

# Section 1: 10-Q (10-Q)

[Table of Contents](#)

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For The Quarterly Period Ended September 30, 2018

Commission File Number 0-16759

FIRST FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

INDIANA

(State or other jurisdiction  
incorporation or organization)

35-1546989

(I.R.S. Employer  
Identification No.)

One First Financial Plaza, Terre Haute, IN

(Address of principal executive office)

47807

(Zip Code)

(812)238-6000

(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 period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No .

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No .

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No .

As of November 5, 2018, the registrant had outstanding 12,255,045 shares of common stock, without par value.



FIRST FINANCIAL CORPORATION

FORM 10-Q

INDEX

	<u>Page No.</u>
<u>PART I. Financial Information</u>	
<u>Item 1. Financial Statements:</u>	
<u>Consolidated Balance Sheets</u>	<u>3</u>
<u>Consolidated Statements of Income and Comprehensive Income</u>	<u>4</u>
<u>Consolidated Statements of Shareholders' Equity</u>	<u>5</u>
<u>Consolidated Statements of Cash Flows</u>	<u>7</u>
<u>Notes to Consolidated Financial Statements</u>	<u>8</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>36</u>
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>38</u>
<u>Item 4. Controls and Procedures</u>	<u>41</u>
<u>PART II. Other Information:</u>	
<u>Item 1. Legal Proceedings</u>	<u>42</u>
<u>Item 1A. Risk Factors</u>	<u>42</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>42</u>
<u>Item 3. Defaults upon Senior Securities</u>	<u>42</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>42</u>
<u>Item 5. Other Information</u>	<u>42</u>
<u>Item 6. Exhibits</u>	<u>43</u>
<u>Signatures</u>	<u>44</u>

## Part I – Financial Information

## Item 1. Financial Statements

FIRST FINANCIAL CORPORATION  
CONSOLIDATED BALANCE SHEETS  
(Dollar amounts in thousands, except per share data)

	September 30, 2018	December 31, 2017
	(unaudited)	
<b>ASSETS</b>		
Cash and due from banks	\$ 50,018	\$ 74,107
Federal funds sold	7,600	—
Securities available-for-sale	785,693	814,931
Loans:		
Commercial	1,150,536	1,139,490
Residential	443,264	436,143
Consumer	345,132	327,976
	1,938,932	1,903,609
(Less) plus:		
Net deferred loan costs	2,848	3,152
Allowance for loan losses	(20,301)	(19,909)
	1,921,479	1,886,852
Restricted stock	10,390	10,379
Accrued interest receivable	14,630	12,913
Premises and equipment, net	46,985	48,272
Bank-owned life insurance	85,901	85,016
Goodwill	34,355	34,355
Other intangible assets	1,310	1,630
Other real estate owned	520	1,880
Other assets	22,054	30,333
<b>TOTAL ASSETS</b>	<b>\$ 2,980,935</b>	<b>\$ 3,000,668</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Deposits:</b>		
Non-interest-bearing	\$ 420,337	\$ 425,001
Interest-bearing:		
Certificates of deposit exceeding the FDIC insurance limits	40,904	43,178
Other interest-bearing deposits	1,945,820	1,990,474
	2,407,061	2,458,653
Short-term borrowings	58,680	57,686
FHLB advances	35,000	—
Other liabilities	52,420	70,760
<b>TOTAL LIABILITIES</b>	<b>2,553,161</b>	<b>2,587,099</b>
<b>Shareholders' equity</b>		
<b>Common stock, \$.125 stated value per share;</b>		
<b>Authorized shares-40,000,000</b>		
<b>Issued shares-14,612,540 in 2018 and 14,595,320 in 2017</b>		
Outstanding shares-12,255,045 in 2018 and 12,246,464 in 2017	1,824	1,822
Additional paid-in capital	76,181	75,624
Retained earnings	451,918	420,275
Accumulated other comprehensive loss	(32,310)	(14,704)
Less: Treasury shares at cost-2,357,495 in 2018 and 2,348,856 in 2017	(69,839)	(69,448)
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>427,774</b>	<b>413,569</b>

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY

See accompanying notes.

\$ 2,980,935 \$ 3,000,668

FIRST FINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME  
(Dollar amounts in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
<b>INTEREST INCOME:</b>				
Loans, including related fees	\$ 25,581	\$ 23,119	\$ 73,982	\$ 67,385
<b>Securities:</b>				
Taxable	3,601	3,500	13,141	10,887
Tax-exempt	1,873	1,859	5,573	5,529
Other	320	327	959	978
<b>TOTAL INTEREST INCOME</b>	<b>31,375</b>	<b>28,805</b>	<b>93,655</b>	<b>84,779</b>
<b>INTEREST EXPENSE:</b>				
Deposits	2,365	1,561	6,254	4,307
Short-term borrowings	167	98	354	215
Other borrowings	16	38	63	82
<b>TOTAL INTEREST EXPENSE</b>	<b>2,548</b>	<b>1,697</b>	<b>6,671</b>	<b>4,604</b>
<b>NET INTEREST INCOME</b>	<b>28,827</b>	<b>27,108</b>	<b>86,984</b>	<b>80,175</b>
Provision for loan losses	1,470	1,185	4,298	3,821
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<b>27,357</b>	<b>25,923</b>	<b>82,686</b>	<b>76,354</b>
<b>NON-INTEREST INCOME:</b>				
Trust and financial services	1,133	1,194	3,888	3,660
Service charges and fees on deposit accounts	3,002	3,048	8,733	8,829
Other service charges and fees	3,256	3,070	9,747	9,369
Securities gains, net	3	27	5	44
Recovery of security previously written down for OTTI	—	—	4,158	3,061
Gain on sales of mortgage loans	618	535	1,458	1,255
Other	897	666	1,984	1,484
<b>TOTAL NON-INTEREST INCOME</b>	<b>8,909</b>	<b>8,540</b>	<b>29,973</b>	<b>27,702</b>
<b>NON-INTEREST EXPENSE:</b>				
Salaries and employee benefits	12,485	12,489	38,028	37,780
Occupancy expense	1,894	1,769	5,308	5,298
Equipment expense	1,673	1,792	5,016	5,424
FDIC Expense	223	228	673	689
Other	6,022	6,006	19,166	17,758
<b>TOTAL NON-INTEREST EXPENSE</b>	<b>22,297</b>	<b>22,284</b>	<b>68,191</b>	<b>66,949</b>
<b>INCOME BEFORE INCOME TAXES</b>	<b>13,969</b>	<b>12,179</b>	<b>44,468</b>	<b>37,107</b>
Provision for income taxes	2,656	3,385	8,941	10,592
<b>NET INCOME</b>	<b>11,313</b>	<b>8,794</b>	<b>35,527</b>	<b>26,515</b>
<b>OTHER COMPREHENSIVE INCOME (LOSS)</b>				
Change in unrealized gains/(losses) on securities, net of reclassifications and taxes	(3,702)	(51)	(16,083)	8,182
Change in funded status of post retirement benefits, net of taxes	281	184	843	551
<b>COMPREHENSIVE INCOME</b>	<b>\$ 7,892</b>	<b>\$ 8,927</b>	<b>\$ 20,287</b>	<b>\$ 35,248</b>
<b>PER SHARE DATA</b>				
Basic and Diluted Earnings per Share	\$ 0.92	\$ 0.72	\$ 2.90	\$ 2.17
Weighted average number of shares outstanding (in thousands)	12,255	12,224	12,253	12,221

See accompanying notes.



FIRST FINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
Three Months Ended  
September 30, 2018, and 2017  
(Dollar amounts in thousands, except per share data)  
(Unaudited)

	Common Stock	Additional Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Treasury Stock	Total
Balance, July 1, 2017	\$ 1,821	\$ 74,877	\$ 433,435	\$ (5,564)	\$ (70,115)	\$ 434,454
Net income	—	—	8,794	—	—	8,794
Other comprehensive income	—	—	—	133	—	133
Omnibus Equity Incentive Plan	1	176	—	—	—	177
Balance, September 30, 2017	<u>\$ 1,822</u>	<u>\$ 75,053</u>	<u>\$ 442,229</u>	<u>\$ (5,431)</u>	<u>\$ (70,115)</u>	<u>\$ 443,558</u>
Balance, July 1, 2018	\$ 1,823	\$ 75,995	\$ 440,605	\$ (28,889)	\$ (69,839)	\$ 419,695
Net income	—	—	11,313	—	—	11,313
Other comprehensive loss	—	—	—	(3,421)	—	(3,421)
Omnibus Equity Incentive Plan	1	186	—	—	—	187
Balance, September 30, 2018	<u>\$ 1,824</u>	<u>\$ 76,181</u>	<u>\$ 451,918</u>	<u>\$ (32,310)</u>	<u>\$ (69,839)</u>	<u>\$ 427,774</u>

See accompanying notes.



FIRST FINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
Nine Months Ended  
September 30, 2018, and 2017  
(Dollar amounts in thousands, except per share data)  
(Unaudited)

	Common Stock	Additional Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Treasury Stock	Total
Balance, January 1, 2017	\$ 1,820	\$ 74,525	\$ 421,826	\$ (14,164)	\$ (69,612)	\$ 414,395
Net income	—	—	26,515	—	—	26,515
Other comprehensive income	—	—	—	8,733	—	8,733
Omnibus Equity Incentive Plan	2	528	—	—	—	530
Treasury shares purchased (9,524 shares)	—	—	—	—	(503)	(503)
Cash dividends, \$.50 per share	—	—	(6,112)	—	—	(6,112)
Balance, September 30, 2017	<u>\$ 1,822</u>	<u>\$ 75,053</u>	<u>\$ 442,229</u>	<u>\$ (5,431)</u>	<u>\$ (70,115)</u>	<u>\$ 443,558</u>
Balance, January 1, 2018	\$ 1,822	\$ 75,624	\$ 420,275	\$ (14,704)	\$ (69,448)	\$ 413,569
Net income	—	—	35,527	—	—	35,527
Other comprehensive loss	—	—	—	(15,240)	—	(15,240)
Omnibus Equity Incentive Plan	2	557	—	—	—	559
Treasury shares purchased (8,639 shares)	—	—	—	—	(391)	(391)
ASU 2018-02 adjustment	—	—	2,366	(2,366)	—	—
Cash dividends, \$.51 per share	—	—	(6,250)	—	—	(6,250)
Balance, September 30, 2018	<u>\$ 1,824</u>	<u>\$ 76,181</u>	<u>\$ 451,918</u>	<u>\$ (32,310)</u>	<u>\$ (69,839)</u>	<u>\$ 427,774</u>

See accompanying notes.

FIRST FINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Dollar amounts in thousands, except per share data)

	Nine Months Ended September 30,	
	2018	2017
	(Unaudited)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net Income	\$ 35,527	\$ 26,515
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization (accretion) of premiums and discounts on investments	2,706	2,799
Provision for loan losses	4,298	3,821
Securities (gains)	(5)	(44)
Loss on sale of other real estate	101	61
Recovery of security previously written down for OTTI	(4,158)	(3,061)
Restricted stock compensation	559	530
Depreciation and amortization	3,126	3,352
Other, net	(633)	1,857
<b>NET CASH FROM OPERATING ACTIVITIES</b>	<b>41,521</b>	<b>35,830</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from sales of securities available-for-sale	—	9,105
Calls, maturities and principal reductions on securities available-for-sale	112,287	106,993
Purchases of securities available-for-sale	(102,731)	(87,528)
Loans made to customers, net of repayment	(39,119)	(30,771)
Purchase of restricted stock	(11)	(20)
Proceeds from sales of other real estate owned	1,568	1,314
Net change in federal funds sold	(7,600)	(2,446)
Additions to premises and equipment	(1,519)	(1,036)
<b>NET CASH FROM INVESTING ACTIVITIES</b>	<b>(37,125)</b>	<b>(4,389)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net change in deposits	(51,592)	24,880
Net change in short-term borrowings	994	(57,475)
Maturities of other borrowings	(55,600)	(170,132)
Proceeds from other borrowings	90,600	170,000
Purchase of treasury stock	(391)	(503)
Dividends paid	(12,496)	(12,220)
<b>NET CASH FROM FINANCING ACTIVITIES</b>	<b>(28,485)</b>	<b>(45,450)</b>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>(24,089)</b>	<b>(14,009)</b>
CASH AND DUE FROM BANKS, BEGINNING OF PERIOD	74,107	75,012
<b>CASH AND DUE FROM BANKS, END OF PERIOD</b>	<b>\$ 50,018</b>	<b>\$ 61,003</b>

See accompanying notes.

FIRST FINANCIAL CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The accompanying September 30, 2018 and 2017 consolidated financial statements are unaudited. The December 31, 2017 consolidated financial statements are as reported in the First Financial Corporation (the “Corporation”) 2017 annual report. The information presented does not include all information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. The following notes should be read together with notes to the consolidated financial statements included in the 10-K filed with the Securities and Exchange Commission for the fiscal year ended December 31, 2017.

1. Significant Accounting Policies

The significant accounting policies followed by the Corporation and its subsidiaries for interim financial reporting are consistent with the accounting policies followed for annual financial reporting. All adjustments which are, in the opinion of management, necessary for a fair statement of the results for the periods reported have been included in the accompanying consolidated financial statements and are of a normal recurring nature. The Corporation reports financial information for only one segment, banking. Some items in the prior year financials were reclassified to conform to the current presentation.

The Omnibus Equity Incentive Plan is a long-term incentive plan that was designed to align the interests of participants with the interests of shareholders. Under the plan, awards may be made based on certain performance measures. The grants are made in restricted stock units that are subject to a vesting schedule. These shares vest over 3 years in increments of 33%, 33%, and 34% respectively. At the nine months ended 2018 and 2017, 17,220 and 16,562 shares were awarded, respectively. These shares had a grant date value of \$784 thousand and \$773 thousand for 2018 and 2017, vest over three years, and their grant is not subject to future performance measures. Outstanding shares are increased at the award date for the total shares awarded.

2. Allowance for Loan Losses

The following table presents the activity of the allowance for loan losses by portfolio segment for the three months ended September 30.

Allowance for Loan Losses: (Dollar amounts in thousands)	September 30, 2018				
	Commercial	Residential	Consumer	Unallocated	Total
Beginning balance	\$ 9,498	\$ 1,382	\$ 7,131	\$ 2,060	\$ 20,071
Provision for loan losses	(106)	(44)	1,593	27	1,470
Loans charged -off	(409)	(158)	(1,781)	—	(2,348)
Recoveries	354	160	594	—	1,108
Ending Balance	<u>\$ 9,337</u>	<u>\$ 1,340</u>	<u>\$ 7,537</u>	<u>\$ 2,087</u>	<u>\$ 20,301</u>

Allowance for Loan Losses: (Dollar amounts in thousands)	September 30, 2017				
	Commercial	Residential	Consumer	Unallocated	Total
Beginning balance	\$ 10,223	\$ 1,514	\$ 6,218	\$ 1,725	\$ 19,680
Provision for loan losses	(227)	14	1,415	(17)	1,185
Loans charged -off	(281)	(100)	(1,583)	—	(1,964)
Recoveries	222	91	588	—	901
Ending Balance	<u>\$ 9,937</u>	<u>\$ 1,519</u>	<u>\$ 6,638</u>	<u>\$ 1,708</u>	<u>\$ 19,802</u>

[Table of Contents](#)

The following table presents the activity of the allowance for loan losses by portfolio segment for the nine months ended September 30.

Allowance for Loan Losses: (Dollar amounts in thousands)	September 30, 2018				
	Commercial	Residential	Consumer	Unallocated	Total
Beginning balance	\$ 10,281	\$ 1,455	\$ 6,709	\$ 1,464	\$ 19,909
Provision for loan losses	(443)	56	4,062	623	4,298
Loans charged -off	(1,053)	(632)	(5,007)	—	(6,692)
Recoveries	552	461	1,773	—	2,786
Ending Balance	\$ 9,337	\$ 1,340	\$ 7,537	\$ 2,087	\$ 20,301

Allowance for Loan Losses: (Dollar amounts in thousands)	September 30, 2017				
	Commercial	Residential	Consumer	Unallocated	Total
Beginning balance	\$ 9,731	\$ 1,553	\$ 5,767	\$ 1,722	\$ 18,773
Provision for loan losses	176	(166)	3,825	(14)	3,821
Loans charged -off	(1,059)	(564)	(4,705)	—	(6,328)
Recoveries	1,089	696	1,751	—	3,536
Ending Balance	\$ 9,937	\$ 1,519	\$ 6,638	\$ 1,708	\$ 19,802

The following table presents the allocation of the allowance for loan losses and the recorded investment in loans by portfolio segment and based on the impairment method at September 30, 2018 and December 31, 2017.

Allowance for Loan Losses (Dollar amounts in thousands)	September 30, 2018				
	Commercial	Residential	Consumer	Unallocated	Total
Individually evaluated for impairment	\$ 34	\$ —	\$ —	\$ —	\$ 34
Collectively evaluated for impairment	9,303	1,340	7,537	2,087	20,267
Acquired with deteriorated credit quality	—	—	—	—	—
Ending Balance	\$ 9,337	\$ 1,340	\$ 7,537	\$ 2,087	\$ 20,301

Loans: (Dollar amounts in thousands)	September 30, 2018			
	Commercial	Residential	Consumer	Total
Individually evaluated for impairment	\$ 5,063	\$ 4,372	\$ —	\$ 9,435
Collectively evaluated for impairment	1,151,707	440,335	346,583	1,938,625
Acquired with deteriorated credit quality	1,527	—	—	1,527
Ending Balance	\$ 1,158,297	\$ 444,707	\$ 346,583	\$ 1,949,587

Allowance for Loan Losses: (Dollar amounts in thousands)	December 31, 2017				
	Commercial	Residential	Consumer	Unallocated	Total
Individually evaluated for impairment	619	6	—	—	625
Collectively evaluated for impairment	9,662	1,449	6,709	1,464	19,284
Acquired with deteriorated credit quality	—	—	—	—	—
Ending Balance	\$ 10,281	\$ 1,455	\$ 6,709	\$ 1,464	\$ 19,909

[Table of Contents](#)

Loans (Dollar amounts in thousands)	December 31, 2017			Total
	Commercial	Residential	Consumer	
Individually evaluated for impairment	9,619	463	—	10,082
Collectively evaluated for impairment	1,134,701	436,944	329,435	1,901,080
Acquired with deteriorated credit quality	1,860	—	—	1,860
Ending Balance	<u>\$ 1,146,180</u>	<u>\$ 437,407</u>	<u>\$ 329,435</u>	<u>\$ 1,913,022</u>

The following tables present loans individually evaluated for impairment by class of loans.

(Dollar amounts in thousands)	September 30, 2018					
	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
<b>With no related allowance recorded:</b>						
<b>Commercial</b>						
Commercial & Industrial	\$ 652	\$ 652	\$ —	\$ 725	\$ —	\$ —
Farmland	3,083	3,083	—	1,468	—	—
Non Farm, Non Residential	—	—	—	1,803	—	—
Agriculture	212	12	—	61	—	—
All Other Commercial	1,142	1,142	—	1,187	—	—
<b>Residential</b>						
First Liens	4,372	4,372	—	3,110	—	—
Home Equity	—	—	—	—	—	—
Junior Liens	—	—	—	29	—	—
Multifamily	—	—	—	—	—	—
All Other Residential	—	—	—	—	—	—
<b>Consumer</b>						
Motor Vehicle	—	—	—	—	—	—
All Other Consumer	—	—	—	—	—	—
<b>With an allowance recorded:</b>						
<b>Commercial</b>						
Commercial & Industrial	174	174	34	405	—	—
Farmland	—	—	—	2,061	—	—
Non Farm, Non Residential	—	—	—	—	—	—
Agriculture	—	—	—	309	—	—
All Other Commercial	—	—	—	—	—	—
<b>Residential</b>						
First Liens	—	—	—	111	—	—
Home Equity	—	—	—	—	—	—
Junior Liens	—	—	—	—	—	—
Multifamily	—	—	—	—	—	—
All Other Residential	—	—	—	—	—	—
<b>Consumer</b>						
Motor Vehicle	—	—	—	—	—	—
All Other Consumer	—	—	—	—	—	—
<b>TOTAL</b>	<u>\$ 9,635</u>	<u>\$ 9,435</u>	<u>\$ 34</u>	<u>\$ 11,269</u>	<u>\$ —</u>	<u>\$ —</u>

[Table of Contents](#)

(Dollar amounts in thousands)	December 31, 2017					
	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Income Recognized
<b>With no related allowance recorded:</b>						
<b>Commercial</b>						
Commercial & Industrial	\$ 802	\$ 802	\$ —	\$ 971	\$ —	\$ —
Farmland	930	930	—	1,265	—	—
Non Farm, Non Residential	2,461	2,461	—	2,781	—	—
Agriculture	123	123	—	239	—	—
All Other Commercial	1,238	1,238	—	1,308	—	—
<b>Residential</b>						
First Liens	21	21	—	23	—	—
Home Equity	—	—	—	—	—	—
Junior Liens	—	—	—	—	—	—
Multifamily	—	—	—	—	—	—
All Other Residential	—	—	—	—	—	—
<b>Consumer</b>						
Motor Vehicle	—	—	—	—	—	—
All Other Consumer	—	—	—	—	—	—
<b>With an allowance recorded:</b>						
<b>Commercial</b>						
Commercial & Industrial	493	493	146	514	—	—
Farmland	3,035	3,035	268	669	—	—
Non Farm, Non Residential	—	—	—	131	—	—
Agriculture	738	537	205	279	—	—
All Other Commercial	—	—	—	—	—	—
<b>Residential</b>						
First Liens	442	442	6	483	—	—
Home Equity	—	—	—	—	—	—
Junior Liens	—	—	—	—	—	—
Multifamily	—	—	—	—	—	—
All Other Residential	—	—	—	—	—	—
<b>Consumer</b>						
Motor Vehicle	—	—	—	—	—	—
All Other Consumer	—	—	—	—	—	—
<b>TOTAL</b>	<b>\$ 10,283</b>	<b>\$ 10,082</b>	<b>\$ 625</b>	<b>\$ 8,663</b>	<b>\$ —</b>	<b>\$ —</b>

[Table of Contents](#)

(Dollar amounts in thousands)	Three Months Ended September 30, 2018			Nine Months Ended September 30, 2018		
	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Income Recognized
With no related allowance recorded:						
Commercial						
Commercial & Industrial	\$ 662	\$ —	\$ —	\$ 725	\$ —	\$ —
Farmland	2,007	—	—	1,468	—	—
Non Farm, Non Residential	1,165	—	—	1,803	—	—
Agriculture	6	—	—	61	—	—
All Other Commercial	1,156	—	—	1,187	—	—
Residential						
First Liens	4,188	—	—	3,110	—	—
Home Equity	—	—	—	—	—	—
Junior Liens	39	—	—	29	—	—
Multifamily	—	—	—	—	—	—
All Other Residential	—	—	—	—	—	—
Consumer						
Motor Vehicle	—	—	—	—	—	—
All Other Consumer	—	—	—	—	—	—
With an allowance recorded:						
Commercial						
Commercial & Industrial	323	—	—	405	—	—
Farmland	1,081	—	—	2,061	—	—
Non Farm, Non Residential	—	—	—	—	—	—
Agriculture	80	—	—	309	—	—
All Other Commercial	—	—	—	—	—	—
Residential						
First Liens	—	—	—	111	—	—
Home Equity	—	—	—	—	—	—
Junior Liens	—	—	—	—	—	—
Multifamily	—	—	—	—	—	—
All Other Residential	—	—	—	—	—	—
Consumer						
Motor Vehicle	—	—	—	—	—	—
All Other Consumer	—	—	—	—	—	—
<b>TOTAL</b>	<b>\$ 10,707</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 11,269</b>	<b>\$ —</b>	<b>\$ —</b>

[Table of Contents](#)

(Dollar amounts in thousands)	Three Months Ended September 30, 2017			Nine Months Ended September 30, 2017		
	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Income Recognized
With no related allowance recorded:						
Commercial						
Commercial & Industrial	\$ 891	\$ —	\$ —	\$ 1,013	\$ —	\$ —
Farmland	2,285	—	—	1,349	—	—
Non Farm, Non Residential	3,218	—	—	2,861	—	—
Agriculture	107	—	—	268	—	—
All Other Commercial	1,297	—	—	1,325	—	—
Residential						
First Liens	23	—	—	24	—	—
Home Equity	—	—	—	—	—	—
Junior Liens	—	—	—	—	—	—
Multifamily	—	—	—	—	—	—
All Other Residential	—	—	—	—	—	—
Consumer						
Motor Vehicle	—	—	—	—	—	—
All Other Consumer	—	—	—	—	—	—
With an allowance recorded:						
Commercial						
Commercial & Industrial	508	—	—	519	—	—
Farmland	156	—	—	78	—	—
Non Farm, Non Residential	—	—	—	164	—	—
Agriculture	430	—	—	215	—	—
All Other Commercial	—	—	—	—	—	—
Residential						
First Liens	473	—	—	493	—	—
Home Equity	—	—	—	—	—	—
Junior Liens	—	—	—	—	—	—
Multifamily	—	—	—	—	—	—
All Other Residential	—	—	—	—	—	—
Consumer						
Motor Vehicle	—	—	—	—	—	—
All Other Consumer	—	—	—	—	—	—
<b>TOTAL</b>	<b>\$ 9,388</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 8,309</b>	<b>\$ —</b>	<b>\$ —</b>



[Table of Contents](#)

The tables below presents the recorded investment in non-performing loans.

(Dollar amounts in thousands)	September 30, 2018			
	Loans Past Due Over 90 Day Still	Troubled Debt Restructured		Nonaccrual Excluding TDR
		Accruing	Accruing	
<b>Commercial</b>				
Commercial & Industrial	\$ 41	\$ 1	\$ 202	\$ 1,096
Farmland	—	—	—	3,258
Non Farm, Non Residential	—	—	—	88
Agriculture	—	—	—	27
All Other Commercial	—	—	—	1,147
<b>Residential</b>				
First Liens	1,063	3,343	564	3,518
Home Equity	12	—	—	75
Junior Liens	18	57	—	68
Multifamily	—	—	—	—
All Other Residential	—	—	—	66
<b>Consumer</b>				
Motor Vehicle	259	2	—	179
All Other Consumer	—	187	475	513
<b>TOTAL</b>	<b>\$ 1,393</b>	<b>\$ 3,590</b>	<b>\$ 1,241</b>	<b>\$ 10,035</b>

(Dollar amounts in thousands)	December 31, 2017			
	Loans Past Due Over 90 Day Still	Troubled Debt Restructured		Nonaccrual Excluding TDR
		Accruing	Accruing	
<b>Commercial</b>				
Commercial & Industrial	\$ 41	\$ 2	\$ 212	\$ 1,679
Farmland	19	—	—	4,141
Non Farm, Non Residential	—	56	2,440	172
Agriculture	—	—	—	707
All Other Commercial	—	—	—	1,236
<b>Residential</b>				
First Liens	1,011	3,105	575	3,972
Home Equity	8	—	—	249
Junior Liens	137	—	—	134
Multifamily	—	—	—	—
All Other Residential	—	—	—	90
<b>Consumer</b>				
Motor Vehicle	268	9	—	242
All Other Consumer	—	177	527	623
<b>TOTAL</b>	<b>\$ 1,484</b>	<b>\$ 3,349</b>	<b>\$ 3,754</b>	<b>\$ 13,245</b>

There were \$131 thousand of loans covered by loss share agreements with the FDIC included in loans past due over 90 days still on accrual at September 30, 2018 and there were \$88 thousand at December 31, 2017. There were \$85 thousand of

[Table of Contents](#)

covered loans included in non-accrual loans at September 30, 2018 and there were \$62 thousand at December 31, 2017. There were no covered loans at September 30, 2018 or December 31, 2017 that were deemed impaired.

Non-performing loans include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following tables presents the aging of the recorded investment in loans by past due category and class of loans.

(Dollar amounts in thousands)	September 30, 2018				Current	Total
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 days Past Due	Total Past Due		
<b>Commercial</b>						
Commercial & Industrial	\$ 765	\$ 487	\$ 481	\$ 1,733	\$ 507,758	\$ 509,491
Farmland	—	8	3,198	3,206	103,902	107,108
Non Farm, Non Residential	20	31	26	77	188,673	188,750
Agriculture	—	—	11	11	142,700	142,711
All Other Commercial	4	—	—	4	210,233	210,237
<b>Residential</b>						
First Liens	528	446	1,939	2,913	236,246	239,159
Home Equity	203	80	81	364	37,449	37,813
Junior Liens	138	53	18	209	47,866	48,075
Multifamily	—	—	—	—	107,179	107,179
All Other Residential	—	—	—	—	12,481	12,481
<b>Consumer</b>						
Motor Vehicle	5,092	861	299	6,252	313,132	319,384
All Other Consumer	106	10	3	119	27,080	27,199
<b>TOTAL</b>	<b>\$ 6,856</b>	<b>\$ 1,976</b>	<b>\$ 6,056</b>	<b>\$ 14,888</b>	<b>\$ 1,934,699</b>	<b>\$ 1,949,587</b>

(Dollar amounts in thousands)	December 31, 2017				Current	Total
	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 days Past Due	Total Past Due		
<b>Commercial</b>						
Commercial & Industrial	\$ 372	\$ 80	\$ 640	\$ 1,092	\$ 474,709	\$ 475,801
Farmland	341	—	3,671	4,012	104,457	108,469
Non Farm, Non Residential	141	—	—	141	200,804	200,945
Agriculture	141	—	561	702	152,388	153,090
All Other Commercial	—	—	—	—	207,875	207,875
<b>Residential</b>						
First Liens	5,467	1,317	1,434	8,218	247,029	255,247
Home Equity	310	46	8	364	35,752	36,116
Junior Liens	274	106	194	574	41,688	42,262
Multifamily	—	—	—	—	90,141	90,141
All Other Residential	300	—	12	312	13,329	13,641
<b>Consumer</b>						
Motor Vehicle	4,770	697	294	5,761	298,211	303,972
All Other Consumer	107	22	—	129	25,334	25,463
<b>TOTAL</b>	<b>\$ 12,223</b>	<b>\$ 2,268</b>	<b>\$ 6,814</b>	<b>\$ 21,305</b>	<b>\$ 1,891,717</b>	<b>\$ 1,913,022</b>

[Table of Contents](#)

During the three and nine months ended September 30, 2018 and 2017, the terms of certain loans were modified as troubled debt restructurings (TDRs). The following tables present the activity for TDRs.

(Dollar amounts in thousands)	2018			
	Commercial	Residential	Consumer	Total
July 1,	\$ 2,577	\$ 3,607	\$ 635	\$ 6,819
Added	—	538	94	632
Charged Off	—	—	(7)	(7)
Payments	(2,374)	(165)	(58)	(2,597)
September 30,	\$ 203	\$ 3,980	\$ 664	\$ 4,847

(Dollar amounts in thousands)	2018			
	Commercial	Residential	Consumer	Total
January 1,	\$ 2,709	\$ 3,611	\$ 714	\$ 7,034
Added	—	751	237	988
Charged Off	—	(16)	(83)	(99)
Payments	(2,506)	(366)	(204)	(3,076)
September 30,	\$ 203	\$ 3,980	\$ 664	\$ 4,847

(Dollar amounts in thousands)	2017			
	Commercial	Residential	Consumer	Total
July 1,	3,061	4,198	725	7,984
Added	—	—	42	42
Charged Off	—	(155)	(17)	(172)
Payments	(153)	(222)	(55)	(430)
September 30,	2,908	3,821	695	7,424

(Dollar amounts in thousands)	2017			
	Commercial	Residential	Consumer	Total
January 1,	3,386	4,447	732	8,565
Added	—	227	251	478
Charged Off	—	(195)	(88)	(283)
Payments	(478)	(658)	(200)	(1,336)
September 30,	2,908	3,821	695	7,424

Modification of the terms of such loans typically include one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan. No modification in 2018 or 2017 resulted in the permanent reduction of the recorded investment in the loan. Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from twelve months to five years. Modifications involving an extension of the maturity date were for periods ranging from twelve months to ten years. Troubled debt restructurings during the three and nine months ended September 30, 2018 and 2017 did not result in any material charge-offs or additional provision expense.

The Corporation has no allocations of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of September 30, 2018 and 2017. The Corporation has not committed to lend additional amounts as of September 30, 2018 and 2017 to customers with outstanding loans that are classified as troubled debt restructurings. None of the charge-offs during the three and nine months ended September 30, 2018 and 2017 were of restructurings that had occurred in the previous 12 months.

[Table of Contents](#)

Credit Quality Indicators:

The Corporation categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Corporation analyzes loans individually by classifying the loans as to credit risk. This analysis includes non-homogeneous loans, such as commercial loans, with an outstanding balance greater than \$100 thousand. Any consumer loans outstanding to a borrower who had commercial loans analyzed will be similarly risk rated. This analysis is performed on a quarterly basis. The Corporation uses the following definitions for risk ratings:

**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 of the institution's credit position at some future date.

**Substandard:** Loans classified as substandard are inadequately protected by the current net worth and debt service capacity of the borrower or of any pledged collateral. These loans have a well-defined weakness or weaknesses which have clearly jeopardized repayment of principal and interest as originally intended. They are characterized by the distinct possibility that the institution will sustain some future loss if the deficiencies are not corrected.

**Doubtful:** Loans classified as doubtful have all the weaknesses inherent in those graded substandard, with the added characteristic that the severity of the weaknesses makes collection or liquidation in full highly questionable or improbable based upon currently existing facts, conditions, and values.

Furthermore, non-homogeneous loans which were not individually analyzed, but are 90+ days past due or on non-accrual are classified as substandard. Loans included in homogeneous pools, such as residential or consumer may be classified as substandard due to 90+ days delinquency, non-accrual status, bankruptcy, or loan restructuring.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. Loans listed as not rated are either those with an outstanding balance less than \$100 thousand or are included in groups of homogeneous loans. As of September 30, 2018 and December 31, 2017, and based on the most recent analysis performed, the risk category of loans by class of loans are as follows:

	September 30, 2018					
(Dollar amounts in thousands)	Pass	Special Mention	Substandard	Doubtful	Not Rated	Total
<b>Commercial</b>						
Commercial & Industrial	\$ 462,286	\$ 21,079	\$ 16,145	\$ —	\$ 8,327	\$ 507,837
Farmland	88,960	7,655	8,427	—	20	105,062
Non Farm, Non Residential	172,165	5,620	10,531	—	—	188,316
Agriculture	113,536	9,823	16,405	—	456	140,220
All Other Commercial	200,398	43	6,923	—	1,737	209,101
<b>Residential</b>						
First Liens	44,443	971	3,935	—	188,857	238,206
Home Equity	673	—	120	—	36,952	37,745
Junior Liens	2,041	76	171	76	45,598	47,962
Multifamily	106,891	—	—	—	19	106,910
All Other Residential	—	—	15	—	12,426	12,441
<b>Consumer</b>						
Motor Vehicle	—	—	674	—	317,387	318,061
All Other Consumer	—	—	43	—	27,028	27,071
<b>TOTAL</b>	<b>\$ 1,191,393</b>	<b>\$ 45,267</b>	<b>\$ 63,389</b>	<b>\$ 76</b>	<b>\$ 638,807</b>	<b>\$ 1,938,932</b>

December 31, 2017

(Dollar amounts in thousands)	Pass	Special Mention	Substandard	Doubtful	Not Rated	Total
<b>Commercial</b>						
Commercial & Industrial	\$ 430,015	\$ 19,889	\$ 18,611	\$ 38	\$ 5,947	\$ 474,500
Farmland	88,338	10,782	7,466	—	10	106,596
Non Farm, Non Residential	179,181	7,689	13,632	—	—	200,502
Agriculture	111,724	17,482	21,388	—	342	150,936
All Other Commercial	194,170	2,723	7,459	—	2,604	206,956
<b>Residential</b>						
First Liens	45,320	750	3,980	5	204,329	254,384
Home Equity	319	—	64	—	35,653	36,036
Junior Liens	1,882	76	342	100	39,755	42,155
Multifamily	89,936	—	—	—	36	89,972
All Other Residential	—	—	67	—	13,529	13,596
<b>Consumer</b>						
Motor Vehicle	—	—	731	—	301,900	302,631
All Other Consumer	—	—	44	—	25,301	25,345
<b>TOTAL</b>	<b>\$ 1,140,885</b>	<b>\$ 59,391</b>	<b>\$ 73,784</b>	<b>\$ 143</b>	<b>\$ 629,406</b>	<b>\$ 1,903,609</b>

3. Securities

The amortized cost and fair value of the Corporation's investments are shown below. All securities are classified as available-for-sale.

(Dollar amounts in thousands)	September 30, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Government agencies	\$ 13,042	\$ 2	\$ (571)	\$ 12,473
Mortgage Backed Securities - residential	189,999	798	(6,146)	184,651
Collateralized mortgage obligations	368,486	26	(13,965)	354,547
State and municipal obligations	231,565	1,764	(2,730)	230,599
Collateralized debt obligations	179	3,244	—	3,423
<b>TOTAL</b>	<b>\$ 803,271</b>	<b>\$ 5,834</b>	<b>\$ (23,412)</b>	<b>\$ 785,693</b>

(Dollar amounts in thousands)	December 31, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. Government agencies	\$ 13,989	\$ 24	\$ (318)	\$ 13,695
Mortgage Backed Securities-residential	215,079	2,071	(1,812)	215,338
Mortgage Backed Securities-commercial	1	—	—	1
Collateralized mortgage obligations	346,005	370	(6,705)	339,670
State and municipal obligations	227,651	4,671	(700)	231,622
Collateralized debt obligations	8,644	5,961	—	14,605
<b>TOTAL</b>	<b>\$ 811,369</b>	<b>\$ 13,097</b>	<b>\$ (9,535)</b>	<b>\$ 814,931</b>

[Table of Contents](#)

Contractual maturities of debt securities at September 30, 2018 were as follows. Securities not due at a single maturity or with no maturity date, primarily mortgage-backed and equity securities are shown separately.

(Dollar amounts in thousands)	Available-for-Sale	
	Amortized Cost	Fair Value
Due in one year or less	\$ 3,965	\$ 3,961
Due after one but within five years	32,844	33,151
Due after five but within ten years	74,009	74,647
Due after ten years	133,968	134,736
	<u>244,786</u>	<u>246,495</u>
Mortgage-backed securities and collateralized mortgage obligations	558,485	539,198
<b>TOTAL</b>	<b>\$ 803,271</b>	<b>\$ 785,693</b>

There were \$3 thousand and \$5 thousand in gross gains and no losses from investment sales/calls realized by the Corporation for the three and nine months ended September 30, 2018. For the three and nine months ended September 30, 2017 there were \$27 thousand and \$44 thousand in gross gains and no losses on sales of investment securities.

The following tables show the securities' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in continuous unrealized loss position, at September 30, 2018 and December 31, 2017.

(Dollar amounts in thousands)	September 30, 2018					
	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government agencies	\$ —	\$ —	\$ 11,782	\$ (571)	\$ 11,782	\$ (571)
Mortgage Backed Securities - Residential	\$ 104,404	\$ (3,323)	\$ 52,106	\$ (2,823)	\$ 156,510	\$ (6,146)
Collateralized mortgage obligations	191,204	(4,317)	158,396	(9,648)	349,600	(13,965)
State and municipal obligations	96,736	(1,627)	21,574	(1,103)	118,310	(2,730)
<b>Total temporarily impaired securities</b>	<b>\$ 392,344</b>	<b>\$ (9,267)</b>	<b>\$ 243,858</b>	<b>\$ (14,145)</b>	<b>\$ 636,202</b>	<b>\$ (23,412)</b>

(Dollar amounts in thousands)	December 31, 2017					
	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Government entity mortgage-backed securities	\$ 9,321	\$ (86)	\$ 3,538	\$ (232)	\$ 12,859	\$ (318)
Mortgage Backed Securities - Residential	\$ 79,918	\$ (425)	\$ 53,815	\$ (1,387)	\$ 133,733	\$ (1,812)
Collateralized mortgage obligations	150,182	(1,418)	146,750	(5,287)	296,932	(6,705)
State and municipal obligations	27,347	(183)	18,660	(517)	46,007	(700)
<b>Total temporarily impaired securities</b>	<b>\$ 266,768</b>	<b>\$ (2,112)</b>	<b>\$ 222,763</b>	<b>\$ (7,423)</b>	<b>\$ 489,531</b>	<b>\$ (9,535)</b>

Management evaluates securities for other-than-temporary impairment (“OTTI”) at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. The investment securities portfolio is evaluated for OTTI by segregating the portfolio into two general segments and applying the appropriate OTTI model. Investment securities are generally evaluated for OTTI under FASB ASC 320, *Investments - Debt and Equity Securities*. However, certain purchased beneficial interests, including non-agency mortgage-backed securities, asset-backed securities, and collateralized debt obligations, that had credit ratings at the time of purchase of below AA are evaluated using the model outlined in FASB ASC 325-40, *Beneficial Interests in Securitized Financial Assets*.

## Table of Contents

When OTTI occurs under either model, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss. If an entity intends to sell or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss, the OTTI shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period loss, the OTTI shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected and is recognized in earnings. The amount of the total OTTI related to other factors is recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment.

Gross unrealized losses on investment securities were \$23.4 million as of September 30, 2018 and \$9.5 million as of December 31, 2017. A majority of these losses represent negative adjustments to market value relative to the interest rate environment reflecting the increase in market rates and not losses related to the creditworthiness of the issuer. Based upon our review of the issuers, we do not believe these investments to be other than temporarily impaired. Management does not intend to sell these securities and it is not more likely than not that we will be required to sell them before their anticipated recovery.

There were three collateralized debt obligations securities with previously recorded OTTI but there was no additional OTTI recorded in 2018 or 2017. During the quarter ended June 30, 2018, one of the obligations was called, resulting in the elimination of the OTTI associated with that obligation. A recovery of previously recorded OTTI of \$4.2 million was received and recognized in non-interest income for the period. In addition the Corporation received \$2.4 million of interest income associated with the call. During the quarter ended March 31, 2017, one of the obligations was partially called, resulting in the elimination of the OTTI associated with that obligation. A cash recovery of \$3.1 million was received and recognized in non-interest income for the period as the book value of the security was previously written down to zero.

Management has consistently used Standard & Poors pricing to value these investments. There are a number of other pricing sources available to determine fair value for these investments. These sources utilize a variety of methods to determine fair value. The result is a wide range of estimates of fair value for these securities. The Standard & Poors pricing was 85.57 while Moody Investor Service pricing was 21.23, with others falling somewhere in between. We recognize that the Standard & Poors pricing utilized is an estimate, but have been consistent in using this source and its estimate of fair value.

The table below presents a rollforward of the credit losses recognized in earnings for the three and nine month periods ended September 30, 2018 and 2017:

(Dollar amounts in thousands)	Three Months Ended September		Nine Months Ended September	
	2018	2017	2018	2017
Beginning balance	\$ 2,974	\$ 7,132	\$ 7,132	\$ 13,974
Increases to the amount related to the credit				
Loss for which other-than-temporary was previously recognized	—	—	—	—
Reductions for increases in cash flows collected	—	—	—	—
Reductions for securities called during the period	—	—	(4,158)	(6,842)
Ending balance	\$ 2,974	\$ 7,132	\$ 2,974	\$ 7,132

#### 4. Fair Value

FASB ASC No. 820-10 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) of identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level I 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.

[Table of Contents](#)

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The fair value of most securities available for sale is determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

For those securities that cannot be priced using quoted market prices or observable inputs a Level 3 valuation is determined. These securities are primarily trust preferred securities, which are priced using Level 3 due to current market illiquidity and certain investments in state and municipal securities. The fair value of the trust preferred securities is obtained from a third party provider without adjustment. As described previously, management obtains values from other pricing sources to validate the Standard & Poors pricing that they currently utilize. The fair value of state and municipal obligations are derived by comparing the securities to current market rates plus an appropriate credit spread to determine an estimated value. Illiquidity spreads are then considered. Credit reviews are performed on each of the issuers. The significant unobservable inputs used in the fair value measurement of the Corporation's state and municipal obligations are credit spreads related to specific issuers. Significantly higher credit spread assumptions would result in significantly lower fair value measurement. Conversely, significantly lower credit spreads would result in a significantly higher fair value measurements.

The fair value of derivatives is based on valuation models using observable market data as of the measurement date (Level 2 inputs).

(Dollar amounts in thousands)	September 30, 2018			
	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)			
	Level 1	Level 2	Level 3	Total
U.S. Government agencies	\$ —	\$ 12,473	\$ —	\$ 12,473
Mortgage Backed Securities-residential	—	184,651	—	184,651
Collateralized mortgage obligations	—	354,547	—	354,547
State and municipal	—	227,464	3,135	230,599
Collateralized debt obligations	—	—	3,423	3,423
<b>TOTAL</b>	<b>\$ —</b>	<b>\$ 779,135</b>	<b>\$ 6,558</b>	<b>\$ 785,693</b>
Derivative Assets		687		
Derivative Liabilities		(687)		

  

(Dollar amounts in thousands)	December 31, 2017			
	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)			
	Level 1	Level 2	Level 3	Total
U.S. Government agencies	\$ —	\$ 13,695	\$ —	\$ 13,695
Mortgage Backed Securities-residential	—	215,338	—	215,338
Mortgage Backed Securities-commercial	—	1	—	1
Collateralized mortgage obligations	—	339,670	—	339,670
State and municipal	—	227,942	3,680	231,622
Collateralized debt obligations	—	—	14,605	14,605
<b>TOTAL</b>	<b>\$ —</b>	<b>\$ 796,646</b>	<b>\$ 18,285</b>	<b>\$ 814,931</b>
Derivative Assets		298		
Derivative Liabilities		(298)		

There were no transfers between Level 1 and Level 2 during 2018 and 2017.



[Table of Contents](#)

The tables below presents a reconciliation and income statement classification of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and nine months ended September 30, 2018 and the year ended December 31, 2017.

Fair Value Measurements Using Significant  
Unobservable Inputs (Level 3)  
Three Months Ended September 30, 2018

(Dollar amounts in thousands)	State and municipal obligations	Collateralized debt obligations	Total
Beginning balance, July 1	\$ 3,135	\$ 3,450	\$ 6,585
Total realized/unrealized gains or losses			
Included in earnings	—	—	—
Included in other comprehensive income	—	13	13
Transfers	—	—	—
Settlements	—	(40)	(40)
Ending balance, September 30	<u>\$ 3,135</u>	<u>\$ 3,423</u>	<u>\$ 6,558</u>

Nine Months Ended September 30, 2018

(Dollar amounts in thousands)	State and municipal obligations	Collateralized debt obligations	Total
Beginning balance, January 1	\$ 3,680	\$ 14,605	\$ 18,285
Total realized/unrealized gains or losses			
Included in earnings	—	—	—
Included in other comprehensive income	—	4,158	4,158
Transfers	—	—	—
Settlements	(545)	(15,340)	(15,885)
Ending balance, September 30	<u>\$ 3,135</u>	<u>\$ 3,423</u>	<u>\$ 6,558</u>

Fair Value Measurements Using Significant  
Unobservable Inputs (Level 3)  
Year Ended December 31, 2017

(Dollar amounts in thousands)	State and municipal obligations	Collateralized debt obligations	Total
Beginning balance, January 1	\$ 4,210	\$ 12,368	\$ 16,578
Total realized/unrealized gains or losses			
Included in earnings	—	—	—
Included in other comprehensive income	—	2,773	2,773
Purchases	—	—	—
Settlements	(530)	(536)	(1,066)
Ending balance, December 31	<u>\$ 3,680</u>	<u>\$ 14,605</u>	<u>\$ 18,285</u>

[Table of Contents](#)

The following table presents quantitative information about recurring and non-recurring Level 3 fair value measurements at September 30, 2018.

(Dollar amounts in thousands)	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range
State and municipal obligations	\$ 3,135	Discounted cash flow	Discount rate Probability of default	2.64%-4.80% 0%
Other real estate	\$ 520	Sales comparison/income approach	Discount rate for age of appraisal and market conditions	5.00%-20.00%
Impaired Loans	\$ 140	Sales comparison/income approach	Discount rate for age of appraisal and market conditions	0.00%-50.00%

The following table presents quantitative information about recurring and non-recurring Level 3 fair value measurements at December 31, 2017.

(Dollar amounts in thousands)	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range
State and municipal obligations	\$ 3,680	Discounted cash flow	Discount rate Probability of default	2.30%-5.45% 0%
Other real estate	\$ 1,880	Sales comparison/income approach	Discount rate for age of appraisal and market conditions	5.00%-20.00%
Impaired Loans	3,882	Sales comparison/income approach	Discount rate for age of appraisal and market conditions	0.00%-50.00%

Impaired loans disclosed in footnote 2, which are measured for impairment using the fair value of collateral, are valued at Level 3. They are carried at a fair value of \$140 thousand, after a valuation allowance of \$34 thousand at September 30, 2018 and at a fair value of \$3.9 million, net of a valuation allowance of \$625 thousand at December 31, 2017. The impact to the provision for loan losses for the three months and nine months ended September 30, 2018 and for the twelve months ended December 31, 2017 was a \$197 thousand decrease, a \$591 thousand decrease, and a \$294 thousand increase, respectively. Other real estate owned is valued at Level 3. Other real estate owned at September 30, 2018 with a value of \$520 thousand was reduced \$527 thousand for fair value adjustment. At September 30, 2018 other real estate owned was comprised of \$303 thousand from commercial loans and \$217 thousand from residential loans. Other real estate owned at December 31, 2017 with a value of \$1.9 million was reduced \$951 thousand for fair value adjustment. At December 31, 2017 other real estate owned was comprised of \$1.7 million from commercial loans and \$212 thousand from residential loans.

Fair value is measured based on the value of the collateral securing those loans, and is determined using several methods. Generally the fair value of real estate is determined based on appraisals by qualified licensed appraisers. Appraisals for real estate generally use three methods to derive value: cost, sales or market comparison and income approach. The cost method bases value on the cost to replace current property. The market comparison evaluates the sales price of similar properties in the same market area. The income approach considers net operating income generated by the property and the investor's required return. The final fair value is based on a reconciliation of these three approaches. If an appraisal is not available, the fair value may be determined by using a cash flow analysis, a broker's opinion of value, the net present value of future cash flows, or an observable market price from an active market. Fair value of other real estate is based upon the current appraised values of the properties as determined by qualified licensed appraisers and the Company's judgment of other relevant market conditions. Appraisals are obtained annually and reductions in value are recorded as a valuation through a charge to expense. The primary unobservable input used by management in estimating fair value are additional discounts to the appraised value to consider market conditions and the age of the appraisal, which are based on management's past experience in resolving these types of properties. These discounts range from 0% to 50%. Values for non-real estate collateral, such as business equipment, are based on appraisals performed by qualified licensed appraisers or the customers financial statements. Values for non real estate collateral use much higher discounts than real estate collateral. Other real estate and impaired loans carried at fair value are primarily comprised of smaller balance properties.

[Table of Contents](#)

The following tables presents loans identified as impaired by class of loans, and carried at fair value on a non-recurring basis, as of September 30, 2018 and December 31, 2017, which are all considered Level 3.

(Dollar amounts in thousands)	September 30, 2018		
	Carrying Value	Allowance for Loan Losses Allocated	Fair Value
<b>Commercial</b>			
Commercial & Industrial	\$ 174	\$ 34	\$ 140
Farmland	—	—	—
Non Farm, Non Residential	—	—	—
Agriculture	—	—	—
All Other Commercial	—	—	—
<b>Residential</b>			
First Liens	—	—	—
Home Equity	—	—	—
Junior Liens	—	—	—
Multifamily	—	—	—
All Other Residential	—	—	—
<b>Consumer</b>			
Motor Vehicle	—	—	—
All Other Consumer	—	—	—
<b>TOTAL</b>	<b>\$ 174</b>	<b>\$ 34</b>	<b>\$ 140</b>

(Dollar amounts in thousands)	December 31, 2017		
	Carrying Value	Allowance for Loan Losses Allocated	Fair Value
<b>Commercial</b>			
Commercial & Industrial	\$ 493	\$ 146	\$ 347
Farmland	3,035	268	2,767
Non Farm, Non Residential	—	—	—
Agriculture	537	205	—
All Other Commercial	—	—	—
<b>Residential</b>			
First Liens	442	6	436
Home Equity	—	—	—
Junior Liens	—	—	—
Multifamily	—	—	—
All Other Residential	—	—	—
<b>Consumer</b>			
Motor Vehicle	—	—	—
All Other Consumer	—	—	—
<b>TOTAL</b>	<b>\$ 4,507</b>	<b>\$ 625</b>	<b>\$ 3,882</b>

[Table of Contents](#)

The carrying amounts and estimated fair value of financial instruments at September 30, 2018 and December 31, 2017, are shown below. Carrying amount is the estimated fair value for cash and due from banks, federal funds sold, short-term borrowings, accrued interest receivable and payable, demand deposits, short-term debt and variable-rate loans or deposits that reprice frequently and fully. Security fair values were described previously. For fixed-rate, non-impaired loans or deposits, variable rate loans or deposits with infrequent repricing or repricing limits, and for longer-term borrowings, fair value is based on discounted cash flows using current market rates applied to the estimated life and considering credit risk. The valuation of impaired loans was described previously. Loan fair value estimates represent an exit price for 2018, but do not necessarily represent an exit price for years prior. Fair values of loans held for sale are based on market bids on the loans or similar loans. It was not practicable to determine the fair value of Federal Home Loan Bank stock due to restrictions placed on its transferability. Fair value of debt is based on current rates for similar financing. The fair value of off-balance sheet items is not considered material.

(Dollar amounts in thousands)	September 30, 2018				
	Carrying Value	Fair Value			Total
		Level 1	Level 2	Level 3	
Cash and due from banks	\$ 50,018	\$ 19,029	\$ 30,989	\$ —	\$ 50,018
Federal funds sold	7,600	—	7,600	—	7,600
Securities available-for-sale	785,693	—	779,135	6,558	785,693
Restricted stock	10,390	n/a	n/a	n/a	n/a
Loans, net	1,921,479	—	—	1,874,643	1,874,643
Accrued interest receivable	14,630	—	4,070	10,560	14,630
Deposits	(2,407,061)	—	(2,394,553)	—	(2,394,553)
Short-term borrowings	(58,680)	—	(58,680)	—	(58,680)
Federal Home Loan Bank advances	(35,000)	—	(35,000)	—	(35,000)
Accrued interest payable	(530)	—	(530)	—	(530)

(Dollar amounts in thousands)	December 31, 2017				
	Carrying Value	Fair Value			Total
		Level 1	Level 2	Level 3	
Cash and due from banks	\$ 74,107	\$ 20,682	\$ 53,425	\$ —	\$ 74,107
Securities available-for-sale	814,931	—	796,646	18,285	814,931
Restricted stock	10,379	n/a	n/a	n/a	n/a
Loans, net	1,886,852	—	—	1,878,166	1,878,166
Accrued interest receivable	12,913	—	3,596	9,317	12,913
Deposits	(2,458,653)	—	(2,456,900)	—	(2,456,900)
Short-term borrowings	(57,686)	—	(57,686)	—	(57,686)
Accrued interest payable	(372)	—	(372)	—	(372)

5. Short-Term Borrowings

Period-end short-term borrowings were comprised of the following:

	(000 's)	
	September 30, 2018	December 31, 2017
Federal Funds Purchased	\$ 33,000	\$ 30,165
Repurchase Agreements	25,680	27,521
	<u>\$ 58,680</u>	<u>\$ 57,686</u>

The Corporation enters into sales of securities under agreements to repurchase. The amounts received under these agreements represent short-term borrowings and are reflected as a liability in the consolidated balance sheets. The securities underlying these agreements are included in investment securities in the consolidated balance sheets. The Corporation has no control over the market value of the securities, which fluctuates due to market conditions. However, the Corporation is obligated to promptly transfer additional securities if the market value of the securities falls below the repurchase agreement price. The Corporation manages this risk by maintaining an unpledged securities portfolio that it believes is sufficient to cover a decline in the market value of the securities sold under agreements to repurchase.

[Table of Contents](#)

Collateral pledged to repurchase agreements by remaining maturity are as follows:

Repurchase Agreements	September 30, 2018				
	Remaining Contractual Maturity of the Agreements				
(Dollar amounts in thousands)	Overnight and continuous	Up to 30 days	30 - 90 days	Greater than 90 days	Total
Mortgage Backed Securities - Residential and Collateralized Mortgage Obligations	\$ 10,033	\$ —	\$ 112	\$ 15,535	\$ 25,680

Repurchase Agreements	December 31, 2017				
	Remaining Contractual Maturity of the Agreements				
(Dollar amounts in thousands)	Overnight and continuous	Up to 30 days	30 - 90 days	Greater than 90 days	Total
Mortgage Backed Securities - Residential and Collateralized Mortgage Obligations	\$ 11,929	\$ 6,282	\$ 8,552	\$ 758	\$ 27,521

6. Components of Net Periodic Benefit Cost

	Three Months Ended September 30, (000's)				Nine Months Ended September 30, (000's)			
	Pension Benefits		Post-Retirement Health Benefits		Pension Benefits		Post-Retirement Health Benefits	
	2018	2017	2018	2017	2018	2017	2018	2017
Service cost	\$ 347	\$ 358	\$ 10	\$ 13	\$ 1,041	\$ 1,074	\$ 31	\$ 40
Interest cost	798	905	33	43	2,395	2,716	98	129
Expected return on plan assets	(991)	(985)	—	—	(2,972)	(2,955)	—	—
Net amortization of prior service cost	—	—	—	—	1	1	—	—
Net amortization of net (gain) loss	362	301	—	—	1,085	903	—	—
Net Periodic Benefit Cost	\$ 516	\$ 579	\$ 43	\$ 56	\$ 1,550	\$ 1,739	\$ 129	\$ 169

Employer Contributions

First Financial Corporation previously disclosed in its financial statements for the year ended December 31, 2017 that it expected to contribute \$2.3 million and \$813 thousand respectively to its Pension Plan and ESOP and \$264 thousand to the Post Retirement Health Benefits Plan in 2018. Contributions of \$1.7 million have been made to the Pension Plan thus far in 2018. Contributions of \$183 thousand have been made through the first nine months of 2018 for the Post Retirement Health Benefits plan. No contributions have been made in 2018 for the ESOP. The Pension plan was frozen for most employees at the end of 2012 and for those employees there will be discretionary contributions to the ESOP plan and a 401K plan in place of the former Pension benefit. In the first nine months of 2018 and 2017 there has been \$1.3 million and \$1.3 million of expense accrued for potential contributions to these alternative retirement benefit options.

## 7. New accounting standards

### Accounting Pronouncements Adopted:

On January 1, 2018, the Corporation adopted ASU 2014-09, Revenue from Contracts with Customers and all subsequent amendments to the ASU (collectively, "ASC 606"), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as OREO. The majority of the Corporation's revenues come from interest income and other sources, including loans, leases, securities and derivatives, that are outside the scope of ASC 606. The Corporation's services that fall within the scope of ASC 606 are presented within Non-Interest Income and are recognized as revenue as the Corporation satisfies its obligation to the customer. Services within the scope of ASC 606 include service charges on deposits, asset management fees, interchange income, and the sale of OREO. Refer to Note 8 Revenue from Contracts with Customers for further discussion on the Corporation's accounting policies for revenue sources within the scope of ASC 606. The Corporation adopted ASC 606 using the modified retrospective method applied to all contracts not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606 while prior period amounts continue to be reported in accordance with legacy GAAP. The adoption of ASC 606 did not result in a change to the accounting for any of the in-scope revenue streams; as such, no cumulative effect adjustment was recorded.

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities, amending ASU Subtopic 825-10. The amendments in this update make targeted improvements to generally accepted accounting principles (GAAP) as follows: 1) Require equity investments to be measured at fair value with changes in fair value recognized in net income.; 2) Simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment.; 3) Eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities.; 4) Eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet.; 5) Require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes.; 6) Require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments.; 7) Require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements.; and 8) Clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. The amendments in this update are effective for fiscal years beginning after December 15, 2017. The Corporation adopted ASU 2016-01 on January 1, 2018 and did not have a significant impact on the financial statements. However, the fair value disclosures for our loan portfolio considers the exit price.

In August of 2016 ASU 2016-15, Statement of Cash Flows (Topic 230) ("ASU 2016-15") was issued and is intended to reduce the diversity in practice around how certain transactions are classified within the statement of cash flows. ASU 2016-15 is effective for public companies for annual periods beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted with retrospective application. The Corporation adopted ASU 2016-15 on January 1, 2018 and did not have a significant impact on its accounting and disclosures.

In March 2017, the FASB issued ASU No. 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. Under the new guidance, employers will present the service cost component of the net periodic benefit cost in the same income statement line item (e.g., Salaries and Benefits) as other employee compensation costs arising from services rendered during the period. In addition, only the service cost component will be eligible for capitalization in assets. Employers will present the other components separately (e.g., Other Noninterest Expense) from the line item that includes the service cost. ASU No. 2017-07 is effective for interim and annual reporting periods beginning after December 15, 2017. Early adoption was permitted. Employers will apply the guidance on the presentation of the components of net periodic benefit cost in the income statement retrospectively. The guidance limiting the capitalization of net periodic benefit cost in assets to the service cost component will be applied prospectively. The Corporation adopted ASU 2017-07 on January 1, 2018, and did not have a significant impact on its accounting and disclosures.

In May 2017, the FASB issued ASU 2017-09, Compensation-Stock Compensation (Topic 718): Scope of Modification. ASU 2017-09 was issued to provide clarity and reduce both 1) diversity in practice and 2) cost and complexity when applying the guidance in Topic 718, Compensation - Stock Compensation, to a change to the terms or conditions of a share-based payment award. Diversity in practice has arisen in part because some entities apply modification accounting under Topic 718 for modifications to terms and conditions that they consider substantive, but do not when they conclude that particular

## [Table of Contents](#)

modifications are not substantive. Others apply modification accounting for any change to an award, except for changes that they consider purely administrative in nature. Still others apply modification accounting when a change to an award changes the fair value, the vesting, or the classification of the award. In practice, it appears that the evaluation of a change in fair value, vesting, or classification may be used to evaluate whether a change is substantive. ASU 2017-09 include guidance on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718. ASU 2017-09 is effective for the annual period, and interim periods within the annual periods, beginning after December 15, 2017. Early adoption was permitted, including adoption in any interim period for: (a) public business entities for reporting periods for which financial statements have not yet been issued, and (b) all other entities for reporting periods for which financial statements have not yet been made available for issuance. ASU 2017-09 should be applied prospectively to an award modified on or after the adoption date. The Corporation adopted ASU 2017-09 on January 1, 2018 on its consolidated financial statements, and did not have a significant impact on its consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. ASU 2018-02 was issued to address the income tax accounting treatment of the stranded tax effects within other comprehensive income due to the prohibition of backward tracing due to an income tax rate change that was initially recorded in other comprehensive income. This issue came about from the enactment of the Tax Cuts and Jobs Act on December 22, 2017 that changed the Company's income tax rate from 35% to 21%. The ASU changed current accounting whereby an entity may elect to reclassify the stranded tax effect from accumulated other comprehensive income to retained earnings. The ASU is effective for periods beginning after December 15, 2018 although early adoption is permitted. The Corporation early adopted the standard in the first quarter of 2018 and reclassified \$2.4 million from accumulated other comprehensive income to retained earnings.

### Recent Accounting Pronouncements:

In February 2016, the FASB issued ASU No. 2016-02, Leases. Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases): 1) a lease liability, which is the present value of a lessee's obligation to make lease payments, and 2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Lessor accounting under the new guidance remains largely unchanged as it is substantially equivalent to existing guidance for sales-type leases, direct financing leases, and operating leases. Leveraged leases have been eliminated, although lessors can continue to account for existing leveraged leases using the current accounting guidance. Other limited changes were made to align lessor accounting with the lessee accounting model and the new revenue recognition standard. All entities will classify leases to determine how to recognize lease-related revenue and expense. Quantitative and qualitative disclosures will be required by lessees and lessors to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The intention is to require enough information to supplement the amounts recorded in the financial statements so that users can understand more about the nature of an entity's leasing activities. ASU No. 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. All entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. They have the option to use certain relief; full retrospective application is prohibited. The Corporation continues to evaluate the provision of the new lease standard, but due to the small number of lease agreements presently in effect for the Corporation, does not expect the new guidance will have a significant impact on the Corporation's financial statements.

In June 2016 ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (ASU 2016-13), was issued and requires entities to use a current expected credit loss ("CECL") model which is a new impairment model based on expected losses rather than incurred losses. Under this model an entity would recognize an impairment allowance equal to its current estimate of all contractual cash flows that the entity does not expect to collect from financial assets measured at amortized cost. The entity's estimate would consider relevant information about past events, current conditions, and reasonable and supportable forecasts, which will result in recognition of lifetime expected credit losses upon loan origination. ASU 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted for annual reporting periods beginning after December 15, 2018. Management has initiated an implementation committee to assist in assessing data and system needs for the new standard. Management anticipates the effect will be an increase to the allowance for loan losses upon adoption, however, the overall increase is uncertain at this time.

In January 2017, the FASB issued ASU No. 2017-04, Simplifying the Test for Goodwill Impairment. The guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. Goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. All other goodwill impairment guidance will remain largely unchanged. ASU No. 2017-04 is effective for interim and annual reporting periods beginning after December 15, 2019, applied prospectively. Early adoption is permitted for any impairment tests performed

## [Table of Contents](#)

after January 1, 2017. The Corporation is assessing ASU 2017-04 but does not expect a significant impact on its accounting and disclosures.

In July 2018, the FASB issued ASU No. 2018-11, Leases - Targeted Improvements, to provide entities with relief from the costs of implementing certain aspects of the new leasing standard, ASU No. 2016-02. Specifically, under the amendments in ASU 2018-11: (1) entities may elect not to recast the comparative periods presented when transitioning to the new leasing standard, and (2) lessors may elect not to separate lease and non-lease components when certain conditions are met. The amendments have the same effective date as ASU 2016-02 (January 1, 2019 for the Corporation). The Corporation expects to elect both transition options. ASU 2018-11 is not expected to have a material impact on the Corporation's financial statements.

In August 2018, the FASB issued ASU No. 2018-13, Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement. This ASU eliminates, adds and modifies certain disclosure requirements for fair value measurements. Among the changes, entities will no longer be required to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, but will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 fair value measurements. ASU No. 2018-13 is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption is permitted. Entities are also allowed to elect early adoption the eliminated or modified disclosure requirements and delay adoption of the new disclosure requirements until their effective date. As ASU No. 2018-13 only revises disclosure requirements, it will not have a material impact on the Corporation's financial statements.

In August 2018, the FASB issued ASU No. 2018-14, Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans. This ASU makes minor changes to the disclosure requirements for employers that sponsor defined benefit pension and/or other postretirement benefit plans. ASU 2018-14 is effective for fiscal years ending after December 15, 2020; early adoption is permitted. As ASU 2018-14 only revises disclosure requirements, it will not have a material impact on the Corporation's financial statements.

In September 2018, the FASB issued ASU No. 2018-15, Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. This ASU requires an entity in a cloud computing arrangement (i.e., hosting arrangement) that is a service contract to follow the internal-use software guidance in ASC 350-40 to determine which implementation costs to capitalize as assets or expense as incurred. Capitalized implementation costs should be presented in the same line item on the balance sheet as amounts prepaid for the hosted service, if any (generally as an "other asset"). The capitalized costs will be amortized over the term of the hosting arrangement, with the amortization expense being presented in the same income statement line item as the fees paid for the hosted service. ASU 2018-15 is effective for interim and annual reporting periods beginning after December 15, 2019; early adoption is permitted. ASU 2018-15 will not have a material impact on the Corporation's financial statements.



8. Revenue from Contracts with Customers

All of the Corporation's revenue from contracts with customers in the scope of ASC 606 is recognized within Non-Interest Income. The following table presents the Corporation's sources of Non-Interest Income for the three and nine months ended September 30, 2018 and 2017. Items outside the scope of ASC 606 are noted as such.

(Dollar amounts in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017 <sup>(c)</sup>	2018	2017 <sup>(c)</sup>
<b>Non-interest income</b>				
Service charges on deposits	\$ 3,386	\$ 3,406	\$ 9,874	\$ 9,883
Asset management fees	1,009	1,110	3,411	3,423
Interchange income	79	57	218	163
Net gains on sales of loans <sup>(a)</sup>	617	536	1,458	1,255
Loan servicing fees <sup>(a)</sup>	418	354	1,209	1,071
Net gains on sales of securities <sup>(a)</sup>	3	27	5	44
Other service charges and fees <sup>(a)</sup>	2,331	2,263	7,058	6,956
Other <sup>(b)</sup>	1,066	787	6,740	4,907
<b>Total non-interest income</b>	<b>\$ 8,909</b>	<b>\$ 8,540</b>	<b>\$ 29,973</b>	<b>\$ 27,702</b>

<sup>(a)</sup> Not within the scope of ASC 606.

<sup>(b)</sup> The Other category includes gains/(losses) on the sale of OREO for the three months ended September 30, 2018 and September 30, 2017, totaling \$(1) thousand and \$60 thousand, respectively, and for the nine months ended for the same periods, totaling \$17 thousand and \$67 thousand, respectively, which is within the scope of ASC 606; the remaining balance is outside the scope of ASC 606.

<sup>(c)</sup> The Corporation elected the modified retrospective approach of adoption; therefore, prior period balances are presented under legacy GAAP and may not be comparable to the current year presentation.

**Service charges on deposits:** The Corporation earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as ATM use fees, stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Corporation fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Corporation satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance.

**Asset management fees:** The Corporation earns asset management fees from its contracts with trust customers to manage assets for investment, and/or to transact on their accounts. These fees are primarily earned over time as the Corporation provides the contracted monthly or quarterly services and are generally assessed based on a tiered scale of the market value of assets under management at month-end. Fees that are transaction based, including trade execution services, are recognized at the point in time that the transaction is executed, i.e. the trade date. Other related services provided and the fees the Corporation earns, which are based on a fixed fee schedule, are recognized when the services are rendered.

**Interchange income:** The Corporation earns interchange fees from debit and credit cardholder transactions conducted through the payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

**Gains/Losses on sales of OREO:** The Corporation records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Corporation finances the sale of OREO to the buyer, the Corporation assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the OREO asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Corporation adjusts the transaction price and related gain (loss) on sale if a significant financing component is present.

9. Acquisitions, Divestitures and FDIC Indemnification Asset

The Bank is party to a loss sharing agreement with the FDIC as a result of a 2009 acquisition. Under the loss-sharing agreement (“LSA”), the Bank will share in the losses on assets covered under the agreement (referred to as covered assets). On losses up to \$29 million, the FDIC has agreed to reimburse the Bank for 80 percent of the losses. On losses exceeding \$29 million, the FDIC has agreed to reimburse the Bank for 95 percent of the losses. The loss-sharing agreement is subject to following servicing procedures as specified in the agreement with the FDIC. Loans acquired that are subject to the loss-sharing agreement with the FDIC are referred to as covered loans for disclosure purposes. Since the acquisition date the Bank has been reimbursed \$19.4 million for losses and carrying expenses and currently carries an immaterial balance in the indemnification asset. The balance of loans covered by the loss share agreement at September 30, 2018 and December 31, 2017 totaled \$3.5 million and \$4.3 million, respectively. The only loans still covered by the loss share agreement are the single family loans.

FASB ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, applies to a loan with evidence of deterioration of credit quality since origination, acquired by completion of a transfer for which it is probable, at acquisition, that the investor will be unable to collect all contractually required payments receivable. FASB ASC 310-30 prohibits carrying over or creating an allowance for loan losses upon initial recognition. The carrying amount of loans accounted for in accordance with FASB ASC 310-30 at September 30, 2018 and 2017 are shown in the following tables:

(Dollar amounts in thousands)	Commercial	Consumer	2018 Total
Beginning balance, July 1,	\$ 1,598	\$ —	\$ 1,598
Discount accretion	—	—	—
Disposals	(16)	—	(16)
ASC 310-30 Loans, September 30,	<u>\$ 1,582</u>	<u>\$ —</u>	<u>\$ 1,582</u>

(Dollar amounts in thousands)	Commercial	Consumer	2018 Total
Beginning balance, January 1,	\$ 1,896	\$ —	\$ 1,896
Discount accretion	—	—	—
Disposals	(314)	—	(314)
ASC 310-30 Loans, September 30,	<u>\$ 1,582</u>	<u>\$ —</u>	<u>\$ 1,582</u>

(Dollar amounts in thousands)	Commercial	Consumer	2017 Total
Beginning balance, July 1,	\$ 1,983	\$ —	\$ 1,983
Discount accretion	—	—	—
Disposals	(47)	—	(47)
ASC 310-30 Loans, September 30,	<u>\$ 1,936</u>	<u>\$ —</u>	<u>\$ 1,936</u>

(Dollar amounts in thousands)	Commercial	Consumer	2017 Total
Beginning balance, January 1,	\$ 3,451	\$ 1,430	\$ 4,881
Discount accretion	—	—	—
Disposals	(1,515)	(1,430)	(2,945)
ASC 310-30 Loans, September 30,	<u>\$ 1,936</u>	<u>\$ —</u>	<u>\$ 1,936</u>

[Table of Contents](#)

10. Accumulated Other Comprehensive Income

The following tables summarize the changes, net of tax, within each classification of accumulated other comprehensive income/(loss) for the three and nine months ended September 30, 2018 and 2017.

(Dollar amounts in thousands)	2018		
	Unrealized gains and (Losses) on available-for-sale Securities	Retirement plans	Total
Beginning balance, July 1,	\$ (9,625)	\$ (19,264)	\$ (28,889)
Change in other comprehensive income (loss) before reclassification	(3,700)	—	(3,700)
Amounts reclassified from accumulated other comprehensive income	(2)	281	279
Net current period other comprehensive income (loss)	(3,702)	281	(3,421)
Ending balance, September 30,	\$ (13,327)	\$ (18,983)	\$ (32,310)

(Dollar amounts in thousands)	2018		
	Unrealized gains and (Losses) on available-for-sale Securities	Retirement plans	Total
Beginning balance, January 1,	\$ 2,258	\$ (16,962)	\$ (14,704)
Change in other comprehensive income (loss) before reclassification	(16,079)	—	(16,079)
Amounts reclassified from accumulated other comprehensive income	(4)	843	839
Net current period other comprehensive loss	(16,083)	843	(15,240)
ASU 2018-02 adjustment	498	(2,864)	(2,366)
Ending balance, September 30,	\$ (13,327)	\$ (18,983)	\$ (32,310)

(Dollar amounts in thousands)	2017		
	Unrealized gains and (Losses) on available-for-sale Securities	Retirement plans	Total
Beginning balance, July 1,	\$ 7,156	\$ (12,720)	\$ (5,564)
Change in other comprehensive income (loss) before reclassification	(33)	—	(33)
Amounts reclassified from accumulated other comprehensive income	(18)	184	166
Net current period other comprehensive income	(51)	184	133
Ending balance, September 30,	\$ 7,105	\$ (12,536)	\$ (5,431)

(Dollar amounts in thousands)	2017		
	Unrealized gains and (Losses) on available-for-sale Securities	Retirement plans	Total
Beginning balance, January 1,	\$ (1,077)	\$ (13,087)	\$ (14,164)
Change in other comprehensive income (loss) before reclassification	8,211	—	8,211
Amounts reclassified from accumulated other comprehensive income	(29)	551	522
Net current period other comprehensive income	8,182	551	8,733
Ending balance, September 30,	\$ 7,105	\$ (12,536)	\$ (5,431)

(Dollar amounts in thousands)	Balance at	Current Period	Balance at
	7/1/2018	Change	9/30/2018
Unrealized gains (losses) on securities available-for-sale without other than temporary impairment	\$ (11,592)	\$ (3,710)	\$ (15,302)
Unrealized gains (losses) on securities available-for-sale with other than temporary impairment	1,967	8	1,975
Total unrealized loss on securities available-for-sale	\$ (9,625)	\$ (3,702)	\$ (13,327)
Unrealized loss on retirement plans	(19,264)	281	(18,983)
TOTAL	\$ (28,889)	\$ (3,421)	\$ (32,310)

(Dollar amounts in thousands)	Balance at	Current Period	Balance at
	1/1/2018	Change	9/30/2018
Unrealized gains (losses) on securities available-for-sale without other than temporary impairment	\$ (1,371)	\$ (13,931)	\$ (15,302)
Unrealized gains (losses) on securities available-for-sale with other than temporary impairment	3,629	(1,654)	1,975
Total unrealized loss on securities available-for-sale	\$ 2,258	\$ (15,585)	\$ (13,327)
Unrealized loss on retirement plans	(16,962)	(2,021)	(18,983)
TOTAL	\$ (14,704)	\$ (17,606)	\$ (32,310)

(Dollar amounts in thousands)	Balance at	Current Period	Balance at
	7/1/2017	Change	9/30/2017
Unrealized gains (losses) on securities available-for-sale without other than temporary impairment	\$ 5,129	\$ (993)	\$ 4,136
Unrealized gains (losses) on securities available-for-sale with other than temporary impairment	2,027	942	2,969
Total unrealized loss on securities available-for-sale	\$ 7,156	\$ (51)	\$ 7,105
Unrealized loss on retirement plans	(12,720)	184	(12,536)
TOTAL	\$ (5,564)	\$ 133	\$ (5,431)

[Table of Contents](#)

(Dollar amounts in thousands)	Balance at 1/1/2017	Current Period Change	Balance at 9/30/2017
Unrealized gains (losses) on securities available-for-sale			
without other than temporary impairment	\$ (3,018)	\$ 7,154	\$ 4,136
Unrealized gains (losses) on securities available-for-sale			
with other than temporary impairment	1,941	1,028	2,969
Total unrealized loss on securities available-for-sale	\$ (1,077)	\$ 8,182	\$ 7,105
Unrealized loss on retirement plans	(13,087)	551	(12,536)
TOTAL	\$ (14,164)	\$ 8,733	\$ (5,431)

Details about accumulated other comprehensive income components	Three Months Ended September 30, 2018		Affected line item in the statement where net income is presented
	Amount reclassified from accumulated other comprehensive income	(in thousands)	
Unrealized gains and losses	\$ 3		Net securities gains (losses)
on available-for-sale	(1)		Income tax expense
securities	\$ 2		Net of tax
Amortization of	\$ (362)		(a) Salary and benefits
retirement plan items	81		Income tax expense
	\$ (281)		Net of tax
Total reclassifications for the period	\$ (279)		Net of tax

(a) Included in the computation of net periodic benefit cost. (see Footnote 6 for additional details).

Details about accumulated other comprehensive income components	Nine Months Ended September 30, 2018		Affected line item in the statement where net income is presented
	Amount reclassified from accumulated other comprehensive income	(in thousands)	
Unrealized gains and losses	\$ 5		Net securities gains (losses)
on available-for-sale	(1)		Income tax expense
securities	\$ 4		Net of tax
Amortization of	\$ (1,085)		(a) Salary and benefits
retirement plan items	242		Income tax expense
	\$ (843)		Net of tax
Total reclassifications for the period	\$ (839)		Net of tax

(a) Included in the computation of net periodic benefit cost. (see Footnote 6 for additional details).

Details about accumulated other comprehensive income components	Three Months Ended September 30, 2017		Affected line item in the statement where net income is presented
	Amount reclassified from accumulated other comprehensive income		
	(in thousands)		
Unrealized gains and losses on available-for-sale securities	\$	27	Net securities gains (losses)
		(9)	Income tax expense
	\$	18	Net of tax
Amortization of retirement plan items	\$	(301)	(a) Salary and benefits
		117	Income tax expense
	\$	(184)	Net of tax
Total reclassifications for the period	\$	(166)	Net of tax

(a) Included in the computation of net periodic benefit cost. (see Footnote 6 for additional details).

Details about accumulated other comprehensive income components	Nine Months Ended September 30, 2017		Affected line item in the statement where net income is presented
	Amount reclassified from accumulated other comprehensive income		
	(in thousands)		
Unrealized gains and losses on available-for-sale securities	\$	44	Net securities gains (losses)
		(15)	Income tax expense
	\$	29	Net of tax
Amortization of retirement plan items	\$	(903)	(a) Salary and benefits
		352	Income tax expense
	\$	(551)	Net of tax
Total reclassifications for the period	\$	(522)	Net of tax

(a) Included in the computation of net periodic benefit cost. (see Footnote 6 for additional details).

ITEMS 2. and 3. Management's Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosures About Market Risk

The purpose of this discussion is to point out key factors in the Corporation's recent performance compared with earlier periods. The discussion should be read in conjunction with the financial statements beginning on page three of this report. All figures are for the consolidated entities. It is presumed the readers of these financial statements and of the following narrative have previously read the Corporation's financial statements for 2017 in the 10-K filed for the fiscal year ended December 31, 2017.

This Quarterly Report on Form 10-Q contains forward-looking statements. Forward-looking statements provide current expectations or forecasts of future events and are not guarantees of future performance, nor should they be relied upon as representing management's views as of any subsequent date. The forward-looking statements are based on management's expectations and are subject to a number of risks and uncertainties. Although management believes that the expectations reflected in such forward-looking statements are reasonable, actual results may differ materially from those expressed or implied in such statements. Risks and uncertainties that could cause actual results to differ materially include, without limitation, the Corporation's ability to effectively execute its business plans; changes in general economic and financial market conditions; changes in interest rates; changes in the competitive environment; continuing consolidation in the financial services industry; new litigation or changes in existing litigation; losses, customer bankruptcy, claims and assessments; changes in banking regulations or other regulatory or legislative requirements affecting the Corporation's business; and changes in accounting policies or procedures as may be required by the Financial Accounting Standards Board or other regulatory agencies. Additional information concerning factors that could cause actual results to differ materially from those expressed or implied in the forward-looking statements is available in the Corporation's Form 10-K for the year ended December 31, 2017, and subsequent filings with the United States Securities and Exchange Commission (SEC). Copies of these filings are available at no cost on the SEC's Web site at [www.sec.gov](http://www.sec.gov) or on the Corporation's Web site at [www.first-online.com](http://www.first-online.com). Management may elect to update forward-looking statements at some future point; however, it specifically disclaims any obligation to do so.

Critical Accounting Policies

Certain of the Corporation's accounting policies are important to the portrayal of the Corporation's financial condition and results of operations, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Estimates associated with these policies are susceptible to material changes as a result of changes in facts and circumstances. Facts and circumstances which could affect these judgments include, without limitation, changes in interest rates, in the performance of the economy or in the financial condition of borrowers. Management believes that its critical accounting policies include determining the allowance for loan losses and the valuation of goodwill and valuing investment securities. See further discussion of these critical accounting policies in the 2017 Form 10-K.

Summary of Operating Results

Net income for the three months ended September 30, 2018 was \$11.3 million, compared to \$8.8 million for the same period of 2017. Basic earnings per share increased to \$0.92 for the second quarter of 2018 compared to \$0.72 for the same period in 2017. Return on Assets and Return on Equity were 1.53% and 10.58% respectively, for the three months ended September 30, 2018 compared to 1.18% and 7.98% for the three months ended September 30, 2017. Net income for the nine months ended September 30, 2018 was \$35.5 million, compared to \$26.5 million for the same period of 2017. Basic earnings per share increased to \$2.90 for the first nine months of 2018 compared to \$2.17 for same period of 2017. Return on Assets and Return on Equity were 1.59% and 11.23% respectively, for the nine months ended September 30, 2018 compared to 1.18% and 8.15% for the nine months ended September 30, 2017.

The primary components of income and expense affecting net income are discussed in the following analysis.

Net Interest Income

The Corporation's primary source of earnings is net interest income, which is the difference between the interest earned on loans and other investments and the interest paid for deposits and other sources of funds. Net interest income increased \$1.7 million in the three months ended September 30, 2018 to \$28.8 million from \$27.1 million in the same period in 2017. The net interest margin for the three months ended September 30, 2018 is 4.29% compared to 4.14% for the same period of 2017, a 3.62% increase. Net interest income increased \$6.8 million in the nine months ended September 30, 2018 to \$87.0 million from \$80.2 million in the same period in 2017. The net interest margin for the nine months ended September 30, 2018 is 4.31% compared to 4.08% for the same period in 2017. A second quarter 2018 recovery of interest on nonaccrual increased interest income \$2.4 million.

### Non-Interest Income

Non-interest income for the three months ended September 30, 2018 was \$8.9 million compared to \$8.5 million for the same period of 2017. Non-interest income for the nine months ended September 30, 2018 was \$30.0 million compared to \$27.7 million for the same period of 2017. A second quarter 2018 recovery of previous other-than-temporary impairment increased non-interest income \$4.2 million in 2018. A first quarter 2017 cash recovery of previous other-than-temporary impairment increased non-interest income \$3.1 million in 2017.

### Non-Interest Expenses

The Corporation's non-interest expense for the quarter ended September 30, 2018 was \$22.3 million compared to \$22.3 million for the same period in 2017. The Corporation's non-interest expense for the nine months ended September 30, 2018 increased by \$1.2 million to \$68.2 million compared to the same period in 2017.

### Allowance for Loan Losses

The Corporation's provision for loan losses increased \$285 thousand to \$1.5 million for third quarter of 2018 compared to \$1.2 million for the same period of 2017. Net charge offs for the third quarter of 2018 were \$1.2 million compared to \$1.1 million for the same period of 2017. The provision for loan losses increased \$477 thousand to \$4.3 million for the nine months ended September 30, 2018 compared to \$3.8 million for the same period of 2017. Net charge offs for the first nine months of 2018 increased \$1.1 million to \$3.9 million compared to the same period of 2017. Based on management's analysis of the current portfolio, an evaluation that includes consideration of historical loss experience, non-performing loans trends, and probable incurred losses on identified problem loans, management believes the allowance is adequate.

### Income Tax Expense

The Corporation's effective income tax rate for the first nine months of 2018 decreased from the same period in 2017 primarily due to the Tax Cuts and Jobs Act signed into law on December 22, 2017.

### Non-performing Loans

Non-performing loans consist of (1) non-accrual loans on which the ultimate collectability of the full amount of interest is uncertain, (2) loans which have been renegotiated to provide for a reduction or deferral of interest or principal because of a deterioration in the financial position of the borrower, and (3) loans past due ninety days or more as to principal or interest. Non-performing loans decreased to \$16.2 million at September 30, 2018 compared to \$21.7 million at December 31, 2017. Nonperforming loans decreased 28.9% compared to \$22.8 million as of September 30, 2017. A summary of non-performing loans at September 30, 2018 and December 31, 2017 follows:

	(000's)	
	September 30, 2018	December 31, 2017
Non-accrual loans	\$ 10,035	\$ 13,245
Accruing restructured loans	3,578	3,280
Nonaccrual restructured loans	1,269	3,754
Accruing loans past due over 90 days	1,314	1,403
	<u>\$ 16,196</u>	<u>\$ 21,682</u>
Ratio of the allowance for loan losses as a percentage of non-performing loans	125.3%	91.8%



## Table of Contents

The following loan categories comprise significant components of the nonperforming non-restructured loans:

	(000's)	
	September 30, 2018	December 31, 2017
<b>Non-accrual loans</b>		
Commercial loans	\$ 5,616	\$ 7,935
Residential loans	3,727	4,445
Consumer loans	692	865
	\$ 10,035	\$ 13,245
<b>Past due 90 days or more</b>		
Commercial loans	\$ 39	\$ 57
Residential loans	1,028	1,088
Consumer loans	247	258
	\$ 1,314	\$ 1,403

## Interest Rate Sensitivity and Liquidity

First Financial Corporation has established risk measures, limits and policy guidelines for managing interest rate risk and liquidity. Responsibility for management of these functions resides with the Asset Liability Committee. The primary goal of the Asset Liability Committee is to maximize net interest income within the interest rate risk limits approved by the Board of Directors.

## Interest Rate Risk

Management considers interest rate risk to be the Corporation's most significant market risk. Interest rate risk is the exposure to changes in net interest income as a result of changes in interest rates. Consistency in the Corporation's net interest income is largely dependent on the effective management of this risk.

The Asset Liability position is measured using sophisticated risk management tools, including earning simulation and market value of equity sensitivity analysis. These tools allow management to quantify and monitor both short-term and long-term exposure to interest rate risk. Simulation modeling measures the effects of changes in interest rates, changes in the shape of the yield curve and the effects of embedded options on net interest income. This measure projects earnings in the various environments over the next three years. It is important to note that measures of interest rate risk have limitations and are dependent on various assumptions. These assumptions are inherently uncertain and, as a result, the model cannot precisely predict the impact of interest rate fluctuations on net interest income. Actual results will differ from simulated results due to timing, frequency and amount of interest rate changes as well as overall market conditions. The Committee has performed a thorough analysis of these assumptions and believes them to be valid and theoretically sound. These assumptions are continuously monitored for behavioral changes.

The Corporation from time to time utilizes derivatives to manage interest rate risk. Management continuously evaluates the merits of such interest rate risk products but does not anticipate the use of such products to become a major part of the Corporation's risk management strategy.

The table below shows the Corporation's estimated sensitivity profile as of September 30, 2018. The change in interest rates assumes a parallel shift in interest rates of 100 and 200 basis points. Given a 100 basis point increase in rates, net interest income would increase 1.88% over the next 12 months and increase 4.95% over the following 12 months. Given a 100 basis point decrease in rates, net interest income would decrease 2.96% over the next 12 months and decrease 6.35% over the following 12 months. These estimates assume all rate changes occur overnight and management takes no action as a result of this change.

Basis Point Interest Rate Change	Percentage Change in Net Interest Income		
	12 months	24 months	36 months
Down 200	-7.28 %	-13.25 %	-18.17 %
Down 100	-2.96	-6.35	-9.10
Up 100	1.88	4.95	8.01
Up 200	0.95	6.91	12.99

## Table of Contents

Typical rate shock analysis does not reflect management's ability to react and thereby reduce the effect of rate changes, and represents a worst-case scenario.

### Liquidity Risk

Liquidity represents an institution's ability to provide funds to satisfy demands from depositors, borrowers, and other creditors by either converting assets into cash or accessing new or existing sources of incremental funds. Generally the Corporation relies on deposits, loan repayments and repayments of investment securities as its primary sources of funds. The Corporation has \$4.1 million of investments that mature throughout the next 12 months. The Corporation also anticipates \$82.9 million of principal payments from mortgage-backed securities. Given the current rate environment, the Corporation anticipates \$23.4 million in securities to be called within the next 12 months. The Corporation also has unused borrowing capacity available with the Federal Home Loan Bank of Indianapolis and several correspondent banks. With these sources of funds, the Corporation currently anticipates adequate liquidity to meet the expected obligations of its customers.

### Financial Condition

Comparing the first nine months of 2018 to the same period in 2017, loans, net of deferred loan costs, have increased \$75 million to \$1.9 billion. Deposits decreased 1.9% to \$2.4 billion at September 30, 2018 compared to September 30, 2017. Shareholders' equity decreased 3.6% or \$15.8 million. The change in equity was a result of the \$1.50 special dividend paid in December 2017 and the revaluation of the deferred tax assets as a result of the Tax Cuts and Jobs Act signed into law on December 22, 2017. These events decreased book value per share 3.8% to \$34.91 at September 30, 2018 from \$36.29 at September 30, 2017. Book value per share is calculated by dividing the total shareholders' equity by the number of shares outstanding.

### Capital Adequacy

The Federal Reserve, OCC and Federal Deposit Insurance Corporation (collectively, joint agencies) establish regulatory capital guidelines for U.S. banking organizations. Regulatory capital guidelines require that capital be measured in relation to the credit and market risks of both on- and off-balance sheet items using various risk weights. On January 1, 2015, the Basel 3 rules became effective and include transition provisions through January 1, 2019. Under Basel 3, Total capital consists of two tiers of capital, Tier 1 and Tier 2. Tier 1 capital is further composed of Common equity tier 1 capital and additional tier 1 capital.

Common equity tier 1 capital primarily includes qualifying common shareholders' equity, retained earnings and certain minority interests. Goodwill, disallowed intangible assets and certain disallowed deferred tax assets are excluded from Common equity tier 1 capital.

Additional tier 1 capital primarily includes qualifying non-cumulative preferred stock, trust preferred securities (Trust Securities) subject to phase-out and certain minority interests. Certain deferred tax assets are also excluded.

Tier 2 capital primarily consists of qualifying subordinated debt, a limited portion of the allowance for loan and lease losses, Trust Securities subject to phase-out and reserves for unfunded lending commitments. The Corporation's Total capital is the sum of Tier 1 capital plus Tier 2 capital.

To meet adequately capitalized regulatory requirements, an institution must maintain a Tier 1 capital ratio of 7.875 percent and a Total capital ratio of 9.875 percent. A "well-capitalized" institution must generally maintain capital ratios 200 bps higher than the minimum guidelines. The risk-based capital rules have been further supplemented by a Tier 1 leverage ratio, defined as Tier 1 capital divided by quarterly average total assets, after certain adjustments. BHCs must have a minimum Tier 1 leverage ratio of at least 4.0 percent. National banks must maintain a Tier 1 leverage ratio of at least 5.0 percent to be classified as "well capitalized." Failure to meet the capital requirements established by the joint agencies can lead to certain mandatory and discretionary actions by regulators that could have a material adverse effect on the Corporation's financial position. Below are the capital ratios for the Corporation and lead bank.

The phase in of the capital conservation buffer will have the minimum ratios for common equity Tier 1 capital at 7%, the Tier 1 capital at 8.5% and the total capital at 10.5% in 2019 when fully phased in. Currently the Corporation exceeds all of these minimums.

[Table of Contents](#)

	September 30, 2018	December 31, 2017	To Be Well Capitalized
<b>Common equity tier 1 capital</b>			
Corporation	18.36%	17.01%	N/A
First Financial Bank	17.64%	16.56%	6.50%
<b>Total risk-based capital</b>			
Corporation	19.24%	17.88%	N/A
First Financial Bank	18.37%	17.30%	10.00%
<b>Tier I risk-based capital</b>			
Corporation	18.36%	17.01%	N/A
First Financial Bank	17.64%	16.56%	8.00%
<b>Tier I leverage capital</b>			
Corporation	14.45%	13.31%	N/A
First Financial Bank	13.82%	12.81%	5.00%

ITEM 4. Controls and Procedures

First Financial Corporation's management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined under Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. As of September 30, 2018, an evaluation was performed under the supervision and with the participation of management, including the principal executive officer and principal financial officer, of the effectiveness of the design and operation of the Corporation's disclosure controls and procedures. Based on that evaluation, management, including the principal executive officer and principal financial officer, concluded that the Corporation's disclosure controls and procedures as of September 30, 2018 were effective in ensuring material information required to be disclosed in this Quarterly Report on Form 10-Q was recorded, processed, summarized, and reported on a timely basis. Additionally, there was no change in the Corporation's internal control over financial reporting that occurred during the quarter ended September 30, 2018 that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

PART II – Other InformationITEM 1. Legal Proceedings.

There are no material pending legal proceedings, other than routine litigation incidental to the business of the Corporation or its subsidiaries, to which the Corporation or any of the subsidiaries is a party to or of which any of their respective property is subject. Further, there is no material legal proceeding in which any director, officer, principal shareholder, or affiliate of the Corporation or any of its subsidiaries, or any associate of such director, officer, principal shareholder or affiliate is a party, or has a material interest, adverse to the Corporation or any of its subsidiaries.

ITEM 1A. Risk Factors.

There have been no material changes in the risk factors from those disclosed in the Corporation's 2017 Form 10-K filed for December 31, 2017.

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

(a) None.

(b) Not applicable.

(c) Purchases of Equity Securities

The Corporation periodically acquires shares of its common stock directly from shareholders in individually negotiated transactions. On February 3, 2016 First Financial Corporation issued a press release announcing that its Board of Directors has authorized a stock repurchase program pursuant to which up to 5% of the Corporations outstanding shares of common stock, or approximately 637,500 shares may be repurchased.

Following is certain information regarding shares of common stock purchased by the Corporation during the quarter covered by this report.

	(a) Total Number Of Shares Purchased	(b) Average Price Paid Per Share	(c) Total Number Of Shares Purchased As Part Of Publicly Announced Plans Or Programs *	(c) Maximum Number of Shares That May Yet Be Purchased *
July 1-31, 2018	—	—	N/A	N/A
August 1-31, 2018	—	—	—	—
September 1-30, 2018	—	—	—	—
Total	—	—	—	71,882

ITEM 3. Defaults upon Senior Securities.

Not applicable.

ITEM 4. Mine Safety Disclosures

Not applicable.

ITEM 5. Other Information.

Not applicable.

## Table of Contents

### ITEM 6. Exhibits.

Exhibit No.:	Description of Exhibit:
<a href="#">3.1</a>	Amended and Restated Articles of Incorporation of First Financial Corporation, incorporated by reference to Exhibit 3(i) of the Corporation's Form 10-Q filed for the quarter ended September 30, 2002.
<a href="#">3.2</a>	Code of By-Laws of First Financial Corporation, incorporated by reference to Exhibit 3(ii) of the Corporation's Form 8-K filed on August 24, 2012.
<a href="#">10.1*</a>	Employment Agreement for Norman L. Lowery, dated and effective July 1, 2018, incorporated by reference to Exhibit 10.01 of the Corporation's Form 8-K filed on April 9, 2018.
<a href="#">10.2*</a>	2001 Long-Term Incentive Plan of First Financial Corporation, incorporated by reference to Exhibit 10.3 of the Corporation's Form 10-Q filed for the quarter ended September 30, 2002.
<a href="#">10.5*</a>	2005 Long-Term Incentive Plan of First Financial Corporation, incorporated by reference to Exhibit 10.7 of the Corporation's Form 8-K filed on September 4, 2007.
<a href="#">10.6*</a>	2005 Executives Deferred Compensation Plan, incorporated by reference to Exhibit 10.5 of the Corporation's Form 8-K filed on September 4, 2007.
<a href="#">10.7*</a>	2005 Executives Supplemental Retirement Plan, incorporated by reference to Exhibit 10.6 of the Corporation's Form 8-K filed on September 4, 2007.
<a href="#">10.9*</a>	First Financial Corporation 2010 Long-Term Incentive Compensation Plan incorporated by reference to Exhibit 10.9 of the Corporation's Form 10-K filed March 15, 2011.
<a href="#">10.10*</a>	First Financial Corporation 2011 Short-Term Incentive Compensation Plan incorporated by reference to Exhibit 10.10 of the Corporation's Form 10-K filed March 15, 2011.
<a href="#">10.11*</a>	First Financial Corporation 2011 Omnibus Equity Incentive Plan incorporated by reference to Exhibit 10.11 of the Corporation's Form 10-Q for the quarter ended March 31, 2011 filed on May 9, 2011.
<a href="#">10.12*</a>	Form of Restricted Stock Award Agreement under the First Financial Corporation 2011 Omnibus Equity Incentive Plan incorporated by reference to Exhibit 10.12 of the Corporation's Form 10-Q for the quarter ended March 31, 2012 filed on May 10, 2012.
<a href="#">10.13*</a>	Employment Agreement for Norman D. Lowery, dated April 2, 2018, incorporated by reference to Exhibit 10.1 of the Corporation's Form 8-K filed April 4, 2018.
<a href="#">10.14*</a>	Employment Agreement for Rodger A. McHargue, dated April 2, 2018, incorporated by reference to Exhibit 10.2 of the Corporation's Form 8-K filed April 4, 2018.
<a href="#">10.15*</a>	Employment Agreement for Steven H. Holliday, dated April 2, 2018, incorporated by reference to Exhibit 10.3 of the Corporation's Form 8-K filed April 4, 2018.
<a href="#">10.16*</a>	Employment Agreement for Karen L. Stinson-Milienu, dated April 2, 2018, incorporated by reference to Exhibit 10.4 of the Corporation's Form 8-K filed April 4, 2018.
<a href="#">31.1</a>	Sarbanes-Oxley Act 302 Certification for Quarterly Report on Form 10-Q for the quarter ended September 30, 2018 by Principal Executive Officer, dated November 7, 2018.
<a href="#">31.2</a>	Sarbanes-Oxley Act 302 Certification for Quarterly Report on Form 10-Q for the quarter ended September 30, 2018 by Principal Financial Officer, dated November 7, 2018.
<a href="#">32.1</a>	Certification, dated November 7, 2018, of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2005 on Form 10-Q for the quarter ended September 30, 2018.
101.1	Financial statements from the Quarterly Report on Form 10-Q of the Corporation for the quarter ended September 30, 2018, formatted in XBRL pursuant to Rule 405 : (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income and Comprehensive Income, (iii) Consolidated Statements of Cash Flows, (iv) Consolidated Statements of Shareholders' Equity, and (v) Notes to Consolidated Financial Statements, as blocks of text and in detail**.

\*Management contract or compensatory plan or arrangement.

\*\*Furnished, not filed, for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

SIGNATURES

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

FIRST FINANCIAL CORPORATION

(Registrant)

Date: November 7, 2018      By  /s/ Norman L. Lowery  
Norman L. Lowery, Vice Chairman, President and CEO  
(Principal Executive Officer)

Date: November 7, 2018      By  /s/ Rodger A. McHargue  
Rodger A. McHargue, Treasurer and CFO  
(Principal Financial Officer)

44

[\(Back To Top\)](#)

## Section 2: EX-31.1 (EXHIBIT 31.1)

Exhibit 31.1

**Sarbanes-Oxley Act of 2002, Section 302  
Certification of Principal Executive Officer**

I, Norman L. Lowery, certify that:

- 1 I have reviewed this quarterly report on Form 10-Q of First Financial Corporation;
- 2 Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3 Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4 The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purpose in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5 The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or

persons performing the equivalent functions):

- a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: November 7, 2018

By /s/ Norman L. Lowery

Norman L. Lowery,  
Vice Chairman, President and CEO  
(Principal Executive Officer)

[\(Back To Top\)](#)

## Section 3: EX-31.2 (EXHIBIT 31.2)

Exhibit 31.2

### Sarbanes-Oxley Act of 2002, Section 302 Certification of Principal Executive Officer

I, Rodger A. McHargue, certify that:

- 1 I have reviewed this quarterly report on Form 10-Q of First Financial Corporation;
- 2 Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3 Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4 The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purpose in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5 The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.



Date: November 7, 2018

By /s/ Rodger A. McHargue

Rodger A. McHargue

Treasurer and CFO

(Principal Financial Officer)

[\(Back To Top\)](#)

## Section 4: EX-32.1 (EXHIBIT 32.1)

Exhibit 32.1

### **Sarbanes-Oxley Act of 2002, Section 906 Certification of Principal Executive and Principal Financial Officers**

In connection with the Quarterly Report on Form 10-Q of First Financial Corporation (the "Company") for the Quarterly period ended September 30, 2018 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Norman L. Lowery, as the Chief Executive Officer of the Company, and Rodger A. McHargue, as the Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to his knowledge:

1. This Report fully complies with the requirements of Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

November 7, 2018

By /s/ Norman L. Lowery

Norman L. Lowery, Vice Chairman, President & CEO

(Principal Executive Officer)

November 7, 2018

By /s/ Rodger A. McHargue

Rodger A. McHargue, Treasurer & CFO

(Principal Financial Officer)

[\(Back To Top\)](#)