

AMES NATIONAL CORP  
Form 10-Q  
May 08, 2018

Table of Contents

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

FORM 10-Q

[Mark One]

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

For the quarterly period ended March 31, 2018

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-32637

**AMES NATIONAL CORPORATION**

(Exact Name of Registrant as Specified in Its Charter)

<b>IOWA</b>	<b>42-1039071</b>
(State or Other Jurisdiction of Incorporation or Organization)	(I. R. S. Employer Identification Number)

**405 FIFTH STREET**

**AMES, IOWA 50010**

(Address of Principal Executive Offices)

Registrant's Telephone Number, Including Area Code: **(515) 232-6251**

**Not Applicable**

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

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

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(1) of the Exchange Act.

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

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

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

<b>COMMON STOCK, \$2.00 PAR VALUE</b>	<b>9,310,913</b>
(Class)	(Shares Outstanding at April 30, 2018)

---

Table of Contents

AMES NATIONAL CORPORATION

INDEX

	Page
Part I. <u>Financial Information</u>	
Item 1. <u>Consolidated Financial Statements (Unaudited)</u>	3
<u>Consolidated Balance Sheets at March 31, 2018 and December 31, 2017</u>	3
<u>Consolidated Statements of Income for the three months ended March 31, 2018 and 2017</u>	4
<u>Consolidated Statements of Comprehensive Income for the three months ended March 31, 2018 and 2017</u>	5
<u>Consolidated Statements of Stockholders' Equity for the three months ended March 31, 2018 and 2017</u>	6
<u>Consolidated Statements of Cash Flows for the three months ended March 31, 2018 and 2017</u>	7
<u>Notes to Consolidated Financial Statements</u>	9
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	28
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	45
Item 4. <u>Controls and Procedures</u>	45
Part II. <u>Other Information</u>	
Item 1. <u>Legal Proceedings</u>	45
Item 1.A. <u>Risk Factors</u>	45
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	45
Item 3. <u>Defaults Upon Senior Securities</u>	46
Item 4. <u>Mine Safety Disclosures</u>	46
Item 5. <u>Other Information</u>	46

Item 6. <u>Exhibits</u>	47
<u>Signatures</u>	48

Table of Contents**AMES NATIONAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS***(unaudited)*

	<b>March 31, 2018</b>	<b>December 31, 2017</b>
<b>ASSETS</b>		
Cash and due from banks	\$22,484,501	\$26,397,550
Interest bearing deposits in financial institutions	68,832,839	43,021,953
Securities available-for-sale	489,091,103	495,321,664
Federal Home Loan Bank (FHLB) and Federal Reserve Bank (FRB) stock, at cost	2,557,400	3,021,200
Loans receivable, net	772,494,978	771,549,655
Loans held for sale	148,906	-
Bank premises and equipment, net	15,348,582	15,399,146
Accrued income receivable	7,730,256	8,382,391
Other real estate owned	385,509	385,509
Deferred income taxes, net	3,849,437	2,542,533
Intangible assets, net	1,018,887	1,091,462
Goodwill	6,732,216	6,732,216
Other assets	1,104,703	1,214,371
<b>Total assets</b>	<b>\$1,391,779,317</b>	<b>\$1,375,059,650</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Deposits		
Demand, noninterest bearing	\$217,191,985	\$227,332,347
NOW accounts	357,058,832	322,392,945
Savings and money market	401,030,635	389,630,180
Time, \$250,000 and over	38,904,107	38,838,782
Other time	156,237,985	156,196,433
<b>Total deposits</b>	<b>1,170,423,544</b>	<b>1,134,390,687</b>
Securities sold under agreements to repurchase	36,534,018	37,424,619
Federal Home Loan Bank (FHLB) advances	2,000,000	13,500,000
Other borrowings	7,000,000	13,000,000
Dividends payable	4,469,238	2,048,401
Accrued expenses and other liabilities	4,806,299	3,942,801
<b>Total liabilities</b>	<b>1,225,233,099</b>	<b>1,204,306,508</b>
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, \$2 par value, authorized 18,000,000 shares; issued and outstanding 9,310,913 shares as of March 31, 2018 and December 31, 2017	18,621,826	18,621,826
Additional paid-in capital	20,878,728	20,878,728
Retained earnings	131,335,175	131,684,961
	(4,289,511 )	(432,373 )

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

Accumulated other comprehensive (loss) - net unrealized (loss) on securities  
available-for-sale

<b>Total stockholders' equity</b>	166,546,218	170,753,142
<b>Total liabilities and stockholders' equity</b>	\$1,391,779,317	\$1,375,059,650

See Notes to Consolidated Financial Statements.

Table of Contents**AMES NATIONAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME***(unaudited)*

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2018</b>	<b>2017</b>
Interest income:		
Loans, including fees	\$8,888,855	\$8,115,685
Securities:		
Taxable	1,556,838	1,512,919
Tax-exempt	1,186,346	1,318,062
Interest bearing deposits and federal funds sold	165,319	137,173
<b>Total interest income</b>	<b>11,797,358</b>	<b>11,083,839</b>
Interest expense:		
Deposits	1,362,481	921,430
Other borrowed funds	248,390	279,401
<b>Total interest expense</b>	<b>1,610,871</b>	<b>1,200,831</b>
<b>Net interest income</b>	<b>10,186,487</b>	<b>9,883,008</b>
Provision for loan losses	29,000	397,574
<b>Net interest income after provision for loan losses</b>	<b>10,157,487</b>	<b>9,485,434</b>
Noninterest income:		
Wealth management income	751,000	698,932
Service fees	338,242	359,132
Securities gains, net	-	365,035
Gain on sale of loans held for sale	177,200	138,012
Merchant and card fees	309,659	315,036
Other noninterest income	187,901	187,504
<b>Total noninterest income</b>	<b>1,764,002</b>	<b>2,063,651</b>
Noninterest expense:		
Salaries and employee benefits	4,568,045	4,045,644
Data processing	781,032	823,779
Occupancy expenses, net	494,946	544,030
FDIC insurance assessments	105,995	103,831
Professional fees	345,407	298,145
Business development	254,548	237,741
Intangible asset amortization	87,535	98,802
Other operating expenses, net	227,629	307,785
<b>Total noninterest expense</b>	<b>6,865,137</b>	<b>6,459,757</b>



<b>Income before income taxes</b>	5,056,352	5,089,328
Provision for income taxes	1,019,600	1,479,200
<b>Net income</b>	<b>\$4,036,752</b>	<b>\$3,610,128</b>
Basic and diluted earnings per share	\$0.43	\$0.39
Dividends declared per share	\$0.48	\$0.22

See Notes to Consolidated Financial Statements.

Table of Contents**AMES NATIONAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME***(unaudited)*

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2018</b>	<b>2017</b>
Net income	\$4,036,752	\$3,610,128
Other comprehensive income (loss), before tax:		
Unrealized gains (losses) on securities before tax:		
Unrealized holding gains (losses) arising during the period	(5,033,043)	2,682,082
Less: reclassification adjustment for gains realized in net income	-	365,035
Other comprehensive income (loss), before tax	(5,033,043)	2,317,047
Tax effect related to other comprehensive income (loss)	1,258,605	(857,307)
Other comprehensive income (loss), net of tax	(3,774,438)	1,459,740
Comprehensive income	\$262,314	\$5,069,868

See Notes to Consolidated Financial Statements.

Table of Contents**AMES NATIONAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY***(unaudited)***Three Months Ended March 31, 2018 and 2017**

				Accumulated	
	Common	Additional	Retained	Other	Total
	Stock	Paid-	Earnings	Comprehensive	Stockholders'
		in Capital		Income (Loss),	Equity
				Net of Taxes	
<b>Balance, December 31, 2016</b>	\$18,621,826	\$20,878,728	\$126,181,376	\$ (576,687 )	\$165,105,243
Net income	-	-	3,610,128	-	3,610,128
Other comprehensive income	-	-	-	1,459,740	1,459,740
Cash dividends declared, \$0.22 per share	-	-	(2,048,401 )	-	(2,048,401 )
<b>Balance, March 31, 2017</b>	\$18,621,826	\$20,878,728	\$127,743,103	\$ 883,053	\$168,126,710
<b>Balance, December 31, 2017</b>	\$18,621,826	\$20,878,728	\$131,684,961	\$ (432,373 )	\$170,753,142
Net income	-	-	4,036,752	-	4,036,752
Other comprehensive (loss)	-	-	-	(3,774,438 )	(3,774,438 )
The cumulative effect from change in accounting policy (1)	-	-	82,700	(82,700 )	-
Cash dividends declared, \$0.48 per share	-	-	(4,469,238 )	-	(4,469,238 )
<b>Balance, March 31, 2018</b>	\$18,621,826	\$20,878,728	\$131,335,175	\$ (4,289,511 )	\$166,546,218

(1) The cumulative effect for the quarter ended March 31, 2018, reflects adoption in first quarter 2018 of ASU 2018-02.

See Notes to Consolidated Financial Statements.

Table of Contents**AMES NATIONAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS***(unaudited)***Three Months Ended March 31, 2018 and 2017**

	<b>2018</b>	<b>2017</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$4,036,752	\$3,610,128
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	29,000	397,574
Provision for off-balance sheet commitments	(4,000 )	10,000
Amortization, net	515,844	728,139
Amortization of intangible asset	87,535	98,802
Depreciation	260,358	274,347
Deferred income taxes	(48,299 )	(221,700 )
Securities gains, net	-	(365,035 )
(Gain) on sales of loans held for sale	(177,200 )	(138,012 )
Proceeds from loans held for sale	7,516,348	4,617,145
Originations of loans held for sale	(7,488,054 )	(4,432,660 )
Loss on sale of premises and equipment, net	115	29,276
(Gain) on sale of other real estate owned, net	-	(7,024 )
Change in assets and liabilities:		
Decrease in accrued income receivable	652,135	497,732
(Increase) decrease in other assets	104,485	(285,212 )
Increase in accrued expenses and other liabilities	867,498	1,428,546
<b>Net cash provided by operating activities</b>	<b>6,352,517</b>	<b>6,242,046</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of securities available-for-sale	(7,854,442 )	(18,797,565)
Proceeds from sale of securities available-for-sale	-	1,491,070
Proceeds from maturities and calls of securities available-for-sale	8,364,369	9,869,153
Purchase of FHLB stock	(227,700 )	(71,900 )
Proceeds from the redemption of FHLB stock	691,500	7,200
Net (increase) in interest bearing deposits in financial institutions	(25,810,886)	(17,624,685)
Net (increase) in loans	(802,576 )	(7,985,518 )
Net proceeds from the sale of other real estate owned	-	26,637
Purchase of bank premises and equipment, net	(204,726 )	(150,578 )
Other	(14,960 )	15,720
<b>Net cash (used in) investing activities</b>	<b>(25,859,421)</b>	<b>(33,220,466)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Increase in deposits	36,032,857	32,263,439
(Decrease) in securities sold under agreements to repurchase	(890,601 )	(7,963,862 )
Payments on FHLB borrowings and other borrowings	(17,500,000)	-
Dividends paid	(2,048,401 )	(1,955,292 )
<b>Net cash provided by financing activities</b>	<b>15,593,855</b>	<b>22,344,285</b>

<b>Net (decrease) in cash and due from banks</b>	(3,913,049 )	(4,634,135 )
<b>CASH AND DUE FROM BANKS</b>		
Beginning	26,397,550	29,478,068
Ending	\$22,484,501	\$24,843,933

7

---

Table of Contents**AMES NATIONAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)***(unaudited)***Three Months Ended March 31, 2018 and 2017**

	<b>2018</b>	<b>2017</b>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash payments for:		
Interest	\$1,538,837	\$1,205,110
Income taxes	-	75,459
<b>SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING ACTIVITIES</b>		
Transfer of loans receivable to other real estate owned	\$-	\$16,668
Proceeds from the sale of securities available-for-sale, recorded in other assets pending settlement	\$-	\$9,149,603

See Notes to Consolidated Financial Statements.

Table of Contents

**AMES NATIONAL CORPORATION AND SUBSIDIARIES**

Notes to Consolidated Financial Statements (*unaudited*)

1. Significant Accounting Policies

The consolidated financial statements for the three months ended March 31, 2018 and 2017 are unaudited. In the opinion of the management of Ames National Corporation (the "Company"), these financial statements reflect all adjustments, consisting only of normal recurring accruals, necessary to present fairly these consolidated financial statements. The results of operations for the interim periods are not necessarily indicative of results which may be expected for an entire year. Certain information and footnote disclosures normally included in complete financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted in accordance with the requirements for interim financial statements. The interim financial statements and notes thereto should be read in conjunction with the year-end audited financial statements contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 (the "Annual Report"). The consolidated financial statements include the accounts of the Company and its wholly-owned banking subsidiaries (the "Banks"). All significant intercompany balances and transactions have been eliminated in consolidation.

**Goodwill:** Goodwill represents the excess of cost over the fair value of net assets acquired. Goodwill resulting from acquisitions is not amortized, but is tested for impairment annually or whenever events change and circumstances indicate that it is more likely than not that an impairment loss has occurred. Goodwill is tested for impairment using a two-step process that begins with an estimation of the fair value of a reporting unit. The second step, if necessary, measures the amount of impairment, if any.

Significant judgment is applied when goodwill is assessed for impairment. This judgment includes developing cash flow projections, selecting appropriate discount rates, identifying relevant market comparables, incorporating general economic and market conditions and selecting an appropriate control premium. At March 31, 2018, Company management has performed a goodwill impairment assessment and determined goodwill was not impaired.

**New and Pending Accounting Pronouncements:** In January 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") No. 2016-01, Financial Instruments—Overall (Subtopic 825-10): *Recognition and Measurement of Financial Assets and Financial Liabilities*. The update enhances the reporting model for financial instruments to provide users of financial statements with more decision-useful information by updating certain aspects of recognition, measurement, presentation and disclosure of financial instruments. Among other changes, the update includes requiring changes in fair value of equity securities with readily determinable fair value to

be recognized in net income and clarifies that entities should evaluate the need for a valuation allowance on a deferred tax asset related to available for sale securities in combination with the entities' other deferred tax assets. Among other items the ASC requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. The Company adopted this guidance effective January 1, 2018 and is to be applied on a modified retrospective basis. The fair value of the Company's loan portfolio is presented using an exit price method. Also, the Company is no longer required to disclose the methodologies used for estimating fair value of financial instruments measured at amortized cost on a recurring or nonrecurring basis. The remaining requirements of this update did not have a material impact on the Company's consolidated financial statements.

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") No. 2016-02, Leases (Topic 842). The ASU requires a lessee to recognize on the balance sheet assets and liabilities for leases with lease terms of more than 12 months. Consistent with current GAAP, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. Unlike current GAAP, which requires that only capital leases be recognized on the balance sheet, the ASC requires that both types of leases be recognized on the balance sheet. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2018. Early application is permitted. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.



Table of Contents

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The ASU requires an organization to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2019. The Company is currently planning for the implementation of this accounting standard. It is too early to assess the impact that the guidance will have on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606): *Summary and Amendments that Create Revenue from Contracts with Customers (Topic 606) and Other Assets and Deferred Costs—Contracts with Customers (Subtopic 340-40)*. The guidance in this update supersedes the revenue recognition requirements in ASC Topic 605, Revenue Recognition, and most industry-specific guidance throughout the industry topics of the Codification. The Company adopted this guidance effective January 1, 2018. The guidance does not apply to revenues associated with financial instruments, including loans and securities that are accounted for under U.S. GAAP. The requirements of this update did not have a material impact on the Company's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles-Goodwill and Other (Topic 350): *Simplifying the Test for Goodwill Impairment*. The guidance in this update eliminates the Step 2 from the goodwill impairment test. For public companies, this update will be effective for interim and annual periods beginning after December 15, 2019, with early adoption permitted for interim and annual goodwill impairment test with a measurement date after January 1, 2017. The Company does not expect the guidance to have a material impact on the Company's 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*. The amendments in this ASU would require a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the newly enacted federal corporate income tax rate. The amount of the reclassification would be the difference between the historical corporate income tax rate and the newly enacted 21 percent corporate income tax rate. The amendments in this update will be effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption of the amendments in this update is permitted. The Company adopted this ASU in the first quarter of 2018. The Company made an election to reclassify the income tax effects of the Tax Cuts and Jobs Act from accumulated comprehensive income to retained earnings. This update did not have a material impact on the Company's financial statements.

Reclassifications: Certain amounts in prior year financial statements have been reclassified, with no effect on net income, comprehensive income or stockholder's equity, to conform with current period presentation.

Table of Contents

2. Dividends

On February 14, 2018, the Company declared a cash dividend on its common stock, payable on May 15, 2018 to stockholders of record as of May 1, 2018, equal to \$0.23 per share. Also on February 14, 2018, the Company declared a one-time cash dividend on its common stock, payable on May 15, 2018 to stockholders of record as of May 1, 2018, equal to \$0.25 per share.

3. Earnings Per Share

Earnings per share amounts were calculated using the weighted average shares outstanding during the periods presented. The weighted average outstanding shares for the three months ended March 31, 2018 and 2017 were 9,310,913. The Company had no potentially dilutive securities outstanding during the periods presented.

4. Off-Balance Sheet Arrangements

The Company is party to financial instruments with off-balance sheet risk in the normal course of business. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. No material changes in the Company's off-balance sheet arrangements have occurred since December 31, 2017.

5. Fair Value Measurements

Assets and liabilities carried at fair value are required to be classified and disclosed according to the process for determining fair value. There are three levels of determining fair value.

Level 1: Inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

Level 2: Inputs to the valuation methodology include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatility, prepayment speeds, credit risk); or inputs derived principally from or can be corroborated by observable market data by correlation or other means.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement. Level 3 assets and liabilities include financial instruments whose value is determined using discounted cash flow methodologies, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Table of Contents

The following table presents the balances of assets measured at fair value on a recurring basis by level as of March 31, 2018 and December 31, 2017. *(in thousands)*

Description	Total	Level 1	Level 2	Level 3
<b>2018</b>				
U.S. government treasuries	\$6,788	\$6,788	\$-	\$ -
U.S. government agencies	112,641	-	112,641	-
U.S. government mortgage-backed securities	76,913	-	76,913	-
State and political subdivisions	235,545	-	235,545	-
Corporate bonds	57,204	-	57,204	-
	\$489,091	\$6,788	\$482,303	\$ -

**2017**

U.S. government treasuries	\$6,367	\$6,367	\$-	\$-
U.S. government agencies	111,263	-	111,263	-
U.S. government mortgage-backed securities	81,780	-	81,780	-
State and political subdivisions	237,413	-	237,413	-
Corporate bonds	58,464	-	58,464	-
Equity securities, other	35	35	-	-
	\$495,322	\$6,402	\$488,920	\$-

Level 1 securities include U.S. Treasury securities and other equity securities that are traded by dealers or brokers in active over-the-counter markets. U.S government agencies, mortgage-backed securities, state and political subdivisions, and most corporate bonds are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the security's terms and conditions, among other things.

The Company's policy is to recognize transfers between levels at the end of each reporting period, if applicable. There were no transfers between levels of the fair value hierarchy during the three months ended March 31, 2018.



Table of Contents

Certain assets are measured at fair value on a nonrecurring basis; that is, they are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets carried on the balance sheet (after specific reserves) by caption and by level within the valuation hierarchy as of March 31, 2018 and December 31, 2017. *(in thousands)*

Description	Total	Level 1	Level 2	Level 3
<b>2018</b>				
Loans receivable	\$2,707	\$ -	\$ -	\$2,707
Other real estate owned	386	-	-	386
Total	\$3,093	\$ -	\$ -	\$3,093
<b>2017</b>				
Loans receivable	\$2,606	\$ -	\$ -	\$2,606
Other real estate owned	386	-	-	386
Total	\$2,992	\$ -	\$ -	\$2,992

**Loans Receivable:** Loans in the tables above consist of impaired credits held for investment. In accordance with the loan impairment guidance, impairment was measured based on the fair value of collateral less estimated selling costs for collateral dependent loans. Fair value for impaired loans is based upon appraised values of collateral adjusted for trends observed in the market. A valuation allowance was recorded for the excess of the loan's recorded investment over the amounts determined by the collateral value method. This valuation allowance is a component of the allowance for loan losses. The Company considers these fair value measurements as level 3.

**Other Real Estate Owned:** Other real estate owned in the table above consists of real estate obtained through foreclosure. Other real estate owned is recorded at fair value less estimated selling costs, at the date of transfer, with any impairment amount charged to the allowance for loan losses. Subsequent to the transfer, other real estate owned is carried at the lower of cost or fair value, less estimated selling costs, with any impairment amount recorded as a noninterest expense. The carrying value of other real estate owned is not re-measured to fair value on a recurring basis but is subject to fair value adjustments when the carrying value exceeds the fair value less estimated selling costs. Management uses appraised values and adjusts for trends observed in the market and for disposition costs in determining the value of other real estate owned. A valuation allowance was recorded for the excess of the asset's recorded investment over the amount determined by the fair value, less estimated selling costs. This valuation allowance is a component of the allowance for other real estate owned. The valuation allowance was \$287,000 as of March 31, 2018 and December 31, 2017. The Company considers these fair value measurements as level 3.





Table of Contents

The significant inputs used in the fair value measurements for Level 3 assets measured at fair value on a nonrecurring basis as of March 31, 2018 and December 31, 2017 are as follows: *(in thousands)*

		<b>2018</b>			
	Estimated	Valuation		Range	
	Fair	Techniques	Unobservable Inputs	(Average)	
	Value				
Impaired Loans	\$2,707	Evaluation of collateral	Estimation of value	NM*	
Other real estate owned	\$386	Appraisal	Appraisal adjustment	6% - 8%	(7%)
		<b>2017</b>			
	Estimated	Valuation		Range	
	Fair	Techniques	Unobservable Inputs	(Average)	
	Value				
Impaired Loans	\$2,606	Evaluation of collateral	Estimation of value	NM*	
Other real estate owned	\$386	Appraisal	Appraisal adjustment	6% - 8%	(7%)

\* Not Meaningful. Evaluations of the underlying assets are completed for each impaired loan with a specific reserve. The types of collateral vary widely and could include accounts receivables, inventory, a variety of equipment and real estate. Collateral evaluations are reviewed and discounted as appropriate based on knowledge of the specific type of collateral. In the case of real estate, an independent appraisal may be obtained. Types of discounts considered included aging of receivables, condition of the collateral, potential market for the collateral and estimated disposal costs. These discounts will vary from loan to loan, thus providing a range would not be meaningful.

GAAP requires disclosure of the fair value of financial assets and financial liabilities, including those that are not measured and reported at fair value on a recurring basis or nonrecurring basis. The methodologies for estimating the fair value of financial assets and financial liabilities that are measured at fair value on a recurring or nonrecurring basis are discussed above. The methodologies for other financial assets and financial liabilities are discussed below.

**Fair value of financial instruments:**

Disclosure of fair value information about financial instruments, for which it is practicable to estimate that value, is required whether or not recognized in the consolidated balance sheets. In cases in which quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are

significantly affected by the assumptions used, including the discount rate and estimate of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases could not be realized in immediate settlement of the instruments. Certain financial instruments with a fair value that is not practicable to estimate and all non-financial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value amounts presented do not necessarily represent the underlying value of the Company.

The following disclosures represent financial instruments in which the ending balances at March 31, 2018 and December 31, 2017 are not carried at fair value in their entirety on the consolidated balance sheets.

Securities available-for-sale: Fair value measurement for Level 1 securities is based upon quoted prices. Fair value measurement for Level 2 securities are based upon quoted prices, if available. If quoted prices are not available, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the security's terms and conditions, among other things. Level 1 securities include U.S. Treasury and other equity securities that are traded by dealers or brokers in active over-the-counter markets. U.S government mortgage-backed securities, state and political subdivisions, and some corporate bonds are reported at fair value utilizing Level 2 inputs.

Table of Contents

Loans held for sale: The fair value of loans held for sale is based on prevailing market prices.

Limitations: Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The estimated fair values of the Company's financial instruments as described above as of March 31, 2018 and December 31, 2017 are as follows: (*in thousands*)

		<b>2018</b>		<b>2017</b>	
	Fair Value Hierarchy Level	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:					
Cash and due from banks	Level 1	\$22,485	\$22,485	\$26,398	\$26,398
Interest bearing deposits	Level 1	68,833	68,833	43,022	43,022
Securities available-for-sale	See previous table	489,091	489,091	495,322	495,322
FHLB and FRB stock	Level 2	2,557	2,557	3,021	3,021
Loans receivable, net	Level 2	772,495	749,858	771,550	768,444
Loans held for sale	Level 2	149	149	-	-
Accrued income receivable	Level 1	7,730	7,730	8,382	8,382
Financial liabilities:					
Deposits	Level 2	\$1,170,424	\$1,169,925	\$1,134,391	\$1,134,468
Securities sold under agreements to repurchase	Level 1	36,534	36,534	37,425	37,425
FHLB advances	Level 2	2,000	1,948	13,500	13,482
Other borrowings	Level 2	7,000	7,025	13,000	13,079
Accrued interest payable	Level 1	480	480	477	477

The methodologies used to determine fair value as of March 31, 2018 did not change from the methodologies described in the December 31, 2017 Annual Financial Statements, except for loans receivables which are now presented using an exit price method.



Table of Contents

## 6. Debt and Equity Securities

The amortized cost of securities available-for-sale and their fair values as of March 31, 2018 and December 31, 2017 are summarized below: *(in thousands)*

<b>2018:</b>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government treasuries	\$ 6,917	\$ -	\$ (129 )	\$ 6,788
U.S. government agencies	114,359	25	(1,743 )	112,641
U.S. government mortgage-backed securities	77,873	173	(1,133 )	76,913
State and political subdivisions	237,150	708	(2,313 )	235,545
Corporate bonds	58,511	11	(1,318 )	57,204
	\$ 494,810	\$ 917	\$ (6,636 )	\$ 489,091

<b>2017:</b>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government treasuries	\$ 6,413	\$ 2	\$ (48 )	\$ 6,367
U.S. government agencies	111,900	136	(773 )	111,263
U.S. government mortgage-backed securities	81,685	422	(327 )	81,780
State and political subdivisions	237,349	1,233	(1,169 )	237,413
Corporate bonds	58,647	206	(389 )	58,464
Equity securities, other	15	20	-	35
	\$ 496,009	\$ 2,019	\$ (2,706 )	\$ 495,322

The proceeds, gains and losses from securities available-for-sale are summarized as follows: *(in thousands)*

	Three Months Ended March 31, <b>2018</b>
Proceeds from sales of securities available-for-sale	\$- \$10,641
Gross realized gains on securities available-for-sale	- 367

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

Gross realized losses on securities available-for-sale	-	(2	)
Tax provision applicable to net realized gains on securities available-for-sale	-	128	

16

---

Table of Contents

Unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position are summarized as of March 31, 2018 and December 31, 2017 are as follows: *(in thousands)*

	Less than 12 Months		12 Months or More		Total	
	Estimated	Unrealized	Estimated	Unrealized	Estimated	Unrealized
<b>2018:</b>	Fair	Losses	Fair	Losses	Fair	Losses
	Value		Value		Value	
Securities available-for-sale:						
U.S. government treasuries	\$6,788	\$ (129 )	\$-	\$ -	\$6,788	\$ (129 )
U.S. government agencies	97,368	(1,408 )	9,678	(335 )	107,046	(1,743 )
U.S. government mortgage-backed securities	60,207	(999 )	5,121	(134 )	65,328	(1,133 )
State and political subdivisions	120,587	(1,588 )	16,348	(725 )	136,935	(2,313 )
Corporate bonds	47,860	(937 )	6,505	(381 )	54,365	(1,318 )
	\$332,810	\$ (5,061 )	\$37,652	\$ (1,575 )	\$370,462	\$ (6,636 )

	Less than 12 Months		12 Months or More		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
<b>2017:</b>	Value	Losses	Value	Losses	Value	Losses
Securities available-for-sale:						
U.S. government treasuries	\$4,894	\$ (48 )	\$-	\$ -	\$4,894	\$ (48 )
U.S. government agencies	73,953	(549 )	10,168	(224 )	84,121	(773 )
U.S. government mortgage-backed securities	39,565	(245 )	5,344	(82 )	44,909	(327 )
State and political subdivisions	89,904	(703 )	16,631	(466 )	106,535	(1,169 )
Corporate bonds	29,808	(198 )	6,709	(191 )	36,517	(389 )
	\$238,124	\$ (1,743 )	\$38,852	\$ (963 )	\$276,976	\$ (2,706 )

Gross unrealized losses on debt securities totaled \$6,636,000 as of March 31, 2018. These unrealized losses are generally due to changes in interest rates or general market conditions. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, state or political subdivision, or corporations. Management then determines whether downgrades by bond rating agencies have occurred, and reviews industry analysts' reports. The Company's procedures for evaluating investments in states, municipalities and political subdivisions include but are not limited to reviewing the offering statement and the most current available financial information, comparing yields to yields of bonds of similar credit quality, confirming capacity to repay, assessing operating and financial performance, evaluating the stability of tax revenues, considering debt profiles and local demographics, and for revenue bonds, assessing the source and strength of revenue structures for municipal authorities. These procedures, as applicable, are utilized for all municipal purchases and are utilized in whole or in part for monitoring the portfolio of municipal holdings. The Company does not utilize third party credit

rating agencies as a primary component of determining if the municipal issuer has an adequate capacity to meet the financial commitments under the security for the projected life of the investment, and, therefore, does not compare internal assessments to those of the credit rating agencies. Credit rating downgrades are utilized as an additional indicator of credit weakness and as a reference point for historical default rates. Management concluded that the gross unrealized losses on debt securities were temporary. Due to potential changes in conditions, it is at least reasonably possible that changes in fair values and management's assessments will occur in the near term and that such changes could materially affect the amounts reported in the Company's financial statements.



Table of Contents

## 7. Loans Receivable and Credit Disclosures

Activity in the allowance for loan losses, on a disaggregated basis, for the three months ended March 31, 2018 and 2017 is as follows: *(in thousands)*

	<b>Three Months Ended March 31, 2018</b>								
	1-4 Family							Consumer and Other	Total
	Construction Real Estate	Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural			
Balance, December 31, 2017	\$ 796	\$ 1,716	\$ 4,734	\$ 997	\$ 1,739	\$ 1,171	\$ 168	\$ 11,321	
Provision (credit) for loan losses	8	26	29	(20 )	(6 )	(3 )	(5 )	29	
Recoveries of loans charged-off	-	2	-	-	18	-	8	28	
Loans charged-off	-	-	-	-	(1 )	-	(54 )	(55 )	
Balance, March 31, 2018	\$ 804	\$ 1,744	\$ 4,763	\$ 977	\$ 1,750	\$ 1,168	\$ 117	\$ 11,323	

	<b>Three Months Ended March 31, 2017</b>								
	1-4 Family							Consumer and Other	Total
	Construction Real Estate	Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural			
Balance, December 31, 2016	\$ 908	\$ 1,711	\$ 3,960	\$ 861	\$ 1,728	\$ 1,216	\$ 123	\$ 10,507	
Provision (credit) for loan losses	24	6	316	37	74	(74 )	15	398	
Recoveries of loans charged-off	-	2	-	-	1	-	3	6	
Loans charged-off	-	-	-	-	-	-	(9 )	(9 )	
Balance, March 31, 2017	\$ 932	\$ 1,719	\$ 4,276	\$ 898	\$ 1,803	\$ 1,142	\$ 132	\$ 10,902	

Allowance for loan losses disaggregated on the basis of impairment analysis method as of March 31, 2018 and December 31, 2017 is as follows: *(in thousands)*

2018

1-4  
Family

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

	Construction Real Estate	Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial Commercial	Agricultural Agricultural	Consumer and Other	Total
Individually evaluated for impairment	\$ -	\$ 69	\$ 115	\$ -	\$ 582	\$ -	\$ 28	\$ 794
Collectively evaluated for impairment	804	1,675	4,648	977	1,168	1,168	89	10,529
Balance March 31, 2018	\$ 804	\$ 1,744	\$ 4,763	\$ 977	\$ 1,750	\$ 1,168	\$ 117	\$ 11,323

**2017**

	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial Commercial	Agricultural Agricultural	Consumer and Other	Total
Individually evaluated for impairment	\$ -	\$ 42	\$ 115	\$ -	\$ 607	\$ -	\$ 47	\$ 811
Collectively evaluated for impairment	796	1,674	4,619	997	1,132	1,171	121	10,510
Balance December 31, 2017	\$ 796	\$ 1,716	\$ 4,734	\$ 997	\$ 1,739	\$ 1,171	\$ 168	\$ 11,321

Table of Contents

Loans receivable disaggregated on the basis of impairment analysis method as of March 31, 2018 and December 31, 2017 is as follows (*in thousands*):

	2018							Total
	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	
Individually evaluated for impairment	\$ -	\$ 902	\$ 366	\$ -	\$ 2,978	\$ -	\$ 33	\$ 4,279
Collectively evaluated for impairment	50,904	146,645	351,546	81,030	70,721	70,773	8,013	779,632
Balance March 31, 2018	\$ 50,904	\$ 147,547	\$ 351,912	\$ 81,030	\$ 73,699	\$ 70,773	\$ 8,046	\$ 783,911
	2017							
	Construction Real Estate	1-4 Family Residential Real Estate	Commercial Real Estate	Agricultural Real Estate	Commercial	Agricultural	Consumer and Other	Total
Individually evaluated for impairment	\$ -	\$ 689	\$ 901	\$ -	\$ 3,140	\$ -	\$ 80	\$ 4,810
Collectively evaluated for impairment	50,309	145,569	349,725	81,790	70,676	69,806	10,265	778,140
Balance December 31, 2017	\$ 50,309	\$ 146,258	\$ 350,626	\$ 81,790	\$ 73,816	\$ 69,806	\$ 10,345	\$ 782,950

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payment of principal and interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. The Company will apply its normal loan review procedures to identify loans that should be evaluated for impairment.

Table of Contents

The following is a recap of impaired loans, on a disaggregated basis, as of March 31, 2018 and December 31, 2017:  
(in thousands)

	2018			2017		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no specific reserve recorded:						
Real estate - construction	\$-	\$ -	\$ -	\$-	\$ -	\$ -
Real estate - 1 to 4 family residential	567	690	-	572	677	-
Real estate - commercial	147	609	-	671	1,353	-
Real estate - agricultural	-	-	-	-	-	-
Commercial	64	68	-	125	148	-
Agricultural	-	-	-	-	-	-
Consumer and other	-	-	-	25	44	-
Total loans with no specific reserve:	778	1,367	-	1,393	2,222	-
With an allowance recorded:						
Real estate - construction	-	-	-	-	-	-
Real estate - 1 to 4 family residential	335	362	69	117	180	42
Real estate - commercial	219	219	115	230	230	115
Real estate - agricultural	-	-	-	-	-	-
Commercial	2,914	3,238	582	3,015	3,336	607
Agricultural	-	-	-	-	-	-
Consumer and other	33	37	28	55	43	47
Total loans with specific reserve:	3,501	3,856	794	3,417	3,789	811
Total						
Real estate - construction	-	-	-	-	-	-
Real estate - 1 to 4 family residential	902	1,052	69	689	857	42
Real estate - commercial	366	828	115	901	1,583	115
Real estate - agricultural	-	-	-	-	-	-
Commercial	2,978	3,306	582	3,140	3,484	607
Agricultural	-	-	-	-	-	-
Consumer and other	33	37	28	80	87	47
	\$4,279	\$ 5,223	\$ 794	\$4,810	\$ 6,011	\$ 811

Table of Contents

The following is a recap of the average recorded investment and interest income recognized on impaired loans for the three months ended March 31, 2018 and 2017: *(in thousands)*

	<b>Three Months Ended March 31,</b>			
	<b>2018</b>		<b>2017</b>	
	Average Interest Recorded Income		Average Interest Recorded Income	
	Investment	Recognized	Investment	Recognized
With no specific reserve recorded:				
Real estate - construction	\$-	\$ -	\$-	\$ -
Real estate - 1 to 4 family residential	570	23	438	3
Real estate - commercial	409	258	580	-
Real estate - agricultural	-	-	-	-
Commercial	95	-	2,774	-
Agricultural	-	-	-	-
Consumer and other	13	-	75	-
Total loans with no specific reserve:	1,087	281	3,867	3
With an allowance recorded:				
Real estate - construction	-	-	32	-
Real estate - 1 to 4 family residential	226	-	196	-
Real estate - commercial	225	-	-	-
Real estate - agricultural	-	-	-	-
Commercial	2,965	-	1,123	-
Agricultural	-	-	-	-
Consumer and other	44	1	2	-
Total loans with specific reserve:	3,460	1	1,353	-
Total				
Real estate - construction	-	-	32	-
Real estate - 1 to 4 family residential	796	23	634	3
Real estate - commercial	634	258	580	-
Real estate - agricultural	-	-	-	-
Commercial	3,060	-	3,897	-
Agricultural	-	-	-	-
Consumer and other	57	1	77	-
	\$4,547	\$ 282	\$5,220	\$ 3

The interest foregone on nonaccrual loans for the three months ended March 31, 2018 and 2017 was approximately \$83,000 and \$98,000, respectively.

Nonaccrual loans at March 31, 2018 and December 31, 2017 were \$4,279,000 and \$4,810,000 respectively.

The Company had loans meeting the definition of a troubled debt restructuring (TDR) of \$2,814,000 as of March 31, 2018, all of which were included in impaired and nonaccrual loans. The Company had TDRs of \$2,984,000 as of December 31, 2017, all of which were included in impaired and nonaccrual loans.

During the three months ended March 31, 2018 and 2017, the Company did not grant any concessions to any borrowers facing financial difficulties.

The Company considers TDR loans to have payment default when it is past due 60 days or more.

One TDR modified during the twelve months ended March 31, 2018 had payment defaults. Three TDR loans modified during the twelve months ended March 31, 2017 had payment defaults.

There were no charge-offs related to TDRs for the three months ended March 31, 2018 and 2017.

Table of Contents

An aging analysis of the recorded investments in loans, on a disaggregated basis, as of March 31, 2018 and December 31, 2017, is as follows: *(in thousands)*

2018	90 Days or Greater			Current	Total	90 Days or Greater
	30-89 Past Due	Past Due	Total Past Due			Accruing
Real estate - construction	\$50	\$-	\$50	\$50,854	\$50,904	\$ -
Real estate - 1 to 4 family residential	563	614	1,177	146,370	147,547	-
Real estate - commercial	-	219	219	351,693	351,912	-
Real estate - agricultural	-	-	-	81,030	81,030	-
Commercial	1,354	308	1,662	72,037	73,699	-
Agricultural	145	-	145	70,628	70,773	-
Consumer and other	21	-	21	8,025	8,046	-
	\$2,133	\$1,141	\$3,274	\$780,637	\$783,911	\$ -

2017	90 Days or Greater			Current	Total	90 Days or Greater
	30-89 Past Due	Past Due	Total Past Due			Accruing
Real estate - construction	\$159	\$-	\$159	\$50,150	\$50,309	\$ -
Real estate - 1 to 4 family residential	940	414	1,354	144,904	146,258	18
Real estate - commercial	363	629	992	349,634	350,626	-
Real estate - agricultural	655	-	655	81,135	81,790	-
Commercial	275	418	693	73,123	73,816	-
Agricultural	77	-	77	69,729	69,806	-
Consumer and other	77	38	115	10,230	10,345	-
	\$2,546	\$1,499	\$4,045	\$778,905	\$782,950	\$ 18

Table of Contents

The credit risk profile by internally assigned grade, on a disaggregated basis, as of March 31, 2018 and December 31, 2017 is as follows: *(in thousands)*

<b>2018</b>	Construction	Commercial	Agricultural			Total
	Real Estate	Real Estate	Real Estate	Commercial	Agricultural	
Pass	\$ 48,120	\$ 319,918	\$ 59,380	\$ 58,578	\$ 45,892	\$531,888
Watch	2,784	19,876	15,356	10,898	23,573	72,487
Special Mention	-	9,942	-	-	-	9,942
Substandard	-	1,810	6,294	1,245	1,308	10,657
Substandard-Impaired	-	366	-	2,978	-	3,344
	\$ 50,904	\$ 351,912	\$ 81,030	\$ 73,699	\$ 70,773	\$628,318

<b>2017</b>	Construction	Commercial	Agricultural			Total
	Real Estate	Real Estate	Real Estate	Commercial	Agricultural	
Pass	\$ 47,726	\$ 319,178	\$ 60,301	\$ 59,535	\$ 45,816	\$532,556
Watch	2,583	27,528	20,114	9,628	22,640	82,493
Special Mention	-	184	-	-	-	184
Substandard	-	2,835	1,375	1,513	1,350	7,073
Substandard-Impaired	-	901	-	3,140	-	4,041
	\$ 50,309	\$ 350,626	\$ 81,790	\$ 73,816	\$ 69,806	\$626,347

The credit risk profile based on payment activity, on a disaggregated basis, as of March 31, 2018 and December 31, 2017 is as follows:

<b>2018</b>	1-4 Family	Consumer	Total
	Residential Real Estate	and Other	
Performing	\$ 146,646	\$ 8,013	\$154,659
Non-performing	901	33	934
	\$ 147,547	\$ 8,046	\$155,593

<b>2017</b>	1-4 Family	Consumer
	Residential	



	Real Estate	and Other	Total
Performing	\$ 145,551	\$ 10,264	\$ 155,815
Non-performing	707	81	788
	\$ 146,258	\$ 10,345	\$ 156,603

## 8. Goodwill

Goodwill is not amortized but is evaluated for impairment at least annually. For income tax purposes, goodwill is amortized over fifteen years.

Table of Contents

## 9. Intangible assets

The following sets forth the carrying amounts and accumulated amortization of the intangible assets at March 31, 2018 and December 31, 2017: *(in thousands)*

	<b>2018</b>		<b>2017</b>	
	Gross Amount	Accumulated Amortization	Gross Amount	Accumulated Amortization
Core deposit intangible asset	\$2,518	\$ 1,929	\$2,518	\$ 1,861
Customer list	535	105	520	86
Total	\$3,053	\$ 2,034	\$3,038	\$ 1,947

The weighted average life of the intangible assets is 2.5 years as of March 31, 2018 and December 31, 2017.

The following sets forth the activity related to the intangible assets for the three months ended March 31, 2018 and 2017: *(in thousands)*

	<b>Three Months Ended March 31,</b>	
	<b>2018</b>	<b>2017</b>
Beginning intangible asset, net	\$1,091	\$1,353
Adjustment to intangible asset	15	(17 )
Amortization	(87 )	(98 )
Ending intangible asset, net	\$1,019	\$1,238

Edgar Filing: AMES NATIONAL CORP - Form 10-Q

Estimated remaining amortization expense on core deposit intangible for the years ending December 31 is as follows:  
(in thousands)

2018	\$242
2019	206
2020	149
2021	149
2022	144
2023	129

Intangible asset, net \$1,019

Table of Contents

## 10. Pledged Collateral Related to Securities Sold Under Repurchase Agreements

The following sets forth the pledged collateral at estimated fair value related to securities sold under repurchase agreements and term repurchase agreements as of March 31, 2018 and December 31, 2017: *(in thousands)*

	2018			2017		
	Remaining Overnight	Contractual Greater than 90 days	Maturity of the Total	Remaining Overnight	Contractual Greater than 90 days	Maturity of the Total
Securities sold under agreements to repurchase:						
U.S. government treasuries	\$1,468	\$-	\$1,468	\$1,474	\$-	\$1,474
U.S. government agencies	46,940	-	46,940	47,323	-	47,323
U.S. government mortgage-backed securities	21,316	-	21,316	22,824	-	22,824
<b>Total</b>	<b>\$69,724</b>	<b>\$-</b>	<b>\$69,724</b>	<b>\$71,621</b>	<b>\$-</b>	<b>\$71,621</b>
Term repurchase agreements (Other borrowings):						
U.S. government agencies	\$-	\$6,927	\$6,927	\$-	\$14,986	\$14,986
<b>Total pledged collateral</b>	<b>\$69,724</b>	<b>\$6,927</b>	<b>\$76,651</b>	<b>\$71,621</b>	<b>\$14,986</b>	<b>\$86,607</b>

In the event the repurchase agreements exceed the estimated fair value of the pledged securities available-for-sale, the Company has unpledged securities available-for-sale that may be pledged on the repurchase agreements.

Table of Contents

## 11. Regulatory Matters

The Company and the Banks capital amounts and ratios are as follows: (*dollars in thousands*)

	Actual		For Capital Adequacy Purposes *		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of March 31, 2018:						
Total capital (to risk-weighted assets):						
Consolidated	\$ 175,304	17.6 %	\$ 98,591	9.875 %	N/A	N/A
Boone Bank & Trust	15,400	16.2	9,379	9.875	\$ 9,498	10.0 %
First National Bank	82,254	15.6	51,925	9.875	52,582	10.0
Reliance State Bank	27,255	15.4	17,484	9.875	17,706	10.0
State Bank & Trust	20,287	16.6	12,045	9.875	12,198	10.0
United Bank & Trust	14,933	20.0	7,387	9.875	7,481	10.0
Tier 1 capital (to risk-weighted assets):						
Consolidated	\$ 163,466	16.4 %	\$ 78,623	7.875 %	N/A	N/A
Boone Bank & Trust	14,503	15.3	7,480	7.875	\$ 7,598	8.0 %
First National Bank	76,237	14.5	41,408	7.875	42,066	8.0
Reliance State Bank	25,042	14.1	13,943	7.875	14,165	8.0
State Bank & Trust	18,758	15.4	9,606	7.875	9,758	8.0
United Bank & Trust	14,121	18.9	5,891	7.875	5,985	8.0
Tier 1 capital (to average-weighted assets):						
Consolidated	\$ 163,466	12.1 %	\$ 54,521	4.000 %	N/A	N/A
Boone Bank & Trust	14,503	10.9	5,312	4.000	\$ 6,640	5.0 %
First National Bank	76,237	10.2	29,850	4.000	37,313	5.0
Reliance State Bank	25,042	11.7	8,598	4.000	10,747	5.0
State Bank & Trust	18,758	11.7	6,421	4.000	8,026	5.0
United Bank & Trust	14,121	13.1	4,316	4.000	5,395	5.0
Common equity tier 1 capital (to risk-weighted assets):						
Consolidated	\$ 163,466	16.4 %	\$ 63,648	6.375 %	N/A	N/A
Boone Bank & Trust	14,503	15.3	6,055	6.375	\$ 6,174	6.5 %
First National Bank	76,237	14.5	33,521	6.375	34,178	6.5
Reliance State Bank	25,042	14.1	11,287	6.375	11,509	6.5
State Bank & Trust	18,758	15.4	7,776	6.375	7,929	6.5

United Bank & Trust	14,121	18.9	4,769	6.375	4,862	6.5
---------------------	--------	------	-------	-------	-------	-----

\* These ratios for March 31, 2018 include a capital conservation buffer of 1.875%, except for the Tier 1 capital to average weighted assets ratios.

Table of Contents

	Actual		For Capital Adequacy Purposes *		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2017:						
Total capital (to risk-weighted assets):						
Consolidated	\$ 176,306	17.6 %	\$ 92,500	9.25 %	N/A	N/A
Boone Bank & Trust	15,344	16.5	8,613	9.25	\$ 9,312	10.0 %
First National Bank	81,390	15.5	48,466	9.25	52,396	10.0
Reliance State Bank	26,982	15.3	16,324	9.25	17,648	10.0
State Bank & Trust	20,064	15.8	11,738	9.25	12,690	10.0
United Bank & Trust	14,833	19.9	6,878	9.25	7,436	10.0
Tier 1 capital (to risk-weighted assets):						
Consolidated	\$ 164,467	16.4 %	\$ 72,500	7.25 %	N/A	N/A
Boone Bank & Trust	14,453	15.5	6,751	7.25	\$ 7,449	8.0 %
First National Bank	75,404	14.4	37,987	7.25	41,917	8.0
Reliance State Bank	24,775	14.0	12,795	7.25	14,118	8.0
State Bank & Trust	18,475	14.6	9,200	7.25	10,152	8.0
United Bank & Trust	14,012	18.8	5,391	7.25	5,649	8.0
Tier 1 capital (to average-weighted assets):						
Consolidated	\$ 164,467	12.1 %	\$ 54,264	4.00 %	N/A	N/A
Boone Bank & Trust	14,453	10.4	5,568	4.00	\$ 6,960	5.0 %
First National Bank	75,404	10.1	29,910	4.00	37,387	5.0
Reliance State Bank	24,775	11.6	8,553	4.00	10,691	5.0
State Bank & Trust	18,475	11.8	6,284	4.00	7,856	5.0
United Bank & Trust	14,012	12.8	4,362	4.00	5,453	5.0
Common equity tier 1 capital (to risk-weighted assets):						
Consolidated	\$ 164,467	16.4 %	\$ 57,500	5.75 %	N/A	N/A
Boone Bank & Trust	14,453	15.5	5,354	5.75	\$ 6,053	6.5 %
First National Bank	75,404	14.4	30,128	5.75	34,058	6.5
Reliance State Bank	24,775	14.0	10,147	5.75	11,471	6.5
State Bank & Trust	18,475	14.6	7,297	5.75	8,248	6.5
United Bank & Trust	14,012	18.8	4,276	5.75	4,833	6.5

\* These ratios for December 31, 2017 include a capital conservation buffer of 1.25%, except for the Tier 1 capital to average weighted assets ratios.

The Federal Reserve Board and the FDIC issued final rules implementing the Basel III regulatory capital framework and related Dodd-Frank Wall Street Reform and Consumer Protection Act changes in July 2013. The rules revise minimum capital requirements and adjust prompt corrective action thresholds. The final rules revise the regulatory capital elements, add a new common equity Tier I capital ratio, increase the minimum Tier 1 capital ratio requirements and implement a new capital conservation buffer. The rules also permit certain banking organizations to retain, through a one-time election, the existing treatment for accumulated other comprehensive income (loss). The Company and the Banks have made the election to retain the existing treatment for accumulated other comprehensive income (loss). The final rules took effect for the Company and the Banks on January 1, 2015, subject to a transition period for certain parts of the rules.



Table of Contents

Beginning in 2016, an additional capital conservation buffer was added to the minimum requirements for capital adequacy purposes, subject to a three year phase-in period. The capital conservation buffer will be fully phased-in on January 1, 2019 at 2.5 percent. A banking organization with a conservation buffer of less than 2.5 percent (or the required phase-in amount in years prior to 2019) will be subject to limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers. At the present time, the ratios for the Company and the Banks are sufficient to meet the fully phased-in conservation buffer.

12. Subsequent Events

Management evaluated subsequent events through the date the financial statements were issued. On April 19, 2018, First National Bank, Ames, Iowa (First National), a 100% owned subsidiary of the Company, entered into a stock purchase agreement with United Bancorporation (United) and Clarke County State Bank (Clarke County), an Iowa state chartered bank and 100% owned subsidiary of United. At closing, First National will pay United cash of approximately \$15,000,000, subject to certain adjustments based on the financial condition of the Clarke County (including total equity capital and loan loss reserve) prior to closing. Closing of the transaction is expected to occur during the third quarter of 2018, subject to regulatory approval and other customary closing conditions. There were no other significant events or transactions occurring after March 31, 2018, but prior to May 8, 2018, that provided additional evidence about conditions that existed at March 31, 2018. There were no other significant events or transactions that provided evidence about conditions that did not exist at March 31, 2018.

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

**Overview**

Ames National Corporation (the "Company") is a bank holding company established in 1975 that owns and operates five bank subsidiaries in central Iowa (the "Banks"). The following discussion is provided for the consolidated operations of the Company and its Banks, First National Bank, Ames, Iowa (First National), State Bank & Trust Co. (State Bank), Boone Bank & Trust Co. (Boone Bank), Reliance State Bank (Reliance Bank), and United Bank & Trust NA (United Bank). The purpose of this discussion is to focus on significant factors affecting the Company's financial condition and results of operations.

The Company does not engage in any material business activities apart from its ownership of the Banks. Products and services offered by the Banks are for commercial and consumer purposes including loans, deposits and wealth management services. The Banks also offer investment services through a third-party broker-dealer. The Company

employs fourteen individuals to assist with financial reporting, human resources, audit, compliance, marketing, technology systems, training and the coordination of management activities, in addition to 206 full-time equivalent individuals employed by the Banks.

The Company's primary competitive strategy is to utilize seasoned and competent Bank management and local decision making authority to provide customers with faster response times and more flexibility in the products and services offered. This strategy is viewed as providing an opportunity to increase revenues through creating a competitive advantage over other financial institutions. The Company also strives to remain operationally efficient to provide better profitability while enabling the Company to offer more competitive loan and deposit rates.

Table of Contents

The principal sources of Company revenues and cash flow are: (i) interest and fees earned on loans made by the Company and Banks; (ii) interest on fixed income investments held by the Banks; (iii) fees on wealth management services provided by those Banks exercising trust powers; (iv) service fees on deposit accounts maintained at the Banks and (v) Merchant and card fees. The Company's principal expenses are: (i) interest expense on deposit accounts and other borrowings; (ii) provision for loan losses; (iii) salaries and employee benefits; (iv) data processing costs associated with maintaining the Banks' loan and deposit functions; (v) occupancy expenses for maintaining the Bank's facilities; and (vi) professional fees. The largest component contributing to the Company's net income is net interest income, which is the difference between interest earned on earning assets (primarily loans and investments) and interest paid on interest bearing liabilities (primarily deposits and other borrowings). One of management's principal functions is to manage the spread between interest earned on earning assets and interest paid on interest bearing liabilities in an effort to maximize net interest income while maintaining an appropriate level of interest rate risk.

The Company had net income of \$4,037,000, or \$0.43 per share, for the three months ended March 31, 2018, compared to net income of \$3,610,000, or \$0.39 per share, for the three months ended March 31, 2017.

The increase in quarterly earnings can be primarily attributed to an increase in loan interest income, a reduction in the provision for loan losses and lower federal income tax expense, offset in part by an increase in deposit interest expense, an increase in salaries and benefits and a decrease in securities gains.

Net loan charge-offs totaled \$27,000 and \$3,000 for the three months ended March 31, 2018 and 2017, respectively. The provision for loan losses totaled \$29,000 and \$398,000 for the three months ended March 31, 2018 and 2017, respectively.

The following management discussion and analysis will provide a review of important items relating to:

Challenges

Key Performance Indicators and Industry Results

Critical Accounting Policies

Income Statement Review

Balance Sheet Review

Asset Quality Review and Credit Risk Management

Liquidity and Capital Resources

## Forward-Looking Statements and Business Risks

## Non-GAAP Financial Measures

**Challenges**

Management has identified certain events or circumstances that may negatively impact the Company's financial condition and results of operations in the future and is attempting to position the Company to best respond to those challenges. These challenges are addressed in the Company's most recent Annual Report on Form 10-K filed on March 12, 2018.

**Key Performance Indicators and Industry Results**

Certain key performance indicators for the Company and the industry are presented in the following chart. The industry figures are compiled by the Federal Deposit Insurance Corporation (the "FDIC") and are derived from 5,670 commercial banks and savings institutions insured by the FDIC. Management reviews these indicators on a quarterly basis for purposes of comparing the Company's performance from quarter-to-quarter against the industry as a whole.

## Selected Indicators for the Company and the Industry

	<b>3 Months Ended March 31, 2018</b>		<b>Years Ended December 31,</b>								
	<b>Company</b>		<b>2017</b>		<b>2016</b>		<b>2015</b>				
			<b>Company</b>	<b>Industry*</b>	<b>Company</b>	<b>Industry</b>	<b>Company</b>	<b>Industry</b>			
Return on assets	1.19	%	1.00	% 0.97	%	1.18	% 1.04	%	1.13	% 1.04	%
Return on equity	9.55	%	8.02	% 8.64	%	9.38	% 9.32	%	9.44	% 9.31	%
Net interest margin	3.19	%	3.25	% 3.25	%	3.36	% 3.13	%	3.33	% 3.07	%
Efficiency ratio	57.45	%	52.70	% 57.94	%	51.95	% 58.28	%	53.59	% 59.91	%
Capital ratio	12.43	%	12.48	% 9.62	%	12.60	% 9.48	%	12.00	% 9.59	%

\*Latest available data

29

---

Table of Contents

Key performances indicators include:

Return on Assets

This ratio is calculated by dividing net income by average assets. It is used to measure how effectively the assets of the Company are being utilized in generating income. The Company's annualized return on average assets was 1.19% and 1.05% for the three months ended March 31, 2018 and 2017, respectively. The increase in this ratio in 2018 from the previous period is primarily due to an increase in net income.

Return on Equity

This ratio is calculated by dividing net income by average equity. It is used to measure the net income or return the Company generated for the shareholders' equity investment in the Company. The Company's return on average equity was at 9.55% and 8.66% for the three months ended March 31, 2018 and 2017, respectively. The increase in this ratio in 2018 from the previous period is primarily due to an increase in net income.

Net Interest Margin

The net interest margin for the three months ended March 31, 2018 and 2017 was 3.19% and 3.20%, respectively. The ratio is calculated by dividing net interest income by average earning assets. Earning assets are primarily made up of loans and investments that earn interest. This ratio is used to measure how well the Company is able to maintain interest rates on earning assets above those of interest-bearing liabilities, which is the interest expense paid on deposits and other borrowings.

Efficiency Ratio

This ratio is calculated by dividing noninterest expense by net interest income and noninterest income. The ratio is a measure of the Company's ability to manage noninterest expenses. The Company's efficiency ratio was 57.45% and 54.14% for the three months ended March 31, 2018 and 2017, respectively. The efficiency ratio increase for the three months ended March 31, 2018 primarily a reduction in the gain on the sale of securities and an increase in salaries and benefits.



## Table of Contents

### Capital Ratio

The average capital ratio is calculated by dividing average total equity capital by average total assets. It measures the level of average assets that are funded by shareholders' equity. Given an equal level of risk in the financial condition of two companies, the higher the capital ratio, generally the more financially sound the company. The Company's capital ratio of 12.43% as of March 31, 2018 is significantly higher than the industry average of 9.62% as of December 31, 2017.

### Industry Results

The FDIC Quarterly Banking Profile reported the following results for the fourth quarter of 2017:

#### Quarterly Net Income Is 40.9% Lower Than a Year Ago Largely Due to One-Time Changes From the New Tax Law

In the fourth quarter, 5,670 insured institutions reported quarterly net income of \$25.5 billion, down \$17.7 billion (40.9%) from a year ago. Higher income taxes, reflecting one-time income tax effects enacted from the new tax law, coupled with higher noninterest expense and loan-loss provisions, lowered quarterly net income. Excluding one-time income tax effects, estimated quarterly net income would have been \$42.2 billion, down 2.3%.

#### Full-Year 2017 Net Income Declines 3.5% Due to One-Time Tax Changes

Net income for full-year 2017 totaled \$164.8 billion a decline of \$6 billion (3.5%) compared to 2016. The decline in full-year net income was due to higher income taxes (up \$21.6 billion, or 28.4%), which reflects one-time changes from the new tax law, combined with higher noninterest expense (up \$19.5 billion, or 4.6%) and higher loan-loss provisions (up \$3 billion, or 6.2%). Net operating revenue (the sum of net interest income and total noninterest income) increased by \$39.5 billion from 2016, as net interest income rose by \$37.7 billion (8.2%) and noninterest income grew by \$1.8 billion (0.7%). The average net interest margin (NIM) increased to 3.25% from 3.13% in 2016. Without the one-time tax charges in the fourth quarter, estimated full-year 2017 net income would have been \$183.1 billion, an increase of 7.2% from 2016.

#### Net Interest Income Rises 8.5% From Fourth Quarter 2016



Net operating revenue of \$192.2 billion, was \$10 billion (5.5%) higher than fourth quarter 2016. Net interest income grew by \$10.2 billion (8.5%), while noninterest income fell by \$202.4 million (0.3%). More than four out of five banks (86.4%) reported higher net interest income from a year ago, as interest-bearing assets increased (up 4.4%) and the average NIM increased to 3.31% from 3.16% a year ago. This is the highest quarterly NIM for the industry since fourth quarter 2012. More than two out of three banks (70%) reported higher net interest margins than a year earlier.

#### Provisions Increase 8.9% From a Year Ago

Loan-loss provisions totaled \$13.6 billion in the fourth quarter, an increase of \$1.1 billion (8.9%) from a year ago. More than one in three (38.9%) institutions reported higher loan-loss provisions than in fourth quarter 2016. Fourth quarter loan-loss provisions totaled 7.1% of net operating revenue, up from 6.8% a year ago. This estimate of net income applies the average quarterly tax rate between fourth quarter 2011 and third quarter 2017 to income before taxes and discontinued operations. This estimate of net income applies the average annual tax rate between 2011 and 2016 to income before taxes and discontinued operations.

## Table of Contents

### Noninterest Expense Increases From a Year Ago

Noninterest expense for the banking industry was \$9.4 billion (8.6%) higher than fourth quarter 2016, led by an increase in “other” noninterest expense (up \$6.3 billion, or 14.1%). Other noninterest expense includes, but is not limited to, information technology costs, legal fees, consulting services, and audit fees. Salary and employee benefits rose by \$3.2 billion (6.3%) from a year ago. Full-time equivalent employees at FDIC-insured institutions rose by 1.1% from a year ago, while industry assets increased by 3.8%. Average assets per employee rose to \$8.4 million from \$8.2 million in fourth quarter 2016.

### Net Charge-Off Rate Increases Slightly

Banks charged off \$13.2 billion in uncollectable loans during the quarter, an increase of \$1 billion (8.6%) from a year ago. This marks a ninth consecutive quarter that net charge-offs increased. Less than half (45.3%) of all banks reported an annual increase in their quarterly net charge-offs. The increase in net charge-offs was led by credit card balances, which grew by \$1.1 billion (15.7%). Net charge-offs declined for commercial and industrial loans (down \$210.3 million, 8.6%), home equity loans (down \$178.1 million, or 68.6%), and residential mortgage loans (down \$68.3 million, or 36.4%). The average net charge-off rate rose from 0.52% in fourth quarter 2016 to 0.55%.

### Noncurrent Loan Rate Remains Stable

After declining for the past six consecutive quarters, noncurrent balances (90 days or more past due or in nonaccrual status) for total loans and leases increased by \$1.5 billion (1.3%) during the fourth quarter. The increase in noncurrent balances was led by residential mortgages (up 2.8 billion, or 5.2%) and credit cards (up \$1.2 billion, or 11.5%), and was partially offset by a decline in noncurrent commercial and industrial loans (down \$1.7 billion, or 8.5%). Despite the overall dollar increase, the average noncurrent loan rate remained unchanged at 1.20% from the previous quarter.

### Loan-Loss Reserves Increase From the Previous Quarter

Banks continued to increase their loan-loss reserves (up \$236.2 million, or 0.2%) during the quarter, as loan-loss provisions of \$13.6 billion exceeded net charge-offs of \$13.2 billion. Banks that itemize their reserves (banks with assets greater than \$1 billion) reported higher reserves for credit card losses (up \$1.9 billion, or 5.2%) from the previous quarter, and lower reserves for residential real estate losses (down \$827.2 million, or 5.4%) and commercial and industrial loan losses (down \$723.5 million, or 2.2%) during the quarter. The coverage ratio (loan-loss reserves to noncurrent loan balances) declined slightly to 106.3%, but has been above 100% for the past three quarters.

### Equity Capital Rises Modestly

Total equity capital increased by \$3.6 billion (0.2%) in fourth quarter 2017. Declared dividends of \$30.1 billion exceeded the quarterly net income of \$25.5 billion during the quarter, reducing retained earnings by \$4.6 billion. Accumulated other comprehensive income declined by \$8.5 billion in the quarter, which was led by a decline in the market value of available-for-sale securities. The equity-to-asset ratio declined to 11.22% from 11.31% in third quarter 2017, but remained above the year-ago ratio of 11.10%. At year-end 2017, 99.4% of all insured institutions, which account for 99.97% of total industry assets, met or exceeded the requirements for the highest regulatory capital category, as defined for Prompt Corrective Action purposes.

## Table of Contents

### Total Loan and Lease Balances Increase \$164.1 Billion During the Fourth Quarter

Total loan and lease balances increased by \$164.1 billion (1.7%) from third quarter 2017, as balances in all major loan categories increased. Credit card balances increased by \$69.6 billion (8.8%) from the previous quarter, commercial and industrial loans grew by \$24.5 billion (1.2%), and residential mortgage loans rose by \$21.7 billion (1.1%). Unused loan commitments were \$108.9 billion (1.5%) higher than the previous quarter, led by higher unused credit card lines (up \$57.7 billion, or 1.6%). Over the past 12 months, loan and lease balances increased by \$416.1 billion (4.5%), exceeding last quarter's annual growth rate of 3.5%. The 12-month increase in loan and lease balances was led by commercial and industrial loans (up \$78.4 billion, or 4.1%), residential mortgage loans (up \$68.7 million, or 3.4%), nonfarm nonresidential loans (up \$67.1 billion, or 5.1%), and credit card balances (up \$65.2 billion, or 8.2%). Home equity lines of credit continued with the year-over-year decline (down \$23 billion, or 5.3%). Unused loan commitments increased 4.4% from a year ago, the largest annual growth rate since third quarter 2016.

### Deposits Grew 1.4% From the Previous Quarter

Total deposits increased by \$179.8 billion (1.4%) in the fourth quarter. Balances in domestic interest-bearing accounts rose by \$153.7 billion (1.8%), and balances in noninterest-bearing accounts grew by \$7.8 billion (0.2%). Domestic deposits in accounts larger than \$250,000 increased by \$159.6 billion (2.5%) from third quarter 2017. Nondeposit liabilities declined by \$8.9 billion (0.4%), as other liabilities were down \$29.3 billion (7.3%).

### “Problem Bank List” Falls Below 100

The FDIC's Problem Bank List declined from 104 to 95 at year-end 2017, the lowest number of problem banks since first quarter 2008. Total assets of problem banks were down from \$16 billion in the third quarter to \$13.9 billion. During the quarter, merger transactions absorbed 64 institutions, two institutions failed, and one new charter was added. For full-year 2017, five new charters were added, 230 institutions were absorbed by mergers, and eight institutions failed.

## **Critical Accounting Policies**

The discussion contained in this Item 2 and other disclosures included within this report are based, in part, on the Company's audited December 31, 2017 consolidated financial statements. These statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The financial information contained in these statements is, for the most part, based on the financial effects of transactions and events that have

already occurred. However, the preparation of these statements requires management to make certain estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses.

The Company's significant accounting policies are described in the "Notes to Consolidated Financial Statements" accompanying the Company's audited financial statements. Based on its consideration of accounting policies that involve the most complex and subjective estimates and judgments, management has identified the allowance for loan losses, the assessment of other-than-temporary impairment for investment securities and the assessment of goodwill to be the Company's most critical accounting policies.

#### Allowance for Loan Losses

The allowance for loan losses is established through a provision for loan losses that is treated as an expense and charged against earnings. Loans are charged against the allowance for loan losses when management believes that collectability of the principal is unlikely. The Company has policies and procedures for evaluating the overall credit quality of its loan portfolio, including timely identification of potential problem loans. On a quarterly basis, management reviews the appropriate level for the allowance for loan losses, incorporating a variety of risk considerations, both quantitative and qualitative. Quantitative factors include the Company's historical loss experience, delinquency and charge-off trends, collateral values, known information about individual loans and other factors. Qualitative factors include various considerations regarding the general economic environment in the Company's market area. To the extent actual results differ from forecasts and management's judgment, the allowance for loan losses may be greater or lesser than future charge-offs. Due to potential changes in conditions, it is at least reasonably possible that changes in estimates will occur in the near term and that such changes could be material to the amounts reported in the Company's financial statements.

## Table of Contents

For further discussion concerning the allowance for loan losses and the process of establishing specific reserves, see the section of the Annual Report on Form 10-K entitled “Asset Quality Review and Credit Risk Management” and “Analysis of the Allowance for Loan Losses”.

### Fair Value and Other-Than-Temporary Impairment of Investment Securities

The Company’s securities available-for-sale portfolio is carried at fair value with “fair value” being defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability is not adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact, and (iv) willing to transact.

Declines in the fair value of available-for-sale securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the intent to sell the investment securities and the more likely than not requirement that the Company will be required to sell the investment securities prior to recovery (2) the length of time and the extent to which the fair value has been less than cost and (3) the financial condition and near-term prospects of the issuer. Due to potential changes in conditions, it is at least reasonably possible that changes in management’s assessment of other-than-temporary impairment will occur in the near term and that such changes could be material to the amounts reported in the Company’s financial statements.

### Goodwill

Goodwill arose in connection with two acquisitions consummated in previous periods. Goodwill is tested annually for impairment or more often if conditions indicate a possible impairment. For the purposes of goodwill impairment testing, determination of the fair value of a reporting unit involves the use of significant estimates and assumptions. Impairment would arise if the fair value of a reporting unit is less than its carrying value. At March 31, 2018, Company’s management has completed the goodwill impairment assessment and determined goodwill was not impaired. Actual future test results may differ from the present evaluation of impairment due to changes in the conditions used in the current evaluation.



Table of Contents**Non-GAAP Financial Measures**

This report contains references to financial measures that are not defined in GAAP. Such non-GAAP financial measures include the Company's presentation of net interest income and net interest margin on a fully taxable equivalent (FTE) basis. Management believes these non-GAAP financial measures provide useful information to both management and investors to analyze and evaluate the Company's financial performance. Limitations associated with non-GAAP financial measures include the risks that persons might disagree as to the appropriateness of items included in these measures and that different companies might calculate these measures differently. These non-GAAP disclosures should not be considered an alternative to the Company's GAAP results. The following table reconciles the non-GAAP financial measures of net interest income and net interest margin on an FTE basis to GAAP. (*dollars in thousands*)

	<b>Three Months Ended</b>			
	<b>March 31,</b>			
	<b>2018</b>		<b>2017</b>	
Reconciliation of net interest income and annualized net interest margin on an FTE basis to GAAP:				
Net interest income (GAAP)	\$ 10,186		\$ 9,883	
Tax-equivalent adjustment <sup>(1)</sup>	316		710	
Net interest income on an FTE basis (non-GAAP)	10,502		10,593	
Average interest-earning assets	\$ 1,318,775		\$ 1,322,438	
Net interest margin on an FTE basis (non-GAAP)	3.19	%	3.20	%

(1) Computed on a tax-equivalent basis using an incremental federal income tax rate of 21 percent for the three months ended March 31, 2018 and 35 percent for the three months ended March 31, 2017, adjusted to reflect the effect of the tax-exempt interest income associated with owning tax-exempt securities and loans.



Table of Contents**Income Statement Review for the Three Months ended March 31, 2018 and 2017**

The following highlights a comparative discussion of the major components of net income and their impact for the three months ended March 31, 2018 and 2017:

**AVERAGE BALANCES AND INTEREST RATES**

The following two tables are used to calculate the Company's net interest margin. The first table includes the Company's average assets and the related income to determine the average yield on earning assets. The second table includes the average liabilities and related expense to determine the average rate paid on interest bearing liabilities. The net interest margin is equal to the interest income less the interest expense divided by average earning assets.

**AVERAGE BALANCE SHEETS AND INTEREST RATES**

	<b>Three Months Ended March 31,</b>					
	<b>2018</b>			<b>2017</b>		
	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
<b>ASSETS</b>						
<i>(dollars in thousands)</i>						
Interest-earning assets						
Loans 1						
Commercial	\$73,424	\$ 868	4.73 %	\$75,103	\$ 814	4.34 %
Agricultural	68,557	968	5.65 %	67,383	835	4.95 %
Real estate	632,041	6,941	4.39 %	601,798	6,327	4.21 %
Consumer and other	8,827	112	5.07 %	11,619	140	4.83 %
Total loans (including fees)	782,849	8,889	4.54 %	755,903	8,116	4.29 %
Investment securities						
Taxable	272,013	1,557	2.29 %	267,419	1,513	2.26 %
Tax-exempt 2	226,429	1,502	2.65 %	249,353	2,028	3.25 %
Total investment securities	498,442	3,059	2.45 %	516,772	3,541	2.74 %
	37,484	165	1.76 %	49,763	137	1.10 %

Interest bearing deposits with banks and federal funds sold

Total interest-earning assets	1,318,775	\$ 12,113	3.67 %	1,322,438	\$ 11,794	3.57 %
Noninterest-earning assets	41,368			49,714		
<b>TOTAL ASSETS</b>	<b>\$1,360,143</b>			<b>\$1,372,152</b>		

1 Average loan balance includes nonaccrual loans, if any. Interest income collected on nonaccrual loans has been included.

2 Tax-exempt income has been adjusted to a tax-equivalent basis using an incremental tax rate for the three months ended March 31, 2018 and 2017 of 21% and 35%, respectively.

Table of Contents**AVERAGE BALANCE SHEETS AND INTEREST RATES**

	<b>Three Months Ended March 31,</b>					
	<b>2018</b>			<b>2017</b>		
	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>						
<i>(dollars in thousands)</i>						
Interest-bearing liabilities						
Deposits						
NOW, savings accounts and money markets	\$721,246	\$ 830	0.46 %	\$712,439	\$ 480	0.27 %
Time deposits > \$100,000	84,953	264	1.24 %	82,701	209	1.01 %
Time deposits < \$100,000	110,120	268	0.97 %	118,758	233	0.78 %
Total deposits	916,319	1,362	0.59 %	913,898	922	0.40 %
Other borrowed funds	59,626	248	1.67 %	79,035	279	1.41 %
Total Interest-bearing liabilities	975,945	1,611	0.66 %	992,934	1,201	0.48 %
Noninterest-bearing liabilities						
Demand deposits	206,726			204,661		
Other liabilities	8,423			7,768		
Stockholders' equity	169,049			166,790		
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$1,360,143</b>			<b>\$1,372,152</b>		
Net interest income		\$ 10,502	3.19 %		\$ 10,593	3.20 %
Spread Analysis						
Interest income/average assets	\$12,113	3.56 %		\$11,794	3.44 %	
Interest expense/average assets	\$1,611	0.47 %		\$1,201	0.35 %	
Net interest income/average assets	\$10,502	3.09 %		\$10,593	3.09 %	

## Net Interest Income

For the three months ended March 31, 2018 and 2017, the Company's net interest margin adjusted for tax exempt income was 3.19% and 3.20%, respectively. Net interest income, prior to the adjustment for tax-exempt income, for the three months ended March 31, 2018 totaled \$10,186,000 compared to \$9,883,000 for the three months ended March 31, 2017.

For the three months ended March 31, 2018, interest income increased \$714,000, or 6%, when compared to the same period in 2017. The increase from 2017 was primarily attributable to higher average balance of loans and recognition of nonaccrual interest income on loans. The higher average balances of loans and recognition of nonaccrual interest income was due primarily to favorable economic conditions in our market areas.

Interest expense increased \$410,000, or 34%, for the three months ended March 31, 2018 when compared to the same period in 2017. The higher interest expense for the period is primarily attributable to higher rates on deposits due to market interest rates and competitive pressures.

## Table of Contents

### Provision for Loan Losses

The Company's provision for loan losses was \$29,000 and \$398,000 for the three months ended March 31, 2018 and 2017, respectively. The growth in the loan portfolio was the primary factor for the provision for loan losses for the quarter ended March 31, 2017, with no significant growth in the loan portfolio for the quarter ended March 31, 2018. Net loan charge-offs were \$27,000 and \$3,000 for the three months ended March 31, 2018 and 2017, respectively. While the current provision for loan losses are not related to agricultural loans, the Iowa agricultural economy remains challenged as the result of the current low grain prices and potential tariff concerns on Iowa exports; however, favorable crop yields provided better than break even cash flows in 2017 even with low crop prices for most of the Company's farm customers.

### Noninterest Income and Expense

Noninterest income decreased \$300,000 for the three months ended March 31, 2018 compared to the same period in 2017. The decrease in noninterest income is primarily due to lower security gains, offset in part by higher wealth management income. The higher wealth management income was primarily due to higher one time estate fees. Exclusive of realized securities gains, noninterest income was 4% higher in the first quarter of 2018 compared to the same period in 2017.

Noninterest expense increased \$405,000 or 6% for the three months ended March 31, 2018 compared to the same period in 2017 primarily as a result of increases in salaries and employee benefits. This increase in salaries and benefits was primarily due to one-time \$1,000 bonus paid to full-time employees, increases in employee benefit costs, additional personnel and normal salary increases. The efficiency ratio was 57.45% for the first quarter of 2018 as compared to 54.14% in 2017.

### Income Taxes

The provision for income taxes expense for the three months ended March 31, 2018 and 2017 was \$1,020,000 and \$1,479,000, respectively, representing an effective tax rate of 20% and 29%, respectively. The expected combined federal and state tax rate was 25% and 37% for the three months ended March 31, 2018 and 2017, respectively. The lower expected tax rate in 2018 is due to the enactment of the Tax Cut and Jobs Act Bill on December 22, 2017. The lower than effective tax rate for both periods is primarily due to tax-exempt interest income.

### **Balance Sheet Review**

As of March 31, 2018, total assets were \$1,391,779,000, a \$16,720,000 increase compared to December 31, 2017. The increase in assets was due primarily to an increase in interest bearing deposits in financial institutions, offset by a decrease in securities available for sale. This increase in assets was funded primarily by an increase in deposits, offset by a decrease in FHLB advances and other borrowings.

#### Investment Portfolio

The investment portfolio totaled \$489,091,000 as of March 31, 2018, a decrease of \$6,231,000 from the December 31, 2017 balance of \$495,322,000. The decrease in the investment portfolio was primarily due to payments on U.S. government mortgage-backed securities and an increase in the net unrealized loss on the investment portfolio.

Table of Contents

On a quarterly basis, the investment portfolio is reviewed for other-than-temporary impairment. As of March 31, 2018, gross unrealized losses of \$6,636,000, are considered to be temporary in nature due to the interest rate environment of 2018 and other general economic factors. As a result of the Company's favorable liquidity position, the Company does not have the intent to sell securities with an unrealized loss at the present time. In addition, management believes it is more likely than not that the Company will hold these securities until recovery of their fair value to cost basis and avoid considering present unrealized loss positions to be other-than-temporary.

At March 31, 2018, the Company's investment securities portfolio included securities issued by 259 government municipalities and agencies located within 21 states with a fair value of \$235.5 million. At December 31, 2017, the Company's investment securities portfolio included securities issued by 272 government municipalities and agencies located within 25 states with a fair value of \$261.6 million. No one municipality or agency represents a concentration within this segment of the investment portfolio. The largest exposure to any one municipality or agency as of March 31, 2018 was \$4.3 million (approximately 2.0% of the fair value of the governmental municipalities and agencies) represented by the Dubuque, Iowa Community School District to be repaid by sales tax revenues and property taxes.

The Company's procedures for evaluating investments in states, municipalities and political subdivisions include but are not limited to reviewing the offering statement and the most current available financial information, comparing yields to yields of bonds of similar credit quality, confirming capacity to repay, assessing operating and financial performance, evaluating the stability of tax revenues, considering debt profiles and local demographics, and for revenue bonds, assessing the source and strength of revenue structures for municipal authorities. These procedures, as applicable, are utilized for all municipal purchases and are utilized in whole or in part for monitoring the portfolio of municipal holdings. The Company does not utilize third party credit rating agencies as a primary component of determining if the municipal issuer has an adequate capacity to meet the financial commitments under the security for the projected life of the investment, and, therefore, does not compare internal assessments to those of the credit rating agencies. Credit rating downgrades are utilized as an additional indicator of credit weakness and as a reference point for historical default rates.

Table of Contents

The following table summarizes the total general obligation and revenue bonds in the Company's investment securities portfolios as of March 31, 2018 and December 31, 2017 identifying the state in which the issuing government municipality or agency operates. (*Dollars in thousands*)

	<b>2018</b>		<b>2017</b>	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Obligations of states and political subdivisions:				
General Obligation bonds:				
Iowa	\$57,516	\$56,906	\$56,029	\$55,829
Texas	11,567	11,497	12,141	12,174
Pennsylvania	8,721	8,682	8,719	8,745
Washington	6,989	6,773	7,017	6,900
Other (2018: 14 states; 2017: 18 states)	21,003	21,092	22,023	22,228
<b>Total general obligation bonds</b>	<b>\$105,796</b>	<b>\$104,950</b>	<b>\$105,929</b>	<b>\$105,876</b>
Revenue bonds:				
Iowa	\$121,720	\$121,021	\$122,044	\$122,140
Other (2018: 9 states; 2017: 9 states)	9,635	9,575	9,376	9,397
<b>Total revenue bonds</b>	<b>\$131,355</b>	<b>\$130,596</b>	<b>\$131,420</b>	<b>\$131,537</b>
<b>Total obligations of states and political subdivisions</b>	<b>\$237,151</b>	<b>\$235,546</b>	<b>\$237,349</b>	<b>\$237,413</b>

As of March 31, 2018 and December 31, 2017, the revenue bonds in the Company's investment securities portfolios were issued by government municipalities and agencies to fund public services such as community school facilities, college and university dormitory facilities, water utilities and electrical utilities. The revenue bonds are to be paid from primarily 5 revenue sources. The revenue sources that represent 5% or more, individually, as a percent of the total revenue bonds are summarized in the following table. (*in thousands*)

	<b>2018</b>		<b>2017</b>	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Revenue bonds by revenue source				
Sales tax	\$73,661	\$73,616	\$74,631	\$74,973
Water	12,754	12,484	12,763	12,611



Edgar Filing: AMES NATIONAL CORP - Form 10-Q

College and universities, primarily dormitory revenues	10,678	10,630	10,452	10,443
Leases	9,571	9,453	9,383	9,331
Electric	7,377	7,359	7,382	7,416
Other	17,314	17,054	16,809	16,763
Total revenue bonds by revenue source	\$131,355	\$130,596	\$131,420	\$131,537

Loan Portfolio

The loan portfolio, net of the allowance for loan losses, totaled \$772,495,000, \$771,550,000 and \$759,786,000 as of March 31, 2018, December 31, 2017 and March 31, 2017, respectively. Loan demand has softened in the first quarter of 2018.

Deposits

Deposits totaled \$1,170,424,000, \$1,134,391,000 and \$1,141,672,000 as of March 31, 2018, December 31, 2017 and March 31, 2017, respectively. The increase in deposits since December 31, 2017 was primarily due to increases in public funds NOW account balances, retail savings account balances and public funds money market account balances. The increase in deposits since March 31, 2017 was primarily due to increases in commercial and retail NOW account balances, and retail demand deposit account balances.

Table of Contents

Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase totaled \$36,534,000 as of March 31, 2018, a decrease of \$891,000, or 2%, from the December 31, 2017 balance of \$37,425,000.

Off-Balance Sheet Arrangements

The Company is party to financial instruments with off-balance-sheet risk in the normal course of business. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. No material changes in the Company's off-balance sheet arrangements have occurred since December 31, 2017.

**Asset Quality Review and Credit Risk Management**

The Company's credit risk is historically centered in the loan portfolio, which on March 31, 2018 totaled \$772,495,000 compared to \$771,550,000 as of December 31, 2017. Net loans comprise 56% of total assets as of March 31, 2018. The object in managing loan portfolio risk is to reduce the risk of loss resulting from a customer's failure to perform according to the terms of a transaction and to quantify and manage credit risk on a portfolio basis. The Company's level of problem loans (consisting of nonaccrual loans and loans past due 90 days or more) as a percentage of total loans was 0.55% at March 31, 2018, as compared to 0.62% at December 31, 2017 and 0.70% at March 31, 2017. The Company's level of problem loans as a percentage of total loans at March 31, 2018 of 0.55% is slightly lower than the Company's peer group (319 bank holding companies with assets of \$1 billion to \$3 billion) of 0.66% as of December 31, 2017.

Impaired loans, net of specific reserves, totaled \$3,485,000 as of March 31, 2018 and have decreased \$514,000 as compared to the impaired loans of \$3,999,000 as of December 31, 2017.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payment of principal and interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. The Company applies its normal loan review procedures to identify loans that should be evaluated for impairment.

The Company had TDRs of \$2,814,000 as of March 31, 2018, all of which were included in impaired and nonaccrual loans. The Company had TDRs of \$2,984,000 as of December 31, 2017, all of which were included in impaired and nonaccrual loans.

TDRs are monitored and reported on a quarterly basis. Certain TDRs are on nonaccrual status at the time of restructuring. These borrowings are typically returned to accrual status after the following: sustained repayment performance in accordance with the restructuring agreement for a reasonable period of at least six months; and, management is reasonably assured of future performance. If the TDR meets these performance criteria and the interest rate granted at the modification is equal to or greater than the rate that the Company was willing to accept at the time of the restructuring for a new loan with comparable risk, then the loan will return to performing status.

## Table of Contents

For TDRs that were on nonaccrual status before the modification, a specific reserve may already be recorded. In periods subsequent to modification, the Company will continue to evaluate all TDRs for possible impairment and, as necessary, recognize impairment through the allowance. A \$12,000 specific reserve was established in the three months ended March 31, 2018 on a TDR loan. The Company had no net charge-offs related to TDRs for the three months ended March 31, 2018 and 2017.

Loans past due 90 days or more that are still accruing interest are reviewed no less frequently than quarterly to determine if there continues to be a strong reason that the credit should not be placed on non-accrual. As of March 31, 2018, non-accrual loans totaled \$4,279,000 and there were no loans past due 90 days and still accruing. This compares to non-accrual loans of \$4,812,000 and loans past due 90 days and still accruing totaled \$18,000 as of December 31, 2017. Other real estate owned totaled \$386,000 as of March 31, 2018 and December 31, 2017.

The agricultural real estate and agricultural operating loan portfolio classifications remain elevated as a result of lower grain prices. The watch and special mention loans in these categories totaled \$38,929,000 as of March 31, 2018 as compared to \$42,754,000 as of December 31, 2017. The substandard loans in these categories totaled \$7,602,000 as of March 31, 2018 as compared to \$2,725,000 as of December 31, 2017. While substandard loan volume increased for the Company's agricultural borrowers; favorable crop yields provided better than break even cash flows in 2017 even with low crop prices, for most of the Company's farm customers.

The allowance for loan losses as a percentage of outstanding loans as of March 31, 2018 was 1.44%, as compared to 1.45% at December 31, 2017. The allowance for loan losses totaled \$11,323,000 and \$11,321,000 as of March 31, 2018 and December 31, 2017, respectively. Net charge-offs of loans totaled \$27,000 and \$3,000 for the three months ended March 31, 2018 and 2017, respectively.

The allowance for loan losses is management's best estimate of probable losses inherent in the loan portfolio as of the balance sheet date. Factors considered in establishing an appropriate allowance include: an assessment of the financial condition of the borrower, a realistic determination of value and adequacy of underlying collateral, the condition of the local economy and the condition of the specific industry of the borrower, an analysis of the levels and trends of loan categories and a review of delinquent and classified loans.

## **Liquidity and Capital Resources**

Liquidity management is the process by which the Company, through its Banks' Asset and Liability Committees (ALCO), ensures that adequate liquid funds are available to meet its financial commitments on a timely basis, at a reasonable cost and within acceptable risk tolerances. These commitments include funding credit obligations to borrowers, funding of mortgage originations pending delivery to the secondary market, withdrawals by depositors,

maintaining adequate collateral for pledging for public funds, trust deposits and borrowings, paying dividends to shareholders, payment of operating expenses, funding capital expenditures and maintaining deposit reserve requirements.

Liquidity is derived primarily from core deposit growth and retention; principal and interest payments on loans; principal and interest payments, sale, maturity and prepayment of securities available-for-sale; net cash provided from operations; and access to other funding sources. Other funding sources include federal funds purchased lines, FHLB advances and other capital market sources.

As of March 31, 2018, the level of liquidity and capital resources of the Company remain at a satisfactory level. Management believes that the Company's liquidity sources will be sufficient to support its existing operations for the foreseeable future.

Table of Contents

The liquidity and capital resources discussion will cover the following topics:

Review of the Company's Current Liquidity Sources

Review of Statements of Cash Flows

Company Only Cash Flows

Review of Commitments for Capital Expenditures, Cash Flow Uncertainties and Known Trends in Liquidity and Cash Flows Needs

Capital Resources

Review of the Company's Current Liquidity Sources

Liquid assets of cash and due from banks and interest-bearing deposits in financial institutions as of March 31, 2018 and December 31, 2017 totaled \$91,317,000 and \$69,420,000, respectively, and provide an adequate level of liquidity given current economic conditions.

Other sources of liquidity available to the Banks as of March 31, 2018 include outstanding lines of credit with the FHLB of Des Moines, Iowa of \$184,934,000, with \$2,000,000 of outstanding FHLB advances. Federal funds borrowing capacity at correspondent banks was \$109,794,000, with no outstanding federal fund purchase balances as of March 31, 2018. The Company had securities sold under agreements to repurchase totaling \$36,534,000 and term repurchase agreements of \$7,000,000 as of March 31, 2018.

Total investments as of March 31, 2018 were \$489,091,000 compared to \$495,322,000 as of December 31, 2017. These investments provide the Company with a significant amount of liquidity since all of the investments are classified as available-for-sale as of March 31, 2018.

The investment portfolio serves an important role in the overall context of balance sheet management in terms of balancing capital utilization and liquidity. The decision to purchase or sell securities is based upon the current assessment of economic and financial conditions, including the interest rate environment, liquidity and credit considerations. The portfolio's scheduled maturities and payments represent a significant source of liquidity.

Review of Statements of Cash Flows

Net cash provided by operating activities for the three months ended March 31, 2018 totaled \$6,353,000 compared to \$6,242,000 for the three months ended March 31, 2017. The increase in cash provided by operating activities was primarily due to higher net income.

Net cash used in investing activities for the three months ended March 31, 2018 was \$25,859,000 compared to \$33,220,000 for the three months ended March 31, 2017. The decrease of \$7,361,000 in cash used in investing activities was primarily due to lower purchases of securities of \$10,943,000 and a net decrease in the change in the loan portfolio of \$7,183,000, offset in part by a net increase in the change in the interest bearing deposits of \$8,186,000.

Net cash provided by financing activities for the three months ended March 31, 2018 totaled \$15,594,000 compared to \$22,344,000 for the three months ended March 31, 2017. The change of \$6,750,000 in net cash provided by financing activities was primarily due to repayments on FHLB and other borrowings, offset in part by a net decrease in the change in the securities sold under agreements to repurchase. As of March 31, 2018, the Company did not have any external debt financing, off-balance sheet financing arrangements, or derivative instruments linked to its stock.

## Table of Contents

### Company Only Cash Flows

The Company's liquidity on an unconsolidated basis is heavily dependent upon dividends paid to the Company by the Banks. The Banks provide adequate liquidity to pay the Company's expenses and stockholder dividends. Dividends paid by the Banks to the Company amounted to \$2,570,000 and \$2,600,000 for the three months ended March 31, 2018 and 2017, respectively. Various federal and state statutory provisions limit the amounts of dividends banking subsidiaries are permitted to pay to their holding companies without regulatory approval. Federal Reserve policy further limits the circumstances under which bank holding companies may declare dividends. For example, a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition. In addition, the Federal Reserve and the FDIC have issued policy statements, which provide that insured banks and bank holding companies should generally pay dividends only out of current operating earnings. Federal and state banking regulators may also restrict the payment of dividends by order. The quarterly dividend declared by the Company increased to \$0.23 per share in 2018 from \$0.22 per share in 2017. The company also declared a one-time dividend of \$0.25 per share in 2018.

The Company, on an unconsolidated basis, has interest bearing deposits totaling \$14,415,000 as of March 31, 2018 that are presently available to provide additional liquidity to the Banks.

### Review of Commitments for Capital Expenditures, Cash Flow Uncertainties and Known Trends in Liquidity and Cash Flows Needs

No other material capital expenditures or material changes in the capital resource mix are anticipated at this time. The primary cash flow uncertainty would be a sudden decline in deposits causing the Banks to liquidate securities. Historically, the Banks have maintained an adequate level of short-term marketable investments to fund the temporary declines in deposit balances. There are no known trends in liquidity and cash flow needs as of March 31, 2018 that are of concern to management.

### Capital Resources

The Company's total stockholders' equity as of March 31, 2018 totaled \$166,546,000 and was \$4,207,000 lower than the \$170,753,000 recorded as of December 31, 2017. The decrease in stockholders' equity was primarily due an increase in other comprehensive loss and dividends declared, offset in part by net income. The increase in other comprehensive loss is created by higher market interest rates compared to December 31, 2017, which resulted in lower fair values in the securities available-for-sale portfolio. At March 31, 2018 and December 31, 2017, stockholders' equity as a percentage of total assets was 11.97% and 12.42%, respectively. The capital levels of the



Company exceed applicable regulatory guidelines as of March 31, 2018.

### **Forward-Looking Statements and Business Risks**

The Private Securities Litigation Reform Act of 1995 provides the Company with the opportunity to make cautionary statements regarding forward-looking statements contained in this Quarterly Report, including forward-looking statements concerning the Company's future financial performance and asset quality. Any forward-looking statement contained in this Quarterly Report is based on management's current beliefs, assumptions and expectations of the Company's future performance, taking into account all information currently available to management. These beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to management. If a change occurs, the Company's business, financial condition, liquidity, results of operations, asset quality, plans and objectives may vary materially from those expressed in the forward-looking statements. The risks and uncertainties that may affect the actual results of the Company include, but are not limited to, the following: economic conditions, particularly in the concentrated geographic area in which the Company and its affiliate banks operate; competitive products and pricing available in the marketplace; changes in credit and other risks posed by the Company's loan and investment portfolios, including declines in commercial or residential real estate values or changes in the allowance for loan losses dictated by new market conditions or regulatory requirements; fiscal and monetary policies of the U.S. government; changes in governmental regulations affecting financial institutions (including regulatory fees and capital requirements); changes in prevailing interest rates; credit risk management and asset/liability management; the financial and securities markets; the availability of and cost associated with sources of liquidity; and other risks and uncertainties inherent in the Company's business, including those discussed under the headings "Risk Factors" and "Forward-Looking Statements and Business Risks" in the Company's Annual Report. Management intends to identify forward-looking statements when using words such as "believe", "expect", "intend", "anticipate", "estimate", "should" or similar expressions. Undue reliance should not be placed on these forward-looking statements. The Company undertakes no obligation to revise or update such forward-looking statements to reflect current events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's market risk is comprised primarily of interest rate risk arising from its core banking activities of lending and deposit taking. Interest rate risk results from the changes in market interest rates which may adversely affect the Company's net interest income. Management continually develops and applies strategies to mitigate this risk. Management does not believe that the Company's primary market risk exposure and how it has been managed year-to-date in 2018 changed significantly when compared to 2017.

Item 4. Controls and Procedures

As of the end of the period covered by this report, an evaluation was performed under the supervision and with the participation of the Company's management, including the Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended). Based on that evaluation, the Company's management, including the Principal Executive Officer and Principal Financial Officer, concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms.

There was no change in the Company's internal control over financial reporting that occurred during the Company's last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Not applicable

Item 1.A. Risk Factors

None.

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

In November, 2017, the Company approved a Stock Repurchase Plan which provided for the repurchase of up to 100,000 shares of the Company's common stock. As of March 31, 2018, there were 100,000 shares remaining to be purchased under the plan.

45

---

Table of Contents

The following table provides information with respect to purchase made by or on behalf of the Company or any “affiliated purchases” (as defined in rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of the Company’s common stock during the three months ended March 31, 2018.

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid Per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans</b>	<b>Maximum Number of Shares that May Yet Be Purchased Under The Plan</b>
January 1, 2018 to January 31, 2018	-	\$ -	-	100,000
February 1, 2018 to February 28, 2018	-	\$ -	-	100,000
March 1, 2018 to March 31, 2018	-	\$ -	-	100,000
Total	-		-	

## Item 3. Defaults Upon Senior Securities

Not applicable

## Item 4. Mine Safety Disclosures

Not applicable

## Item 5. Other information

Not applicable

46

---

Table of Contents

Item 6. Exhibits

- 2 Stock purchase agreement, dated April 19, 2018, between First National Bank, Ames, Iowa and United Bancorporation and Clarke County State Bank.
- 31.1 Certification of Principal Executive Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Principal Financial Officer Pursuant to Section 302 of Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350.
- 32.2 Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350.
  
- 101.INS XBRL Instance Document (1)
- 101.SCH XBRL Taxonomy Extension Schema Document (1)
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document (1)
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document (1)
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document (1)
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document (1)

(1) These interactive data files shall not be deemed filed for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under those sections.

Table of Contents

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.

AMES NATIONAL CORPORATION

DATE: May 8, 2018

By: /s/ Thomas H. Pohlman

Thomas H. Pohlman, Chief Executive Officer and President

By: /s/ John P. Nelson

John P. Nelson, Chief Financial Officer and Executive Vice President

Table of Contents

EXHIBIT INDEX

The following exhibits are filed herewith:

<u>Exhibit No.</u>	Description
2	Stock purchase agreement, dated April 19, 2018, between First National Bank, Ames, Iowa and United Bancorporation and Clarke County State Bank.
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes Oxley Act of 2002
32.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350
32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350
101.INS	XBRL Instance Document (1)
101.SCH	XBRL Taxonomy Extension Schema Document (1)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document (1)
101.LAB	XBRL Taxonomy Extension Label Linkbase Document (1)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document (1)
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document (1)

(1) These interactive data files shall not be deemed filed for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under those sections.