

Friendship BanCorp

Independent Auditor's Report and Consolidated Financial Statements

December 31, 2017 and 2016

Friendship BanCorp

December 31, 2017 and 2016

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Independent Auditor's Report

Audit Committee and Board of Directors
Friendship BanCorp
Friendship, Indiana

We have audited the accompanying consolidated financial statements of Friendship BanCorp and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Friendship BanCorp and its subsidiaries as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

BKD, LLP

Indianapolis, Indiana
April 6, 2018

Friendship BanCorp
Consolidated Balance Sheets
December 31, 2017 and 2016

Assets

	<u>2017</u>	<u>2016</u>
Cash and due from banks	\$ 11,933,724	\$ 9,544,759
Federal funds sold	10,082,186	536,647
Cash and cash equivalents	22,015,910	10,081,406
Interest-bearing time deposits	7,656,133	5,300,000
Available-for-sale securities	40,315,399	51,461,293
Held to maturity securities (fair value of \$12,709,277 and \$10,323,907, respectively)	12,653,394	10,298,441
Loans	261,471,539	252,592,692
Allowance for loan losses	(2,315,898)	(2,533,194)
Loans, net	259,155,641	250,059,498
Premises and equipment, net	8,678,395	9,033,947
Restricted equity investments, at cost	1,983,150	1,983,150
Cash surrender value of life insurance policies	4,650,636	4,521,357
Goodwill	2,122,953	2,122,953
Intangible assets	1,475,238	1,624,107
Other real estate owned	109,000	243,967
Other assets	2,478,941	2,479,233
	<u>2,478,941</u>	<u>2,479,233</u>
Total assets	<u>\$ 363,294,790</u>	<u>\$ 349,209,352</u>

Liabilities and Shareholders' Equity

Liabilities

Deposits		
Noninterest-bearing	\$ 27,104,550	\$ 25,548,165
Interest-bearing	294,264,631	283,685,452
Total deposits	321,369,181	309,233,617
Federal Home Loan Bank advances	1,000,000	1,000,000
Accrued interest payable and other liabilities	3,115,093	3,115,963
Total liabilities	<u>325,484,274</u>	<u>313,349,580</u>

Shareholders' Equity

Common stock, no par value		
4,000,000 shares authorized; 1,790,917 (2017) and		
1,789,069 (2016) shares issued and outstanding	4,792,962	4,761,546
Retained earnings	33,249,566	31,499,174
Accumulated other comprehensive loss	(232,012)	(400,948)
Total shareholders' equity	<u>37,810,516</u>	<u>35,859,772</u>
	<u>37,810,516</u>	<u>35,859,772</u>
Total liabilities and shareholders' equity	<u>\$ 363,294,790</u>	<u>\$ 349,209,352</u>

Friendship BanCorp
Consolidated Statements of Income
Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Interest Income		
Loans	\$ 13,868,557	\$ 13,324,358
Securities		
Taxable	857,082	874,347
Nontaxable	199,288	275,226
Other	294,704	186,750
Total interest income	<u>15,219,631</u>	<u>14,660,681</u>
Interest Expense		
Deposits	1,713,628	1,706,785
Borrowings	51,946	58,451
Total interest expense	<u>1,765,574</u>	<u>1,765,236</u>
Net Interest Income	13,454,057	12,895,445
Provision for Loan Losses	<u>50,000</u>	<u>375,000</u>
Net Interest Income After Provision for Loan Losses	<u>13,404,057</u>	<u>12,520,445</u>
Noninterest Income		
Service charges and fees	1,086,833	960,145
Insurance revenues	2,239,401	2,255,336
Net gain on sale of loans	233,619	403,491
Net gain (loss) on sales of securities	(33,927)	15,826
Trust and investment product fees	169,708	160,472
Interchange income	635,611	539,797
Other	342,523	285,050
Total noninterest income	<u>4,673,768</u>	<u>4,620,117</u>
Noninterest Expense		
Salaries and employee benefits	7,999,922	7,608,865
Net occupancy and equipment expense	1,752,984	1,655,663
Data processing	887,644	703,673
Advertising	278,500	235,209
Professional services	178,677	175,192
Office operations	298,885	308,911
Loan services	483,977	489,098
FDIC insurance	114,000	148,800
Other	708,452	811,324
Total noninterest expense	<u>12,703,041</u>	<u>12,136,735</u>
Income Before Income Tax	5,374,784	5,003,827
Income tax expense	<u>1,743,968</u>	<u>1,547,121</u>
Net Income	<u>\$ 3,630,816</u>	<u>\$ 3,456,706</u>
Earnings per Share	\$ 2.03	\$ 1.93
Average Shares Outstanding	1,790,818	1,794,066

Friendship BanCorp
Consolidated Statements of Comprehensive Income
Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Net Income	<u>\$ 3,630,816</u>	<u>\$ 3,456,706</u>
Other Comprehensive Income (Loss)		
Net unrealized appreciation (depreciation) on securities	221,946	(768,574)
Reclassification adjustment for realized (gains) losses included in net income	<u>33,927</u>	<u>(15,826)</u>
	255,873	(784,400)
Tax effect	<u>(86,937)</u>	<u>284,741</u>
Total other comprehensive income (loss)	<u>168,936</u>	<u>(499,659)</u>
Comprehensive Income	<u><u>\$ 3,799,752</u></u>	<u><u>\$ 2,957,047</u></u>

Friendship BanCorp
Consolidated Statements of Changes in Shareholders' Equity
Years Ended December 31, 2017 and 2016

	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, January 1, 2016	\$ 4,767,171	\$ 29,715,655	\$ 98,711	\$ 34,581,537
Net income		3,456,706		3,456,706
Other comprehensive loss			(499,659)	(499,659)
Stock-based compensation expense	819			819
Exercise of stock options	37,944			37,944
Purchase of treasury stock	(44,388)			(44,388)
Cash dividend (\$0.94 per share)		(1,673,187)		(1,673,187)
Balance, December 31, 2016	4,761,546	31,499,174	(400,948)	35,859,772
Net income		3,630,816		3,630,816
Other comprehensive income			168,936	168,936
Exercise of stock options	31,416			31,416
Cash dividend (\$1.05 per share)		(1,880,424)		(1,880,424)
Balance, December 31, 2017	<u>\$ 4,792,962</u>	<u>\$ 33,249,566</u>	<u>\$ (232,012)</u>	<u>\$ 37,810,516</u>

Friendship BanCorp

Consolidated Statements of Cash Flows

Years Ended December 31, 2017 and 2016

	2017	2016
Operating Activities		
Net income	\$ 3,630,816	\$ 3,456,706
Items not requiring (providing) cash		
Provision for loan losses	50,000	375,000
Depreciation and amortization	687,567	612,598
Net amortization and accretion of securities	205,560	195,168
Net realized (gain) loss on available-for-sale securities	33,927	(15,826)
Net realized (gain) loss on sale of other real estate	(54,424)	4,418
Deferred income taxes	(14,240)	(178,865)
Earnings on life insurance	(129,279)	(115,056)
Gain on sale of loans	(233,619)	(403,491)
Amortization of intangible assets	283,869	265,476
Stock-based compensation	-	819
Changes in		
Accrued interest and other assets	(19,981)	1,278,512
Accrued expenses and other liabilities	(870)	238,005
Net cash provided by operating activities	4,439,326	5,713,464
Investing Activities		
Available-for-sale securities:		
Sales	5,978,436	982,000
Maturities, prepayments and calls	11,815,355	27,317,035
Purchases	(9,532,519)	(33,703,699)
Held-to-maturity securities:		
Maturities, prepayments and calls	3,036,318	1,673,413
Purchases	(2,551,765)	(537,215)
Loan originations and payments, net	(9,345,971)	(18,860,137)
Net change in interest-bearing time deposits	(2,356,133)	1,093,312
Additions to premises and equipment, net	(457,937)	(2,301,205)
Cash paid in acquisition	-	(2,505,000)
Proceeds from sale of other real estate	622,838	448,808
Purchase of bank-owned life insurance	-	(1,000,000)
Net cash used in investing activities	(2,791,378)	(27,392,688)
Financing Activities		
Net change in deposits	12,135,564	25,894,956
Repayments on Federal Home Loan Bank advances	-	(5,000,000)
Cash dividends paid	(1,880,424)	(1,673,187)
Purchase of treasury stock	-	(44,388)
Proceeds from exercise of stock options	31,416	37,944
Net cash provided by financing activities	10,286,556	19,215,325
Net Change in Cash and Cash Equivalents	11,934,504	(2,463,899)
Cash and Cash Equivalents, Beginning of Year	10,081,406	12,545,305
Cash and Cash Equivalents, End of Year	\$ 22,015,910	\$ 10,081,406
Supplemental Cash Flows Information		
Interest paid	\$ 1,754,102	\$ 1,783,735
Income taxes paid	1,680,000	1,630,000
Noncash Supplemental Information		
Loans transferred to other real estate	\$ 433,447	\$ 635,193

Friendship BanCorp
Notes to Consolidated Financial Statements
December 31, 2017 and 2016

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include Friendship BanCorp (Company) and its wholly owned subsidiary, The Friendship State Bank, with its wholly owned subsidiaries, Friendship Financial Services, LLC and Friendship Portfolio Management, Inc. and its wholly owned subsidiary, Friendship Real Estate Holdings, Inc., together referred to as “the Bank.” Intercompany transactions and balances are eliminated upon consolidation.

Nature of Operations

The Bank is primarily engaged in providing a variety of deposit and lending services to individual customers in southeastern Indiana. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are residential mortgage, commercial, and installment loans. Substantially all loans are secured by specific items of collateral including business assets, consumer assets and real estate. Commercial loans are expected to be repaid from cash flow from operations of businesses. Real estate loans are secured by both residential and commercial real estate. There are no significant concentrations of loans to any one industry or customer. However, the customers’ ability to repay their loans is dependent on the real estate and general economic conditions in the area. Friendship Financial Services, LLC is a full service insurance agency and sells those products, as agent, to its customers.

Use of Estimates

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

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses. In connection with the determination of the allowance for loan losses, management obtains independent appraisals for significant properties.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Bank to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

Friendship BanCorp

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand and in other institutions, federal funds sold and interest-bearing demand deposits.

Interest-Bearing Time Deposits

Interest-bearing time deposits mature within five years and are carried at cost.

Investment Securities

Debt securities are classified as held to maturity when the Company has the positive intent and ability to hold the securities to maturity. Securities held to maturity are carried at amortized cost. Debt securities not classified as held to maturity are classified as available for sale. Securities available for sale are carried at fair value with unrealized gains and losses reported separately in accumulated other comprehensive income (loss), net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and are based on the amortized cost of the individual security sold.

When the Company does not intend to sell a debt security, and it is more likely than not, the Company will not have to sell the security before recovery of its cost basis, it recognizes the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive loss. For held-to-maturity debt securities, the amount of an other-than-temporary impairment recorded in other comprehensive loss for the noncredit portion of a previous other-than-temporary impairment is amortized prospectively over the remaining life of the security on the basis of the timing of future estimated cash flows of the security.

Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to noninterest income. Gains and losses on loan sales are recorded in noninterest income, and direct loan origination costs and fees are deferred at origination of the loan and are recognized in noninterest income upon sale of the loan.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoffs are reported at their outstanding principal balances adjusted for unearned income, charge-offs, the allowance for loan losses, any unamortized deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans.

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Notes to Consolidated Financial Statements

December 31, 2017 and 2016

For loans amortized at cost, interest income is accrued based on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, as well as premiums and discounts, are deferred and amortized as a level yield adjustment over the respective term of the loan.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Past-due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged off are reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Discounts and premiums on purchased residential real estate loans are amortized to income using the interest method over the remaining period to contractual maturity, adjusted for anticipated prepayments. Discounts and premiums on purchased consumer loans are recognized over the expected lives of the loans using methods that approximate the interest method.

Concentration of Credit Risk

Most of the Company's business activity is with customers located within Ripley, Dearborn, Ohio, and Switzerland counties. Therefore, the Company's exposure to credit risk is significantly affected by changes in the economy in the area. The Company considers loans with credit scores below 660 to be subprime. Subprime loans make up approximately 24% of the loan portfolio for the years ended 2017 and 2016.

Allowance for Loan Losses

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

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

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The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers nonclassified loans and is based on historical charge-off experience and expected loss given default derived from the Bank's internal risk rating process. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent.

Groups of loans with similar risk characteristics are collectively evaluated for impairment based on the group's historical loss experience adjusted for changes in trends, conditions and other relevant factors that affect repayment of the loans. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment measurements, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

Premises and Equipment

Land is carried at cost. Depreciable assets are stated at cost, less accumulated depreciation. Depreciation is charged to expense using the straight-line method over the estimated useful lives of the assets.

The Bank evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value. No asset impairment was recognized during the years ended December 31, 2017 and 2016.

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Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Restricted Equity Investments

Restricted equity investments include Federal Home Loan Bank (FHLB) of Indianapolis stock, Federal Reserve Bank (FRB) stock, and Bankers' Bank of Kentucky stock. This restricted stock is carried at cost and periodically evaluated for impairment. Because this stock is viewed as a long-term investment, impairment is based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Cash Surrender Value of Life Insurance Policies

The Bank has purchased life insurance policies on certain key executives. Bank-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Goodwill and Other Intangible Assets

Goodwill resulting from business combinations prior to January 1, 2009 represents the excess of the purchase price over the fair value of the net assets of businesses acquired. Goodwill resulting from business combinations after January 1, 2009, is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquired business, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. If the implied fair value of goodwill is lower than its carrying amount, a goodwill impairment is indicated and goodwill is written down to its implied fair value. Subsequent increases in goodwill value are not recognized in the consolidated financial statements. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimate residual values. Goodwill is the only intangible asset with an indefinite life on the consolidated balance sheets.

Intangible assets are amortized on an accelerated method over their estimated useful lives, which range from 2 to 7 years. The current balance of intangible assets is \$1,475,238 and \$1,624,107 at December 31, 2017 and 2016, respectively. Amortization expense was \$283,869 and \$297,857 for 2017 and 2016, respectively.

Other Real Estate Owned

Assets acquired through or instead of loan foreclosure are initially recorded at fair value, less costs to sell when acquired, establishing a new cost basis. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating costs after acquisition are expensed.

Friendship BanCorp

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Stock-Based Compensation

Compensation cost is recognized for stock options issued to employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Income Taxes

The Bank accounts for income taxes in accordance with income tax accounting guidance (ASC 740, *Income Taxes*). The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Bank determines deferred income taxes using the liability method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax basis of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term “more-likely-than-not” means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances and information available at the reporting date and is subject to the management’s judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Bank would recognize interest and penalties on income taxes as a component of income tax expense, if applicable.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the consolidated financial statements.

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Notes to Consolidated Financial Statements
December 31, 2017 and 2016

Off-Balance Sheet Financial Instruments

Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and standby letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale, which is recognized as a separate component of equity.

Dividend Restriction

Banking regulations require maintaining certain capital levels and may limit the dividends paid by the bank to the holding company or by the holding company to shareholders.

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Subsequent Events

Subsequent events have been evaluated through April 6, 2018, which is the date of the consolidated financial statements were available to be issued.

Note 2: Restriction on Cash and Due from Banks

Cash and cash equivalents consist of cash on hand and in other institutions and federal funds sold.

At December 31, 2017, the Company's cash accounts exceeded federally insured limits by \$14,328,099. Additionally, the Company has \$3,191,239 on deposit with the Federal Reserve Bank and Federal Home Loan Bank of Indianapolis as of December 31, 2017, which are not federally insured.

The Company is required to maintain reserve funds in cash on deposit with the Federal Reserve Bank. The reserve required at December 31, 2017 was \$6,837,000.

Friendship BanCorp
Notes to Consolidated Financial Statements
December 31, 2017 and 2016

Note 3: Securities

The following table summarizes the amortized cost and fair value of the available-for-sale securities portfolio at December 31, 2017 and 2016 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale Securities				
December 31, 2017				
U.S. Treasury and government agency	\$ 28,141,526	\$ 25,613	\$ (336,309)	\$ 27,830,830
Mortgage-backed securities - residential	11,799,921	55,596	(150,183)	11,705,334
Corporate debt	749,785	29,450	-	779,235
	<u>\$ 40,691,232</u>	<u>\$ 110,659</u>	<u>\$ (486,492)</u>	<u>\$ 40,315,399</u>
December 31, 2016				
U.S. Treasury and government agency	\$ 36,158,029	\$ 55,808	\$ (423,465)	\$ 35,790,372
Mortgage-backed securities - residential	12,529,004	84,229	(328,796)	12,284,437
State and political subdivisions	2,406,109	605	(62,107)	2,344,607
Corporate debt	999,858	42,019	-	1,041,877
	<u>\$ 52,093,000</u>	<u>\$ 182,661</u>	<u>\$ (814,368)</u>	<u>\$ 51,461,293</u>

The amortized cost, unrecognized gains and losses, and fair value of securities held to maturity were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Fair Value
Held-to-Maturity Securities				
December 31, 2017				
State and political subdivisions	<u>\$ 12,653,394</u>	<u>\$ 151,835</u>	<u>\$ (95,952)</u>	<u>\$ 12,709,277</u>
December 31, 2016				
State and political subdivisions	<u>\$ 10,298,441</u>	<u>\$ 156,174</u>	<u>\$ (130,708)</u>	<u>\$ 10,323,907</u>

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Notes to Consolidated Financial Statements

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During 2017 and 2016, the Company recognized gross gains of \$0 and \$15,826 and gross losses of approximately \$33,963 and \$0, respectively, on the sales of available-for-sale and held-to-maturity securities.

Certain investment securities at December 31, 2017 and 2016 were reported in the consolidated financial statements at an amount less than their historical cost. Total fair value of these investments at December 31, 2017 and 2016 were \$41,881,843 and \$39,403,632, which is approximately 79% and 64% of the Company's investment portfolio, respectively.

Based on evaluation of available evidence, including recent changes in market interest rates, credit rating information and information obtained from regulatory filings, management believes the declines in fair value for the Company's securities are temporary.

Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment is identified.

The following tables show the Company's investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2017 and 2016:

Description of Securities	2017					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available for sale						
U.S. Treasury and government agency	\$ 11,793,343	\$ (82,887)	\$ 15,000,534	\$ (253,422)	\$ 26,793,877	\$ (336,309)
Mortgage-backed securities - residential	4,342,230	(36,843)	5,837,779	(113,340)	10,180,009	(150,183)
Held to maturity						
States and political subdivisions	2,788,287	(20,714)	2,119,670	(75,238)	4,907,957	(95,952)
Total temporarily impaired	<u>\$ 18,923,860</u>	<u>\$ (140,444)</u>	<u>\$ 22,957,983</u>	<u>\$ (442,000)</u>	<u>\$ 41,881,843</u>	<u>\$ (582,444)</u>

Description of Securities	2016					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available for sale						
U.S. Treasury and government agency	\$ 24,741,272	\$ (423,465)	\$ -	\$ -	\$ 24,741,272	\$ (423,465)
Mortgage-backed securities - residential	10,103,739	(328,796)	-	-	10,103,739	(328,796)
States and political subdivisions	1,834,273	(62,107)	-	-	1,834,273	(62,107)
Held to maturity						
States and political subdivisions	2,061,843	(58,210)	662,505	(72,498)	2,724,348	(130,708)
Total temporarily impaired	<u>\$ 38,741,127</u>	<u>\$ (872,578)</u>	<u>\$ 662,505</u>	<u>\$ (72,498)</u>	<u>\$ 39,403,632</u>	<u>\$ (945,076)</u>

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U.S. Treasury, Government Agencies, and Mortgage Backed Securities

The unrealized losses on the Company's investments in direct obligations of U.S. government agencies were caused by interest rate changes and illiquidity. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2017.

State and Political Subdivisions

The unrealized losses on the Company's investments in securities of state and political subdivisions were caused by interest rate changes and illiquidity. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2017.

The amortized cost and fair value of the investment securities portfolio by contractual maturity are shown below. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities, not due at a single maturity date, primarily mortgage-backed securities are shown separately.

	Available-for-Sale	
	Amortized Cost	Fair Value
Within one year	\$ 3,248,115	\$ 3,247,755
One to five years	25,393,196	25,098,229
Five to ten years	250,000	264,081
After ten years	-	-
	<u>28,891,311</u>	<u>28,610,065</u>
Mortgage-backed securities - residential	<u>11,799,921</u>	<u>11,705,334</u>
Total	<u>\$ 40,691,232</u>	<u>\$ 40,315,399</u>

	Held-to-Maturity	
	Amortized Cost	Fair Value
Within one year	\$ 1,199,456	\$ 1,202,675
One to five years	3,399,481	3,451,147
Five to ten years	5,274,419	5,259,906
After ten years	<u>2,780,038</u>	<u>2,795,549</u>
Total	<u>\$ 12,653,394</u>	<u>\$ 12,709,277</u>

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Notes to Consolidated Financial Statements
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Note 4: Loans and Allowance for Loan Losses

Total loans are comprised at December 31, 2017 and 2016 include:

	2017	2016
Commercial	\$ 8,339,771	\$ 8,682,514
Agricultural	29,456,002	24,531,481
Real estate	213,041,356	209,154,114
Consumer	10,634,410	10,224,583
	<u>\$ 261,471,539</u>	<u>\$ 252,592,692</u>

Certain directors and executive officers of the Company, including their families and companies in which they are the principal owners, were customers of and had other transactions with the Company. Total loans to these persons were \$6,543,329 and \$6,983,720 at December 31, 2017 and 2016.

Mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of these loans at December 31, 2017 and 2016 were \$56,457,179 and \$54,395,258. At December 31, 2017 and 2016, the mortgage-servicing rights recorded are immaterial to the consolidated financial statements.

The following tables present the activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2017 and 2016.

	2017				
	Commercial	Agricultural	Real Estate	Consumer	Total
Beginning Balance	\$ 64,623	\$ 157,418	\$ 2,118,741	\$ 192,412	\$ 2,533,194
Provision	175,726	48,712	(176,558)	2,120	50,000
Loans charged off	-	-	(326,733)	(93,069)	(419,802)
Recoveries	20	-	100,940	51,546	152,506
Ending Balance	<u>\$ 240,369</u>	<u>\$ 206,130</u>	<u>\$ 1,716,390</u>	<u>\$ 153,009</u>	<u>\$ 2,315,898</u>

	2016				
	Commercial	Agricultural	Real Estate	Consumer	Total
Beginning Balance	\$ 67,112	\$ 54,258	\$ 2,116,144	\$ 189,990	\$ 2,427,504
Provision	(2,814)	103,160	170,868	103,786	375,000
Loans charged off	-	-	(196,301)	(126,373)	(322,674)
Recoveries	325	-	28,030	25,009	53,364
Ending Balance	<u>\$ 64,623</u>	<u>\$ 157,418</u>	<u>\$ 2,118,741</u>	<u>\$ 192,412</u>	<u>\$ 2,533,194</u>

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Notes to Consolidated Financial Statements

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The following tables present the balance in the allowance for loan losses and the recorded investment in loans based on the portfolio segment and impairment method as of December 31, 2017 and 2016:

	December 31, 2017				
	Commercial	Agricultural	Real Estate	Consumer	Total
Allowance Balances:					
Individually evaluated for impairment	\$ 231	\$ 2,751	\$ 253,667	\$ 38,129	\$ 294,778
Collectively evaluated for impairment	240,138	203,379	1,462,723	114,880	2,021,120
Total allowance for loan losses	<u>\$ 240,369</u>	<u>\$ 206,130</u>	<u>\$ 1,716,390</u>	<u>\$ 153,009</u>	<u>\$ 2,315,898</u>
Loan Balances:					
Individually evaluated for impairment	\$ 1,042,439	\$ 1,829,479	\$ 6,260,220	\$ 41,872	\$ 9,174,010
Collectively evaluated for impairment	7,297,332	27,626,523	206,781,136	10,592,538	252,297,529
Total loan balances	<u>\$ 8,339,771</u>	<u>\$ 29,456,002</u>	<u>\$ 213,041,356</u>	<u>\$ 10,634,410</u>	<u>\$ 261,471,539</u>
	December 31, 2016				
	Commercial	Agricultural	Real Estate	Consumer	Total
Allowance Balances:					
Individually evaluated for impairment	\$ 231	\$ 2,751	\$ 253,667	\$ 38,129	\$ 294,778
Collectively evaluated for impairment	64,392	154,667	1,865,074	154,283	2,238,416
Total allowance for loan losses	<u>\$ 64,623</u>	<u>\$ 157,418</u>	<u>\$ 2,118,741</u>	<u>\$ 192,412</u>	<u>\$ 2,533,194</u>
Loan Balances:					
Individually evaluated for impairment	\$ 150,055	\$ 1,043,178	\$ 6,206,057	\$ 95,786	\$ 7,495,076
Collectively evaluated for impairment	8,532,459	23,488,303	202,948,057	10,128,797	245,097,616
Total loan balances	<u>\$ 8,682,514</u>	<u>\$ 24,531,481</u>	<u>\$ 209,154,114</u>	<u>\$ 10,224,583</u>	<u>\$ 252,592,692</u>

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Notes to Consolidated Financial Statements

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The risk characteristics of each loan portfolio segment are as follows:

Commercial

Commercial loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. Borrowers may be subject to adverse economic conditions that can lead to decreases in product demand; increasing material or other production costs; interest rate increase that could have an adverse impact on profitability; non-payment of credit that has been extended under normal vendor terms for goods sold or services extended; interruption related to the importing or exporting of production materials or sold products.

Agricultural

Agricultural loans are typically secured by crops or other farm equipment. These loans are subject to risks which could cause poor operating performance of the borrower, such as adverse weather conditions; fluctuation of price of agricultural commodities; and the general economy.

Real Estate

Real estate loans are generally secured by 1-4 family residences, multifamily residences, or farm real estate, and are generally owner occupied. Home equity loans are typically secured by a subordinate interest in 1-4 family residences. Commercial real estate loans typically involve larger principal amounts, and repayment of these loans is generally dependent on the successful operations of the property securing the loan or the business conducted on the property securing the loan. Construction and land development real estate loans are usually based upon estimates of costs and estimated value of the completed project and include independent appraisal reviews and a financial analysis of the developers and property owners. These loans are subject to adverse employment conditions in the local economy leading to increased default rate; decreased market values from oversupply in a geographic area; impact to borrowers' ability to maintain payments in the event of incremental rate increases on adjustable rate mortgages.

Consumer

Consumer loans generally consist of loans secured by personal property or unsecured loans such as credit cards. Repayment of these loans is primarily dependent on the personal income of the borrowers, who are subject to adverse employment conditions in the local economy, which may lead to higher unemployment.

Internal Risk Categories

Loan grades are numbered 1 through 8. Grades 1 through 4 are considered satisfactory grades. The grade of 5, Special Mention, represents loans of lower quality and is considered criticized. The grades of 6, or Substandard, and 7, or Doubtful, refer to assets that are classified. The use and application of these grades by the bank will be uniform and shall conform to the bank's policy.

Pass (1-4) Loans of reasonable credit strength and repayment ability providing an average credit risk due to one or more underlying weaknesses.

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Special Mention (5) A special mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. Ordinarily, special mention credits have characteristics which corrective management action would remedy.

Substandard (6) Loans in this category are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Substandard loans have a high probability of payment default, or they have other well-defined weaknesses. Such loans have a distinct potential for loss; however, an individual loan's potential for loss does not have to be distinct for the loan to be rated substandard.

The following are examples of situations that might cause a loan to be graded a "6":

- Cash flow deficiencies (losses) jeopardize future loan payments.
- Sale of noncollateral assets has become a primary source of loan repayment.
- The relationship has deteriorated to the point that sale of collateral is now the Company's primary source of repayment, unless this was the original source of loan repayment.
- The borrower is bankrupt or for any other reason future repayment is dependent on court action.

Doubtful (7) A loan classified as doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of current existing facts, conditions, and values, highly questionable and improbable. A doubtful loan has a high probability of total or substantial loss. Doubtful borrowers are usually in default, lack adequate liquidity or capital, and lack the resources necessary to remain an operating entity. Because of high probability of loss, nonaccrual accounting treatment will be required for doubtful loans.

Loss (8) Loans classified loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off the loan even though partial recovery may be affected in the future.

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The following tables present the credit risk profile of the Company's loan portfolio based on rating category and payment activity as of December 31, 2017 and 2016:

December 31, 2017					
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	\$ 6,838,173	\$ 459,159	\$ 1,042,439	\$ -	\$ 8,339,771
Agricultural	26,626,523	1,000,000	1,829,479	-	29,456,002
Real estate					
Construction	12,123,577	-	151,727	-	12,275,304
Commercial	29,846,872	728,772	1,825,911	-	32,401,555
Residential	164,081,915	-	4,282,582	-	168,364,497
Consumer	10,592,538	-	41,872	-	10,634,410
Total	\$ 250,109,598	\$ 2,187,931	\$ 9,174,010	\$ -	\$ 261,471,539

December 31, 2016					
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	\$ 8,500,396	\$ 32,063	\$ 150,055	\$ -	\$ 8,682,514
Agricultural	23,322,338	165,965	1,043,178	-	24,531,481
Real estate					
Construction	12,242,340	-	211,326	-	12,453,666
Commercial	30,563,335	882,514	2,016,142	-	33,461,991
Residential	159,259,778	-	3,978,679	-	163,238,457
Consumer	10,128,887	-	95,696	-	10,224,583
Total	\$ 244,017,074	\$ 1,080,542	\$ 7,495,076	\$ -	\$ 252,592,692

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The following tables present the Company's loan portfolio aging analysis of the recorded investment in loans as of December 31, 2017 and 2016:

	December 31, 2017					
	30-59 Past Due	60-89 Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans
Commercial	\$ 956,382	\$ 14,357	\$ -	\$ 970,739	\$ 7,369,032	\$ 8,339,771
Agricultural	276,890	25,739	-	302,629	29,153,373	29,456,002
Real Estate						
Construction	-	-	-	-	12,275,304	12,275,304
Commercial	-	130,000	-	130,000	32,271,555	32,401,555
Residential	3,650,907	511,904	669,236	4,832,047	163,532,450	168,364,497
Consumer	199,045	38,495	-	237,540	10,396,870	10,634,410
Total loans	\$ 5,083,224	\$ 720,495	\$ 669,236	\$ 6,472,955	\$ 254,998,584	\$ 261,471,539

	December 31, 2016					
	30-59 Past Due	60-89 Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans
Commercial	\$ 33,044	\$ -	\$ -	\$ 33,044	\$ 8,649,470	\$ 8,682,514
Agricultural	29,838	-	14,805	44,643	24,486,838	24,531,481
Real Estate						
Construction	64,093	40,000	-	104,093	12,349,573	12,453,666
Commercial	80,328	-	-	80,328	33,381,663	33,461,991
Residential	4,155,136	533,057	754,150	5,442,343	157,796,114	163,238,457
Consumer	156,851	10,985	20,676	188,512	10,036,071	10,224,583
Total loans	\$ 4,519,290	\$ 584,042	\$ 789,631	\$ 5,892,963	\$ 246,699,729	\$ 252,592,692

Loans greater than 90 days past due and still accruing interest totaled \$0 and \$41,544 as of December 31, 2017 and 2016, respectively.

The following table presents the Company's nonaccrual loans at December 31, 2017 and 2016:

	2017	2016
Agricultural	\$ -	\$ 14,805
Real estate		
Construction	-	40,000
Residential	706,638	712,607
Consumer	-	26,275
Total nonaccrual loans	\$ 706,638	\$ 793,687

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The following tables present impaired loans for the years ended December 31, 2017 and 2016:

	December 31, 2017				
	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Average Investment in Impaired Loans	Interest Income Recognized
Impaired loans without a specific valuation allowance:					
Commercial	\$ 142,997	\$ 142,997	\$ -	\$ 97,030	\$ 6,641
Agricultural	821,256	821,256	-	899,455	54,018
Real estate					
Construction	-	-	-	-	-
Commercial	242,875	242,875	-	133,042	3,331
Residential	1,475,015	1,475,015	-	1,711,635	79,936
Consumer	-	-	-	3,615	202
Total	<u>2,682,143</u>	<u>2,682,143</u>	<u>-</u>	<u>2,844,777</u>	<u>144,128</u>
Impaired loans with a specific valuation allowance:					
Commercial	899,442	899,442	231	158,961	10,845
Agricultural	1,008,223	1,008,223	2,751	229,007	71,502
Real estate					
Construction	151,727	151,727	54,071	197,114	10,089
Commercial	1,583,036	1,583,036	32,000	1,897,666	116,510
Residential	2,807,567	2,925,899	167,596	1,716,115	98,406
Consumer	41,872	41,872	38,129	94,588	10,773
Total	<u>6,491,867</u>	<u>6,610,199</u>	<u>294,778</u>	<u>4,293,451</u>	<u>318,125</u>
Total impaired loans	<u>\$ 9,174,010</u>	<u>\$ 9,292,342</u>	<u>\$ 294,778</u>	<u>\$ 7,138,228</u>	<u>\$ 462,253</u>

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	December 31, 2016				
	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Average Investment in Impaired Loans	Interest Income Recognized
Impaired loans without a specific valuation allowance:					
Commercial	\$ 36,381	\$ 36,381	\$ -	\$ 54,484	\$ 6,814
Agricultural	1,008,788	1,008,788	-	1,031,552	44,060
Real estate					
Construction	-	-	-	-	-
Commercial	188,770	188,770	-	259,135	5,897
Residential	2,272,773	2,272,773	-	2,273,920	143,059
Consumer	9,221	9,221	-	14,204	859
Total	<u>3,515,933</u>	<u>3,515,933</u>	<u>-</u>	<u>3,633,295</u>	<u>200,689</u>
Impaired loans with a specific valuation allowance:					
Commercial	113,674	113,674	231	158,961	10,845
Agricultural	34,390	34,390	2,751	229,007	71,502
Real estate					
Construction	211,236	217,157	54,071	197,114	10,089
Commercial	1,827,372	1,827,372	32,000	1,897,666	116,510
Residential	1,705,906	1,738,940	167,596	1,716,115	98,406
Consumer	86,565	86,565	38,129	94,588	10,773
Total	<u>3,979,143</u>	<u>4,018,098</u>	<u>294,778</u>	<u>4,293,451</u>	<u>318,125</u>
Total impaired loans	<u>\$ 7,495,076</u>	<u>\$ 7,534,031</u>	<u>\$ 294,778</u>	<u>\$ 7,926,746</u>	<u>\$ 518,814</u>

There were no newly classified troubled debt restructured loans for the year 2017 or 2016.

The Company has not had any current year troubled debt restructurings that subsequently defaulted in the current year. Default occurs when a loan is 90 days or more past due or transferred to nonaccrual within 12 months of restructuring.

Note 5: Premises and Equipment

Major classifications of premises and equipment, stated at cost, are as follows:

	2017	2016
Land	\$ 2,421,245	\$ 2,269,135
Buildings and improvements	7,806,971	7,932,102
Furniture and equipment	4,467,421	5,102,822
Construction in process	44,570	1,741
	<u>14,740,207</u>	<u>15,305,800</u>
Less accumulated depreciation	<u>(6,061,812)</u>	<u>(6,271,853)</u>
Net premises and equipment	<u>\$ 8,678,395</u>	<u>\$ 9,033,947</u>

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Note 6: Income Taxes

The provision for income taxes includes these components:

	2017	2016
Taxes currently payable	\$ 1,758,208	\$ 1,725,986
Deferred income benefit	(14,240)	(178,865)
	\$ 1,743,968	\$ 1,547,121
	2017	2016
Computed at the statutory rate (34%)	\$ 1,827,427	\$ 1,706,614
Tax-exempt interest	(88,769)	(105,138)
State income taxes, net	48,623	29,856
Income tax credits	(42,884)	(48,924)
Bank-owned life insurance	(43,955)	(39,119)
Revaluation of net deferred tax assets	22,052	-
Other	21,474	3,832
	\$ 1,743,968	\$ 1,547,121

A reconciliation of income tax expense at the statutory rate to the Bank's actual income tax expense is shown below:

	2017	2016
Deferred tax assets		
Allowance for loan losses	\$ 538,847	\$ 848,474
Net unrealized loss on securities available for sale	114,343	230,758
Deferred compensation	350,154	509,262
Other	119,185	126,193
Total assets	1,122,529	1,714,687
Deferred tax liabilities		
Depreciation	(135,949)	(305,093)
Goodwill	(418,584)	(585,307)
Mortgage-servicing rights	(46,956)	(73,311)
Prepaid expenses	(54,434)	(70,878)
REIT deferred income	(191,572)	(310,140)
Deferred FHLB stock dividends	(21,437)	(31,697)
Other	(26,805)	(32,300)
Total liabilities	(895,737)	(1,408,726)
	\$ 226,792	\$ 305,961

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The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax of the state of Indiana. The Company does not expect the total amount of unrecognized tax benefits to significantly change in the next 12 months.

The Company recognizes interest and/or penalties related to income tax matters in income tax expenses. The Company did not have any amounts accrued for interest and penalties at December 31, 2017.

On December 22, 2017, the United States enacted tax reform legislation the *Tax Cuts and Jobs Act*, which significantly changes the existing U.S. tax laws, including a reduction in the corporate tax rate from 35% to 21%, as well as other changes. As a result of enactment of the legislation, the Company incurred additional one-time income tax expense of \$22,000 during the fourth quarter of 2017, related to the remeasurement of the Company's deferred tax assets and liabilities. Included in this additional one-time income tax expense of \$22,000 is income tax expense of \$23,000 related to the adjustment of the deferred tax asset for net unrealized losses on available-for-sale securities.

Note 7: Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the years ended December 31, 2017 and 2016, were:

	<u>2017</u>	<u>2016</u>
Balance as of January 1	\$ 2,122,953	\$ 1,457,953
Goodwill acquired during the year	<u>-</u>	<u>665,000</u>
Balance as of December 31	<u>\$ 2,122,953</u>	<u>\$ 2,122,953</u>

Goodwill is evaluated on annual basis for impairment. No goodwill impairment loss was recorded during the years ended December 31, 2017 and 2016.

The carrying basis and accumulated amortization of recognized intangible assets at December 31, 2017 and 2016, were:

	2017		2016	
	Gross Carrying Value	Accumulated Amortization	Gross Carrying Value	Accumulated Amortization
Intangible assets	\$ 2,300,000	\$ 824,762	\$ 2,165,000	\$ 540,893

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Amortization expense for the years ended December 31, 2017 and 2016 was \$284,000 and \$265,000, respectively. Estimated amortization expense for each of the following five years is:

2018	\$	282,143
2019		282,143
2020		282,143
2021		282,143
2022		282,143

Note 8: Deposits

	<u>2017</u>	<u>2016</u>
Demand deposits	\$ 151,584,207	\$ 145,158,193
Savings and money market accounts	88,445,707	79,699,668
Certificates and other time deposits of \$250,000 or more	22,667,735	23,125,386
Other certificates and time deposits	<u>58,671,532</u>	<u>61,250,370</u>
Total deposits	<u>\$ 321,369,181</u>	<u>\$ 309,233,617</u>

At December 31, 2017, the scheduled maturities of certificates and time deposits are as follows:

2018	\$	45,966,485
2019		11,561,553
2020		8,932,715
2021		6,084,868
2022		8,625,684
Thereafter		<u>167,962</u>
	<u>\$</u>	<u>81,339,267</u>

Deposits from related parties totaled approximately \$5,052,321 and \$3,967,068 at December 31, 2017 and 2016, respectively.

Note 9: Federal Home Loan Advances

Federal Home Loan advances at December 31, 2017 and 2016 consisted of the following:

	<u>2017</u>	<u>2016</u>
Federal Home Loan Bank advances	<u>\$ 1,000,000</u>	<u>\$ 1,000,000</u>

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The advance is payable at its maturity date. The Company's advance, at an interest rate of 5.03 percent is subject to restrictions or penalties in the event of prepayment. The Federal Home Loan Bank advance is secured by first mortgage loans totaling approximately \$84,029,024 at December 31, 2017.

The future maturities of borrowings at December 31, 2017 were as follows:

2018	\$ 1,000,000
2019	-
2020	-
2021	-
2022	-
	<hr/>
	<u>\$ 1,000,000</u>

Note 10: Commitments and Contingencies

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet financing needs of its customers. These financial instruments include commitments to extend loans and unused credit lines to customers. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument is represented by the contractual amount of those instruments. The Bank uses the same credit policy to make such commitments as it uses for on-balance-sheet items.

Off-balance-sheet commitments are as follows at December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Commitments to extend credit	\$ 2,531,000	\$ 1,241,000
Unused lines of credit	19,168,000	18,294,000
Standby letters of credit	275,000	330,000

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party.

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The Company and Bank are subject to claims and lawsuits which arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the consolidated financial position of the Company.

As of December 31, 2017, the Bank had a line of credit agreement with the Federal Home Loan Bank, which allow the Bank to borrow up to \$6,000,000. There was no outstanding balance on this line of credit as of December 31, 2017.

As of December 31, 2017, the Bank had a line of credit agreement with the Bankers' Bank of Wisconsin, which allow the Bank to borrow up to \$6,000,000. There was no outstanding balance on this line of credit as of December 31, 2017.

Note 11: Benefit Plans

The Company sponsors a defined-contribution 401(k) plan with ESOP provisions, which covers substantially all employees. Eligible employees can elect to defer up to 15 percent of their salary, not to exceed IRS limitations. The Company matches one half of employee contributions, up to six percent of their salaries. Employer's contributions are 100% vested after five years of service. The Plan includes an employee stock ownership option. The Company's total 401(k) contributions charged to expense in 2017 and 2016 were \$112,061 and \$107,781.

Participants receive distributions from the plan of their vested shares of Company common stock subsequent to the end of their employment. The Company is required to redeem the shares of Company common stock that have been distributed from the plan at current market value, upon request of the participants receiving such distributions. An independent appraisal is obtained annually to determine the market value of Company stock.

The ESOP shares as of December 31, 2017 and 2016 were as follows:

	2017	2016
Allocated shares, beginning of year	313,856	314,360
Shares released during the year for allocation	-	-
Shares distributed during the year	(100)	(504)
Unreleased shares, end of year	-	-
Total ESOP shares	313,756	313,856

The Company is obligated at the option of each beneficiary to repurchase shares of the ESOP upon the beneficiary's termination or after retirement. At December 31, 2017, the fair value, as estimated by an independent third party, of the 313,756 allocated shares held by the ESOP is \$8,549,851. As of December 31, 2017 and 2016, there were 82,209 and 66,658 allocated shares with a fair value of \$2,240,197 and \$1,599,785 subject to repurchase obligation.

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In addition, the Company has entered into deferred compensation, salary continuation agreements that provide benefits to certain directors and officers or their beneficiaries. The benefits expected to be paid are being accrued to date of full eligibility. Benefit payments under the agreements may be accelerated upon death, disability or termination by the Company prior to full eligibility. The salary continuation plan was frozen in 2007. The expense incurred for the deferred compensation plan in 2017 and 2016 was \$50,876 and \$98,689.

Note 12: Stock Options

Options to buy stock are granted to directors, officers and employees under the Employee Stock Option Plan, which provides for issue of up to 200,000 options. The maximum option term is ten years. At December 31, 2017, options to purchase 167,136 shares of stock remain for future grants under this plan.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model. Expected volatilities are based on historical volatilities of the Company's common stock. The Company uses historical data to estimate option exercise and post-vesting termination behavior. The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding. The risk-free rate of interest for the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. There were no grants in 2017 or 2016.

A summary of the activity in the plan is as follows.

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, beginning of year	12,354	17.00	4.03	
Granted	-			
Exercised	(1,848)	17.00		
Forfeited or expired	-			
	<u>10,506</u>	<u>17.00</u>	<u>3.03</u>	<u>\$ 107,687</u>
Outstanding, end of year	<u>10,506</u>	<u>17.00</u>	<u>3.03</u>	<u>\$ 107,687</u>
Exercisable, end of year	<u>10,506</u>	<u>17.00</u>	<u>3.03</u>	<u>\$ 107,687</u>

The total intrinsic value of options exercised during the years ended December 31, 2017 and 2016 was \$18,942 and \$15,624, respectively. Cash received from option exercises for the years ended December 31, 2017 and 2016 was \$31,416 and \$37,944, respectively.

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Note 13: Changes in Accumulated Other Comprehensive Income (AOCI) by Component

Amounts reclassified from AOCI and the affected line items in the consolidated statements of income during the years ended December 31, 2017 and 2016, were as follows:

	Amounts Reclassified		Affected Line Item in the Statements of Income
	From AOCI 2017	2016	
Realized gains on available-for-sale securities			
	\$ (33,927)	\$ 15,826	Realized gains (losses) on sale of securities
	<u>12,451</u>	<u>(6,269)</u>	Tax benefit (expense)
Total reclassification out of AOCI	<u>\$ (21,476)</u>	<u>\$ 9,557</u>	

Note 14: Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance-sheet items as calculated under U.S. GAAP, regulatory reporting requirements and regulatory capital standards. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Furthermore, the Bank's regulators could require adjustments to regulatory capital not reflected in these consolidated financial statements.

Quantitative measures established by regulatory reporting standards to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined) to risk-weighted assets (as defined), common equity Tier I capital (as defined) to total risk-weighted assets (as defined) and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2017 and 2016, that the Bank meets all capital adequacy requirements to which it is subject.

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

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The Bank's actual and required capital amounts and ratios are as follows (table amounts in thousands):

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2017						
Total capital ¹ (to risk-weighted assets)	\$ 36,769	17.4%	\$ 16,914	8.0%	\$ 21,143	10.0%
Tier 1 capital ¹ (to risk-weighted assets)	34,453	16.3%	12,686	6.0%	16,914	8.0%
Common Equity Tier I capital ¹ (to risk-weighted assets)	34,453	16.3%	9,514	4.5%	13,743	6.5%
Tier 1 capital ¹ (to average assets)	34,453	9.5%	14,527	4.0%	18,159	5.0%
As of December 31, 2016						
Total capital ¹ (to risk-weighted assets)	\$ 35,442	17.3%	\$ 16,426	8.0%	\$ 20,533	10.0%
Tier 1 capital ¹ (to risk-weighted assets)	32,909	16.0%	12,320	6.0%	16,426	8.0%
Common Equity Tier I capital ¹ (to risk-weighted assets)	32,909	16.0%	9,240	4.5%	13,346	6.5%
Tier 1 capital ¹ (to average assets)	32,909	9.4%	13,982	4.0%	17,477	5.0%

Without prior approval, current regulations allow the Bank to pay dividends not exceeding net profits (as defined) for the current year, plus those for the previous two years. The Bank normally restricts dividends to a lesser amount because of the need to maintain an adequate capital structure.

Basel III Capital Rules

In July 2013, the three federal bank regulatory agencies jointly published final rules (the Basel III Capital Rules) establishing a new comprehensive capital framework for U.S. banking organizations. The rules implement the Basel Committee's December 2010 framework known as "Basel III" for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. These rules substantially revise the risk-based capital requirements applicable to bank holding companies and depository institutions, compared to the current U.S. risk-based capital rules. The Basel III Capital Rules define the components of capital and address other issues affecting the numerator in banking institutions' regulatory capital ratios. These rules also address risk weights and other issues affecting the denominator in banking institutions' regulatory capital ratios and replace the existing risk-weighting approach with a more risk-sensitive approach. The Basel III Capital Rules were effective for the Bank on January 1, 2015 (subject to a four-year phase-in period).

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The Basel III Capital Rules, among other things, (i) introduce a new capital measure called “Common Equity Tier 1” (CET1), (ii) specify that Tier 1 capital consist of CET1 and “Additional Tier 1 Capital” instruments meeting specified requirements, (iii) define CET1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) expand the scope of the deductions/adjustments as compared to existing regulations.

The above minimum capital requirements exclude the capital conservation buffer required to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019. The capital conservation buffer was 1.25% at December 31, 2017. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital.

Note 15: Disclosures About Fair Values of Financial Instruments

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities.
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities

Following is a description of the valuation methodologies and inputs used for instruments measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Available-for-Sale Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Matrix pricing is a mathematical technique widely used in the banking industry to value investment securities without relying exclusively on quoted prices for specific investment securities but rather relying on the investment securities relationship to other benchmark quoted investment securities.

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Level 2 securities include U.S. Government-sponsored agencies, mortgage-backed securities, state and political securities and corporate debt. Matrix pricing is a mathematical technique widely used in the banking industry to value investment securities without relying exclusively on quoted prices for specific investment securities but rather relying on the investment securities' relationship to other benchmark quoted investment securities.

In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

The following table presents the fair value measurements of assets recognized in the accompanying consolidated balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2017 and 2016:

Assets Measured on a Recurring Basis

Assets measured at fair value on a recurring basis, are summarized below:

	Fair Value	Recurring Basis Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2017				
Available-for-sale securities				
U.S. Treasury and government agency	\$ 27,830,830	\$ -	\$ 27,830,830	\$ -
Mortgage-backed - residential	11,705,334	-	11,705,334	-
Corporate debt	779,235	-	779,235	-
	<u>40,315,399</u>	<u>-</u>	<u>40,315,399</u>	<u>-</u>
Total investment securities available-for-sale	<u>\$ 40,315,399</u>	<u>\$ -</u>	<u>\$ 40,315,399</u>	<u>\$ -</u>
December 31, 2016				
Available-for-sale securities				
U.S. Treasury and government agency	\$ 35,790,372	\$ 10,543,694	\$ 25,246,678	\$ -
Mortgage-backed - residential	12,284,437	-	12,284,437	-
State and political subdivisions	2,344,607	-	2,344,607	-
Corporate debt	1,041,877	-	1,041,877	-
	<u>51,461,293</u>	<u>10,543,694</u>	<u>40,917,599</u>	<u>-</u>
Total investment securities available-for-sale	<u>\$ 51,461,293</u>	<u>\$ 10,543,694</u>	<u>\$ 40,917,599</u>	<u>\$ -</u>

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Following is a description of the valuation methodologies and inputs used for assets and liabilities measured at fair value on a nonrecurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy.

Impaired Loans (Collateral Dependent)

The estimated fair value of collateral-dependent impaired loans is based on the appraised fair value of the collateral, less estimated cost to sell. Collateral-dependent impaired loans are classified within Level 3 of the fair value hierarchy.

The Company considers the appraisal or evaluation as the starting point for determining fair value and then considers other factors and events in the environment that may affect the fair value. Appraisals of the collateral underlying collateral-dependent loans are obtained when the loan is determined to be collateral-dependent and subsequently as deemed necessary by management. Appraisals are reviewed for accuracy and consistency by management. Appraisers are selected from the list of approved appraisers maintained by management. The appraised values are reduced by discounts to consider lack of marketability and estimated cost to sell if repayment or satisfaction of the loan is dependent on the sale of the collateral. These discounts and estimates are developed by management by comparison to historical results.

The following tables present the fair value measurement of assets measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2017 and 2016:

	Nonrecurring Basis Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2017				
Impaired loans	\$ 1,205,286	\$ -	\$ -	\$ 1,205,286
December 31, 2016				
Impaired loans	\$ 1,301,840	\$ -	\$ -	\$ 1,301,840

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Unobservable (Level 3) Inputs

The following tables present quantitative information about unobservable inputs used in nonrecurring Level 3 fair value measurements.

	Fair Value at December 31, 2017	Valuation Technique	Unobservable Inputs	Range (Weighted - Range)
Impaired loans - collateral dependent	\$ 1,205,286	Sales comparison approach	Marketability discount	0-72% (28%)

	Fair Value at December 31, 2016	Valuation Technique	Unobservable Inputs	Range (Weighted - Range)
Impaired loans - collateral dependent	\$ 1,301,840	Sales comparison approach	Marketability discount	0-87% (29%)

Note 16: Business Combinations

Effective January 1, 2016, the Company entered into an agreement to assume substantially all of the assets and liabilities of Pollerts' Insurance Agency, including but not limited to the current and former insurance accounts and clients of Pollerts' Insurance Agency, a division of Milt Pollert Real Estate, Inc. (a/k/a Pollerts' Inc.), headquartered in Seymour, Indiana. The purchase price of the acquisition was \$2,055,000, and the fair value of the net assets was \$1,500,000, resulting in goodwill of \$555,000.

Effective September 1, 2016, the Company entered into an agreement to assume all of the assets and liabilities of Wunderlich Insurance Agency. The purchase price of the acquisition was \$450,000, and the fair value of the net assets was \$340,000, resulting in goodwill of \$110,000.

The goodwill of approximately \$665,000 arising from the acquisition consists largely of the synergies and economies of scale expected from combining the operations of the Company and the aforementioned insurance agencies. None of the goodwill amount is expected to be deductible for tax purposes.