FIRST NATIONAL CORP /VA/
Form 10-Q
November 16, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2015

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: 0-23976

(Exact name of registrant as specified in its charter)

Virginia	**54-1232965**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
112 West King Street, Strasburg, Virginia	**22657**
(Address of principal executive offices)	**(Zip Code)**

(540) 465-9121

(Registrant s telephone number, including area code)

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

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

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. As of November 16, 2015, 4,912,662 shares of common stock, par value $1.25 per share, of the registrant were outstanding.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements
FIRST NATIONAL CORPORATION

Consolidated Balance Sheets

(in thousands, except share and per share data)

	(unaudited) September 30, 2015	December 31, 2014
Assets		
Cash and due from banks	$ 9,890	$ 6,043
Interest-bearing deposits in banks	66,956	18,802
Securities available for sale, at fair value	109,166	83,292
Securities held to maturity, at carrying value (fair value, 2015, $54,303; 2014, $0)	54,276	
Restricted securities, at cost	1,391	1,366
Loans held for sale	471	328
Loans, net of allowance for loan losses, 2015, $5,575; 2014, $6,718	400,838	371,692
Other real estate owned, net of valuation allowance, 2015, $230; 2014, $375	2,760	1,888
Premises and equipment, net	21,493	16,126
Accrued interest receivable	1,543	1,261
Bank owned life insurance	11,627	11,357
Core deposit intangibles, net	2,539	55
Other assets	5,945	5,955
Total assets	$ 688,895	$ 518,165
Liabilities and Shareholders Equity		
Liabilities		
Deposits:		
Noninterest-bearing demand deposits	$ 149,178	$ 104,986
Savings and interest-bearing demand deposits	318,510	237,618
Time deposits	146,219	101,734
Total deposits	$ 613,907	$ 444,338
Federal funds purchased		52
Other borrowings	7	26

Junior subordinated debt		9,279		9,279
Accrued interest payable and other liabilities		5,303		4,906
Total liabilities	$	628,496	$	458,601
Shareholders Equity				
Preferred stock, $1,000 per share liquidation preference; authorized 1,000,000 shares; 14,595 shares issued and outstanding	$	14,595	$	14,595
Common stock, par value $1.25 per share; authorized 8,000,000 shares; issued and outstanding, 2015, 4,912,662 shares; 2014, 4,904,577 shares		6,141		6,131
Surplus		6,922		6,835
Retained earnings		33,917		33,557
Accumulated other comprehensive loss, net		(1,176)		(1,554)
Total shareholders equity	$	60,399	$	59,564
Total liabilities and shareholders equity	$	688,895	$	518,165

See Notes to Consolidated Financial Statements

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FIRST NATIONAL CORPORATION

Consolidated Statements of Income

Three months ended September 30, 2015 and 2014

(in thousands, except per share data)

	(unaudited) September 30, 2015	(unaudited) September 30, 2014
Interest and Dividend Income		
Interest and fees on loans	$ 4,854	$ 4,536
Interest on deposits in banks	61	3
Interest and dividends on securities available for sale:		
Taxable interest	713	536
Tax-exempt interest	116	86
Dividends	20	20
Total interest and dividend income	$ 5,764	$ 5,181
Interest Expense		
Interest on deposits	$ 282	$ 343
Interest on federal funds purchased		2
Interest on junior subordinated debt	56	55
Interest on other borrowings		30
Total interest expense	$ 338	$ 430
Net interest income	$ 5,426	$ 4,751
Recovery of loan losses		(100)
Net interest income after recovery of loan losses	$ 5,426	$ 4,851
Noninterest Income		
Service charges on deposit accounts	$ 897	$ 655
ATM and check card fees	529	367
Wealth management fees	477	494
Fees for other customer services	172	94
Income from bank owned life insurance	106	103

Net (losses) on sale of securities available for sale				(91)
Net gains on sale of loans		53		
Other operating income		10		32
Total noninterest income	$	2,244	$	1,654
Noninterest Expense				
Salaries and employee benefits	$	3,637	$	2,668
Occupancy		396		303
Equipment		400		299
Marketing		176		114
Stationery and supplies		116		84
Legal and professional fees		243		250
ATM and check card fees		236		167
FDIC assessment		134		90
Bank franchise tax		131		106
Telecommunications expense		131		75
Data processing expense		130		129
Postage expense		73		49
Amortization expense		226		4
Other real estate owned expense (income), net		144		(23)
Other operating expense		528		438
Total noninterest expense	$	6,701	$	4,753

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FIRST NATIONAL CORPORATION

Consolidated Statements of Income

(Continued)

Three months ended September 30, 2015 and 2014

(in thousands, except per share data)

	(unaudited) September 30, 2015	(unaudited) September 30, 2014
Income before income taxes	$ 969	$ 1,752
Income tax expense	243	505
Net income	$ 726	$ 1,247
Effective dividend on preferred stock	328	329
Net income available to common shareholders	$ 398	$ 918
Earnings per common share		
Basic	$ 0.08	$ 0.19
Diluted	$ 0.08	$ 0.19

See Notes to Consolidated Financial Statements

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FIRST NATIONAL CORPORATION

Consolidated Statements of Income

Nine months ended September 30, 2015 and 2014

(in thousands, except per share data)

	(unaudited) September 30, 2015	(unaudited) September 30, 2014
Interest and Dividend Income		
Interest and fees on loans	$ 14,082	$ 13,154
Interest on deposits in banks	134	33
Interest and dividends on securities available for sale:		
Taxable interest	1,611	1,660
Tax-exempt interest	258	276
Dividends	59	62
Total interest and dividend income	$ 16,144	$ 15,185
Interest Expense		
Interest on deposits	$ 848	$ 1,115
Interest on federal funds purchased	2	2
Interest on junior subordinated debt	165	163
Interest on other borrowings	3	89
Total interest expense	$ 1,018	$ 1,369
Net interest income	$ 15,126	$ 13,816
Recovery of loan losses	(100)	(700)
Net interest income after recovery of loan losses	$ 15,226	$ 14,516
Noninterest Income		
Service charges on deposit accounts	$ 2,196	$ 1,928
ATM and check card fees	1,375	1,067
Wealth management fees	1,479	1,450
Fees for other customer services	463	307
Income from bank owned life insurance	270	266

Net (losses) on sale of securities available for sale		(52)		(69)
Net gains on sale of loans		158		
Other operating income		255		46
Total noninterest income	$	6,144	$	4,995
Noninterest Expense				
Salaries and employee benefits	$	10,359	$	7,731
Occupancy		1,052		896
Equipment		1,103		898
Marketing		436		349
Stationery and supplies		690		258
Legal and professional fees		886		699
ATM and check card fees		581		493
FDIC assessment		265		384
Bank franchise tax		383		305
Telecommunications expense		316		219
Data processing expense		543		378
Postage expense		270		138
Amortization expense		426		12
Other real estate owned expense (income), net		260		(62)
Net loss on disposal of premises and equipment				2
Other operating expense		1,473		1,214
Total noninterest expense	$	19,043	$	13,914

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FIRST NATIONAL CORPORATION

Consolidated Statements of Income

(Continued)

Nine months ended September 30, 2015 and 2014

(in thousands, except per share data)

	(unaudited) September 30, 2015	(unaudited) September 30, 2014
Income before income taxes	$ 2,327	$ 5,597
Income tax expense	613	1,662
Net income	$ 1,714	$ 3,935
Effective dividend and accretion on preferred stock	985	810
Net income available to common shareholders	$ 729	$ 3,125
Earnings per common share		
Basic	$ 0.15	$ 0.64
Diluted	$ 0.15	$ 0.64

See Notes to Consolidated Financial Statements

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FIRST NATIONAL CORPORATION

Consolidated Statements of Comprehensive Income

Three months ended September 30, 2015 and 2014

(in thousands)

	(unaudited) September 30, 2015	(unaudited) September 30, 2014
Net income	$ 726	$ 1,247
Other comprehensive income, net of tax		
Unrealized holding gains on available for sale securities, net of tax of $341 and $51, respectively	660	101
Reclassification adjustment for losses included in net income, net of tax of $0 and $31, respectively		60
Total other comprehensive income	660	161
Total comprehensive income	$ 1,386	$ 1,408

See Notes to Consolidated Financial Statements

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FIRST NATIONAL CORPORATION

Consolidated Statements of Comprehensive Income

Nine months ended September 30, 2015 and 2014

(in thousands)

	(unaudited) September 30, 2015	(unaudited) September 30, 2014
Net income	$ 1,714	$ 3,935
Other comprehensive income, net of tax		
Unrealized holding gains on available for sale securities, net of tax of $176 and $522, respectively	344	1,016
Reclassification adjustment for losses included in net income, net of tax of $18 and $24, respectively	34	45
Total other comprehensive income	378	1,061
Total comprehensive income	$ 2,092	$ 4,996

See Notes to Consolidated Financial Statements

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FIRST NATIONAL CORPORATION

Consolidated Statements of Cash Flows

Nine months ended September 30, 2015 and 2014

(in thousands)

	(unaudited) September 30, 2015	(unaudited) September 30, 2014
Cash Flows from Operating Activities		
Net income	$ 1,714	$ 3,935
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	896	729
Amortization of core deposit intangibles	426	12
Origination of loans held for sale	(11,493)	(181)
Proceeds from sale of loans held for sale	11,508	1,450
Net gains on sales of loans held for sale	(158)	
Recovery of loan losses	(100)	(700)
Provision for other real estate owned	230	93
Net losses on sale of securities available for sale	52	69
Net gains on sale of other real estate owned	(72)	(234)
Losses on disposal of premises and equipment		2
Income from bank owned life insurance	(270)	(266)
Accretion of discounts and amortization of premiums on securities, net	521	490
Accretion of premium on time deposits	164	
Stock-based compensation	70	
Bargain purchase gain on branch acquisition	(201)	
Changes in assets and liabilities:		
Increase in interest receivable	(282)	(25)
(Increase) decrease in other assets	(70)	708
Increase (decrease) in other liabilities	380	(1,056)
Net cash provided by operating activities	$ 3,315	$ 5,026
Cash Flows from Investing Activities		
Proceeds from sales of securities available for sale	$	$ 3,453
Proceeds from maturities, calls, and principal payments of securities available for sale	11,836	10,408
	1,220	

Proceeds from maturities, calls, and principal payments of securities held to maturity				
Purchase of securities available for sale		(37,638)		(14,219)
Purchase of securities held to maturity		(55,569)		
Proceeds from redemption of restricted securities		638		168
Purchase of restricted securities		(663)		
Purchase of premises and equipment		(1,768)		(264)
Proceeds from sale of other real estate owned		354		1,502
Net increase in loans		(30,430)		(19,415)
Acquisition of branches, net of cash paid		179,501		
Net cash provided by (used in) investing activities	$	67,481	$	(18,367)
Cash Flows from Financing Activities				
Net (decrease) increase in demand deposits and savings accounts	$	(813)	$	719
Net decrease in time deposits		(16,584)		(12,511)
Proceeds from other borrowings		15,000		
Principal payments on other borrowings		(15,019)		(19)
Cash dividends paid on preferred stock		(985)		(707)
Cash dividends paid on common stock, net of reinvestment		(341)		(227)
Repurchase of common stock		(1)		
(Decrease) increase in federal funds purchased		(52)		5,325
Net cash used in financing activities	$	(18,795)	$	(7,420)

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FIRST NATIONAL CORPORATION

Consolidated Statements of Cash Flows

(Continued)

Nine months ended September 30, 2015 and 2014

(in thousands)

	(unaudited) September 30, 2015		(unaudited) September 30, 2014	
Increase (decrease) in cash and cash equivalents	$	52,001	$	(20,761)
Cash and Cash Equivalents				
Beginning		24,845		31,508
Ending	$	76,846	$	10,747
Supplemental Disclosures of Cash Flow Information				
Cash payments for:				
Interest	$	873	$	1,403
Income Taxes	$	752	$	601
Supplemental Disclosures of Noncash Investing and Financing Activities				
Unrealized gains on securities available for sale	$	572	$	1,607
Transfer from loans to loans held for sale	$		$	1,450
Transfer from loans to other real estate owned	$	1,384	$	139
Issuance of common stock, dividend reinvestment plan	$	25	$	18
Transactions Related to Acquisition				
Assets acquired	$	193,638	$	
Liabilities assumed		186,819		

Net assets acquired	$	6,819	$

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FIRST NATIONAL CORPORATION

Consolidated Statements of Changes in Shareholders Equity

Nine months ended September 30, 2015 and 2014

(in thousands)

(unaudited)

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance, December 31, 2013	$ 14,564	$ 6,127	$ 6,813	$ 27,360	$ (1,304)	$ 53,560
Net income				3,935		3,935
Other comprehensive income					1,061	1,061
Cash dividends on common stock ($0.05 per share)				(245)		(245)
Issuance of 2,148 shares common stock, dividend reinvestment plan		3	15			18
Cash dividends on preferred stock				(707)		(707)
Accretion of preferred stock discount	31			(31)		
Balance, September 30, 2014	$ 14,595	$ 6,130	$ 6,828	$ 30,312	$ (243)	$ 57,622

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance, December 31, 2014	$ 14,595	$ 6,131	$ 6,835	$ 33,557	$ (1,554)	$ 59,564
Net income				1,714		1,714
Other comprehensive income					378	378
Cash dividends on common stock ($0.075 per share)				(369)		(369)
Stock-based compensation			70			70
Issuance of 3,081 shares common stock, dividend reinvestment plan		4	24			28
Issuance of 5,142 shares common stock, stock incentive plan		6	(6)			
			(1)			(1)

Repurchase of 138 shares common stock, stock incentive plan						
Cash dividends on preferred stock				(985)		(985)
Balance, September 30, 2015	$ 14,595	$ 6,141	$ 6,922	$ 33,917	$ (1,176)	$ 60,399

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FIRST NATIONAL CORPORATION

Notes to Consolidated Financial Statements

(unaudited)

Note 1. General

The accompanying unaudited consolidated financial statements of First National Corporation (the Company) and its subsidiaries, including First Bank (the Bank), have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP. All significant intercompany balances and transactions have been eliminated. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments and reclassifications of a normal and recurring nature considered necessary to present fairly the financial positions at September 30, 2015 and December 31, 2014, the results of operations and comprehensive income for the three and nine months ended September 30, 2015 and 2014 and the cash flows and changes in shareholders equity for the nine months ended September 30, 2015 and 2014. The statements should be read in conjunction with the consolidated financial statements and related notes included in the Annual Report on Form 10-K for the year ended December 31, 2014. Operating results for the three and nine month periods ended September 30, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015.

Recent Accounting Pronouncements

In June 2014, the FASB issued ASU No. 2014-11, Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures . This ASU aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. The new guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement. The amendments in the ASU also require a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets throughout the term of the transaction. Additional disclosures will be required for the nature of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. The amendments in this ASU are effective for the first interim or annual period beginning after December 15, 2014; however, the disclosure for transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and interim periods beginning after March 15, 2015. Early adoption is not permitted. The adoption of ASU 2014-11 did not have an impact on the Company s consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, Compensation Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period . The new guidance applies to reporting entities that grant employees share-based payments in which the terms of the award allow a performance target to be achieved after the requisite service period. The amendments in the ASU require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. Existing guidance in Compensation Stock

Compensation (Topic 718) , should be applied to account for these types of awards. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Early adoption is permitted and reporting entities may choose to apply the amendments in the ASU either on a prospective or retrospective basis. The Company does not expect the adoption of ASU 2014-12 to have an impact on its consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern . This update is intended to provide guidance about management s responsibility to evaluate whether there is substantial doubt about an entity s ability to continue as a going concern and to provide related footnote disclosures. Management is required under the new guidance to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity s ability to continue as a going concern within one year after the date the financial statements are issued when preparing financial statements for each interim and annual reporting period. If conditions or events are identified, the ASU specifies the process that must be followed by management and also clarifies the timing and content of going concern footnote disclosures in order to reduce diversity in practice. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2016. Early adoption is permitted. The Company does not expect the adoption of ASU 2014-15 to have an impact on its consolidated financial statements.

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(unaudited)

In November 2014, the FASB issued ASU No. 2014-16, Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity. The amendments in this ASU do not change the current criteria in U.S. GAAP for determining when separation of certain embedded derivative features in a hybrid financial instrument is required. The amendments clarify how current U.S. GAAP should be interpreted in evaluating the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share. Specifically, the amendments clarify that an entity should consider all relevant terms and features, including the embedded derivative feature being evaluated for bifurcation, in evaluating the nature of the host contract. Furthermore, the amendments clarify that no single term or feature would necessarily determine the economic characteristics and risks of the host contract. Rather, the nature of the host contract depends upon the economic characteristics and risks of the entire hybrid financial instrument. The amendments in this ASU also clarify that, in evaluating the nature of a host contract, an entity should assess the substance of the relevant terms and features (i.e., the relative strength of the debt-like or equity-like terms and features given the facts and circumstances) when considering how to weight those terms and features. The amendments in this ASU are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption, including adoption in an interim period, is permitted. The Company does not expect the adoption of ASU 2014-16 to have an impact on its consolidated financial statements.

In January 2015, the FASB issued ASU No. 2015-01, Income Statement Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items. The amendments in this ASU eliminate from U.S. GAAP the concept of extraordinary items. Subtopic 225-20, Income Statement - Extraordinary and Unusual Items, required that an entity separately classify, present, and disclose extraordinary events and transactions. Presently, an event or transaction is presumed to be an ordinary and usual activity of the reporting entity unless evidence clearly supports its classification as an extraordinary item. If an event or transaction meets the criteria for extraordinary classification, an entity is required to segregate the extraordinary item from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. The entity also is required to disclose applicable income taxes and either present or disclose earnings-per-share data applicable to the extraordinary item. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The Company does not expect the adoption of ASU 2015-01 to have an impact on its consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis. The amendments in this ASU are intended to improve targeted areas of consolidation guidance for legal entities such as limited partnerships, limited liability corporations, and securitization structures (collateralized debt obligations, collateralized loan obligations, and mortgage-backed security transactions). In addition to reducing the number of consolidation models from four to two, the new standard simplifies the FASB Accounting Standards Codification and improves current GAAP by placing more emphasis on risk of loss when determining a controlling financial interest, reducing the frequency of the application of related-party guidance when determining a controlling financial interest in a variable interest entity (VIE), and changing consolidation conclusions for public and private companies in several industries that typically make use of limited partnerships or VIEs. The amendments in this ASU are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. ASU 2015-02 may be applied retrospectively in previously issued financial statements for one or more years with a cumulative-effect adjustment to retained earnings as of the beginning of the first year restated. The Company does not expect the adoption of ASU 2015-02 to have an impact on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, Interest Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The amendments in this ASU are intended to simplify the presentation of debt issuance costs. These amendments require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The amendments in this ASU are effective for public business entities for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. The Company does not expect the adoption of ASU 2015-03 to have an impact on its consolidated financial statements.

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Notes to Consolidated Financial Statements

(unaudited)

In April 2015, the FASB issued ASU No. 2015-05, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer s Accounting for Fees Paid in a Cloud Computing Arrangement. The amendments in this ASU provide guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The amendments do not change the accounting for a customer s accounting for service contracts. As a result of the amendments, all software licenses within the scope of Subtopic 350-40 will be accounted for consistent with other licenses of intangible assets. The amendments in this ASU are effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. An entity can elect to adopt the amendments either: (1) prospectively to all arrangements entered into or materially modified after the effective date; or (2) retrospectively. The Company is currently assessing the impact that ASU 2015-05 will have on its consolidated financial statements.

In May 2015, the FASB issued ASU No. 2015-08, Business Combinations (Topic 805): Pushdown Accounting Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115. The amendments in ASU 2015-08 amend various SEC paragraphs pursuant to the issuance of Staff Accounting Bulletin No. 115, Topic 5: Miscellaneous Accounting, regarding various pushdown accounting issues, and did not have an impact on the Company s consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-12, Plan Accounting: Defined Benefit Pension Plans (Topic 960), Defined Contribution Pension Plans (Topic 962), and Health and Welfare Benefit Plans (Topic 965) 1. Fully Benefit-Responsive Investment Contracts, 2. Plan Investment Disclosures, and 3. Measurement Date Practical Expedient. The amendments within this ASU are in 3 parts. Among other things, Part 1 amendments designate contract value as the only required measure for fully benefit-responsive investment contracts; Part II amendments eliminate the requirement that plans disclose: (a) individual investments that represent 5 percent or more of net assets available for benefits; and (b) the net appreciation or depreciation for investments by general type requirements for both participant-directed investments and nonparticipant-directed investments. Part III amendments provide a practical expedient to permit plans to measure investments and investment-related accounts (e.g., a liability for a pending trade with a broker) as of a month-end date that is closest to the plan s fiscal year-end, when the fiscal period does not coincide with month-end. The amendments in Parts 1 and 2 of this ASU are effective on a retrospective basis and Part 3 is effective on a prospective basis, for fiscal years beginning after December 15, 2015. Early adoption is permitted. The Company is currently assessing the impact that ASU 2015-12 will have on its consolidated financial statements.

In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of Effective Date. The amendments in ASU 2015-14 defer the effective date of ASU 2014-09 for all entities by one year. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. All other entities should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. All other entities may apply the guidance in ASU 2014-09 earlier as of an annual reporting period beginning after December 15, 2016, including interim reporting periods within that reporting period. All other entities also may apply the guidance in ASU 2014-09 earlier as of an annual reporting period beginning after December 15, 2016, and interim reporting periods within annual reporting periods beginning one year after the annual reporting period in which the entity first applies the guidance in ASU 2014-09. The Company does not expect the adoption of ASU 2015-14 (or ASU 2014-09) to have a material impact on its consolidated financial statements.

In August 2015, the FASB issued ASU 2015-15, Interest Imputation of Interest (Subtopic 835-30) Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements (Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting). On April 7, 2015, the FASB issued ASU 2015-03, Interest Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, which requires entities to present debt issuance costs related to a recognized debt liability as a direct deduction from the carrying amount of that debt liability. The guidance in ASU 2015-03 (see paragraph 835-30-45-1A) does not address presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements. Given the absence of authoritative guidance within ASU 2015-03 for debt issuance costs related to line-of-credit arrangements, the SEC staff stated that they

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would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. ASU 2015-15 adds these SEC comments to the S section of the Codification. The Company does not expect the adoption of ASU 2015-15 to have a material impact on its consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. The amendments in ASU 2015-16 require that an acquirer recognize adjustments to estimated amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The amendments require that the acquirer record, in the same period s financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the estimated amounts, calculated as if the accounting had been completed at the acquisition date. The amendments also require an entity to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the estimated amounts had been recognized as of the acquisition date. The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. The amendments should be applied prospectively to adjustments to provisional amounts that occur after the effective date with earlier application permitted for financial statements that have not been issued. The Company does not expect the adoption of ASU 2015-16 to have a material impact on its consolidated financial statements.

Note 2. Securities

The Company invests in U.S. agency and mortgage-backed securities, obligations of state and political subdivisions and corporate equity securities. Amortized costs and fair values of securities at September 30, 2015 and December 31, 2014 were as follows (in thousands):

	September 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
Securities available for sale:				
U.S. agency and mortgage-backed securities	$ 92,758	$ 568	$ (463)	$ 92,863
Obligations of states and political subdivisions	16,037	308	(50)	16,295

Corporate equity securities		1		7				8
Total securities available for sale	$	108,796	$	883	$	(513)	$	109,166
Securities held to maturity:								
U.S. agency and mortgage-backed securities	$	42,490	$	137	$	(124)	$	42,503
Obligations of states and political subdivisions		11,786		55		(41)		11,800
Total securities held to maturity	$	54,276	$	192	$	(165)	$	54,303
Total securities	$	163,072	$	1,075	$	(678)	$	163,469

	December 31, 2014							
		Amortized Cost		Gross Unrealized Gains		Gross Unrealized (Losses)		Fair Value
Securities available for sale:								
U.S. agency and mortgage-backed securities	$	67,462	$	374	$	(807)	$	67,029
Obligations of states and political subdivisions		16,031		325		(99)		16,257
Corporate equity securities		1		5				6
Total securities available for sale	$	83,494	$	704	$	(906)	$	83,292

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At September 30, 2015 and December 31, 2014, investments in an unrealized loss position that were temporarily impaired were as follows (in thousands):

	September 30, 2015					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)
Securities available for sale:						
U.S. agency and mortgage-backed securities	$ 24,974	$ (125)	$ 18,114	$ (338)	$ 43,088	$ (463)
Obligations of states and political subdivisions	2,286	(15)	1,058	(35)	3,344	(50)
Total securities available for sale	$ 27,260	$ (140)	$ 19,172	$ (373)	$ 46,432	$ (513)
Securities held to maturity:						
U.S. agency and mortgage-backed securities	$ 14,612	$ (124)	$	$	$ 14,612	$ (124)
Obligations of states and political subdivisions	5,000	(41)			5,000	(41)
Total securities held to maturity	$ 19,612	$ (165)	$	$	$ 19,612	$ (165)
Total securities	$ 46,872	$ (305)	$ 19,172	$ (373)	$ 66,044	$ (678)

	December 31, 2014					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)
Securities available for sale:						
U.S. agency and mortgage-backed securities	$ 8,677	$ (60)	$ 32,527	$ (747)	$ 41,204	$ (807)
Obligations of states and political subdivisions	715	(1)	2,841	(98)	3,556	(99)
Total securities available for sale	$ 9,392	$ (61)	$ 35,368	$ (845)	$ 44,760	$ (906)

The tables above provide information about securities that have been in an unrealized loss position for less than twelve consecutive months and securities that have been in an unrealized loss position for twelve consecutive months or more. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Impairment is considered to be other-than-temporary if the Company (1) intends to sell the security, (2) more likely than not will be required to sell the security before recovering its cost, or (3) does not expect to recover the security s entire amortized cost basis. Presently, the Company does not intend to sell any of these securities, does not expect to be required to sell these securities, and expects to recover the entire amortized cost of all the securities.

At September 30, 2015, there were thirty-one U.S. agency and mortgage-backed securities and twenty obligations of state and political subdivisions in an unrealized loss position. One hundred percent of the Company s investment portfolio is considered investment grade. The weighted-average re-pricing term of the portfolio was 4.4 years at September 30, 2015. At December 31, 2014, there were twenty-nine U.S. agency and mortgage-backed securities and seven obligations of states and political subdivisions in an unrealized loss position. One hundred percent of the Company s investment portfolio was considered investment grade at December 31, 2014. The weighted-average re-pricing term of the portfolio was 3.9 years at December 31, 2014. The unrealized losses at September 30, 2015 in the U.S. agency and mortgage-backed securities portfolio and the obligation of states and political subdivisions portfolio were related to changes in market interest rates and not credit concerns of the issuers.

The amortized cost and fair value of securities at September 30, 2015 by contractual maturity are shown below (in thousands). Expected maturities of mortgage-backed securities will differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepayment penalties. Corporate equity securities are not included in the maturity categories in the following maturity summary because they do not have a stated maturity date.

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	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within one year	$ 391	$ 393	$	$
Due after one year through five years	7,806	7,853	633	631
Due after five years through ten years	20,377	20,499	15,215	15,245
Due after ten years	80,221	80,413	38,428	38,427
Corporate equity securities	1	8		
	$ 108,796	$ 109,166	$ 54,276	$ 54,303

Federal Home Loan Bank, Federal Reserve Bank and Community Bankers Bank stock are generally viewed as long-term investments and as restricted securities, which are carried at cost, because there is a minimal market for the stock. Therefore, when evaluating restricted securities for impairment, their value is based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The Company does not consider these investments to be other-than-temporarily impaired at September 30, 2015, and no impairment has been recognized. Restricted securities are not part of the securities portfolio.

The composition of restricted securities at September 30, 2015 and December 31, 2014 was as follows (in thousands):

	September 30, 2015	December 31, 2014
Federal Home Loan Bank stock	$ 466	$ 470
Federal Reserve Bank stock	875	846
Community Bankers Bank stock	50	50
	$ 1,391	$ 1,366

Note 3. Loans

Loans at September 30, 2015 and December 31, 2014 are summarized as follows (in thousands):

	September 30, 2015	December 31, 2014

Real estate loans:				
Construction and land development	$	29,935	$	29,475
Secured by 1-4 family residential		179,419		163,727
Other real estate loans		165,661		151,802
Commercial and industrial loans		19,950		21,166
Consumer and other loans		11,448		12,240
Total loans	$	406,413	$	378,410
Allowance for loan losses		(5,575)		(6,718)
Loans, net	$	400,838	$	371,692

Net deferred loan costs included in the above loan categories were $128 thousand and $130 thousand at September 30, 2015 and December 31, 2014, respectively. Consumer and other loans included $421 thousand and $285 thousand of demand deposit overdrafts at September 30, 2015 and December 31, 2014, respectively.

Risk characteristics of each loan portfolio class that are considered by the Company include:

1-4 family residential mortgage loans carry risks associated with the continued creditworthiness of the borrower and changes in the value of the collateral.

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Real estate construction and land development loans carry risks that the project may not be finished according to schedule, the project may not be finished according to budget and the value of the collateral may, at any point in time, be less than the principal amount of the loan. Construction loans also bear the risk that the general contractor, who may or may not be a loan customer, may be unable to finish the construction project as planned because of financial pressure or other factors unrelated to the project.

Other real estate loans carry risks associated with the successful operation of a business or a real estate project, in addition to other risks associated with the ownership of real estate, because repayment of these loans may be dependent upon the profitability and cash flows of the business or project.

Commercial and industrial loans carry risks associated with the successful operation of a business because repayment of these loans may be dependent upon the profitability and cash flows of the business. In addition, there is risk associated with the value of collateral other than real estate which may depreciate over time and cannot be appraised with as much reliability.

Consumer and other loans carry risk associated with the continued creditworthiness of the borrower and the value of the collateral, i.e. rapidly depreciating assets such as automobiles, or lack thereof. Consumer loans are likely to be immediately adversely affected by job loss, divorce, illness or personal bankruptcy, or other changes in circumstances.

The following table provides a summary of loan classes and an aging of past due loans as of September 30, 2015 and December 31, 2014 (in thousands):

	September 30, 2015							
	30-59 Days Past Due	60-89 Days Past Due	> 90 Days Past Due	Total Past Due	Current	Total Loans	Non-accrual Loans	90 Days or More Past Due and Accruing
Real estate loans:								

Construction and land development	$ 430	$	$	$ 430	$ 29,505	$ 29,935	$ 1,911	$
1-4 family residential	1,004	19	269	1,292	178,127	179,419	298	55
Other real estate loans	419		1,247	1,666	163,995	165,661	2,622	
Commercial and industrial	188		92	280	19,670	19,950	99	92
Consumer and other loans	18	6		24	11,424	11,448		
Total	$ 2,059	$ 25	$ 1,608	$ 3,692	$ 402,721	$ 406,413	$ 4,930	$ 147

	December 31, 2014							
	30-59 Days Past Due	60-89 Days Past Due	> 90 Days Past Due	Total Past Due	Current	Total Loans	Non-accrual Loans	90 Days or More Past Due and Accruing
Real estate loans:								
Construction and land development	$ 2,441	$ 71	$	$ 2,512	$ 26,963	$ 29,475	$ 1,787	$
1-4 family residential	504	323	754	1,581	162,146	163,727	1,342	
Other real estate loans	554	800	2,519	3,873	147,929	151,802	4,756	
Commercial and industrial	10	106		116	21,050	21,166	115	
Consumer and other loans	14			14	12,226	12,240		
Total	$ 3,523	$ 1,300	$ 3,273	$ 8,096	$ 370,314	$ 378,410	$ 8,000	$

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Credit Quality Indicators

As part of the ongoing monitoring of the credit quality of the Company s loan portfolio, management tracks certain credit quality indicators including trends related to the risk grading of specified classes of loans. The Company utilizes a risk grading matrix to assign a rating to each of its loans. The loan ratings are summarized into the following categories: pass, special mention, substandard, doubtful and loss. Pass rated loans include all risk rated credits other than those included in special mention, substandard or doubtful. Loans classified as loss are charged-off. Loan officers assign risk grades to loans at origination and as renewals arise. The Bank s Credit Administration department reviews risk grades for accuracy on a quarterly basis and as credit issues arise. In addition, a certain amount of loans are reviewed each year through the Company s internal and external loan review process. A description of the general characteristics of the loan grading categories is as follows:

Pass Loans classified as pass exhibit acceptable operating trends, balance sheet trends, and liquidity. Sufficient cash flow exists to service the loan. All obligations have been paid by the borrower as agreed.

Special Mention Loans classified as special mention have a potential weakness that deserves management s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or the Bank s credit position at some future date.

Substandard Loans classified as substandard are inadequately protected by the current net worth and payment capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The Company considers all doubtful loans to be impaired and places the loan on non-accrual status.

Loss Loans classified as loss are considered uncollectable and of such little value that their continuance as bankable assets is not warranted.

The following tables provide an analysis of the credit risk profile of each loan class as of September 30, 2015 and December 31, 2014 (in thousands):

	September 30, 2015				
	Pass	Special Mention	Substandard	Doubtful	Total
Real estate loans:					
Construction and land development	$ 23,168	$ 2,398	$ 4,369	$	$ 29,935
Secured by 1-4 family residential	172,444	3,022	3,953		179,419
Other real estate loans	149,137	9,857	6,667		165,661
Commercial and industrial	19,243	429	278		19,950
Consumer and other loans	11,442		6		11,448
Total	$ 375,434	$ 15,706	$ 15,273	$	$ 406,413

	December 31, 2014				
	Pass	Special Mention	Substandard	Doubtful	Total
Real estate loans:					
Construction and land development	$ 20,476	$ 2,962	$ 6,037	$	$ 29,475
Secured by 1-4 family residential	152,004	5,058	6,665		163,727
Other real estate loans	126,211	14,776	10,815		151,802
Commercial and industrial	20,428	463	275		21,166
Consumer and other loans	12,240				12,240