readily marketable or that can be pledged, or which mature in the near future. These assets primarily include cash and due from banks, federal funds sold, investment securities, and cash flow generated by the repayment of principal and interest on loans and investment securities. For liabilities, sources of funds primarily include the Bank’s core deposits, FHLB and other borrowings, and federal funds purchased and securities sold under agreements to repurchase. While maturities and scheduled amortization of loans and investment securities are generally a predictable source of funds, deposit outflows and mortgage prepayments are influenced significantly by general interest rates, economic conditions, and competition in our local markets.

As of June 30, 2017, the Company had $424 million of additional borrowing capacity under various FHLB, federal funds, and other borrowing agreements. However, there is no guarantee that these sources of funds will continue to be available to the Company, or that current borrowings can be refinanced upon maturity, although the Company is not aware of any events or uncertainties that are likely to cause a decrease in the Company's liquidity from these sources. The Company's borrowing capacity was $275 million at year-end 2016.

For the longer term, the liquidity position is managed by balancing the maturity structure of the balance sheet. This process allows for an orderly flow of funds over an extended period of time. The Company's Asset and Liability Management Committee meets regularly and monitors the composition of the balance sheet to ensure comprehensive management of interest rate risk and liquidity.

Liquid assets consist of cash and cash equivalents and available for sale investment securities. At June 30, 2017, consolidated liquid assets were $562 million, down $32.8 million or 5.5% compared to $594 million at year-end 2016. Although liquid assets decreased in the comparison, the Company's liquidity position remains elevated mainly as a result of the Company's overall net funding position. The overall funding position of the Company changes as loan demand, deposit levels, and other sources and uses of funds fluctuate.

Net cash provided by operating activities was $13.4 million and $10.3 million for the first six months of 2017 and 2016, respectively. This represents an increase of $3.1 million or 29.7%. Net cash used in investing activities was $1.5 million for the first six months of 2017 compared to net cash provided by investing activities of $11.2 million in the comparable period. The change was primarily driven by loan activity, investment securities activity and, to a lesser extent, purchases of restricted stock investments. For loans, the Company had cash outflow representing overall net principal advances of $17.2 million for 2017 compared to net principal collections of $3.2 million a year earlier. The Company had net cash proceeds of $18.9 million related to investment securities for 2017, up $12.3 million compared with the year-ago period. Net cash inflows represent proceeds from the sale, maturity, and call of investment securities in excess of purchases. In the six months of 2017, the Company purchased $3.6 million of restricted stock investments consisting of Federal Reserve Bank ("FRB") stock compared to purchases of $472 thousand in 2016. The Company purchased the additional FRB stock in 2017 as a result of the merger of its subsidiaries. Two of the merged banks were previously not members of a regional FRB.

Net cash used in financing activities was $27.4 million and $30.0 million for the first six months of 2017 and 2016, respectively. This represents a decrease of $2.6 million or 8.8%, driven primarily by cash paid in the prior year to extinguish subordinated notes payable to unconsolidated trusts, partially offset by net repayments of FHLB advances. During 2016, the Company paid $11.0 million to purchase the trust preferred securities issued by Trust II and subsequently extinguished the subordinated debt issued to the trust. There was no similar transaction in the current year. For 2017, the Company had net repayments of FHLB advances of $5.1 million, up $5.0 million from $80 thousand in 2016.

Commitments to extend credit are entered into with customers in the ordinary course of providing traditional banking services and are considered in addressing the Company's liquidity management. The Company does not expect these commitments to significantly affect the liquidity position in future periods. The Company has not entered into any contracts for financial derivative instruments such as futures, swaps, options, or similar instruments.

CAPITAL RESOURCES

Shareholders' equity was $193 million at June 30, 2017, an increase of $8.8 million or 4.8% compared to $184 million at year-end 2016. The increase in shareholders' equity was driven by net income of $7.8 million and higher accumulated other comprehensive income of $2.4 million, partially offset by dividends declared on common stock of $1.5 million. The increase in accumulated other comprehensive income is primarily due to a $2.3 million after-tax increase in the market value of the available for sale investment securities portfolio, which correlates with a general decline in long term market interest rates during the quarter. As market interest rates fall, the value of fixed rate investments generally increase.

At June 30, 2017, the Company's tangible common equity ratio was 11.67%, an increase of 65 basis points compared to 11.02% at year-end 2016. The tangible common equity ratio represents tangible common equity as a percentage of tangible assets, which excludes intangible assets.

In July 2013, U.S. banking regulators adopted final rules related to standards on bank capital adequacy and liquidity (commonly referred to as "Basel III"). The new rules were effective for the Company beginning on January 1, 2015, subject to a phase-in period for certain provisions extending through January 1, 2019. The rules include a new common equity Tier 1 capital ratio, an increase to the minimum Tier 1 capital ratio, an increase to risk-weightings of certain assets, implementation of a new capital conservation buffer in excess of the required minimum (which began being phased in during 2016), and changes to how regulatory capital is defined. At June 30, 2017, the Company and the Bank met the minimum capital ratios and a fully phased-in capital conservation buffer under the new rules.

Consistent with the objective of operating a sound financial organization, the Company's goal is to maintain capital ratios well above the regulatory minimum requirements. The capital ratios of the Company and its subsidiary bank are presented in the following table for the dates indicated.

	June 30, 2017				December 31, 2016			
	Common Equity Tier 1 Risk-based Capital[1]	Tier 1 Risk-based Capital[1]	Total Risk-based Capital[1]	Tier 1 Leverage[2]	Common Equity Tier 1 Risk-based Capital[1]	Tier 1 Risk-based Capital[1]	Total Risk-based Capital[1]	Tier 1 Leverage[2]
Consolidated	16.60 %	19.39 %	20.18 %	13.64 %	16.43 %	19.28 %	20.10 %	13.20 %
United Bank & Capital Trust Company	14.76	14.76	15.55	10.49	*	*	*	*
Farmers Bank & Capital Trust Company	*	*	*	*	16.53	16.53	17.23	9.80
United Bank & Trust Company	*	*	*	*	15.54	15.54	16.47	12.38
First Citizens Bank	*	*	*	*	13.56	13.56	14.16	9.76
Citizens Bank of Northern Kentucky, Inc.	*	*	*	*	15.24	15.24	16.40	10.68
Regulatory minimum	4.50	6.00	8.00	4.00	4.50	6.00	8.00	4.00
Well-capitalized status	6.50	8.00	10.00	5.00	6.50	8.00	10.00	5.00

[1]Common Equity Tier 1 Risked-based, Tier 1 Risk-based, and Total Risk-based Capital ratios are computed by dividing a bank's Common Equity Tier 1, Tier 1 or Total Capital, as defined by regulation, by a risk-weighted sum of the bank's assets, with the risk weighting determined by general standards established by regulation.

[2]Tier 1 Leverage ratio is computed by dividing a bank's Tier 1 Capital by its total quarterly average assets, as defined by regulation.

*In February 2017, the Company merged United Bank & Trust Company, First Citizens Bank, Inc., and Citizens Bank of Northern Kentucky, Inc. into Farmers Bank & Capital Trust Company in Frankfort, KY, the name of which was immediately changed to United Bank & Capital Trust Company.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company uses a simulation model as a tool to monitor and evaluate interest rate risk exposure. The model is designed to measure the sensitivity of net interest income and net income to changing interest rates over future time periods. Forecasting net interest income and its sensitivity to changes in interest rates requires the Company to make assumptions about the volume and characteristics of many attributes, including assumptions relating to the replacement of maturing earning assets and liabilities. Other assumptions include, but are not limited to, projected prepayments, projected new volume, and the predicted relationship between changes in market interest rates and changes in customer account balances. These effects are combined with the Company's estimate of the most likely rate environment to produce a forecast of net interest income and net income. The forecasted results are then adjusted for the effect of a gradual increase and decrease in market interest rates on the Company's net interest income and net income. Because assumptions are inherently uncertain, the model cannot precisely estimate net interest income and net income or the effect of interest rate changes on net interest income and net income. Actual results could differ significantly from simulated results.

At June 30, 2017, the model indicated that if rates were to gradually increase by 150 basis points during the remainder of the calendar year, then net interest income and net income would increase 0.26% and 0.64%, respectively for the year ending December 31, 2017 when compared to the forecasted results for the most likely rate environment. The model indicated that if rates were to gradually decrease by 150 basis points over the same period, then net interest income and net income would decrease 0.78% and 1.85%, respectively.

In the current low interest rate environment, it is not practical or possible to reduce certain deposit rates by the same magnitude as rates on earning assets. The average rate paid on the Company's deposits is presently below 1.5%. This situation magnifies the model's predicted results when modeling a decrease in interest rates, as earning assets with higher yields have more of an opportunity to reprice at lower rates than lower-rate deposits.

Item 4. Controls and Procedures

The Company’s Chief Executive Officer and Chief Financial Officer have reviewed and evaluated the effectiveness of the Company’s disclosure controls and procedures as of the end of the period covered by this report, and have concluded that the Company’s disclosure controls and procedures were adequate and effective to ensure that all material information required to be disclosed in this report has been made known to them in a timely fashion.

The Company’s Chief Executive Officer and Chief Financial Officer have also concluded that there were no significant changes during the quarter ended June 30, 2017 in the Company’s internal control over financial reporting or in other factors that have materially affected, or are reasonably likely to materially affect, the registrant’s internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

As of June 30, 2017, there were various pending legal actions and proceedings against the Company arising from the normal course of business and in which claims for damages are asserted. It is the opinion of management, after discussion with legal counsel, that the disposition or ultimate resolution of such claims and legal actions will not have a material effect upon the consolidated financial statements of the Company.

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

During 2014, the Company changed the form of payment to its directors for board meeting and quarterly fees from 100% cash to 50% in cash and 50% in Company common stock. The shares are issued as part of a plan adopted by the Board of Directors. Each director has elected to participate by entering into an agreement with the Company to accept common stock in lieu of cash for 50% of the director’s board meeting and quarterly fees. As the shares are only issued to directors as part of a plan approved by the Board, the shares are exempt from the registration requirements of the Securities Act of 1933, as amended (the “1933 Act”), as a sale not involving any public offering under Section 4(2) of the 1933 Act. Attendance for committee meetings continues to be paid completely in cash. As employee directors are not paid director’s fees, only non-employee directors receive stock under this plan.

The Company issued a total of 448 shares and 1,194 shares of common stock to its non-employee directors under this plan in the three and six months ended June 30, 2017, respectively, as compensation for director fees of $18 thousand and $46 thousand for those respective periods. The cash retained by the Company by issuing common stock in lieu of paying cash is used for general corporate purposes. There are no brokers involved in the issuance of stock to directors and no commissions or other broker fees are paid.

At various times, the Company’s Board of Directors has authorized the purchase of shares of the Company’s outstanding common stock. No stated expiration dates have been established under any of the previous authorizations. There were no shares of common stock repurchased by the Company during the quarter ended June 30, 2017. There are 84,971 shares that may still be purchased under the various authorizations, although no shares have been purchased since 2008.

Item 6. Exhibits

List of Exhibits

3.1	Second Amended and Restated Articles of Incorporation of Farmers Capital Bank Corporation (incorporated by reference to the Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006 (File No. 000-14412)).
3.2	Articles of Amendment to Second Amended and Restated Articles of Incorporation of Farmers Capital Bank Corporation dated January 6, 2009 (incorporated by reference to the Current Report on Form 8-K dated January 13, 2009 (File No. 000-14412)).

3.3	Articles of Amendment to Second Amended and Restated Articles of Incorporation of Farmers Capital Bank Corporation dated November 16, 2009 (incorporated by reference to the Current Report on Form 8-K dated November 17, 2009 (File No. 000-14412)).
3.4	Amended and Restated Bylaws of Farmers Capital Bank Corporation (incorporated by reference to the Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2015 (File No. 000-14412)).
4.1*	Junior Subordinated Indenture, dated as of July 21, 2005, between Farmers Capital Bank Corporation and Wilmington Trust Company, as Trustee, relating to unsecured junior subordinated deferrable interest notes that mature in 2035.
4.2*	Amended and Restated Trust Agreement, dated as of July 21, 2005, among Farmers Capital Bank Corporation, as Depositor, Wilmington Trust Company, as Property and Delaware Trustee, the Administrative Trustees (as named therein), and the Holders (as defined therein).
4.3*	Guarantee Agreement, dated as of July 21, 2005, between Farmers Capital Bank Corporation, as Guarantor, and Wilmington Trust Company, as Guarantee Trustee.
4.4*	Junior Subordinated Indenture, dated as of July 26, 2005, between Farmers Capital Bank Corporation and Wilmington Trust Company, as Trustee, relating to unsecured junior subordinated deferrable interest notes that mature in 2035.
4.5*	Amended and Restated Trust Agreement, dated as of July 26, 2005, among Farmers Capital Bank Corporation, as Depositor, Wilmington Trust Company, as Property and Delaware Trustee, the Administrative Trustees (as named therein), and the Holders (as defined therein).
4.6*	Guarantee Agreement, dated as of July 26, 2005, between Farmers Capital Bank Corporation, as Guarantor, and Wilmington Trust Company, as Guarantee Trustee.
4.7*	Indenture, dated as of August 14, 2007 between Farmers Capital Bank Corporation, as Issuer, and Wilmington Trust Company, as Trustee, relating to fixed/floating rate junior subordinated debt due 2037.
4.8*	Amended and Restated Declaration of Trust, dated as of August 14, 2007, by Farmers Capital Bank Corporation, as Sponsor, Wilmington Trust Company, as Delaware and Institutional Trustee, the Administrative Trustees (as named therein), and the Holders (as defined therein).
4.9*	Guarantee Agreement, dated as of August 14, 2007, between Farmers Capital Bank Corporation, as Guarantor, and Wilmington Trust Company, as Guarantee Trustee.
10.1	Employee Stock Purchase Plan of Farmers Capital Bank Corporation (incorporated by reference to Form S-8 effective June 24, 2004 (File No. 333-116801)).
10.2	Nonqualified Stock Option Plan of Farmers Capital Bank Corporation (incorporated by reference to Form S-8 effective September 8, 1998 (File No. 333-63037)).
10.3	Employment agreement dated December 10, 2012 between Farmers Capital Bank Corporation and Lloyd C. Hillard, Jr. (incorporated by reference to Exhibit 10.1 to Form 8-K/A filed December 26, 2012 (File No. 000-14412)).

10.4	Amendment No. 1 to Employment agreement dated December 10, 2012 between Farmers Capital Bank Corporation and Lloyd C. Hillard, Jr. (incorporated by reference to Exhibit 10.1 to Form 8-K filed December 30, 2013 (File No. 000-14412)).
10.5	Amendment No. 2 to Employment agreement dated December 10, 2012 between Farmers Capital Bank Corporation and Lloyd C. Hillard, Jr. (incorporated by reference to Exhibit 10.1 to Form 8-K filed December 8, 2014 (File No. 000-14412)).

10.6	Amendment No. 3 to Employment agreement dated December 10, 2012 between Farmers Capital Bank Corporation and Lloyd C. Hillard, Jr. (incorporated by reference to Exhibit 10.1 to Form 8-K filed December 9, 2015 (File No. 000-14412)).
10.7	Amendment No. 4 to Employment agreement dated December 10, 2012 between Farmers Capital Bank Corporation and Lloyd C. Hillard, Jr. (incorporated by reference to Exhibit 10.1 to Form 8-K filed January 4, 2017).
10.8	Employment agreement dated December 17, 2013 between Farmers Capital Bank Corporation and Rickey D. Harp (incorporated by reference to Exhibit 10.1 to Form 8-K filed December 30, 2013 (File No. 000-14412)).
10.9	Employment agreement dated October 28, 2014 between Farmers Capital Bank Corporation and Mark A. Hampton (incorporated by reference to Exhibit 10.1 to Form 8-K filed October 28, 2014 (File No. 000-14412)).
10.10	Employment agreement dated November 18, 2015 between Farmers Capital Bank Corporation and J. David Smith, Jr. (incorporated by reference to Exhibit 10.1 to Form 8-K filed November 19, 2015 (File No. 000-14412)).
10.11	Executive Short-Term Incentive Plan January 1, 2017 (incorporated by reference to Exhibit 10.1 to Form 8-K filed January 24, 2017).
31.1**	CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2**	CFO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32**	CEO & CFO Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101**	Interactive Data Files

* Exhibit not included pursuant to Item 601(b)(4)(iii) and (v) of Regulation S-K. The Company will provide a copy of such exhibit to the Securities and Exchange Commission upon request.

** Filed with this Quarterly Report on Form 10-Q.

SIGNATURES

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

Date: August 7, 2017	*/s/ Lloyd C. Hillard, Jr.* Lloyd C. Hillard, Jr. President and CEO (Principal Executive Officer)
Date: August 7, 2017	*/s/ Mark A. Hampton* Mark A. Hampton Executive Vice President, CFO, and Secretary (Principal Financial and Accounting Officer)