QNB CORP
Form 10-Q
November 07, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 0-17706

QNB Corp.

(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania	23-2318082
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

15 North Third Street, P.O. Box 9005 Quakertown, PA	18951-9005
(Address of Principal Executive Offices)	(Zip Code)

(215) 538-5600

Registrant's Telephone Number, Including Area Code

Not Applicable

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

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

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

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller Reporting Company
Emerging growth company	

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

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

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

Class	Outstanding at November 2, 2018
Common Stock, par value $0.625	3,471,997

QNB CORP. AND SUBSIDIARY

FORM 10-Q

QUARTER ENDED SEPTEMBER 30, 2018

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QNB Corp. and Subsidiary

CONSOLIDATED BALANCE SHEETS

	(in thousands, except share data) (current period unaudited)	
	September 30, 2018	December 31, 2017
Assets		
Cash and due from banks	$12,843	$10,793
Interest-bearing deposits in banks	1,139	5,538
Total cash and cash equivalents	13,982	16,331
Investment debt securities		
Available-for-sale (amortized cost $361,297 and $380,440)	347,392	374,570
Investment equity securities (cost of $10,232 and $5,296)	10,436	4,975
Restricted investment in stocks	1,582	1,501
Loans held-for-sale	154	—
Loans receivable	785,962	733,283
Allowance for loan losses	(8,645)	(7,841)
Net loans	777,317	725,442
Bank-owned life insurance	11,108	10,894
Premises and equipment, net	9,825	8,495
Accrued interest receivable	4,114	3,545
Net deferred tax assets	5,061	3,319
Other assets	3,418	3,265
Total assets	$1,184,389	$1,152,337
Liabilities		
Deposits		
Demand, non-interest bearing	$128,089	$129,212
Interest-bearing demand	316,462	297,470
Money market	72,666	84,562
Savings	283,339	257,522
Time	118,817	124,485
Time of $100 or more	105,192	100,697
Total deposits	1,024,565	993,948
Short-term borrowings	55,923	55,756
Accrued interest payable	425	384
Other liabilities	4,642	3,679
Total liabilities	1,085,555	1,053,767

Shareholders' Equity		
Common stock, par value $0.625 per share; authorized 10,000,000 shares; 3,636,566 shares and 3,612,677 shares issued; 3,471,997 and 3,448,108 shares outstanding	2,273	2,258
Surplus	19,602	18,691
Retained earnings	90,420	84,183
Accumulated other comprehensive loss, net of tax	(10,985)	(4,086)
Treasury stock, at cost; 164,569 shares	(2,476)	(2,476)
Total shareholders' equity	98,834	98,570
Total liabilities and shareholders' equity	$1,184,389	$1,152,337

The accompanying notes are an integral part of the consolidated financial statements.

QNB Corp. and Subsidiary

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data) (unaudited)	Three months ended September 30, 2018	2017	Nine months ended September 30, 2018	2017
Interest income				
Interest and fees on loans	$8,869	$7,722	$25,808	$21,909
Interest and dividends on investment securities (AFS & Equity):				
Taxable	1,553	1,558	4,681	4,672
Tax-exempt	456	507	1,400	1,456
Interest on trading securities	—	—	—	45
Interest on interest-bearing balances and other interest income	48	43	108	76
Total interest income	10,926	9,830	31,997	28,158
Interest expense				
Interest on deposits				
Interest-bearing demand	708	351	1,518	753
Money market	92	59	212	187
Savings	423	300	1,122	837
Time	403	387	1,160	1,127
Time of $100,000 or more	442	357	1,256	1,008
Interest on short-term borrowings	154	61	534	193
Total interest expense	2,222	1,515	5,802	4,105
Net interest income	8,704	8,315	26,195	24,053
Provision for loan losses	568	100	943	700
Net interest income after provision for loan losses	8,136	8,215	25,252	23,353
Non-interest income				
Net gain on sales of investment debt and equity securities	181	178	314	1,042
Other-than-temporary impairment loss on investment securities	—	(80)	—	(80)
Unrealized gain on investment equity securities	731	—	526	—
Net gain on trading activities	—	—	—	27
Fees for services to customers	419	429	1,248	1,242
ATM and debit card	476	435	1,393	1,301
Retail brokerage and advisory	96	168	304	375
Bank-owned life insurance	70	70	207	261
Merchant	85	91	241	263
Net gain on sale of loans	38	65	82	316
Other	131	114	433	328
Total non-interest income	2,227	1,470	4,748	5,075
Non-interest expense				
Salaries and employee benefits	3,612	3,514	10,584	9,837

Net occupancy	472	469	1,391	1,345
Furniture and equipment	528	475	1,578	1,360
Marketing	167	188	698	724
Third party services	473	379	1,389	1,180
Telephone, postage and supplies	170	201	524	600
State taxes	203	161	538	509
FDIC insurance premiums	146	156	467	431
Other	614	648	1,927	1,735
Total non-interest expense	6,385	6,191	19,096	17,721
Income before income taxes	3,978	3,494	10,904	10,707
Provision for income taxes	767	940	1,896	2,907
Net income	$3,211	$2,554	$9,008	$7,800
Earnings per share - basic	$0.93	$0.74	$2.60	$2.28
Earnings per share - diluted	$0.92	$0.74	$2.59	$2.27
Cash dividends per share	$0.32	$0.31	$0.96	$0.93

The accompanying notes are an integral part of the consolidated financial statements.

QNB Corp. and Subsidiary

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	(in thousands - unaudited)					
	2018			2017		
Three months ended September 30,	Before tax amount	Tax expense (benefit)	Net of tax amount	Before tax amount	Tax expense (benefit)	Net of tax amount
Net income	$3,978	$767	$3,211	$3,494	$940	$2,554
Other comprehensive (loss) income:						
Net unrealized holding (losses) gains on securities:						
Unrealized holding (losses) gains arising during the period	(1,770)	(372)	(1,398)	96	33	63
Reclassification adjustment for gains included in net income	—	—	—	(98)	(33)	(65)
Other comprehensive (loss)	(1,770)	(372)	(1,398)	(2)	-	(2)
Total comprehensive income	$2,208	$395	$1,813	$3,492	$940	$2,552

Nine months ended September 30,	2018			2017		
	Before tax amount	Tax expense (benefit)	Net of tax amount	Before tax amount	Tax expense (benefit)	Net of tax amount
Net income	$10,904	$1,896	$9,008	$10,707	$2,907	$7,800
Other comprehensive (loss) income:						
Net unrealized holding (losses) gains on securities:						
Unrealized holding (losses) gains arising during the period	(8,033)	(1,687)	(6,346)	3,027	1,029	1,998
Reclassification adjustment for gains included in net income	(3)	(1)	(2)	(962)	(326)	(636)
Other comprehensive (loss) income	(8,036)	(1,688)	(6,348)	2,065	703	1,362
Total comprehensive income	$2,868	$208	$2,660	$12,772	$3,610	$9,162

Tax rate of 21% for 2018 and 34% for 2017

The accompanying notes are an integral part of the consolidated financial statements

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QNB Corp. and Subsidiary

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

Nine months ended September 30, 2018 and 2017

(unaudited) (in thousands, except share and per share data)	Number of Shares Outstanding	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Balance, December 31, 2017	3,448,108	$ 2,258	$ 18,691	$ 84,183	$ (4,086)	$ (2,476)	$ 98,570
Net income		—	—	9,008	—	—	9,008
Other comprehensive loss, net of tax		—	—	—	(6,348)	—	(6,348)
Cash dividends declared ($0.96 per share)		—	—	(3,322)	—	—	(3,322)
Equity securities fair value reclassification [1]				(254)	254		—
ASU 2018-02 stranded tax reclassification [2]				805	(805)		—
Stock issued in connection with dividend reinvestment and stock purchase plan	16,463	10	707	—	—	—	717
Stock issued for employee stock purchase plan	1,426	1	55	—	—	—	56
Stock issued for options exercised	6,000	4	65	—	—	—	69
Stock-based compensation expense		—	84	—	—	—	84
Balance, September 30, 2018	3,471,997	$ 2,273	$ 19,602	$ 90,420	$ (10,985)	$ (2,476)	$ 98,834

[1] Refer to Note 2, ASU 2016-01

[2] Refer to Note 2, ASU 2018-02

(unaudited) (in thousands, except share and per share data)	Number of Shares Outstanding	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Balance, December 31, 2016	3,411,701	$ 2,235	$ 17,418	$ 80,147	$ (3,757)	$ (2,476)	$ 93,567
Net income		—	—	7,800	—	—	7,800
		—	—	—	1,362	—	1,362

Other comprehensive income, net of tax							
Cash dividends declared ($0.93 per share)		—	—	(3,186)	—	—	(3,186)
Stock issued in connection with dividend reinvestment and stock purchase plan	19,495	12	727	—	—	—	739
Stock issued for employee stock purchase plan	1,318	1	41	—	—	—	42
Stock issued for options exercised	7,742	5	111	—	—	—	116
Stock-based compensation expense		—	72	—	—	—	72
Balance, September 30, 2017	3,440,256	$ 2,253	$ 18,369	$ 84,761	$ (2,395)	$ (2,476)	$ 100,512

The accompanying notes are an integral part of the consolidated financial statements.

QNB Corp. and Subsidiary

CONSOLIDATED STATEMENTS OF CASH FLOWS

	(in thousands, unaudited)	
Nine months ended September 30,	2018	2017
Operating Activities		
Net income	$9,008	$7,800
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	684	607
Provision for loan losses	943	700
Net gain on sales of debt and equity securities	(314)	(962)
Net unrealized gain on equity securities	(526)	—
Net gain on sale of other real estate owned, repossessed assets and premises and equipment	(1)	(1)
Net gain on sale of loan held for investment	—	(99)
Net gain on sale of loans	(82)	(217)
Proceeds from sales of residential mortgages held-for-sale	3,297	6,867
Origination of residential mortgages held-for-sale	(3,369)	(5,976)
Income on bank-owned life insurance	(207)	(261)
Stock-based compensation expense	84	72
Net decrease in trading securities	—	3,596
Deferred income tax (benefit) provision	(2)	28
Net increase in income taxes payable	478	205
Net increase in accrued interest receivable	(569)	(488)
Amortization of mortgage servicing rights and change in valuation allowance	47	65
Net amortization of premiums and discounts on investment securities	1,093	1,267
Net increase in accrued interest payable	41	1
Increase in other assets	(371)	(1,219)
Increase increase in other liabilities	596	464
Net cash provided by operating activities	10,830	12,449
Investing Activities		
Proceeds from payments, maturities and calls of debt securities available-for-sale	33,760	39,570
Proceeds from the sale of debt securities available-for-sale	4,159	26,387
Proceeds from the sale of equity securities	2,720	7,324
Purchases of debt securities available-for-sale	(19,866)	(71,712)
Purchases of equity securities	(7,344)	(5,747)
Proceeds from redemption of investment in restricted bank stock	8,025	4,790
Purchase of restricted stock	(8,106)	(4,351)
Proceeds from sale of loan held for investment	—	99
Net increase in loans	(52,818)	(71,104)
Net purchases of premises and equipment	(2,014)	(471)
Redemption of bank-owned life insurance	—	754
Proceeds from sales of other real estate owned and repossessed assets	1	2
Net cash used in investing activities	(41,483)	(74,459)

Financing Activities		
Net (decrease) increase in non-interest bearing deposits	(1,123)	3,686
Net increase in interest-bearing deposits	31,740	88,404
Net increase (decrease) in short-term borrowings	167	(12,484)
Cash dividends paid, net of reinvestment	(2,892)	(2,794)
Proceeds from issuance of common stock	412	505
Net cash provided by financing activities	28,304	77,317
(Decrease) increase in cash and cash equivalents	(2,349)	15,307
Cash and cash equivalents at beginning of year	16,331	10,721
Cash and cash equivalents at end of period	$13,982	$26,028
Supplemental Cash Flow Disclosures		
Interest paid	$5,761	$4,104
Income taxes paid	1,420	2,668

The accompanying notes are an integral part of the consolidated financial statements

QNB CORP. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements include the accounts of QNB Corp. and its wholly-owned subsidiary, QNB Bank (the “Bank”). The consolidated entity is referred to herein as “QNB” or the “Company”. All significant intercompany accounts and transactions are eliminated in the consolidated financial statements.

These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in QNB's 2017 Annual Report incorporated in the Form 10-K. Operating results for the nine-month period ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018.

The unaudited consolidated financial statements reflect all adjustments which, in the opinion of management, are necessary for a fair presentation of the results of operations for the period and are of a normal and recurring nature.

Tabular information, other than share and per share data, is presented in thousands of dollars.

In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from such estimates.

QNB has evaluated events and transactions occurring subsequent to the balance sheet date of September 30, 2018, for items that should potentially be recognized or disclosed in these consolidated financial statements.

2. RECENT ACCOUNTING PRONOUNCEMENTS

QNB adopted ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, effective January 1, 2018. This ASU was issued by the Financial Accounting Standards Board (FASB) on January 5, 2016 to enhance the reporting model for financial instruments to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The FASB issued ASU 2018-03 in February 2018 which provides technical corrections and improvements to ASU 2016-01. QNB adopted the applicable requirements under these ASUs as follows:

- Equity investments with readily determinable fair values are measured at fair value with changes in fair value recognized in net income.
- Equity investments without readily determinable fair values must be measured at either fair value or at cost adjusted for changes in observable prices minus impairment. Changes in value under either of these methods would be recognized in net income. The Company chose to continue to measure equity investments without readily

determinable fair value at cost adjusted for changes in observable prices minus impairment. The Company will reassess at each reporting period whether these equity investments without readily determinable fair values qualify to be measured in accordance with the practical expedient to estimate fair value. The Company can subsequently elect to measure these equity investments, if they qualify, at the estimated fair value under the practical expedient; but the election would be irrevocable. Any gains or losses resulting from changes in the fair value would be recognized in net income.

- Entities must assess whether a valuation allowance is required for deferred tax assets related to available-for-sale debt securities.

QNB used the modified retrospective method for transition in which the cumulative effect will be recognized at the date of adoption with no restatement of comparative periods presented. QNB reclassified a net loss of $254,000 from accumulated other comprehensive loss to retained earnings on January 1, 2018. Based on an evaluation of our deferred tax asset and considering the effect of the new guidance, management believes that deferred tax assets related to AFS debt securities are realizable and no valuation allowance would be required. Management believes the potential effect of using exit versus entry price is most relevant for fair value disclosures of loans, which considers the impact of credit risk on fair value.

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (2017 Tax Reform Act) was enacted into law. The 2017 Tax Reform Act made significant changes to U.S. corporate income tax laws including a decrease in the corporate income tax rate from 35% to 21% effective January 1, 2018. The Company recorded less tax expense for the three and nine months periods of 2018 than in the

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(Unaudited)

comparable periods of 2017, with effective tax rates of 19.3% in 2018 compared to 26.9% in 2017 for the three months and 17.4% in 2018 compared to 27.2% in 2017 for the nine months, primarily a result of the 2017 Tax Reform Act.

QNB adopted ASU 2018-02, Income Statement—Reporting Comprehensive Income (Topic 202) during the first quarter of 2018. The amendments in this ASU, issued by the FASB on February 2, 2018, affect any entity that is required to apply the provisions of Topic 220, Income Statement—Reporting Comprehensive Income, and has items of other comprehensive income for which the related tax effects are presented in other comprehensive income as required by GAAP. The amendments in this ASU allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the 2017 Tax Reform Act and eliminates the stranded tax effects resulting from the 2017 Tax Reform Act. The Company chose to early adopt the amendments in this update as permitted. QNB reclassified $805,000 from accumulated other comprehensive loss to retained earnings in the consolidated statement of shareholders' equity during the first quarter of 2018.

QNB adopted Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606) (ASC 606), effective January 1, 2018. Under ASU 2014-09, revenue is recognized when a customer obtains control of promised services in an amount that reflects the consideration the entity expects to receive in exchange for those services. In addition, the standard requires disclosure of the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. QNB applied the five-step method outlined in ASU 2014-09 to all revenue streams scoped-in by the ASU and elected the modified retrospective implementation method. Substantially all of QNB's interest income and non-interest income were not impacted by the adoption of this ASU because either the revenue from those contracts with customers is covered by other guidance in U.S. GAAP or the revenue recognition outcomes were similar to our current revenue recognition practices. We reviewed non-interest sources of income and related contracts to document the impact of the new standard on our service offerings that are in the scope of the ASU including: service charges on deposits; ATM and debit card income; retail brokerage and advisory fees; merchant income; credit card income; sale of checks to depositors; miscellaneous fees; and sale of OREOs. Upon our analysis we concluded that the adoption of ASC 606 did not change the timing and pattern of revenue recognition related to scoped in non-interest income sources and only required additional disclosures. In addition, we reviewed, and where necessary, enhanced our business processes, systems and controls to support recognition and disclosures under the new standard.

The implementation of the guidance had no material impact on the measurement or recognition of revenue of prior periods, however, additional disclosures have been added in accordance with the ASU which can be found in Note 12 – Revenue Recognition from Contracts with Customers.

On February 25, 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This new standard on accounting for leases introduces a lessee model that brings most leases on the balance sheet but recognizes expenses in the income statement similar to how items are recorded today. The new standard eliminates the requirement in current U.S. GAAP for an entity to use bright-line tests in determining lease classification. The ASU also eliminates the current real estate-specific provisions and changes the guidance on sale-leaseback transactions, initial direct costs and lease executory costs for all entities. All entities will classify leases to determine how to recognize the related revenue and expense and this classification will affect amounts that lessors record on the balance sheet. The new guidance will be effective for public companies for annual periods beginning after December 15, 2018, and interim periods therein. Early adoption is permitted. In 2018, the FASB added a transition option for all entities to help reduce the cost and complexity of implementation. Under this transition option, entities can opt to not apply the new guidance, including disclosure requirements, in the comparative periods they present in their financial statements in the year of adoption. QNB does not expect the adoption of ASU 2016-02 to have a material impact on net income; however, as of January 1, 2019, QNB expects to record a right of use asset of approximately $1,960,000, a finance lease liability of approximately $1,940,000, an operating lease liability of approximately $300,000, and the reversal of a deferred rent liability of approximately $280,000.

On June 16, 2016, the FASB issued ASU No. 2016-13, Financial Instruments—Credit Losses (Topic 326). The new guidance requires organizations to measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts.

To that end, the new guidance:

- Eliminates the probable initial recognition threshold in current U.S. GAAP and, instead, reflects an organization’s current estimate of all expected credit losses over the contractual term of its financial assets

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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- Broadens the information an entity can consider when measuring credit losses to include forward-looking information
- Increases usefulness of the financial statements by requiring timely inclusion of forecasted information in forming expectations of credit losses
- Increases comparability of purchased financial assets with credit deterioration (PCD assets) with other purchased assets that do not have credit deterioration as well as originated assets because credit losses that are expected will be recorded through an allowance for credit losses for all assets
- Increases users' understanding of underwriting standards and credit quality trends by requiring additional information about credit quality indicators by year of origination (vintage)
- For available-for-sale debt securities, aligns the income statement recognition of credit losses with the reporting period in which changes occur by recording credit losses (and subsequent changes in credit losses) through an allowance rather than a write down

The new guidance affects organizations that hold financial assets and net investments in leases that are not accounted for at fair value with changes in fair value reported in net income. The new guidance affects loans, debt securities, trade receivables, net investments in leases, off-balance-sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash.

For public business entities that are U.S. Securities and Exchange Commission (SEC) filers, the new guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. QNB is evaluating the impact of this new standard on its consolidated financial statements.

On March 30, 2017, the FASB issued ASU 2017-08, Premium Amortization on Purchased Callable Debt Securities. This ASU is intended to enhance the accounting for the amortization of premiums for purchased callable debt securities and will require premiums to be amortized to the earliest call date. For public companies, the ASU is effective for annual reporting periods beginning after December 15, 2018, including interim periods within those annual reporting periods. QNB does not anticipate this new standard will have a material impact on its consolidated financial statements as it already uses the earliest call date to amortize premiums on callable debt securities.

On August 28, 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement. This ASU changes the fair value measurement disclosure requirements of ASC 820. The amendments in this ASU are the result of a broader disclosure project called FASB Concepts Statement, Conceptual Framework for Financial Reporting — Chapter 8: Notes to Financial Statements, which the FASB finalized on August 28, 2018. The FASB used the guidance in the Concepts Statement to improve the effectiveness of ASC 820's disclosure requirements. New disclosure requirements include: 1) Changes in unrealized gains or losses included in other comprehensive income (OCI) for recurring Level 3 fair value measurements held at the end of the reporting period; and 2) Explicit requirement to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. Disclosure eliminated include: 1) Amount of and reasons for transfers between Level 1 and Level 2; 2) Valuation processes for Level 3 fair value measurements; and 3) Policy for timing of transfers between levels of the fair value hierarchy. The ASU is effective for all entities for fiscal years beginning after December 15, 2019, including interim periods therein. Early adoption is permitted for any eliminated or modified disclosures upon issuance of this ASU.

3. STOCK-BASED COMPENSATION AND SHAREHOLDERS' EQUITY

QNB sponsors stock-based compensation plans, administered by a Board committee, under which both qualified and non-qualified stock options may be granted periodically to certain employees. Compensation cost has been measured using the fair value of an award on the grant date and is recognized over the service period, which is usually the vesting period.

Stock-based compensation expense was $26,000 and $21,000 for the three months ended September 30, 2018 and 2017, respectively. Stock-based compensation expense was $84,000 and $72,000 for the nine months ended September 30, 2018 and 2017, respectively. As of September 30, 2018, there was approximately $137,000 of unrecognized compensation cost related to unvested share-based compensation award grants that is expected to be recognized over the next 29 months.

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(Unaudited)

Options are granted to certain employees at prices equal to the market value of the stock on the date the options are granted. The 2005 Plan authorized the issuance of 200,000 shares. The time period during which any option is exercisable under the Plan is determined by the Committee but shall not commence before the expiration of six months after the date of grant or continue beyond the expiration of five years after the date the option is awarded. The granted options vest after a three-year period. As of September 30, 2018, there were 184,200 options granted, 65,850 options forfeited, 91,825 options exercised, and 26,525 options outstanding under this Plan. The 2005 Plan expired on March 15, 2015.

The 2015 Plan authorizes the issuance of 300,000 shares. The terms of the 2015 Plan are identical to the 2005 Plan. There were 73,500 options granted and outstanding under this Plan as of September 30, 2018. There were 1,100 options forfeited and no options exercised as of September 30, 2018. The 2015 Plan expires on February 24, 2025.

The fair value of each option is amortized into compensation expense on a straight-line basis between the grant date for the option and each vesting date. QNB estimated the fair value of stock options on the date of the grant using the Black-Scholes option pricing model. The model requires the use of numerous assumptions, many of which are highly subjective in nature.

The following assumptions were used in the option pricing model in determining the fair value of options granted during the period:

Nine months ended September 30,	2018	2017
Risk free interest rate	2.15 %	1.48 %
Dividend yield	1.24 %	3.19 %
Volatility	18.12 %	17.89 %
Expected life (years)	4.20	4.20

The risk-free interest rate was selected based upon yields of U.S. Treasury issues with a term approximating the expected life of the option being valued. Historical information was the primary basis for the selection of the expected dividend yield, expected volatility and expected lives of the options.

The fair market value of options granted in the first nine months of 2018 and 2017 was $5.29 and $3.88, respectively.

Stock option activity during the nine months ended September 30, 2018 and 2017 is as follows:

	Number	Weighted	Weighted	Aggregate

	of options	average exercise price	average remaining contractual term (in years)	intrinsic value
Outstanding at December 31, 2017	85,525	$ 30.94		
Granted	25,000	43.60		
Exercised	(10,000)	24.86		
Forfeited	(1,600)	32.52		
Outstanding at September 30, 2018	98,925	$ 34.73	2.74	$ 1,105
Exercisable at September 30, 2018	26,525	$ 27.46	0.90	$ 489

	Number of options	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value
Outstanding at December 31, 2016	73,950	$ 27.14		
Granted	25,000	37.60		
Exercised	(11,775)	22.33		
Forfeited	(100)	21.35		
Outstanding at September 30, 2017	87,075	$ 30.80	2.87	$ 848
Exercisable at September 30, 2017	20,725	$ 24.39	0.93	$ 335

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4. EARNINGS PER SHARE & SHARE REPURCHASE PLAN

The following sets forth the computation of basic and diluted earnings per share:

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Numerator for basic and diluted earnings per share - net income	$3,211	$2,554	$9,008	$7,800
Denominator for basic earnings per share - weighted average shares outstanding	3,466,672	3,433,811	3,459,906	3,424,813
Effect of dilutive securities - employee stock options	22,389	18,771	21,083	16,393
Denominator for diluted earnings per share - adjusted weighted average shares outstanding	3,489,061	3,452,582	3,480,989	3,441,206
Earnings per share - basic	$0.93	$0.74	$2.60	$2.28
Earnings per share - diluted	0.92	0.74	2.59	2.27

There were 25,000 stock options that were anti-dilutive for both three- and nine-month periods ended September 30, 2018 and 2017. These stock options were not included in the above calculation.

The Board of Directors has authorized the repurchase of up to 100,000 shares of its common stock in open market or privately negotiated transactions. The repurchase authorization does not bear a termination date. There were no shares repurchased during the three and nine months ended September 30, 2018 and 2017. As of September 30, 2018, 57,883 shares were repurchased under this authorization at an average price of $16.97 and a total cost of $982,000.

5. COMPREHENSIVE INCOME (LOSS)

The following shows the components of accumulated other comprehensive income (loss) at September 30, 2018 and December 31, 2017:

	September 30, 2018	December 31, 2017
Unrealized net holding losses on available-for-sale securities	$ (13,902)	$ (6,165)
Unrealized losses on available-for-sale securities for which a portion of an other-than-temporary impairment loss has been recognized in earnings	(3)	(26)
Accumulated other comprehensive loss	(13,905)	(6,191)
Tax effect	2,920	1,300
Stranded tax effect (1)	—	805
Accumulated other comprehensive loss, net of tax	$ (10,985)	$ (4,086)

(1) Refer to Note 2, ASU 2018-02

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The following tables present amounts reclassified out of accumulated other comprehensive income (loss) for the three and nine months ended September 30, 2018 and 2017:

Three months ended September 30,	Amount reclassified from accumulated other comprehensive loss		
Details about accumulated other comprehensive loss	2018	2017	Affected line item in statement of income
Unrealized net holding gains on available-for-sale securities	$ —	$ 178	Net gain on sale of investment securities
Other-than-temporary impairment losses on investment securities	—	(80)	Net other-than-temporary impairment losses on investment securities
	—	98	
Tax effect	—	(33)	Provision for income taxes
Total reclass out of accumulated other comprehensive income, net of tax	$ —	$ 65	Net of tax

Nine months ended September 30,	Amount reclassified from accumulated other comprehensive loss		
Details about accumulated other comprehensive loss	2018	2017	Affected line item in statement of income
Unrealized net holding gains on available-for-sale securities	$ 3	$ 1,042	Net gain on sale of investment securities
Other-than-temporary impairment losses on investment securities	—	(80)	Net other-than-temporary impairment losses on investment securities
	3	962	

Tax effect	(1)	(326)	Provision for income taxes
Total reclass out of accumulated other comprehensive income, net of tax	$ 2	$ 636	Net of tax

6. INVESTMENT SECURITIES

QNB engaged in trading activities for its own account. Municipal securities that were held principally for resale in the near term were recorded in the trading account at fair value with changes in fair value recorded in non-interest income. During the second quarter of 2017, QNB Bank redeemed the trading securities portfolio, as lack of volatility and the interest rate environment resulted in the declined performance of the portfolio. The net realized gains were $27,000 for the nine months ended September 30, 2017. Interest and dividends were included in interest income.

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The amortized cost and estimated fair values of investment debt securities available-for-sale and equity securities at September 30, 2018 and December 31, 2017 were as follows:

September 30, 2018	Fair value	Gross unrealized holding gains	Gross unrealized holding losses	Amortized cost
U.S. Government agency	$69,369	$ —	$(3,110)	$72,479
State and municipal	69,002	147	(1,038)	69,893
U.S. Government agencies and sponsored enterprises (GSEs):				
Mortgage-backed	127,898	80	(5,940)	133,758
Collateralized mortgage obligations (CMOs)	76,049	7	(3,972)	80,014
Pooled trust preferred	119	—	(3)	122
Corporate debt	4,955	13	(89)	5,031
Equity	10,436	804	(600)	10,232
Total investment debt securities available-for-sale and equity securities	$357,828	$ 1,051	$(14,752)	$371,529

December 31, 2017	Fair value	Gross unrealized holding gains	Gross unrealized holding losses	Amortized cost
U.S. Government agency	$70,524	$ —	$(1,948)	$72,472
State and municipal	76,804	717	(113)	76,200
U.S. Government agencies and sponsored enterprises (GSEs):				
Mortgage-backed	142,703	195	(2,401)	144,909
Collateralized mortgage obligations (CMOs)	76,302	29	(2,292)	78,565
Pooled trust preferred	215	—	(26)	241
Corporate debt	8,022	6	(37)	8,053
Equity	4,975	28	(349)	5,296
Total investment debt securities available-for-sale and equity securities	$379,545	$ 975	$(7,166)	$385,736

The amortized cost and estimated fair value of debt securities available-for-sale by contractual maturity at September 30, 2018 are shown in the following table. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities are assigned to categories based on contractual maturity except for mortgage-backed securities and CMOs which are based on the estimated average life of these securities and municipal securities that have been pre-refunded.

September 30, 2018	Fair value	Amortized cost
Due in one year or less	$9,443	$ 9,431
Due after one year through five years	198,468	206,465
Due after five years through ten years	119,065	124,327
Due after ten years	20,416	21,074
Total investment debt securities available-for-sale	$347,392	$ 361,297

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Proceeds from sales of investment debt securities available-for-sale were approximately $0 and $4,431,000 for the three months ended September 30, 2018 and 2017, respectively. Proceeds from sales of investment equity securities were approximately $1,330,000 and $2,062,000 for the three months ended September 30, 2018 and 2017, respectively. Proceeds from sales of investment debt securities available-for-sale were approximately $4,159,000 and $26,387,000 for the nine months ended September 30, 2018 and 2017, respectively. Proceeds from sales of investment equity securities were approximately $2,720,000 and $7,324,000 for the nine months ended September 30, 2018 and 2017, respectively.

At September 30, 2018 and December 31, 2017, investment debt securities available-for-sale totaling approximately $206,843,000 and $202,887,000, respectively, were pledged as collateral for repurchase agreements and deposits of public funds.

The following table presents information related to the Company's gains and losses on the sales of equity and debt securities, and losses recognized for the other-than-temporary impairment ("OTTI") of these investments. Gains and losses on available-for-sale securities are computed on the specific identification method and included in non-interest income. Gross realized losses on equity and debt securities are net of other-than-temporary impairment charges:

	Three months ended September 30, 2018						Three months ended September 30, 2017			
	Gross realized gains	Gross realized losses	Other-than-temporary impairment losses	Gross unrealized gains	Gross unrealized losses	Net gains	Gross realized gains	Gross realized losses	Other-than-temporary impairment losses	Net gains
Equity securities	$206	$ (25)	$ —	$ 858	$ (127)	$912	$164	$ —	$ (80)	$ 84
Debt securities available-for-sale	—	—	—	—	—	—	56	(42)	—	14
Total	$206	$ (25)	$ —	$ 858	$ (127)	$912	$220	$ (42)	$ (80)	$ 98

	Nine months ended September 30, 2018						Nine months ended September 30, 2017			
	Gross realized gains	Gross realized losses	Other-than-temporary impairment losses	Gross unrealized gains	Gross unrealized losses	Net gains	Gross realized gains	Gross realized losses	Other-than-temporary impairment losses	Net gains
Equity securities	$336	$ (25)	$ —	$ 840	$ (314)	$837	$1,020	$ —	$ (80)	$940
Debt securities available-for-sale	25	(22)	—	—	—	3	566	(544)	—	22
Total	$361	$ (47)	$ —	$ 840	$ (314)	$840	$1,586	$ (544)	$ (80)	$962

Tax expense applicable to the net realized gains for the three-month periods ended September 30, 2018 and 2017 were $52,000 and $33,000, respectively. Tax expense applicable to the net realized gains for the nine-month periods ended September 30, 2018 and 2017 were $91,000 and $327,000, respectively.

QNB recognizes OTTI for debt securities classified as available-for-sale in accordance with FASB ASC 320, Investments – Debt and Equity Securities, which requires that we assess whether we intend to sell or it is more likely than not that the Company will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other-than-temporarily impaired and that we do not intend to sell and will not be required to sell prior to recovery of our amortized cost basis, the amount of the impairment is separated into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows discounted at the security's effective yield. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and, therefore, is not required to be recognized as a loss in the income statement but is recognized in other comprehensive income. For equity securities, once a decline in value is determined to be other-than-temporary, the value of the equity security is reduced to fair value and a corresponding charge to earnings is recognized. QNB believes that we will fully collect the carrying value of securities on which we have recorded a non-credit related impairment in other comprehensive income.

The following table presents a roll forward of the credit loss component recognized in earnings. The credit loss component of the amortized cost represents the difference between the present value of expected future cash flows and the amortized cost basis of the

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security prior to considering credit losses. The beginning balance represents the credit loss component for debt securities for which OTTI occurred prior to the beginning of the year. Credit-impaired debt securities must be presented in two components based upon whether the current period is the first time the debt security was credit-impaired (initial credit impairment) or is not the first time the debt security was credit-impaired (subsequent credit impairments). No credit impairments were recognized on debt securities during first nine months of 2018 or 2017. The table presents a summary of the cumulative credit-related other-than-temporary impairment charges recognized as components of earnings for debt securities still held by QNB:

Nine months ended September 30,	2018	2017
Balance, beginning of period	$ 1	$ 1,153
Reductions: sale, collateralized debt obligation	—	(1,152)
Additions:		
Initial credit impairments	—	—
Subsequent credit impairments	—	—
Balance, end of period	$ 1	$ 1

The following table indicates the length of time individual securities have been in a continuous unrealized loss position at September 30, 2018 and December 31, 2017:

		Less than 12 months		12 months or longer		Total	
September 30, 2018	No. of securities	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
U.S. Government agency	53	$998	$ (1)	$68,371	$ (3,109)	$69,369	$ (3,110)
State and municipal	120	40,315	(680)	8,964	(358)	49,279	(1,038)
U.S. Government agencies and sponsored enterprises (GSEs):							
Mortgage-backed	113	21,731	(517)	104,077	(5,423)	125,808	(5,940)
Collateralized mortgage obligations (CMOs)	82	15,961	(282)	59,466	(3,690)	75,427	(3,972)
Pooled trust preferred	1	—	—	119	(3)	119	(3)

Corporate debt	4	991	(18)	2,950	(71)	3,941	(89)
Equity	13	2,005	(145)	1,577	(455)	3,582	(600)
Total	386	$82,001	$(1,643)	$245,524	$(13,109)	$327,525	$(14,752)

		Less than 12 months		12 months or longer		Total	
December 31, 2017	No. of securities	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
U.S. Government agency	53	$10,828	$(155)	$59,696	$(1,793)	$70,524	$(1,948)
State and municipal	37	10,577	(49)	4,446	(64)	15,023	(113)
U.S. Government agencies and sponsored enterprises (GSEs):							
Mortgage-backed	99	61,069	(705)	72,318	(1,696)	133,387	(2,401)
Collateralized mortgage obligations (CMOs)	70	21,660	(349)	52,833	(1,943)	74,493	(2,292)
Pooled trust preferred	1	—	—	215	(26)	215	(26)
Corporate debt	4	3,018	(20)	988	(17)	4,006	(37)
Equity	11	2,727	(277)	275	(72)	3,002	(349)
Total	275	$109,879	$(1,555)	$190,771	$(5,611)	$300,650	$(7,166)

Management evaluates debt securities, which are comprised of U.S. Government agencies, state and municipalities, mortgage-backed securities, CMOs and corporate debt securities, for other-than-temporary impairment and considers the current economic conditions, the length of time and the extent to which the fair value has been less than cost, interest rates and the bond rating of each security. The unrealized losses at September 30, 2018 in U.S. Government agency securities, state and municipal securities, mortgage-backed

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securities, CMOs and corporate debt securities are primarily the result of interest rate fluctuations. If held to maturity, these bonds will mature at par, and QNB will not realize a loss. The Company has the intent to hold the securities and does not believe it will be required to sell the securities before recovery occurs.

The Company’s investment in marketable equity securities primarily consists of investments in large cap stock companies. These equity securities are analyzed for impairment on an ongoing basis. Management believes these equity securities will recover in the foreseeable future. QNB evaluated the near-term prospects of the issuers in relation to the severity and duration of the impairment. Based on that evaluation and the Company’s ability and intent to hold those securities for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider these equity securities to be other-than-temporarily impaired.

QNB holds one pooled trust preferred security as of September 30, 2018. This security has a total amortized cost of approximately $122,000 and a fair value of $119,000. The pooled trust preferred security is in available-for-sale securities and is carried at fair value.

The following table provides additional information related to the pooled trust preferred security (PreTSL) as of September 30, 2018:

Deal	Class	Book value	Fair value	Unrealized gains (losses)	Realized OTTI credit loss (YTD 2018)	Total recognized OTTI credit loss	Moody's /Fitch ratings	Current number of performing banks	Current number of performing insurance companies	Actual deferrals and defaults as a % of total collateral	Total performing collateral as a % of outstanding bonds
PreTSL IV	Mezzanine*	$122	$119	$ (3)	$ —	$ (1)	Ba1/BB	4	—	0.00 %	186.3 %

Mezzanine* - only class of bonds still outstanding (represents the senior-most obligation of the trust)

7. RESTRICTED INVESTMENT IN STOCK

Restricted investment in stock includes Federal Home Loan Bank of Pittsburgh (FHLB) with a carrying cost of $1,570,000, Atlantic Community Bankers Bank (ACBB) stock with a carrying cost of $12,000 and VISA Class B stock with a carrying cost of $0 at September 30, 2018. FHLB and ACBB stock was issued to the Bank as a requirement to facilitate the Bank's participation in borrowing and other banking services. The Bank's investment in FHLB stock may fluctuate, as it is based on the member banks' use of FHLB's services.

The Bank owns 6,502 shares of Visa Class B stock, which was necessary to participate in Visa services in support of the Bank's credit card, debit card, and related payment programs (permissible activities under banking regulations) as a member institution. Following the resolution of Visa's covered litigation, shares of Visa's Class B stock will be converted to Visa Class A shares using a conversion factor (1.6298 as of September 30, 2018), which is periodically adjusted to reflect VISA's ongoing litigation costs. There is a very limited market for this stock, as only current owners of Class B shares are permitted to transact in Class B. Due to the lack of orderly trades and public information of such trades, Visa Class B does not have a readily determinable fair value.

These restricted investments are carried at cost and evaluated for OTTI periodically. As of September 30, 2018, there was no OTTI associated with these shares.

8. LOANS & ALLOWANCE FOR LOAN LOSSES

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are stated at the principal amount outstanding, net of deferred loan fees and costs. Interest income is accrued on the principal amount outstanding. Loan origination and commitment fees and related direct costs are deferred and amortized to income over the term of the respective loan and loan commitment period as a yield adjustment.

Loans held-for-sale consists of residential mortgage loans that are carried at the lower of aggregate cost or fair value. Net unrealized losses, if any, are recognized through a valuation allowance charged to income. Gains and losses on residential mortgages held-for-sale are included in non-interest income.

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QNB maintains an allowance for loan losses, which is intended to absorb probable known and inherent losses in the outstanding loan portfolio. The allowance is reduced by actual credit losses and is increased by the provision for loan losses and recoveries of previous losses. The provisions for loan losses are charged to earnings to bring the total allowance for loan losses to a level considered necessary by management.

The allowance for loan losses is based on management's continuing review and evaluation of the loan portfolio. The level of the allowance is determined by assigning specific reserves to individually identified problem credits and general reserves to all other loans. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value) of the impaired loan is lower than the carrying value of that loan. The portion of the allowance that is allocated to internally criticized and non-accrual loans is determined by estimating the inherent loss on each credit after giving consideration to the value of underlying collateral. The general component covers pools of loans by loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate, home equity and other consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates. These loss rates are based on a three year history of charge-offs and are more heavily weighted for recent experience for each of these categories of loans, adjusted for qualitative factors. These qualitative risk factors include:

1. Lending policies and procedures, including underwriting standards and collection, charge-off and recovery practices.
2. Effect of external factors, such as legal and regulatory requirements.
3. National, regional, and local economic and business conditions as well as the condition of various market segments, including the value of underlying collateral for collateral dependent loans.
4. Nature and volume of the portfolio including growth.
5. Experience, ability, and depth of lending management and staff.
6. Volume and severity of past due, classified and nonaccrual loans.
7. Quality of the Company's loan review system, and the degree of oversight by the Company's Board of Directors.
8. Existence and effect of any concentrations of credit and changes in the level of such concentrations.

Each factor is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information available at the time of the evaluation.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Management emphasizes loan quality and close monitoring of potential problem credits. Credit risk identification and review processes are utilized in order to assess and monitor the degree of risk in the loan portfolio. QNB's lending and credit administration staff are charged with reviewing the loan portfolio and identifying changes in the economy or in a borrower's circumstances which may affect the ability to repay debt or the value of pledged collateral. A loan classification and review system exists that identifies those loans with a higher than normal risk of uncollectibility. Each commercial loan is assigned a grade based upon an assessment of the borrower's financial capacity to service the debt and the presence and value of collateral for the loan. An independent firm reviews risk assessment and reviews the adequacy of the allowance for loan losses. Management meets monthly to review the credit quality of the loan portfolio and quarterly to review the allowance for loan losses.

In addition, various regulatory agencies, as an integral part of their examination process, periodically review QNB's allowance for loan losses. Such agencies may require QNB to recognize additions to the allowance based on their judgments using information available to them at the time of their examination.

Management believes that it uses the best information available to make determinations about the adequacy of the allowance and that it has established its existing allowance for loan losses in accordance with GAAP. If circumstances differ substantially from the assumptions used in making determinations, future adjustments to the allowance for loan losses may be necessary and results of operations could be affected. Because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that increases to the allowance will not be necessary should the quality of any loans deteriorate as a result of the factors discussed above.

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Major classes of loans are as follows:

	September 30, 2018	December 31, 2017
Commercial:		
Commercial and industrial	$ 153,742	$ 147,190
Construction	54,007	51,157
Secured by commercial real estate	307,889	286,867
Secured by residential real estate	69,088	71,703
State and political subdivisions	52,034	38,087
Retail:		
1-4 family residential mortgages	66,228	55,818
Home equity loans and lines	75,978	75,576
Consumer	6,780	6,680
Total loans	785,746	733,078
Net unearned costs	216	205
Loans receivable	$ 785,962	$ 733,283

Loans secured by commercial real estate include all loans collateralized at least in part by commercial real estate. These loans may not be for the expressed purpose of conducting commercial real estate transactions.

Overdrafts are reclassified as loans and are included in consumer loans above and total loans on the balance sheet. At September 30, 2018 and December 31, 2017, overdrafts were approximately $136,000 and $126,000, respectively.

QNB generally lends in its trade area which is comprised of Quakertown and the surrounding communities. To a large extent, QNB makes loans collateralized at least in part by real estate. Its lending activities could be affected by changes in the general economy, the regional economy, or real estate values. Other than disclosed in the table above, at September 30, 2018, there was a concentration of loans to lessors or residential buildings and dwellings of 16.1% of total loans and to lessors of nonresidential buildings of 18.3% of total loans, compared with 15.7% and of 17.3% of total loans, respectively, at December 31, 2017. These concentrations were primarily within the commercial real estate categories.

The Company engages in a variety of lending activities, including commercial, residential real estate and consumer transactions. The Company focuses its lending activities on individuals, professionals and small to medium sized businesses. Risks associated with lending activities include economic conditions and changes in interest rates, which can adversely impact both the ability of borrowers to repay their loans and the value of the associated collateral.

Commercial and industrial loans, commercial real estate loans, construction loans and residential real estate loans with a business purpose are generally perceived as having more risk of default than residential real estate loans with a personal purpose and consumer loans. These types of loans involve larger loan balances to a single borrower or groups of related borrowers and are more susceptible to a risk of loss during a downturn in the business cycle. These loans may involve greater risk because the availability of funds to repay these loans depends on the successful operation of the borrower’s business. The assets financed are used within the business for its ongoing operation. Repayment of these kinds of loans generally comes from the cash flow of the business or the ongoing conversions of assets, such as accounts receivable and inventory, to cash. Typical collateral for com