

FIRST COMMUNITY CORP /SC/  
Form 10-Q  
May 09, 2018

**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 No. 000-28344**

**FIRST COMMUNITY CORPORATION**

(Exact name of registrant as specified in its charter)

South Carolina

(State or other jurisdiction of incorporation

or organization)

57-1010751

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

5455 Sunset Boulevard, Lexington, South Carolina 29072

(Address of principal executive offices) (Zip Code)

(803) 951-2265

(Registrant's telephone number, including area code)

(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 (§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, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company”, and “emerging growth company” in Rule 12b-2 of the Exchange Act.

|  |   |
|--|---|
| Large accelerated filer <input type="checkbox"/>   | Accelerated filer <input checked="" type="checkbox"/> |
| Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company <input type="checkbox"/>    |
|  | Emerging growth company <input type="checkbox"/>      |

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(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date: On May 9, 2018, 7,600,690 shares of the issuer’s common stock, par value \$1.00 per share, were issued and outstanding.

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**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements****FIRST COMMUNITY CORPORATION****CONSOLIDATED BALANCE SHEETS**

| (Dollars in thousands, except par value)  | March 31,<br>2018<br>(Unaudited) | December 31,<br>2017 |
|---|----------------------------------|----------------------|
| <b>ASSETS</b>   |                                  |                      |
| Cash and due from banks   | \$ 13,231                        | \$ 14,803            |
| Interest-bearing bank balances  | 25,081                           | 15,186               |
| Federal funds sold and securities purchased under agreements to resell  | 602                              | 602                  |
| Investment securities held-to-maturity  | 16,966                           | 17,012               |
| Investment securities available-for-sale  | 253,715                          | 264,824              |
| Other investments, at cost  | 1,956                            | 2,559                |
| Loans held for sale   | 7,546                            | 5,093                |
| Loans   | 668,583                          | 646,805              |
| Less, allowance for loan losses   | 5,986                            | 5,797                |
| Net loans   | 662,597                          | 641,008              |
| Property, furniture and equipment - net   | 34,816                           | 36,103               |
| Bank owned life insurance   | 25,230                           | 25,413               |
| Other real estate owned   | 1,887                            | 1,934                |
| Intangible assets   | 2,427                            | 2,569                |
| Goodwill  | 14,589                           | 14,589               |
| Other assets  | 9,896                            | 9,036                |
| Total assets  | \$ 1,070,539                     | \$ 1,050,731         |
| <b>LIABILITIES</b>  |                                  |                      |
| Deposits:   |                                  |                      |
| Non-interest bearing  | \$ 238,132                       | \$ 226,546           |
| Interest bearing  | 681,766                          | 661,777              |
| Total deposits  | 919,898                          | 888,323              |
| Securities sold under agreements to repurchase  | 21,959                           | 19,270               |
| Federal Home Loan Bank advances   | 245                              | 14,250               |
| Junior subordinated debt  | 14,964                           | 14,964               |
| Other liabilities   | 7,990                            | 8,261                |
| Total liabilities   | 965,056                          | 945,068              |
| <b>SHAREHOLDERS' EQUITY</b>   |                                  |                      |
| Preferred stock, par value \$1.00 per share, 10,000,000 shares authorized; none issued and outstanding  | —                                | —                    |
| Common stock, par value \$1.00 per share; 10,000,000 shares authorized; issued and outstanding 7,600,690 at March 31, 2018 7,587,918 at December 31, 2017 | 7,600                            | 7,588                |
| Common stock warrants issued  | 46                               | 46                   |
| Nonvested restricted stock  | (318)                            | (109)                |

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|  |              |              |
|--|--------------|--------------|
| Additional paid in capital                 | 94,773       | 94,516       |
| Retained earnings                          | 6,018        | 4,066        |
| Accumulated other comprehensive loss       | (2,636 )     | (444 )       |
| Total shareholders' equity                 | 105,483      | 105,663      |
| Total liabilities and shareholders' equity | \$ 1,070,539 | \$ 1,050,731 |

See Notes to Consolidated Financial Statements

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FIRST COMMUNITY CORPORATION  
CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited)

| (Dollars in thousands, except per share amounts)                     | Three Months ended March 31, |          |
|--|------------------------------|----------|
|  | 2018                         | 2017     |
| Interest and dividend income:  |                              |          |
| Loans, including fees  | \$ 7,617                     | \$ 6,326 |
| Investment securities - taxable                                      | 1,185                        | 945      |
| Investment securities - non taxable                                  | 458                          | 473      |
| Federal funds sold and securities purchased under resale agreements  | 66                           | 19       |
| Other  | 5                            | 10       |
| Total interest income  | 9,331                        | 7,773    |
| Interest expense:  |                              |          |
| Deposits   | 547                          | 442      |
| Federal funds sold and securities sold under agreement to repurchase | 41                           | 10       |
| Other borrowed money   | 209                          | 260      |
| Total interest expense   | 797                          | 712      |
| Net interest income  | 8,534                        | 7,061    |
| Provision for loan losses  | 202                          | 116      |
| Net interest income after provision for loan losses                  | 8,332                        | 6,945    |
| Non-interest income:   |                              |          |
| Deposit service charges  | 463                          | 320      |
| Mortgage banking income  | 951                          | 670      |
| Investment advisory and non-deposit commissions                      | 383                          | 258      |
| Gain (loss) on sale of securities                                    | (104                         | ) 54     |
| Gain on sale of other real estate owned                              | 15                           | 20       |
| Loss on early extinguishment of debt                                 | —                            | (58      |
| Other  | 923                          | 714      |
| Total non-interest income  | 2,631                        | 1,978    |
| Non-interest expense:  |                              |          |
| Salaries and employee benefits                                       | 4,577                        | 4,086    |
| Occupancy  | 614                          | 527      |
| Equipment  | 381                          | 446      |
| Marketing and public relations                                       | 89                           | 221      |
| FDIC Assessment  | 81                           | 78       |
| Other real estate expense  | 18                           | 27       |
| Amortization of intangibles  | 142                          | 75       |
| Other  | 1,692                        | 1,260    |
| Total non-interest expense   | 7,594                        | 6,720    |
| Net income before tax  | 3,369                        | 2,203    |
| Income taxes   | 660                          | 447      |
| Net income   | \$ 2,709                     | \$ 1,756 |
| Basic earnings per common share                                      | \$ 0.36                      | \$ 0.27  |
| Diluted earnings per common share                                    | \$ 0.35                      | \$ 0.26  |

See Notes to Consolidated Financial Statements



**FIRST COMMUNITY CORPORATION****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Unaudited)**

(Dollars in thousands)

|  | Three months ended March<br>31, |          |
|--|---------------------------------|----------|
|  | 2018                            | 2017     |
| Net income   | \$ 2,709                        | \$ 1,756 |
| Other comprehensive income (loss):   |                                 |          |
| Unrealized (loss) gain during the period on available-for-sale securities, net of tax of \$605 and \$206, respectively                               | (2,274 )                        | 399      |
| Less: Reclassification adjustment for loss (gain) on available-for-sale securities included in net income, net of tax of \$22 and \$18, respectively | 82                              | (36 )    |
| Other comprehensive income (loss)  | (2,192 )                        | 363      |
| Comprehensive income   | \$ 517                          | \$ 2,119 |

See Notes to Consolidated Financial Statements



**FIRST COMMUNITY CORPORATION**  
**Consolidated Statements of Changes in Shareholders' Equity**  
**Three Months ended March 31, 2018 and March 31, 2017**  
**(Unaudited)**

| (Dollars in thousands)                                  | Common<br>Shares<br>Issued | Common<br>Stock | Common<br>Stock<br>Warrant | Additional<br>Paid-in<br>Capital | Nonvested<br>Restricted<br>Stock | Retained<br>Earnings<br>(Deficit) | Accumulated<br>Other<br>Comprehensive<br>Income<br>(loss) | Total      |
|---|----------------------------|-----------------|----------------------------|----------------------------------|----------------------------------|-----------------------------------|---|------------|
| Balance December 31, 2016                               | 6,708                      | \$ 6,708        | \$ 46                      | \$ 75,991                        | \$ (220 )                        | \$ 573                            | \$ (1,237 )   | \$ 81,861  |
| Net income  |                            |                 |                            |                                  |                                  | 1,756                             |   | 1,756      |
| Other comprehensive income<br>net of tax of \$188       |                            |                 |                            |                                  |                                  |                                   | 363   | 363        |
| Issuance of restricted stock                            | 5                          | 5               |                            | 100                              | (105 )                           |                                   |   | —          |
| Amortization of compensation<br>on restricted stock     |                            |                 |                            |                                  | 60                               |                                   |   | 60         |
| Shares forfeited  | (2 )                       | (2 )            |                            | (27 )                            | 9                                |                                   |   | (20 )      |
| Shares retired  | (19 )                      | (19 )           |                            | (369 )                           |                                  |                                   |   | (388 )     |
| Dividends: Common (\$0.09 per<br>share)                 |                            |                 |                            |                                  |                                  | (597 )                            |   | (597 )     |
| Dividend reinvestment plan                              | 5                          | 5               |                            | 91                               |                                  |                                   |   | 96         |
| Balance March 31, 2017                                  | 6,697                      | \$ 6,697        | \$ 46                      | \$ 75,786                        | \$ (256 )                        | \$ 1,732                          | \$ (874 )   | \$ 83,131  |
| Balance December 31, 2017                               | 7,588                      | \$ 7,588        | \$ 46                      | \$ 94,516                        | \$ (109 )                        | \$ 4,066                          | \$ (444 )   | \$ 105,663 |
| Net income  |                            |                 |                            |                                  |                                  | 2,709                             |   | 2,709      |
| <b>Other comprehensive loss net<br/>of tax of \$583</b> |                            |                 |                            |                                  |                                  |                                   | (2,192 )  | (2,192 )   |
| Issuance of restricted stock                            | 11                         | 11              |                            | 233                              | (244 )                           |                                   |   | —          |
| Amortization of compensation<br>on restricted stock     |                            |                 |                            |                                  | 35                               |                                   |   | 35         |
| Shares retired  | (2 )                       | (2 )            |                            | (55 )                            |                                  |                                   |   | (57 )      |
| Dividends: Common (\$0.10 per<br>share)                 |                            |                 |                            |                                  |                                  | (757 )                            |   | (757 )     |
| Dividend reinvestment plan                              | 3                          | 3               |                            | 79                               |                                  |                                   |   | 82         |
| Balance March 31, 2018                                  | 7,600                      | \$ 7,600        | \$ 46                      | \$ 94,773                        | \$ (318 )                        | \$ 6,018                          | \$ (2,636 )   | \$ 105,483 |

See Notes to Consolidated Financial Statements

FIRST COMMUNITY CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

|   | Three months ended<br>March 31, |          |
|---|---------------------------------|----------|
| (Dollars in thousands)  | 2018                            | 2017     |
| Cash flows from operating activities:   |                                 |          |
| Net income  | \$2,709                         | \$1,756  |
| Adjustments to reconcile net income to net cash provided from operating activities: |                                 |          |
| Depreciation  | 374                             | 357      |
| Premium amortization  | 727                             | 871      |
| Provision for loan losses   | 202                             | 116      |
| Write-down of other real estate owned   | —                               | 11       |
| Gain on sale of other real estate owned   | (15 )                           | (20 )    |
| Origination of loans held-for-sale  | (26,734)                        | (19,162) |
| Sale of loans held-for-sale   | 24,280                          | 20,678   |
| Amortization of intangibles   | 142                             | 75       |
| Accretion on acquired loans   | (77 )                           | (70 )    |
| Writedown of land held for sale   | 42                              | 90       |
| Loss (gain) on sale of securities   | 104                             | (54 )    |
| Loss on extinguishment of debt  | —                               | 58       |
| Gain on sale of fixed assets  | (123 )                          | —        |
| (Increase) decrease in other assets   | (59 )                           | 5,768    |
| Decrease in other liabilities   | (272 )                          | (1,512 ) |
| Net cash provided from operating activities   | 1,300                           | 8,962    |
| Cash flows from investing activities:   |                                 |          |
| Purchase of investment securities available-for-sale                                | (10,505)                        | (1,733 ) |
| Maturity/call of investment securities available-for-sale                           | 12,457                          | 8,679    |
| Proceeds from sale of securities available-for-sale                                 | 5,605                           | 2,414    |
| Proceeds from sale of other securities  | 603                             | 314      |
| Increase in loans   | (21,747)                        | (8,596 ) |
| Proceeds from sale of other real estate owned                                       | 62                              | 5        |
| Proceeds from sale of fixed assets  | 1,143                           | —        |
| Purchase of property and equipment  | (149 )                          | (1,379 ) |
| Net cash used in investing activities   | (12,531)                        | (296 )   |
| Cash flows from financing activities:   |                                 |          |
| Increase in deposit accounts  | 31,602                          | 9,003    |
| Increase (decrease) in securities sold under agreements to repurchase               | 2,689                           | (139 )   |
| Advances from the Federal Home Loan Bank  | —                               | 14,000   |
| Repayment of advances from Federal Home Loan Bank                                   | (14,005)                        | (22,563) |
| Shares forfeited  | —                               | (20 )    |
| Shares retired  | (57 )                           | (388 )   |
| Dividends paid: Common Stock  | (757 )                          | (597 )   |
| Dividend reinvestment plan  | 82                              | 96       |
| Net cash provided (used) from financing activities                                  | 19,554                          | (608 )   |
| Net increase in cash and cash equivalents   | 8,323                           | 8,058    |
| Cash and cash equivalents at beginning of period                                    | 30,591                          | 21,999   |
| Cash and cash equivalents at end of period  | \$38,914                        | \$30,057 |

Supplemental disclosure:

Cash paid during the period for:

|              |       |       |
|--------------|-------|-------|
| Interest     | \$797 | \$705 |
| Income taxes | \$—   | \$275 |

Non-cash investing and financing activities:

|  |            |       |
|--|------------|-------|
| Unrealized gain (loss) on securities     | \$(2,192 ) | \$363 |
| Transfer of loans to foreclosed property | \$—        | \$26  |

See Notes to Consolidated Financial Statements

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**Notes to Consolidated Financial Statements (Unaudited)**

*Note 1—Basis of Presentation*

In the opinion of management, the accompanying unaudited consolidated balance sheets, and the consolidated statements of income, comprehensive income, changes in shareholders' equity, and the cash flows of First Community Corporation (the "Company"), present fairly in all material respects the Company's financial position at March 31, 2018 and December 31, 2017, and the Company's results of operations and cash flows for the three months ended March 31, 2018 and 2017. The results of operations for the three months ended March 31, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018.

In the opinion of management, all adjustments necessary to fairly present the consolidated financial position and consolidated results of operations have been made. All such adjustments are of a normal, recurring nature. All significant intercompany accounts and transactions have been eliminated in consolidation. The consolidated financial statements and notes thereto are presented in accordance with the instructions for Form 10-Q. The information included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 should be referred to in connection with these unaudited interim financial statements.

*Note 2—Earnings Per Common Share*

The following reconciles the numerator and denominator of the basic and diluted earnings per common share computation:

(In thousands except average market price)

|   | Three months<br>ended<br>March 31, |         |
|---|------------------------------------|---------|
|   | 2018                               | 2017    |
| Numerator (Net income available to common shareholders)               | \$2,709                            | \$1,756 |
| Denominator   |                                    |         |
| Weighted average common shares outstanding for:                       |                                    |         |
| Basic shares  | 7,569                              | 6,619   |
| Dilutive securities:  |                                    |         |
| Deferred compensation   | 16                                 | 55      |
| Warrants/Restricted stock -Treasury stock method                      | 128                                | 140     |
| Diluted shares  | 7,713                              | 6,814   |
| The average market price used in calculating assumed number of shares | \$21.94                            | \$20.42 |

There were no options outstanding as of March 31, 2018 and 2017.

In the fourth quarter of 2011, we issued \$2.5 million in 8.75% subordinated notes maturing December 16, 2019. On November 15, 2012, the subordinated notes were redeemed in full at par. Warrants for 107,500 shares of common stock at \$5.90 per share were issued in connection with the issuance of the subordinated debt. There were 97,180 warrants outstanding at March 31, 2018. These warrants expire December 16, 2019 and are included in dilutive securities in the table above.

The Company has issued a total of 26,626 unvested restricted shares under the terms of its compensation plans and employment agreements. The employee shares cliff vest over a three year period; the non-employee director shares vest one year after issuance. The unrecognized compensation cost at March 31, 2018 for non-vested shares amounts to \$313.1 thousand. In February 2017 and 2018, the Company issued 353 and 3,201 stock units, respectively, to employees that cliff vest over three years. Each unit is convertible into one share of common stock at the time the unit vests. The related compensation cost is accrued over the vesting period.

In 2006, the Company established a Non-Employee Director Deferred Compensation Plan, whereby a director may elect to defer all or any part of annual retainer and monthly meeting fees payable with respect to service on the board of directors or a committee of the board. Units of common stock are credited to the director's account at the time compensation is earned and are included in dilutive securities in the table above. At March 31, 2018 and December 31, 2017, there were 113,145 and 110,320 units in the plan, respectively. The accrued liability at March 31, 2018 and December 31, 2017 amounted to \$1.2 million and \$1.1 million, respectively, and is included in "Other liabilities" on the balance sheet.

*Note 3—Investment Securities*

The amortized cost and estimated fair values of investment securities are summarized below:

| AVAILABLE-FOR-SALE:                 |            | Gross      | Gross      |            |
|-------------------------------------|------------|------------|------------|------------|
| (Dollars in thousands)              | Amortized  | Unrealized | Unrealized | Fair Value |
| March 31, 2018                      | Cost       | Gains      | Losses     |            |
| US Treasury securities              | \$ 1,527   | \$ —       | \$ 38      | \$ 1,489   |
| Government Sponsored Enterprises    | 1,088      | 11         | 2          | 1,097      |
| Mortgage-backed securities          | 142,673    | 112        | 2,985      | 139,800    |
| Small Business Administration pools | 54,566     | 278        | 561        | 54,283     |
| State and local government          | 53,118     | 739        | 863        | 52,994     |
| Other securities                    | 4,080      | 2          | 30         | 4,052      |
|                                     | \$ 257,052 | \$ 1,142   | \$ 4,479   | \$ 253,715 |

| (Dollars in thousands)              |            | Gross      | Gross      |            |
|-------------------------------------|------------|------------|------------|------------|
| December 31, 2017                   | Amortized  | Unrealized | Unrealized | Fair Value |
|                                     | Cost       | Gains      | Losses     |            |
| US Treasury securities              | \$ 1,529   | \$ —       | \$ 24      | \$ 1,505   |
| Government Sponsored Enterprises    | 1,085      | 24         | —          | 1,109      |
| Mortgage-backed securities          | 145,185    | 285        | 1,702      | 143,768    |
| Small Business Administration pools | 61,544     | 374        | 330        | 61,588     |
| State and local government          | 55,111     | 1,309      | 416        | 56,004     |
| Other securities                    | 932        | —          | 82         | 850        |
|                                     | \$ 265,386 | \$ 1,992   | \$ 2,554   | \$ 264,824 |

*Note 3—Investment Securities – continued*

| HELD-TO-MATURITY:          |           | Gross      | Gross      |            |
|----------------------------|-----------|------------|------------|------------|
| (Dollars in thousands)     | Amortized | Unrealized | Unrealized | Fair Value |
|                            | Cost      | Gains      | Losses     |            |
| March 31, 2018             |           |            |            |            |
| State and local government | \$ 16,966 | \$ 54      | \$ 119     | \$ 16,901  |
|                            | \$ 16,966 | \$ 54      | \$ 119     | \$ 16,901  |
|                            |           | Gross      | Gross      |            |
| (Dollars in thousands)     | Amortized | Unrealized | Unrealized | Fair Value |
|                            | Cost      | Gains      | Losses     |            |
| December 31, 2017          |           |            |            |            |
| State and local government | \$ 17,012 | \$ 223     | \$ 15      | \$ 17,220  |
|                            | \$ 17,012 | \$ 223     | \$ 15      | \$ 17,220  |

During the three months ended March 31, 2018 and 2017, the Company received proceeds of \$5.6 million and \$2.4 million, respectively, from the sale of investment securities available-for-sale. For the three months ended March 31, 2018, gross realized gains from the sale of investment securities available-for-sale amounted to \$33.8 thousand and gross realized losses amounted to \$138.0 thousand. For the three months ended March 31, 2017, gross realized gains from the sale of investment securities available-for-sale amounted to \$73.5 thousand and gross realized losses amounted to \$19.2 thousand.

At March 31, 2018, other securities available-for-sale included the following at fair value: a mutual fund at \$9.8 thousand, asset backed securities at \$3.9 million and foreign debt of \$60.0 thousand. As required by Accounting Standards Update (ASU) 2016-01-Financial Instruments-Overall (Subtopic 825-10), the Company has measured its equity investments at fair value with changes in the fair value recognized through net income. For the three months ended March 31, 2018, a \$2.0 thousand gain was recognized on a mutual fund. At December 31, 2017, corporate and other securities available-for-sale included the following at fair value: mutual funds at \$790.0 thousand and foreign debt of \$60.0 thousand. Other investments, at cost include Federal Home Loan Bank (“FHLB”) stock in the amount of \$955.6 thousand and \$1.6 million and corporate stock in the amount of \$1.0 million and \$1.0 million at March 31, 2018 and December 31, 2017, respectively.



*Note 3—Investment Securities – continued*

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

| (Dollars in thousands)                                     | Less than 12 months |                 | 12 months or more |                 | Total      |                 |
|--|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
| March 31, 2018   | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| Available-for-sale securities:                             |                     |                 |                   |                 |            |                 |
| US Treasury securities                                     | \$ —                | \$ —            | \$ 1,489          | \$ 38           | \$ 1,489   | \$ 38           |
| Government Sponsored Enterprise                            | 122                 | 2               | —                 | —               | 122        | 2               |
| Government Sponsored Enterprise mortgage-backed securities | 73,187              | 1,265           | 42,662            | 1,720           | 115,849    | 2,985           |
| Small Business Administration pools                        | 18,846              | 283             | 11,752            | 278             | 30,598     | 561             |
| State and local government                                 | 10,995              | 142             | 12,621            | 721             | 23,616     | 863             |
| Corporate and other securities                             | 3,982               | 30              | —                 | —               | 3,982      | 30              |
|  | \$ 107,132          | \$ 1,722        | \$ 68,524         | \$ 2,757        | \$ 175,656 | \$ 4,479        |

| (Dollars in thousands)       | Less than 12 months |                 | 12 months or more |                 | Total      |                 |
|------------------------------|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
| March 31, 2018               | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| Held-to-maturity securities: |                     |                 |                   |                 |            |                 |
| State and local government   | \$ 11,565           | \$ 119          | \$ 0              | \$ 0            | \$ 11,565  | \$ 119          |

| (Dollars in thousands)                                     | Less than 12 months |                 | 12 months or more |                 | Total      |                 |
|--|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
| December 31, 2017  | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| Available-for-sale securities:                             |                     |                 |                   |                 |            |                 |
| US Treasury securities                                     | \$ —                | \$ —            | \$ 1,505          | \$ 24           | \$ 1,505   | \$ 24           |
| Government Sponsored Enterprise mortgage-backed securities | 50,377              | 420             | 46,071            | 1,282           | 96,448     | 1,702           |
| Small Business Administration pools                        | 17,607              | 164             | 16,311            | 166             | 33,918     | 330             |
| State and local government                                 | 3,639               | 15              | 12,990            | 401             | 16,629     | 416             |
| Corporate and other securities                             | —                   | —               | 790               | 82              | 790        | 82              |
|  | \$ 71,623           | \$ 599          | \$ 77,667         | \$ 1,955        | \$ 149,290 | \$ 2,554        |

**Note 3—Investment Securities – continued**

| (Dollars in thousands)       | Less than 12 months |                 | 12 months or more |                 | Total      |                 |
|------------------------------|---------------------|-----------------|-------------------|-----------------|------------|-----------------|
|                              | Fair Value          | Unrealized Loss | Fair Value        | Unrealized Loss | Fair Value | Unrealized Loss |
| December 31, 2017            |                     |                 |                   |                 |            |                 |
| Held-to-maturity securities: |                     |                 |                   |                 |            |                 |
| State and local government   | \$2,899             | \$ 15           | \$ —              | \$ —            | \$2,899    | \$ 15           |

**Government Sponsored Enterprise, Mortgage-Backed Securities:** The Company owned mortgage-backed securities (“MBSs”), including collateralized mortgage obligations (“CMOs”), issued by government sponsored enterprises (“GSEs”) with an amortized cost of \$142.5 million and \$145.0 million and approximate fair value of \$139.6 million and \$143.6 million at March 31, 2018 and December 31, 2017, respectively. As of March 31, 2018 and December 31, 2017, all of the MBSs issued by GSEs were classified as “Available for Sale.” Unrealized losses on certain of these investments are not considered to be “other than temporary,” and we have the intent and ability to hold these until they mature or recover the current book value. The contractual cash flows of the investments are guaranteed by the GSE. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the Company’s investment. Because the Company does not intend to sell these securities and it is more likely than not that the Company will not be required sell these securities before a recovery of its amortized cost, which may be maturity, the Company does not consider the investments to be other-than-temporarily impaired at March 31, 2018.

**Non-agency Mortgage Backed Securities:** The Company held private label mortgage-backed securities (“PLMBSs”), including CMOs, at March 31, 2018 with an amortized cost of \$190.5 thousand and approximate fair value of \$197.7 thousand. The Company held PLMBSs, including CMOs, at December 31, 2017 with an amortized cost of \$199.9 thousand and approximate fair value of \$204.1 thousand. Management monitors each of these securities on a quarterly basis to identify any deterioration in the credit quality, collateral values and credit support underlying the investments.

**State and Local Governments and Other:** Management monitors these securities on a quarterly basis to identify any deterioration in the credit quality. Included in the monitoring is a review of the credit rating, a financial analysis and certain demographic data on the underlying issuer. The Company does not consider these securities to be other-than-temporarily impaired at March 31, 2018.

The following sets forth the amortized cost and fair value of investment securities at March 31, 2018 by contractual maturity. Expected maturities differ from contractual maturities because borrowers may have the right to call or prepay the obligations with or without prepayment penalties. MBSs are based on average life at estimated prepayment speeds.

| March 31, 2018                         | Available-for-sale |            | Held-to-maturity |            |
|--|--------------------|------------|------------------|------------|
|  | Amortized Cost     | Fair Value | Amortized Cost   | Fair Value |
| (Dollars in thousands)                 |                    |            |                  |            |
| Due in one year or less                | \$8,858            | \$8,875    | \$—              | \$—        |
| Due after one year through five years  | 144,121            | 142,522    | 8,929            | 8,909      |
| Due after five years through ten years | 89,405             | 87,672     | 8,037            | 7,992      |
| Due after ten years                    | 14,668             | 14,646     | —                | —          |
|  | \$257,052          | \$253,715  | \$16,966         | \$16,901   |

**Note 4—Loans**

Loans summarized by category as of March 31, 2018, December 31, 2017 and March 31, 2017 are as follows:

| (Dollars in thousands)                 | March 31,<br>2018 | December 31,<br>2017 | March 31,<br>2017 |
|--|-------------------|----------------------|-------------------|
| Commercial, financial and agricultural | \$ 44,724         | \$ 51,040            | \$ 40,537         |
| Real estate:                           |                   |                      |                   |
| Construction                           | 44,273            | 45,401               | 32,438            |
| Mortgage-residential                   | 46,801            | 46,901               | 46,668            |
| Mortgage-commercial                    | 488,597           | 460,276              | 397,179           |
| Consumer:                              |                   |                      |                   |
| Home equity                            | 32,544            | 32,451               | 30,481            |
| Other                                  | 11,644            | 10,736               | 7,995             |
| Total                                  | \$ 668,583        | \$ 646,805           | \$ 555,298        |

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*Note 4—Loans – continued*

The detailed activity in the allowance for loan losses and the recorded investment in loans receivable as of and for the three months ended March 31, 2018 and March 31, 2017 and for the year ended December 31, 2017 is as follows:

(Dollars in thousands)

|                                       | Real estate<br>Commercial | Real estate<br>Construction | Real estate<br>Mortgage Residential | Real estate<br>Mortgage Commercial | Consumer<br>Home equity | Consumer<br>Other | Consumer<br>Unallocated | Total      |
|---------------------------------------|---------------------------|-----------------------------|-------------------------------------|------------------------------------|-------------------------|-------------------|-------------------------|------------|
| March 31, 2018                        |                           |                             |                                     |                                    |                         |                   |                         |            |
| Allowance for loan losses:            |                           |                             |                                     |                                    |                         |                   |                         |            |
| Beginning balance December 31, 2017   | \$ 221                    | \$ 101                      | \$ 461                              | \$ 3,077                           | \$ 308                  | \$ 35             | \$ 1,594                | \$ 5,797   |
| Charge-offs                           | —                         | —                           | (1 )                                | —                                  | —                       | (47 )             | —                       | (48 )      |
| Recoveries                            | —                         | —                           | —                                   | 27                                 | —                       | 8                 | —                       | 35         |
| Provisions                            | (11 )                     | (3 )                        | 256                                 | 13                                 | 171                     | 67                | (291 )                  | 202        |
| Ending balance March 31, 2018         | \$ 210                    | \$ 98                       | \$ 716                              | \$ 3,117                           | \$ 479                  | \$ 63             | \$ 1,303                | \$ 5,986   |
| Ending balances:                      |                           |                             |                                     |                                    |                         |                   |                         |            |
| Individually evaluated for impairment | \$ —                      | \$ —                        | \$ 1                                | \$ 19                              | \$ —                    | \$ —              | \$ —                    | \$ 20      |
| Collectively evaluated for impairment | 210                       | 98                          | 715                                 | 3,098                              | 479                     | 63                | 1,303                   | 5,966      |
| March 31, 2018                        |                           |                             |                                     |                                    |                         |                   |                         |            |
| Loans receivable:                     |                           |                             |                                     |                                    |                         |                   |                         |            |
| Ending balance-total                  | \$ 44,724                 | \$ 44,273                   | \$ 46,801                           | \$ 488,597                         | \$ 32,544               | \$ 11,644         | \$ —                    | \$ 668,583 |
| Ending balances:                      |                           |                             |                                     |                                    |                         |                   |                         |            |
| Individually evaluated for impairment | —                         | —                           | 436                                 | 4,440                              | 35                      | —                 | —                       | 4,911      |
| Collectively evaluated for impairment | \$ 44,724                 | \$ 44,273                   | \$ 46,365                           | \$ 484,157                         | \$ 32,509               | \$ 11,644         | \$ —                    | \$ 663,672 |

**Note 4—Loans – continued**

(Dollars in thousands)

|                                       | Real estate |              | Real estate          | Consumer          | Consumer  |          | Total       |            |
|---------------------------------------|-------------|--------------|----------------------|-------------------|-----------|----------|-------------|------------|
|                                       | Commercial  | Construction | Mortgage Residential | Commercial equity | Home      | Other    | Unallocated |            |
| March 31, 2017                        |             |              |                      |                   |           |          |             |            |
| Allowance for loan losses:            |             |              |                      |                   |           |          |             |            |
| Beginning balance                     | \$ 145      | \$ 104       | \$ 438               | \$ 2,793          | \$ 153    | \$ 127   | \$ 1,454    | \$ 5,214   |
| December 31, 2016                     |             |              |                      |                   |           |          |             |            |
| Charge-offs                           | —           | —            | —                    | (24 )             | —         | (27 )    | —           | (51 )      |
| Recoveries                            | 2           | —            | 1                    | 81                | 1         | 4        | —           | 89         |
| Provisions                            | (7 )        | (33 )        | (41 )                | 8                 | 9         | 55       | 125         | 116        |
| Ending balance                        | \$ 140      | \$ 71        | \$ 398               | \$ 2,858          | \$ 163    | \$ 159   | \$ 1,579    | \$ 5,368   |
| March 31, 2017                        |             |              |                      |                   |           |          |             |            |
| Ending balances:                      |             |              |                      |                   |           |          |             |            |
| Individually evaluated for impairment | \$ —        | \$ —         | \$ 2                 | \$ 5              | \$ —      | \$ —     | \$ —        | \$ 7       |
| Collectively evaluated for impairment | 140         | 71           | 396                  | 2,853             | 163       | 159      | 1,579       | 5,361      |
| March 31, 2017                        |             |              |                      |                   |           |          |             |            |
| Loans receivable:                     |             |              |                      |                   |           |          |             |            |
| Ending balance-total                  | \$ 40,537   | \$ 32,438    | \$ 46,668            | \$ 397,179        | \$ 30,481 | \$ 7,995 | \$ —        | \$ 555,298 |
| Ending balances:                      |             |              |                      |                   |           |          |             |            |
| Individually evaluated for impairment | —           | —            | 731                  | 4,441             | 56        | —        | —           | 5,228      |
| Collectively evaluated for impairment | \$ 40,537   | \$ 32,438    | \$ 45,937            | \$ 392,738        | \$ 30,425 | \$ 7,995 | \$ —        | \$ 550,070 |

**Note 4—Loans – continued**

(Dollars in thousands)

|   | Real estate<br>Commercial | Real estate<br>Construction | Real estate<br>Mortgage Residential | Real estate<br>Mortgage Commercial | Consumer<br>Home equity | Consumer<br>Other | Unallocated | Total      |
|---|---------------------------|-----------------------------|-------------------------------------|------------------------------------|-------------------------|-------------------|-------------|------------|
| December 31, 2017<br>Allowance for loan losses: |                           |                             |                                     |                                    |                         |                   |             |            |
| Beginning balance December 31, 2016             | \$ 145                    | \$ 104                      | \$ 438                              | \$ 2,793                           | \$ 153                  | \$ 127            | \$ 1,454    | \$ 5,214   |
| Charge-offs                                     | (5 )                      | —                           | —                                   | (30 )                              | (7 )                    | (131 )            | —           | (173 )     |
| Recoveries                                      | 5                         | —                           | 5                                   | 172                                | 24                      | 20                | —           | 226        |
| Provisions                                      | 76                        | (3 )                        | 18                                  | 142                                | 138                     | 19                | 140         | 530        |
| Ending balance December 31, 2017                | \$ 221                    | \$ 101                      | \$ 461                              | \$ 3,077                           | \$ 308                  | \$ 35             | \$ 1,594    | \$ 5,797   |
| Ending balances:                                |                           |                             |                                     |                                    |                         |                   |             |            |
| Individually evaluated for impairment           | \$ —                      | \$ —                        | \$ 2                                | \$ 25                              | \$ —                    | \$ —              | \$ —        | \$ 27      |
| Collectively evaluated for impairment           | 221                       | 101                         | 459                                 | 3,052                              | 308                     | 35                | 1,594       | 5,770      |
| December 31, 2017<br>Loans receivable:          |                           |                             |                                     |                                    |                         |                   |             |            |
| Ending balance-total                            | \$ 51,040                 | \$ 45,401                   | \$ 46,901                           | \$ 460,276                         | \$ 32,451               | \$ 10,736         | \$ —        | \$ 646,805 |
| Ending balances:                                |                           |                             |                                     |                                    |                         |                   |             |            |
| Individually evaluated for impairment           | —                         | —                           | 413                                 | 4,742                              | —                       | —                 | —           | 5,155      |
| Collectively evaluated for impairment           | \$ 51,040                 | \$ 45,401                   | \$ 46,488                           | \$ 455,534                         | \$ 32,451               | \$ 10,736         | \$ —        | \$ 641,650 |

Related party loans and lines of credit are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and generally do not involve more than the normal risk of collectability. The following table presents related party loan transactions for the three months ended March 31, 2018 and March 31, 2017:

| (Dollars in thousands)         | 2018     | 2017     |
|--------------------------------|----------|----------|
| Beginning Balance December 31, | \$ 5,549 | \$ 6,103 |
| New Loans                      | 567      | 2        |
| Less loan repayments           | 641      | 519      |
| Ending Balance March 31,       | \$ 5,475 | \$ 5,586 |

**Note 4—Loans – continued**

The following table presents at March 31, 2018 and December 31, 2017 loans individually evaluated and considered impaired under Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 310 “Accounting by Creditors for Impairment of a Loan.” Impairment includes performing troubled debt restructurings (“TDRs”).

| (Dollars in thousands)  | March 31,<br>2018 | December 31,<br>2017 |
|---|-------------------|----------------------|
| Total loans considered impaired   | \$ 4,911          | \$ 5,155             |
| Loans considered impaired for which there is a related allowance for loan loss: |                   |                      |
| Outstanding loan balance  | \$ 1,675          | \$ 1,669             |
| Related allowance   | \$ 20             | \$ 27                |
| Loans considered impaired and previously written down to fair value             | \$ 3,236          | \$ 3,485             |
| Average impaired loans  | \$ 5,126          | \$ 5,513             |
| Amount of interest earned during period of impairment                           | \$ 86             | \$ 132               |

The following tables are by loan category and present at March 31, 2018, March 31, 2017 and December 31, 2017 loans individually evaluated and considered impaired under FASB ASC 310 “Accounting by Creditors for Impairment of a Loan.” Impairment includes performing TDRs.

| (Dollars in thousands)      | March 31, 2018 | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Three months ended<br>Average Interest<br>Recorded Investment | Income<br>Recognized |
|-----------------------------|----------------|--------------------------------|----------------------|---|----------------------|
| With no allowance recorded: |                |                                |                      |   |                      |
| Commercial                  | \$ —           | \$ —                           | \$ —                 | \$ —  | \$ —                 |
| Real estate:                |                |                                |                      |   |                      |
| Construction                | —              | —                              | —                    | —   | —                    |
| Mortgage-residential        | 395            | 466                            | —                    | 394   | 4                    |
| Mortgage-commercial         | 2,807          | 5,674                          | —                    | 3,000   | 52                   |
| Consumer:                   |                |                                |                      |   |                      |
| Home Equity                 | 35             | 35                             | —                    | 35  | —                    |
| Other                       | —              | —                              | —                    | —   | —                    |
| With an allowance recorded: |                |                                |                      |   |                      |
| Commercial                  | —              | —                              | —                    | —   | —                    |
| Real estate:                |                |                                |                      |   |                      |
| Construction                | —              | —                              | —                    | —   | —                    |
| Mortgage-residential        | 41             | 41                             | 1                    | 41  | 1                    |
| Mortgage-commercial         | 1,633          | 1,633                          | 19                   | 1,655   | 29                   |
| Consumer:                   |                |                                |                      |   |                      |
| Home Equity                 | —              | —                              | —                    | —   | —                    |

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|                      |          |          |       |          |       |
|----------------------|----------|----------|-------|----------|-------|
| Other                | —        | —        | —     | —        | —     |
| Total:               |          |          |       |          |       |
| Commercial           | —        | —        | —     | —        | —     |
| Real estate:         |          |          |       |          |       |
| Construction         | —        | —        | —     | —        | —     |
| Mortgage-residential | 436      | 507      | 1     | 435      | 5     |
| Mortgage-commercial  | 4,440    | 7,307    | 19    | 4,655    | 81    |
| Consumer:            |          |          |       |          |       |
| Home Equity          | 35       | 35       | —     | 35       | —     |
| Other                | —        | —        | —     | —        | —     |
|                      | \$ 4,911 | \$ 7,849 | \$ 20 | \$ 5,126 | \$ 86 |



*Note 4—Loans – continued*

| (Dollars in thousands)      |            |           |           | Three months ended |          |
|-----------------------------|------------|-----------|-----------|--------------------|----------|
| March 31, 2017              | Recorded   | Unpaid    | Related   | Average Interest   | Recorded |
|                             | Investment | Principal | Allowance | Investment         | Income   |
|                             |            | Balance   |           | Recognized         |          |
| With no allowance recorded: |            |           |           |                    |          |
| Commercial                  | \$ —       | \$ —      | \$ —      | \$ —               | \$ —     |
| Real estate:                |            |           |           |                    |          |
| Construction                | —          | —         | —         | —                  | —        |
| Mortgage-residential        | 686        | 696       | —         | 749                | 5        |
| Mortgage-commercial         | 4,265      | 6,711     | —         | 7,428              | 75       |
| Consumer:                   |            |           |           |                    |          |
| Home Equity                 | 56         | 56        | —         | 56                 | —        |
| Other                       | —          | —         | —         | —                  | —        |
| With an allowance recorded: |            |           |           |                    |          |
| Commercial                  | —          | —         | —         | —                  | —        |
| Real estate:                |            |           |           |                    |          |
| Construction                | —          | —         | —         | —                  | —        |
| Mortgage-residential        | 45         | 45        | 2         | 45                 | 1        |
| Mortgage-commercial         | 176        | 176       | 5         | 176                | 4        |
| Consumer:                   |            |           |           |                    |          |
| Home Equity                 | —          | —         | —         | —                  | —        |
| Other                       | —          | —         | —         | —                  | —        |
| Total:                      |            |           |           |                    |          |
| Commercial                  | —          | —         | —         | —                  | —        |
| Real estate:                |            |           |           |                    |          |
| Construction                | —          | —         | —         | —                  | —        |
| Mortgage-residential        | 731        | 741       | 2         | 794                | 6        |
| Mortgage-commercial         | 4,441      | 6,887     | 5         | 7,604              | 79       |
| Consumer:                   |            |           |           |                    |          |
| Home Equity                 | 56         | 56        | —         | 56                 | —        |
| Other                       | —          | —         | —         | —                  | —        |
|                             | \$ 5,228   | \$ 7,684  | \$ 7      | \$ 8,454           | \$ 85    |

*Note 4—Loans – continued*

(Dollars in thousands)

December 31, 2017

|                             | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
|-----------------------------|------------------------|--------------------------------|----------------------|-----------------------------------|----------------------------------|
| With no allowance recorded: |                        |                                |                      |                                   |                                  |
| Commercial                  | \$ —                   | \$ —                           | \$ —                 | \$ —                              | \$ —                             |
| Real estate:                |                        |                                |                      |                                   |                                  |
| Construction                | —                      | —                              | —                    | —                                 | —                                |
| Mortgage-residential        | 371                    | 437                            | —                    | 399                               | —                                |
| Mortgage-commercial         | 3,087                  | 5,966                          | —                    | 3,420                             | 13                               |
| Consumer:                   |                        |                                |                      |                                   |                                  |
| Home Equity                 | —                      | —                              | —                    | —                                 | —                                |
| Other                       | —                      | —                              | —                    | —                                 | —                                |
| With an allowance recorded: |                        |                                |                      |                                   |                                  |
| Commercial                  | —                      | —                              | —                    | —                                 | —                                |
| Real estate:                |                        |                                |                      |                                   |                                  |
| Construction                | —                      | —                              | —                    | —                                 | —                                |
| Mortgage-residential        | 42                     | 42                             | 2                    | 43                                | 2                                |
| Mortgage-commercial         | 1,655                  | 2,261                          | 25                   | 1,652                             | 117                              |
| Consumer:                   |                        |                                |                      |                                   |                                  |
| Home Equity                 | —                      | —                              | —                    | —                                 | —                                |
| Other                       | —                      | —                              | —                    | —                                 | —                                |
| Total:                      |                        |                                |                      |                                   |                                  |
| Commercial                  | —                      | —                              | —                    | —                                 | —                                |
| Real estate:                |                        |                                |                      |                                   |                                  |
| Construction                | —                      | —                              | —                    | —                                 | —                                |
| Mortgage-residential        | 413                    | 479                            | 2                    | 442                               | 2                                |
| Mortgage-commercial         | 4,742                  | 8,227                          | 25                   | 5,072                             | 130                              |
| Consumer:                   |                        |                                |                      |                                   |                                  |
| Home Equity                 | —                      | —                              | —                    | —                                 | —                                |
| Other                       | —                      | —                              | —                    | —                                 | —                                |
|                             | \$ 5,155               | \$ 8,706                       | \$ 27                | \$ 5,513                          | \$ 132                           |

**Note 4—Loans – continued**

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt, including: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on a monthly basis. The Company uses the following definitions for risk ratings:

**Special Mention.** Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

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

**Doubtful.** Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered as pass rated loans. As of March 31, 2018 and December 31, 2017, and based on the most recent analysis performed, the risk category of loans by class of loans is shown in the table below. As of March 31, 2018 and December 31, 2017, no loans were classified as doubtful.

(Dollars in thousands)

| March 31, 2018                       | Pass      | Special<br>Mention | Substandard | Doubtful | Total     |
|--------------------------------------|-----------|--------------------|-------------|----------|-----------|
| Commercial, financial & agricultural | \$44,342  | \$ 161             | \$ 221      | \$ —     | \$44,724  |
| Real estate:                         |           |                    |             |          |           |
| Construction                         | 44,273    | —                  | —           | —        | 44,273    |
| Mortgage – residential               | 45,296    | 655                | 850         | —        | 46,801    |
| Mortgage – commercial                | 475,959   | 7,015              | 5,623       | —        | 488,597   |
| Consumer:                            |           |                    |             |          |           |
| Home Equity                          | 30,691    | 1,518              | 335         | —        | 32,544    |
| Other                                | 11,640    | —                  | 4           | —        | 11,644    |
| Total                                | \$652,201 | \$ 9,349           | \$ 7,033    | \$ —     | \$668,583 |

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(Dollars in thousands)

December 31, 2017

|                                      | Pass      | Special<br>Mention | Substandard | Doubtful | Total     |
|--------------------------------------|-----------|--------------------|-------------|----------|-----------|
| Commercial, financial & agricultural | \$50,680  | \$179              | \$ 181      | \$ —     | \$51,040  |
| Real estate:                         |           |                    |             |          |           |
| Construction                         | 45,401    | —                  | —           | —        | 45,401    |
| Mortgage – residential               | 45,343    | 720                | 838         | —        | 46,901    |
| Mortgage – commercial                | 446,531   | 7,698              | 6,047       | —        | 460,276   |
| Consumer:                            |           |                    |             |          |           |
| Home Equity                          | 30,618    | 1,524              | 309         | —        | 32,451    |
| Other                                | 10,731    | —                  | 5           | —        | 10,736    |
| Total                                | \$629,304 | \$10,121           | \$ 7,380    | \$ —     | \$646,805 |

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**Note 4—Loans – continued**

At March 31, 2018 and December 31, 2017, non-accrual loans totaled \$3.1 million and \$3.3 million, respectively.

TDRs that are still accruing and included in impaired loans at March 31, 2018 and at December 31, 2017 amounted to \$1.8 million. TDRs in non-accrual status at March 31, 2018 and December 31, 2017 amounted to \$1.1 million and \$1.2 million, respectively.

Loans greater than 90 days delinquent and still accruing interest were \$34.1 thousand and \$32.0 thousand at March 31, 2018 and December 31, 2017, respectively.

Acquired credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality, found in FASB ASC Topic 310-30, (*Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality*), and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loans. Loans acquired in business combinations with evidence of credit deterioration are considered impaired. Loans acquired through business combinations that do not meet the specific criteria of FASB ASC Topic 310-30, but for which a discount is attributable, at least in part to credit quality, are also accounted for under this guidance. Certain acquired loans, including performing loans and revolving lines of credit (consumer and commercial), are accounted for in accordance with FASB ASC Topic 310-20, where the discount is accreted through earnings based on estimated cash flows over the estimated life of the loan.

A summary of changes in the accretable yield for PCI loans for the three months ended March 31, 2018 and March 31, 2017 follows:

| (Dollars in thousands)   | Three Months<br>Ended<br>March 31,<br>2018 | Three Months<br>Ended<br>March 31,<br>2017 |
|--|--|--|
| Accretable yield, beginning of period  | \$ 22                                      | \$ 34                                      |
| Additions  | —  | 44   |
| Accretion  | (10  | ) (22                                      |
| Reclassification of nonaccretable difference due to improvement in expected cash flows | —  | —  |
| Other changes, net   | —  | —  |
| Accretable yield, end of period  | \$ 12                                      | \$ 56                                      |

At March 31, 2018 and December 31, 2017 the recorded investment in purchased impaired loans was \$679 thousand and \$733 thousand, respectively. The unpaid principal balance was \$961 thousand and \$1.0 million at March 31, 2018 and December 31, 2017, respectively. At March 31, 2018 and December 31, 2017, these loans were all secured by commercial real estate.

*Note 4—Loans – continued*

The following tables are by loan category and present loans past due and on non-accrual status as of March 31, 2018 and December 31, 2017:

| (Dollars in thousands) |                        |                        |   |            |                   |           |             |
|------------------------|------------------------|------------------------|---|------------|-------------------|-----------|-------------|
| March 31, 2018         | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | Greater than<br>90 Days and<br>Accruing | Nonaccrual | Total<br>Past Due | Current   | Total Loans |
| Commercial             | \$ 32                  | \$ 80                  | \$ —                                    | \$ —       | \$ 112            | \$44,612  | \$ 44,725   |
| Real estate:           |                        |                        |   |            | —                 |           |             |
| Construction           | —                      | —                      | —                                       | —          | —                 | 44,273    | 44,273      |
| Mortgage-residential   | 300                    | —                      | —                                       | 394        | 694               | 46,107    | 46,801      |
| Mortgage-commercial    | 2,402                  | —                      | 34                                      | 2,688      | 5,124             | 483,473   | 488,596     |
| Consumer:              |                        |                        |   |            | —                 |           |             |
| Home equity            | 152                    | 280                    | —                                       | 35         | 467               | 32,077    | 32,544      |
| Other                  | 60                     | —                      | —                                       | —          | 60                | 11,584    | 11,644      |
|                        | \$ 2,946               | \$ 360                 | \$ 34                                   | \$ 3,117   | \$ 6,457          | \$662,126 | \$ 668,583  |

| (Dollars in thousands) |                        |                        |   |            |                   |           |             |
|------------------------|------------------------|------------------------|---|------------|-------------------|-----------|-------------|
| December 31, 2017      | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | Greater than<br>90 Days and<br>Accruing | Nonaccrual | Total<br>Past Due | Current   | Total Loans |
| Commercial             | \$ 26                  | \$ —                   | \$ 32                                   | \$ —       | \$ 58             | \$50,982  | \$ 51,040   |
| Real estate:           |                        |                        |   |            | —                 |           |             |
| Construction           | —                      | —                      | —                                       | —          | —                 | 45,401    | 45,401      |
| Mortgage-residential   | 109                    | 38                     | —                                       | 371        | 518               | 46,383    | 46,901      |
| Mortgage-commercial    | 290                    | 828                    | —                                       | 2,971      | 4,089             | 456,187   | 460,276     |
| Consumer:              |                        |                        |   |            | —                 |           |             |
| Home equity            | 805                    | 36                     | —                                       | —          | 841               | 31,610    | 32,451      |
| Other                  | 1                      | 5                      | —                                       | —          | 6                 | 10,730    | 10,736      |
|                        | \$ 1,231               | \$ 907                 | \$ 32                                   | \$ 3,342   | \$ 5,512          | \$641,293 | \$ 646,805  |

The Company identifies TDRs as impaired under the guidance in ASC 310-10-35. There were no loans determined to be TDRs that were restructured during the three-month periods ended March 31, 2018 and March 31, 2017.

During the three month periods ended March 31, 2018 and March 31, 2017, there were no loans determined to be TDRs in the previous twelve months that had payment defaults. Defaulted loans are those loans that are greater than 89 days past due.

In the determination of the allowance for loan losses, all TDRs are reviewed to ensure that one of the three proper valuation methods (fair market value of the collateral, present value of cash flows, or observable market price) is

adhered to. All non-accrual loans are written down to their corresponding collateral value. All troubled TDR accruing loans that have a loan balance that exceeds the present value of cash flows will have a specific allocation. All nonaccrual loans are considered impaired. Under ASC 310-10, a loan is impaired when it is probable that the Company will be unable to collect all amounts due including both principal and interest according to the contractual terms of the loan agreement.



***Note 5—Recently Issued Accounting Pronouncements***

The following is a summary of recent authoritative pronouncements:

In May 2014, the FASB issued guidance (ASU 2014-09) to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance is effective for the Company as of January 1, 2018. The Company evaluated the overall impact on affected revenue streams and any related contracts, including asset management fees, gains and losses on the sale of real estate, deposit related fees and interchange fees. Based on this evaluation, the Company determined that ASU 2014-09 did not materially change the method in which revenue from impacted revenue streams was previously being recognized. The Company applied the guidance using a modified retrospective approach. This approach requires the application of the new guidance to uncompleted contracts at the date of adoption. Periods prior to the date of adoption were not retrospectively revised as the impact on uncompleted contracts at the date of adoption was not material.

In January 2016, the FASB amended the Financial Instruments topic of the Accounting Standards Codification (ASU 2016-01) to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments were effective for the Company on January 1, 2018. The guidance affects the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure of financial instruments. The amendments related to equity securities without readily determinable fair values were applied prospectively to equity investments that exist as of the date of adoption of the amendments. ASU 2016-01 requires the use of exit price rather than entrance price in determining the fair value of loans not measured at fair value on a non-recurring basis in the consolidated balance sheets. See Note 6 - Fair Value of Financial Instruments for information regarding the change in the valuation of these loans. The adoption of ASU 2016-01 did not have a material impact on the Company's Consolidated Financial Statements.

In February 2016, the FASB amended the Leases topic of the Accounting Standards Codification to revise certain aspects of recognition, measurement, presentation, and disclosure of leasing transactions. The amendments will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the effect that implementation of the new standard will have on its financial position, results of operations, and cash flows.

In June 2016, the FASB issued guidance to change the accounting for credit losses and modify the impairment model for certain debt securities. The amendments will be effective for the Company for reporting periods beginning after December 15, 2019. Early adoption is permitted for all organizations for periods beginning after December 15, 2018. The Company is currently evaluating the effect that implementation of the new standard will have on its financial position, results of operations, and cash flows.

In August 2016, the FASB amended the Statement of Cash Flows topic of the Accounting Standards Codification to clarify how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments are effective for the Company for fiscal years beginning after December 15, 2017 including interim periods within those fiscal years. These amendments had no material effect on its financial statements.

In January 2017, the FASB issued guidance to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendment to the Business Combinations Topic is intended to address concerns that the existing definition of a business has been applied too broadly and has resulted in many transactions being recorded as business acquisitions that in substance are more akin to asset acquisitions. The guidance was effective for the Company for reporting periods beginning after December 15, 2017. These amendments had no material effect on its financial statements.

In January 2017, the FASB amended the Goodwill and Other Topic of the Accounting Standards Codification to simplify the accounting for goodwill impairment for public business entities and other entities that have goodwill reported in their financial statements and have not elected the private company alternative for the subsequent measurement of goodwill. The amendment removes Step 2 of the goodwill impairment test. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The effective date and transition requirements for the technical corrections will be effective for the Company for reporting periods beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect these amendments to have a material effect on its financial statements.

*Note 5—Recently Issued Accounting Pronouncements – continued*

In March 2017, the FASB amended the requirements in the Receivables—Nonrefundable Fees and Other Costs Topic of the Accounting Standards Codification related to the amortization period for certain purchased callable debt securities held at a premium. The amendments shorten the amortization period for the premium to the earliest call date. The amendments will be effective for the Company for interim and annual periods beginning after December 15, 2018. The Company does not expect these amendments to have a material effect on its financial statements.

In November 2017, the FASB updated the Income Statement and Revenue from Contracts with Customers Topics of the Accounting Standards Codification. The amendments incorporate into the Accounting Standards Codification recent SEC guidance related to revenue recognition. The amendments were effective upon issuance. The Company is currently evaluating the impact on revenue recognition, however, it does not expect these amendments to have a material effect on its financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's financial position, results of operations or cash flows.

**Note 6—Fair Value of Financial Instruments**

The Company adopted FASB ASC Fair Value Measurement Topic 820, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Quoted prices in active markets for identical assets or liabilities.

**Level 1**

Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market

**Level 2** data for substantially the full term of the assets or liabilities.

Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

**Level 3**

FASB ASC 825-10-50 “Disclosure about Fair Value of Financial Instruments”, requires the Company to disclose estimated fair values for its financial instruments. Fair value estimates, methods, and assumptions are set forth below.

**Cash and Short Term Investments** - The carrying amount of these financial instruments (cash and due from banks, interest-bearing bank balances, federal funds sold and securities purchased under agreements to resell) approximates fair value. All mature within 90 days and do not present unanticipated credit concerns and are classified as Level 1.

**Investment Securities** - Measurement is on a recurring basis based upon quoted market prices, if available. If quoted market prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for prepayment assumptions, projected credit losses, and liquidity. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, or by dealers or brokers in active over-the-counter markets. Level 2 securities include MBSs issued both by government sponsored enterprises and PLMBSs. Generally these fair values are priced from established pricing models. Level 3 securities include corporate debt obligations and asset-backed securities that are less liquid or for which there is an inactive market.

**Loans Held for Sale** - The Company originates fixed rate residential loans on a servicing released basis in the secondary market. Loans closed but not yet settled with an investor, are carried in the Company's loans held for sale portfolio. These loans are fixed rate residential loans that have been originated in the Company's name and have closed. Virtually all of these loans have commitments to be purchased by investors at a locked in price with the investors on the same day that the loan was locked in with the company's customers. Therefore, these loans present very little market risk for the Company and are classified as Level 2. The carrying amount of these loans approximates fair value.

**Loans** - The fair value of loans at March 31, 2018 were measured using an exit price methodology. Prior to adoption of ASU 2016-01, the Company measured fair value using an entry price notion. The entry price notion used a discounted cash flow method to calculate the present future value of expected future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. The exit price uses this methodology but also incorporates other assumptions such as market factors illiquidity risk and enhanced credit risk. These added assumptions are intended to approximate the fair value that a market participant would realize in a hypothetical orderly transaction. In estimating the fair value the Company's portfolio is segmented using the six categories in Note 4 – Loans. Loans which are deemed to be impaired are primarily valued on a nonrecurring basis at the fair value of the underlying real estate collateral. Prior to adoption of ASU 2016-01 loans other than impaired loans were classified as a Level 2 measurement, as of March 31, 2018 all loans are classified as a Level 3 measurement.

*Note 6—Fair Value of Financial Instruments – continued*

**Other Real Estate Owned (“OREO”)** - OREO is carried at the lower of carrying value or fair value on a non-recurring basis. Fair value is based upon independent appraisals or management’s estimation of the collateral and is considered a Level 3 measurement.

**Accrued Interest Receivable** - The fair value approximates the carrying value and is classified as Level 1.

**Deposits** - The fair value of demand deposits, savings accounts, and money market accounts is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposits is estimated by discounting the future cash flows using rates currently offered for deposits of similar remaining maturities. Deposits are classified as Level 2.

**Federal Home Loan Bank Advances** - Fair value is estimated based on discounted cash flows using current market rates for borrowings with similar terms and are classified as Level 2.

**Short Term Borrowings** - The carrying value of short term borrowings (securities sold under agreements to repurchase and demand notes to the Treasury) approximates fair value. These are classified as Level 2.

**Junior Subordinated Debentures** - The fair values of junior subordinated debentures is estimated by using discounted cash flow analyses based on incremental borrowing rates for similar types of instruments. These are classified as Level 2.

**Accrued Interest Payable** -The fair value approximates the carrying value and is classified as Level 1.

**Commitments to Extend Credit** - The fair value of these commitments is immaterial because their underlying interest rates approximate market.

**Note 6—Fair Value of Financial Instruments – continued**

The carrying amount and estimated fair value by classification level of the Company's financial instruments as of March 31, 2018 and December 31, 2017 are as follows:

| (Dollars in thousands)                                     | March 31, 2018    |           |          |           |         |
|--|-------------------|-----------|----------|-----------|---------|
|  | Carrying Amount   | Total     | Level 1  | Level 2   | Level 3 |
| <b>Financial Assets:</b>                                   |                   |           |          |           |         |
| Cash and short term investments                            | \$38,914          | \$38,914  | \$38,914 | \$—       | \$—     |
| Held-to-maturity securities                                | 16,966            | 16,901    | —        | 16,901    | —       |
| Available-for-sale securities                              | 253,715           | 253,715   | 10       | 253,705   | —       |
| Other investments, at cost                                 | 1,956             | 1,956     | —        | —         | 1,956   |
| Loans held for sale  | 7,546             | 7,546     | —        | 7,546     | —       |
| Net loans receivable                                       | 668,583           | 655,296   | —        | —         | 655,296 |
| Accrued interest   | 3,265             | 3,265     | 3,265    | —         | —       |
| <b>Financial liabilities:</b>                              |                   |           |          |           |         |
| Non-interest bearing demand deposits                       | \$238,132         | \$238,132 | \$—      | \$238,132 | \$—     |
| Interest bearing demand deposits and money market accounts | 379,217           | 379,217   | —        | 379,217   | —       |
| Savings  | 107,686           | 107,686   | —        | 107,686   | —       |
| Time deposits  | 194,863           | 194,703   | —        | 194,703   | —       |
| Total deposits   | 919,898           | 919,738   | —        | 919,738   | —       |
| Federal Home Loan Bank Advances                            | 245               | 245       | —        | 245       | —       |
| Short term borrowings                                      | 21,959            | 21,959    | —        | 21,959    | —       |
| Junior subordinated debentures                             | 14,964            | 11,984    | —        | 11,984    | —       |
| Accrued interest payable                                   | 604               | 604       | 604      | —         | —       |
| <br>   |                   |           |          |           |         |
| (Dollars in thousands)                                     | December 31, 2017 |           |          |           |         |
|  | Carrying Amount   | Total     | Level 1  | Level 2   | Level 3 |
| <b>Financial Assets:</b>                                   |                   |           |          |           |         |
| Cash and short term investments                            | \$30,591          | \$30,591  | \$30,591 | \$—       | \$—     |
| Held-to-maturity securities                                | 17,012            | 17,220    | —        | 17,220    | —       |
| Available-for-sale securities                              | 264,824           | 264,824   | 790      | 264,034   | —       |
| Other investments, at cost                                 | 2,559             | 2,559     | —        | —         | 2,559   |
| Loans held for sale  | 5,093             | 5,093     | —        | 5,093     | —       |
| Net loans receivable                                       | 641,008           | 639,489   | —        | 634,361   | 5,128   |
| Accrued interest   | 3,489             | 3,489     | 3,489    | —         | —       |
| <b>Financial liabilities:</b>                              |                   |           |          |           |         |
| Non-interest bearing demand                                | \$226,546         | \$226,546 | \$—      | \$226,546 | \$—     |
| NOW and money market accounts                              | 364,358           | 364,358   | —        | 364,358   | —       |
| Savings  | 104,756           | 104,756   | —        | 104,756   | —       |
| Time deposits  | 192,663           | 192,186   | —        | 192,186   | —       |

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|                                 |         |         |     |         |   |
|---------------------------------|---------|---------|-----|---------|---|
| Total deposits                  | 888,323 | 887,846 | —   | 887,846 | — |
| Federal Home Loan Bank Advances | 14,250  | 14,248  | —   | 14,248  | — |
| Short term borrowings           | 19,270  | 19,270  | —   | 19,270  | — |
| Junior subordinated debentures  | 14,964  | 15,025  | —   | 15,025  | — |
| Accrued interest payable        | 562     | 562     | 562 | —       | — |

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**Note 6—Fair Value of Financial Instruments – continued**

The following tables summarize quantitative disclosures about the fair value for each category of assets carried at fair value as of March 31, 2018 and December 31, 2017 that are measured on a recurring basis. There were no liabilities carried at fair value as of March 31, 2018 or December 31, 2017 that are measured on a recurring basis.

**(Dollars in thousands)**

| Description                         | March 31,<br>2018 | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|-------------------------------------|-------------------|--|---|--|
| Available for sale securities       |                   |  |   |  |
| US Treasury Securities              | \$ 1,489          | \$ —   | \$ 1,489  | \$ —   |
| Government sponsored enterprises    | 1,097             | —  | 1,097   | —  |
| Mortgage-backed securities          | 139,800           | —  | 139,800   | —  |
| Small Business Administration pools | 54,283            | —  | 54,283  | —  |
| State and local government          | 52,994            | —  | 52,994  | —  |
| Corporate and other securities      | 4,052             | 10   | 4,042   | —  |
|                                     | 253,715           | 10   | 253,705   | —  |
| Loans held for sale                 | 7,546             | —  | 7,546   | —  |
| Total                               | \$ 261,261        | \$ 10  | \$ 261,251  | \$ —   |

**(Dollars in thousands)**

| Description                              | December 31,<br>2017 | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|--|----------------------|--|---|--|
| Available for sale securities            |                      |  |   |  |
| US Treasury Securities                   | \$ 1,505             | \$ —   | \$ 1,505  | \$ —   |
| Government sponsored enterprises         | 1,109                | —  | 1,109   | —  |
| Mortgage-backed securities               | 143,768              | —  | 143,768   | —  |
| Small Business Administration securities | 61,588               | —  | 61,588  | —  |

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|                                |            |        |            |      |
|--------------------------------|------------|--------|------------|------|
| State and local government     | 56,004     | —      | 56,004     | —    |
| Corporate and other securities | 850        | 790    | 60         | —    |
|                                | 264,824    | 790    | 264,034    | —    |
| Loans held for sale            | 5,093      | —      | 5,093      | —    |
| Total                          | \$ 269,917 | \$ 790 | \$ 269,127 | \$ — |

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**Note 6—Fair Value of Financial Instruments – continued**

The following table reconciles the changes in Level 3 financial instruments for the three months ended March 31, 2017 measured on a recurring basis. There were no Level 3 financial instruments for the three months ended March 31, 2018 measured on a recurring basis.

| <b>(Dollars in thousands)</b>               | Corporate<br>Preferred Stock |
|---|------------------------------|
| Beginning Balance                           | \$ 1,000                     |
| Total gains or losses (realized/unrealized) | —                            |
| Included in earnings                        |                              |
| Included in other comprehensive income      | —                            |
| Purchases, issuances, and settlements       | —                            |
| Transfers in and/or out of Level 3          | (1,000 )                     |
| Ending Balance                              | \$ —                         |

The following tables summarize quantitative disclosures about the fair value for each category of assets carried at fair value as of March 31, 2018 and December 31, 2017 that are measured on a non-recurring basis.

(Dollars in thousands)

| Description                   | March<br>31,<br>2018 | Quoted<br>Prices<br>in Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|-------------------------------|----------------------|---|---|--|
| Impaired loans:               |                      |   |   |  |
| Commercial                    | \$—                  | \$ —  | \$ —  | \$ —   |
| Real estate:                  |                      |   |   |  |
| Mortgage-residential          | 435                  | —   | —   | 435  |
| Mortgage-commercial           | 4,421                | —   | —   | 4,421  |
| Consumer:                     |                      |   |   |  |
| Home equity                   | 35                   | —   | —   | 35   |
| Other                         | —                    | —   | —   | —  |
| Total impaired                | 4,891                | —   | —   | 4,891  |
| Other real estate owned:      |                      |   |   |  |
| Construction                  | 828                  | —   | —   | 141  |
| Mortgage-residential          | —                    | —   | —   | —  |
| Mortgage-commercial           | 1,058                | —   | —   | 1,058  |
| Total other real estate owned | 1,887                | —   | —   | 1,887  |
| Total                         | \$6,778              | \$ —  | \$ —  | \$ 6778  |



**Note 6—Fair Value of Financial Instruments – continued**

(Dollars in thousands)

| Description                   | December 31,<br>2017 | Quoted Prices<br>in Active<br>Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|-------------------------------|----------------------|--|---|--|
| Impaired loans:               |                      |  |   |  |
| Commercial & Industrial       | \$ —                 | \$ —   | \$ —  | \$ —   |
| Real estate:                  |                      |  |   |  |
| Mortgage-residential          | 411                  | —  | —   | 411  |
| Mortgage-commercial           | 4,717                | —  | —   | 4,717  |
| Consumer:                     |                      |  |   |  |
| Home equity                   | —                    | —  | —   | —  |
| Other                         | —                    | —  | —   | —  |
| Total impaired                | 5,128                | —  | —   | 5,128  |
| Other real estate owned:      |                      |  |   |  |
| Construction                  | 828                  | —  | —   | 828  |
| Mortgage-residential          | 47                   | —  | —   | 47   |
| Mortgage-commercial           | 1,059                | —  | —   | 1,059  |
| Total other real estate owned | 1,934                | —  | —   | 1,934  |
| Total                         | \$ 7,062             | \$ —   | \$ —  | \$ 7,062   |

The Company has a large percentage of loans with real estate serving as collateral. Loans which are deemed to be impaired are primarily valued on a nonrecurring basis at the fair value of the underlying real estate collateral. Such fair values are obtained using independent appraisals, which the Company considers to be Level 3 inputs. Third party appraisals are generally obtained when a loan is identified as being impaired or at the time it is transferred to OREO. This internal process consists of evaluating the underlying collateral to independently obtained comparable properties. With respect to less complex or smaller credits, an internal evaluation may be performed. Generally, the independent and internal evaluations are updated annually. Factors considered in determining the fair value include, among others, geographic sales trends, the value of comparable surrounding properties and the condition of the property. The aggregate amount of impaired loans was \$4.9 million and \$5.2 million as of March 31, 2018 and December 31, 2017, respectively.

**Note 6—Fair Value of Financial Instruments – continued**

For Level 3 assets and liabilities measured at fair value on a non-recurring basis as of March 31, 2018 and December 31, 2017, the significant unobservable inputs used in the fair value measurements were as follows:

| <b>(Dollars in thousands)</b> | Fair Value as of March 31, 2018    | Valuation Technique                              | Significant Observable Inputs                    | Significant Unobservable Inputs  |
|-------------------------------|------------------------------------|--|--|--|
| OREO                          | \$ 1,887                           | Appraisal Value/Comparison Sales/Other estimates | Appraisals and or sales of comparable properties | Appraisals discounted 6% to 16% for sales commissions and other holding cost |
| Impaired loans                | \$ 4,891                           | Appraisal Value                                  | Appraisals and or sales of comparable properties | Appraisals discounted 6% to 16% for sales commissions and other holding cost |
| <b>(Dollars in thousands)</b> | Fair Value as of December 31, 2017 | Valuation Technique                              | Significant Observable Inputs                    | Significant Unobservable Inputs  |
| OREO                          | \$ 1,934                           | Appraisal Value/Comparison Sales/Other estimates | Appraisals and or sales of comparable properties | Appraisals discounted 6% to 16% for sales commissions and other holding cost |
| Impaired loans                | \$ 5,128                           | Appraisal Value                                  | Appraisals and or sales of comparable properties | Appraisals discounted 6% to 16% for sales commissions and other holding cost |

**Note 7—Deposits**

The Company's total deposits are comprised of the following at the dates indicated:

| Dollars in thousands                                       | March 31,<br>2018 | December 31,<br>2017 |
|--|-------------------|----------------------|
| Non-interest bearing demand deposits                       | \$ 238,132        | \$ 226,546           |
| Interest bearing demand deposits and money market accounts | 379,217           | 364,358              |
| Savings  | 107,686           | 104,756              |
| Time deposits  | 194,863           | 192,663              |
| Total deposits   | \$ 919,898        | \$ 888,323           |

As of March 31, 2018 and December 31, 2017, the Company had time deposits greater than \$250,000 of \$36.8 million and \$38.4 million, respectively.

**Note 8—Reportable Segments**

The Company's reportable segments represent the distinct product lines the Company offers and are viewed separately for strategic planning by management. The Company has four reportable segments:

Commercial and retail banking: The Company's primary business is to provide deposit and lending products and services to its commercial and retail customers.

Mortgage banking: This segment provides mortgage origination services for loans that will be sold to investors in the secondary market.

Investment advisory and non-deposit: This segment provides investment advisory services and non-deposit products.

Corporate: This segment includes the parent company financial information, including interest on parent company debt and dividend income received from First Community Bank (the "Bank").

| Three months ended March 31, 2018<br>(Dollars in thousands) | Commercial<br>and Retail<br>Banking | Mortgage<br>Banking | Investment<br>advisory<br>and<br>non-deposit | Corporate | Eliminations | Consolidated |
|---|-------------------------------------|---------------------|--|-----------|--------------|--------------|
| Dividend and Interest Income                                | \$ 9,128                            | \$ 198              | \$ —   | \$ 909    | \$ (904 )    | 9,331        |
| Interest expense  | 639                                 | —                   | —  | 158       | —            | 797          |
| Net interest income   | \$ 8,489                            | \$ 198              | \$ —   | \$ 751    | \$ (904 )    | \$ 8,534     |
| Provision for loan losses                                   | 202                                 | —                   | —  | —         | —            | 202          |
| Noninterest income  | 1,297                               | 951                 | 383  | —         | —            | 2,631        |
| Noninterest expense   | 6,409                               | 755                 | 340  | 90        | —            | 7,594        |

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|                                |          |        |       |        |         |   |          |
|--------------------------------|----------|--------|-------|--------|---------|---|----------|
| Net income before taxes        | \$ 3,175 | \$ 394 | \$ 43 | \$ 661 | \$ (904 | ) | \$ 3,369 |
| Income tax provision (benefit) | 725      | —      | —     | (65    | )       | — | 660      |
| Net income                     | \$ 2,450 | \$ 394 | \$ 43 | \$ 726 | \$ (904 | ) | \$ 2,709 |

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**Note 8—Reportable Segments – continued**

| Three months ended March 31, 2017 | Commercial<br>and Retail<br>Banking | Mortgage<br>Banking | Investment<br>advisory<br>and<br>non-deposit | Corporate | Eliminations | Consolidated |
|-----------------------------------|-------------------------------------|---------------------|--|-----------|--------------|--------------|
| (Dollars in thousands)            |                                     |                     |  |           |              |              |
| Dividend and Interest Income      | \$ 7,620                            | \$ 59               | \$ —   | \$ 797    | \$ (703 )    | 7,773        |
| Interest expense                  | 583                                 | —                   | —  | 129       | —            | 712          |
| Net interest income               | \$ 7,037                            | \$ 59               | \$ —   | \$ 668    | \$ (703 )    | \$ 7,061     |
| Provision for loan losses         | 116                                 | —                   | —  | —         | —            | 116          |
| Noninterest income                | 1,050                               | 670                 | 258  | —         | —            | 1,978        |
| Noninterest expense               | 5,721                               | 609                 | 294  | 96        | —            | 6,720        |
| Net income before taxes           | \$ 2,250                            | \$ 120              | \$ (36 )                                     | \$ 572    | \$ (703 )    | \$ 2,203     |
| Income tax provision (benefit)    | 486                                 | —                   | —  | (39 )     | —            | 447          |
| Net income                        | \$ 2,736                            | \$ 120              | \$ (36 )                                     | \$ 611    | \$ (703 )    | \$ 1,756     |

| (Dollars in thousands)               | Commercial<br>and Retail<br>Banking | Mortgage<br>Banking | Investment<br>advisory<br>and<br>non-deposit | Corporate  | Eliminations  | Consolidated |
|--------------------------------------|-------------------------------------|---------------------|--|------------|---------------|--------------|
| Total Assets as of March 31, 2018    | \$ 1,051,311                        | \$ 18,361           | \$ 17  | \$ 123,501 | \$ (122,651 ) | \$ 1,070,539 |
| Total Assets as of December 31, 2017 | \$ 1,033,483                        | \$ 16,298           | \$ 19  | \$ 121,326 | \$ (120,395 ) | \$ 1,050,731 |

**Note 9—Mergers and Acquisitions**

On October 20, 2017, the Company acquired all of the outstanding common stock of Cornerstone Bancorp of Easley, South Carolina (“Cornerstone”) the bank holding company for Cornerstone National Bank (“CNB”), in a cash and stock transaction. The total purchase price was approximately \$27.1 million, consisting of \$7.8 million in cash and 877,364 shares of our common stock valued at \$19.3 million based on a provision in the merger agreement that 30% of the outstanding shares of Cornerstone common stock be exchanged for cash and 70% of the outstanding shares of Cornerstone common stock be exchanged for shares of the Company’s common stock. The value of the Company’s common stock issued was determined based on the closing price of the common stock on October 19, 2017 as reported by NASDAQ, which was \$22.05. Cornerstone common shareholders received 0.54 shares of the Company’s common stock in exchange for each share of Cornerstone common stock, or \$11.00 per share, subject to the limitations discussed above. The Company issued 877,364 shares of its common stock in connection with the merger.

The Cornerstone transaction was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at estimated fair value on the acquisition date based on a third party valuation of significant accounts. Fair values are subject to refinement for up to a year.



**Note 9—Mergers and Acquisitions – continued**

The following table presents the assets acquired and liabilities assumed as of October 20, 2017 as recorded by the Company on the acquisition date and initial fair value adjustments.

| (Dollars in thousands, except per share data)                    | As Recorded by<br>Cornerstone | Fair Value<br>Adjustments | As Recorded<br>by the Company |
|--|-------------------------------|---------------------------|-------------------------------|
| <b>Assets</b>  |                               |                           |                               |
| Cash and cash equivalents  | \$ 30,060                     | \$ —                      | \$ 30,060                     |
| Investment securities  | 44,018                        | (358 )                    | (a) 43,660                    |
| Loans  | 60,835                        | (734 )                    | (b) 60,101                    |
| Premises and equipment   | 4,164                         | 573                       | (c) 4,737                     |
| Intangible assets  | —                             | 1,810                     | (d) 1,810                     |
| Bank owned life insurance  | 2,384                         | —                         | 2,384                         |
| Other assets   | 3,082                         | (473 )                    | (e) 2,609                     |
| <b>Total assets</b>  | <b>\$ 144,543</b>             | <b>\$ 818</b>             | <b>\$ 145,361</b>             |
| <b>Liabilities</b>   |                               |                           |                               |
| <b>Deposits:</b>   |                               |                           |                               |
| Noninterest-bearing  | \$ 27,296                     | \$ —                      | \$ 27,296                     |
| Interest-bearing   | 99,152                        | 150                       | (f) 99,302                    |
| <b>Total deposits</b>  | <b>126,448</b>                | <b>150</b>                | <b>126,598</b>                |
| Securities sold under agreements to repurchase                   | 849                           | —                         | 849                           |
| Other liabilities  | 320                           | —                         | 319                           |
| <b>Total liabilities</b>   | <b>127,617</b>                | <b>150</b>                | <b>127,766</b>                |
| <b>Net identifiable assets acquired over liabilities assumed</b> | <b>16,926</b>                 | <b>668</b>                | <b>17,594</b>                 |
| Goodwill   | —                             | 9,510                     | 9,510                         |
| <b>Net assets acquired over liabilities assumed</b>              | <b>\$ 16,926</b>              | <b>\$ 10,178</b>          | <b>\$ 27,104</b>              |
| <b>Consideration:</b>  |                               |                           |                               |
| First Community Corporation common shares issued                 | 877,364                       |                           |                               |
| Purchase price per share of the Company's common stock           | \$ 22.05                      |                           |                               |
|  | \$ 19,346                     |                           |                               |
| Cash exchanged for stock and fractional shares                   | 7,758                         |                           |                               |
| <b>Fair value of total consideration transferred</b>             | <b>\$ 27,104</b>              |                           |                               |

**Explanation of fair value adjustments**

(a)—Adjustment reflects marking the securities portfolio to fair value as of the acquisition date.

(b)—Adjustment reflects the fair value adjustments based on the Company's evaluation of the acquired loan portfolio and excludes the allowance for loan losses recorded by Cornerstone.

(c)—Adjustment reflects the fair value adjustments based on the Company's evaluation of the acquired premises and equipment.

(d)—Adjustment reflects the recording of the core deposit intangible on the acquired deposit accounts.

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**Note 9—Mergers and Acquisitions – continued**

(e)—Adjustment reflects the deferred tax adjustment related to fair value adjustments at 34%.

(f)—Adjustment reflects the fair value adjustment on interest-bearing deposits.

The operating results of the Company for the period ended March 31, 2018 include the operating results of the acquired assets and assumed liabilities for the entire period.

The following table presents certain pro forma information as if Cornerstone had been acquired on January 1, 2017. These results combine the historical results of Cornerstone in the Company's consolidated statement of income and, while certain adjustments were made for the estimated impact of certain fair value adjustments and other acquisition-related activity, they are not indicative of what would have occurred had the acquisition taken place on January 1, 2017

| (Dollars in thousands)  | Pro Forma<br>Three Months Ended<br>March 31, 2017 |
|---|---|
| Total revenues ( <i>net interest income plus noninterest income</i> ) | \$ 10,391   |
| Net income  | \$ 1,912  |

**Note 10—Subsequent Events**

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through the date the financial statements were available to be issued and no subsequent events occurred requiring accrual or disclosure.

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

This report contains statements which constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements may relate to, among other matters, the financial condition, results of operations, plans, objectives, future performance, and business of our Company. Forward-looking statements are based on many assumptions and estimates and are not guarantees of future performance. Our actual results may differ materially from those anticipated in any forward-looking statements, as they will depend on many factors about which we are unsure, including many factors which are beyond our control. The words "may," "would," "could," "should," "will," "expect," "anticipate," "predict," "project," "potential," "continue," "assume," "believe," "intend," "plan," "forecast," "goal," and "estimate," as well as similar expressions are used herein to identify such forward-looking statements. Potential risks and uncertainties that could cause our actual results to differ materially from those anticipated in our forward-looking statements include, without limitation, those described under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017 as filed with the SEC on March 14, 2018 and the following:

- credit losses as a result of, among other potential factors, declining real estate values, increasing interest rates, increasing unemployment, changes in customer payment behavior or other factors;
  - the amount of our loan portfolio collateralized by real estate and weaknesses in the real estate market;
- restrictions or conditions imposed by our regulators on our operations;
- the adequacy of the level of our allowance for loan losses and the amount of loan loss provisions required in future periods;
- examinations by our regulatory authorities, including the possibility that the regulatory authorities may, among other things, require us to increase our allowance for loan losses or write-down assets;
- reduced earnings due to higher other-than-temporary impairment charges resulting from additional decline in the value of our securities portfolio, specifically as a result of increasing default rates, and loss severities on the underlying real estate collateral;
- merger and merger integration risk, including potential customer loss, higher than expected costs, loss of key employees, and business disruption associated with completed combinations, and including the potential inability to identify and successfully negotiate, complete and integrate additional potential combinations with merger or acquisition partners or to realize the benefits and cost savings sought from, and acceptably limit unexpected liabilities associated with, any business combinations;
  - increases in competitive pressure in the banking and financial services industries;
- changes in the interest rate environment which could reduce anticipated or actual margins;
- changes in political conditions or the legislative or regulatory environment, including governmental initiatives affecting the financial services industry;
- general economic conditions resulting in, among other things, a deterioration in credit quality;
- changes occurring in business conditions and inflation;
- changes in access to funding or increased regulatory requirements with regard to funding;
  - increased cybersecurity risk, including potential business disruptions or financial losses;

- changes in deposit flows;
- changes in technology;
- our current and future products, services, applications and functionality and plans to promote them;
- changes in monetary and tax policies;
- changes in accounting standards, policies, estimates, practices and procedures;
- our assumptions and estimates used in applying critical accounting policies, which may prove unreliable, inaccurate or not predictive of actual results;
- the rate of delinquencies and amounts of loans charged-off;
- the rate of loan growth in recent years and the lack of seasoning of a portion of our loan portfolio;
- our ability to maintain appropriate levels of capital, including levels of capital required under the capital rules implementing Basel III;
- our ability to attract and retain key personnel;
- our ability to retain our existing clients, including our deposit relationships;
- adverse changes in asset quality and resulting credit risk-related losses and expenses;
- loss of consumer confidence and economic disruptions resulting from terrorist activities;
- disruptions due to flooding, severe weather or other natural disasters; and
- other risks and uncertainties detailed from time to time in our filings with the SEC.

Because of these and other risks and uncertainties, our actual future results may be materially different from the results indicated by any forward-looking statements. For additional information with respect to factors that could cause actual results to differ from the expectations stated in the forward-looking statements, see “Risk Factors” under Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017. In addition, our past results of operations do not necessarily indicate our future results. Therefore, we caution you not to place undue reliance on our forward-looking information and statements.

All forward-looking statements in this report are based on information available to us as of the date of this report. Although we believe that the expectations reflected in our forward-looking statements are reasonable, we cannot guarantee you that these expectations will be achieved. We undertake no obligation to publicly update or otherwise revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

## Overview

The following discussion describes our results of operations for the three months ended March 31, 2018 as compared to the three-month period ended March 31, 2017 and also analyzes our financial condition as of March 31, 2018 as compared to December 31, 2017. Like most community banks, we derive most of our income from interest we receive on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, on which we pay interest. Consequently, one of the key measures of our success is our amount of net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as deposits. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities.

There are risks inherent in all loans, so we maintain an allowance for loan losses to absorb probable losses on existing loans that may become uncollectible. We establish and maintain this allowance by charging a provision for loan losses against our operating earnings. In the following section we have included a discussion of this process, as well as several tables describing our allowance for loan losses and the allocation of this allowance among our various categories of loans.

In addition to earning interest on our loans and investments, we earn income through fees and other expenses we charge to our customers. We describe the various components of this non-interest income, as well as our non-interest expense, in the following discussion.

The following discussion and analysis identifies significant factors that have affected our financial position and operating results during the periods included in the accompanying financial statements. We encourage you to read this discussion and analysis in conjunction with the financial statements and the related notes and the other statistical information also included in this report.

### **Critical Accounting Policies**

We have adopted various accounting policies that govern the application of accounting principles generally accepted in the United States and with general practices within the banking industry in the preparation of our financial statements. Our significant accounting policies are described in the footnotes to our unaudited consolidated financial statements as of March 31, 2018 and our notes included in the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2017 as filed with the SEC on March 14, 2018.

Certain accounting policies involve significant judgments and assumptions by us that have a material impact on the carrying value of certain assets and liabilities. We consider these accounting policies to be critical accounting policies. The judgment and assumptions we use are based on historical experience and other factors, which we believe to be reasonable under the circumstances. Because of the nature of the judgment and assumptions we make, actual results could differ from these judgments and estimates that could have a material impact on the carrying values of our assets and liabilities and our results of operations.

#### Allowance for Loan Losses

We believe the allowance for loan losses is the critical accounting policy that requires the most significant judgment and estimates used in preparation of our consolidated financial statements. Some of the more critical judgments supporting the amount of our allowance for loan losses include judgments about the credit worthiness of borrowers, the estimated value of the underlying collateral, the assumptions about cash flow, determination of loss factors for estimating credit losses, the impact of current events, and conditions, and other factors impacting the level of probable inherent losses. Under different conditions or using different assumptions, the actual amount of credit losses incurred



by us may be different from management's estimates provided in our consolidated financial statements. Refer to the portion of this discussion that addresses our allowance for loan losses for a more complete discussion of our processes and methodology for determining our allowance for loan losses.

### Goodwill and Other Intangibles

Goodwill represents the excess of the purchase price over the sum of the estimated fair values of the tangible and identifiable intangible assets acquired less the estimated fair value of the liabilities assumed. Goodwill has an indefinite useful life and is evaluated for impairment annually or more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. Qualitative factors are assessed to first determine if it is more likely than not (more than 50%) that the carrying value of goodwill is less than fair value. These qualitative factors include but are not limited to overall deterioration in general economic conditions, industry and market conditions, and overall financial performance. If determined that it is more likely than not that there has been a deterioration in the fair value of the carrying value than the first of a two-step process would be performed. The first step, used to identify potential impairment, involves comparing each reporting unit's estimated fair value to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds estimated fair value, there is an indication of potential impairment and the second step is performed to measure the amount of impairment.

If required, the second step involves calculating an implied fair value of goodwill for each reporting unit for which the first step indicated impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value of the reporting unit, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. An impairment loss cannot exceed the carrying value of goodwill assigned to a reporting unit, and the loss establishes a new basis in the goodwill. Subsequent reversal of goodwill impairment losses is not permitted. Management has determined that the Company has one reporting unit.

Core deposit intangibles consist of costs that resulted from the acquisition of deposits from Savannah River First South, and Cornerstone. Core deposit intangibles represent the estimated value of long-term deposit relationships acquired in this transaction. These costs are amortized over the estimated useful lives of the deposit accounts acquired on a method that we believe reasonably approximates the anticipated benefit stream from the accounts. The estimated useful lives are periodically reviewed for reasonableness.

### Income Taxes and Deferred Tax Assets and Liabilities

Income taxes are provided for the tax effects of the transactions reported in our consolidated financial statements and consist of taxes currently due plus deferred taxes related to differences between the tax basis and accounting basis of certain assets and liabilities, including available-for-sale securities, allowance for loan losses, write downs of OREO properties, accumulated depreciation, net operating loss carry forwards, accretion income, deferred compensation, intangible assets, and pension plan and post-retirement benefits. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred tax assets and liabilities are reflected at income tax rates applicable to the

period in which the deferred tax assets or liabilities are expected to be realized or settled. A valuation allowance is recorded when it is “more likely than not” that a deferred tax asset will not be realized. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. We file a consolidated federal income tax return for the Bank. At March 31, 2018 and December 31, 2017, we were in a net deferred tax asset position.

### Other-Than-Temporary Impairment

We evaluate securities for other-than-temporary impairment at least on a quarterly basis. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) the outlook for receiving the contractual cash flows of the investments, (4) the anticipated outlook for changes in the general level of interest rates, and (5) our intent and ability to retain our investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value or for a debt security whether it is more-likely-than-not that the Company will be required to sell the debt security prior to recovering its fair value (See Note 3 to the Consolidated Financial Statements).

### Business Combinations, Method of Accounting for Loans Acquired

We account for acquisitions under FASB ASC Topic 805, *Business Combinations*, which requires the use of the acquisition method of accounting. All identifiable assets acquired, including loans, are recorded at fair value. No allowance for loan losses related to the acquired loans is recorded on the acquisition date because the fair value of the loans acquired incorporates assumptions regarding credit risk.

Acquired credit-impaired loans are accounted for under the accounting guidance for loans and debt securities acquired with deteriorated credit quality, found in FASB ASC Topic 310-30, *Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality*, and initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loans. Loans acquired in business combinations with evidence of credit deterioration are considered impaired. Loans acquired through business combinations that do not meet the specific criteria of FASB ASC Topic 310-30, but for which a discount is attributable, at least in part to credit quality, are also accounted for under this guidance. Certain acquired loans, including performing loans and revolving lines of credit (consumer and commercial), are accounted for in accordance with FASB ASC Topic 310-20, where the discount is accreted through earnings based on estimated cash flows over the estimated life of the loan.

### **Comparison of Results of Operations for Three Months Ended March 31, 2018 to the Three Months Ended March 31, 2017**

#### Net Income

Our net income for the three months ended March 31, 2018 was \$2.7 million, or \$0.35 diluted earnings per common share, as compared to \$1.8 million, or \$0.26 diluted earnings per common share, for the three months ended March 31, 2017. On October 20, 2017, we completed the acquisition of Cornerstone Bancorp (“Cornerstone”) and its wholly-owned subsidiary, Cornerstone National Bank. The operating results of the acquired assets and assumed liabilities of Cornerstone are included in the operating results of the Company for the quarter ended March 31, 2018. The increase in net income between the two periods is primarily due to an increase in net interest income of \$1.5 million. Average earning assets increased by \$119.4 million in the first quarter of 2018 as compared to the same period in 2017. The net interest margin on a tax equivalent basis increased to 3.66% during the first quarter of 2018 as compared to 3.52% during the first quarter of 2017. On December 22, 2017, the Tax Cuts and Jobs Act was signed into law. The Tax Cuts and Jobs Act, among other things, reduced the corporate tax rate to 21% from 35%, effective

for 2018. As a result of the change in tax rates, our effective tax rate decreased in the first quarter of 2018 (See “Income Tax” below).

Net Interest Income

Please refer to the table at the end of this Item 2 for the yield and rate data for interest-bearing balance sheet components during the three-month periods ended March 31, 2018 and 2017, along with average balances and the related interest income and interest expense amounts.

Net interest income was \$8.5 million and \$7.1 million for the three months ended March 31, 2018 and 2017, respectively. Our net interest margin increased by 19 basis points from 3.42% at March 31, 2017 to 3.61% at March 31, 2018. Average earning assets were \$957.9 million for the quarter ended March 31, 2018 as compared to \$838.5 million in the same period of 2017. The growth in earning assets as well as the 14 basis increase in margin resulted in the \$1.4 million increase in net interest income in the first quarter of 2018 as compared to the first quarter of 2017. Our continued focus on changing the mix of earning assets from investment securities to loans also contributed to our increased net interest margin. During the three months ended March 31, 2017, loans represented 66.5% of average earning assets as compared to 68.7% in the same period of 2018. The yield on loans increased 9 basis points in the first quarter of 2018 (4.69%) as compared to the same period in 2017 (4.60%). The yield on earning assets for the three months ended March 31, 2018 and 2017 was 3.95% and 3.76%, respectively. The yield on our securities portfolio increased from 2.14% for the three months ended March 31, 2017 to 2.39% for the same period in 2018. This increase results from the variable rate portion of the investment portfolio being positively impacted by the three rate increases in the federal funds rate in 2017. The cost of interest-bearing liabilities at 45 basis points remained unchanged in the first quarter 2018 as compared to the first quarter of 2017. During the first quarter of 2018, deposit account funding, excluding time deposits, represented 78.3% of total average deposits. For the first quarter of 2017, funding from these lower cost deposit sources represented 76.5% of total average deposits.

#### Provision and Allowance for Loan Losses

At March 31, 2018 and December 31, 2017, the allowance for loan losses was \$6.0 million, or 0.90% of total loans (excluding loans held for sale), and \$5.8 million, or 0.90% of total loans (excluding loans held for sale), respectively. Loans that were acquired in the acquisition of Cornerstone in 2017 as well as in the acquisition of Savannah River Financial Corporation (“Savannah River”) in 2014 are accounted for under Financial Accounting Standards Board (“FASB”) Accounting Standard Codification (“ASC”) 310-30. These acquired loans were initially measured at fair value, which includes estimated future credit losses expected to be incurred over the life of the loans. The credit component on loans related to cash flows not expected to be collected is not subsequently accreted (non-accretable difference) into interest income. Any remaining portion representing the excess of a loan’s or pool’s cash flows expected to be collected over the fair value is accreted (accretable difference) into interest income. At March 31, 2018 and December 31, 2017, the remaining credit component on loans attributable to acquired loans in the Cornerstone and Savannah River transactions was \$1.4 million and \$1.5 million, respectively. Our provision for loan losses was \$202 thousand and \$116 thousand for the three months ended March 31, 2018 and 2017, respectively. The allowance for loan losses represents an amount which we believe will be adequate to absorb probable losses on existing loans that may become uncollectible. Our judgment as to the adequacy of the allowance for loan losses is based on a number of assumptions about future events, which we believe to be reasonable, but which may or may not prove to be accurate. Our determination of the allowance for loan losses is based on evaluations of the collectability of loans, including consideration of factors such as the balance of impaired loans, the quality, mix, and size of our overall loan portfolio, the experience ability and depth of lending personnel, economic conditions (local and national) that may affect the borrower’s ability to repay, the amount and quality of collateral securing the loans, our historical loan loss experience, and a review of specific problem loans. We also consider subjective issues such as changes in the lending policies and procedures, changes in the local/national economy, changes in volume or type of credits, changes in volume/severity of problem loans, quality of loan review and board of director oversight, and concentrations of credit. Periodically, we adjust the amount of the allowance based on changing circumstances. We charge recognized losses to the allowance and add subsequent recoveries back to the allowance for loan losses.

We perform an analysis quarterly to assess the risk within the loan portfolio. The portfolio is segregated into similar risk components for which historical loss ratios are calculated and adjusted for identified changes in current portfolio characteristics. Historical loss ratios are calculated by product type and by regulatory credit risk classification (See Note 4 – Loans). The annualized weighted average loss ratios over the last 36 months for loans classified substandard, special mention and pass have been approximately 1.96%, 0.82% and 0.01%, respectively. The allowance consists of an allocated and unallocated allowance. The allocated portion is determined by types and ratings of loans within the portfolio. The unallocated portion of the allowance is established for losses that exist in the remainder of the portfolio and compensates for uncertainty in estimating the loan losses. The allocated portion of the allowance is based on historical loss experience as well as certain qualitative factors as explained above. The qualitative factors have been established based on certain assumptions made as a result of the current economic conditions and are adjusted as conditions change to be directionally consistent with these changes. The unallocated portion of the allowance is composed of factors based on management’s evaluation of various conditions that are not directly measured in the estimation of probable losses through the experience formula or specific allowances. The unallocated portion of the allowance is composed of factors based on management’s evaluation of various conditions that are not directly measured in the estimation of probable losses through the experience formula or specific allowances. The overall risk as measured in our three-year lookback, both quantitatively and qualitatively, does not encompass a full economic cycle. The U.S. economy has been in an extended period of recovery and slow economic growth. The period at which we will reach full recovery or revert back to a slowing economy is not determinable. Net charge-offs in the 2009 to 2011 period averaged 63 basis points annualized in our loan portfolio. Over the most recent three-year period, net charge-offs have averaged approximately 5 basis points annualized. We believe the unallocated portion of our allowance represents potential risk associated throughout a full economic cycle. With an anemic national economic recovery, subpar inflation, geopolitical risks, and global economic slowdown, management does not believe it would be judicious to reduce substantially the overall level of the allowance at this time.

Our Company has a significant portion of its loan portfolio with real estate as the underlying collateral. At March 31, 2018 and December 31, 2017, approximately 91.6% and 90.4%, respectively, of the loan portfolio had real estate collateral. When loans, whether commercial or personal, are granted, they are based on the borrower’s ability to generate repayment cash flows from income sources sufficient to service the debt. Real estate is generally taken to reinforce the likelihood of the ultimate repayment and as a secondary source of repayment. We work closely with all our borrowers that experience cash flow or other economic problems, and we believe that we have the appropriate processes in place to monitor and identify problem credits. There can be no assurance that charge-offs of loans in future periods will not exceed the allowance for loan losses as estimated at any point in time or that provisions for loan losses will not be significant to a particular accounting period. The allowance is also subject to examination and testing for adequacy by regulatory agencies, which may consider such factors as the methodology used to determine adequacy and the size of the allowance relative to that of peer institutions. Such regulatory agencies could require us to adjust our allowance based on information available to them at the time of their examination.

Non-performing assets were \$5.1 million (0.47% of total assets) at March 31, 2018 as compared to \$5.3 million (0.51% of total assets) at December 31, 2017. While we believe the non-performing assets to total assets ratios are favorable in comparison to current industry results (both nationally and locally), we continue to be concerned about the impact of this economic environment on our customer base of local businesses and professionals. There were 34 loans totaling \$3.1 million included in non-performing status (non-accrual loans and loans past due 90 days and still accruing) at March 31, 2018. The largest loan included in non-accrual status is in the amount of \$825 thousand and is secured by a first mortgage on developed lots to be sold for residential use. The average balance of the remaining 33 loans is approximately \$70 thousand, and the majority of these loans are secured by first mortgage liens. At the time the loans are placed in non-accrual status, we typically obtain an updated appraisal and, if the loan balance exceeds

fair value, write the balance down to the fair value. At March 31, 2018, we had loans totaling \$3.3 million that were delinquent 30 days to 89 days representing 0.49% of total loans.

Our management continuously monitors non-performing, classified and past due loans to identify deterioration regarding the condition of these loans. At March 31, 2018, there have been no loans identified as potential problem loans.



The following table summarizes the activity related to our allowance for loan losses for the periods indicated:

Allowance for Loan Losses

| (Dollars in thousands)                                    | Three Months Ended |           |       |   |
|---|--------------------|-----------|-------|---|
|   | March 31,          |           |       |   |
|   | 2018               | 2017      |       |   |
| Average loans outstanding (including loans held for sale) | \$658,227          | \$557,512 |       |   |
| Loans outstanding at period end                           | \$668,583          | \$555,298 |       |   |
| Non-performing assets:                                    |                    |           |       |   |
| Nonaccrual loans  | \$3,117            | \$3,465   |       |   |
| Loans 90 days past due still accruing                     | 34                 | 108       |       |   |
| Foreclosed real estate                                    | 1,887              | 1,156     |       |   |
| Repossessed-other   | 20                 | —         |       |   |
| Total non-performing assets                               | \$5,058            | \$4,729   |       |   |
| Beginning balance of allowance                            | \$5,797            | \$5,214   |       |   |
| Loans charged-off:  |                    |           |       |   |
| Construction and development                              | —                  | —         |       |   |
| 1-4 family residential mortgage                           | 1                  | —         |       |   |
| Non-residential real estate                               | —                  | 24        |       |   |
| Home equity   | 47                 | —         |       |   |
| Commercial  | —                  | —         |       |   |
| Installment & credit card                                 | —                  | 27        |       |   |
| Total loans charged-off                                   | 48                 | 51        |       |   |
| Recoveries:   |                    |           |       |   |
| 1-4 family residential mortgage                           | —                  | 1         |       |   |
| Non-residential real estate                               | 27                 | 81        |       |   |
| Home equity   | —                  | 1         |       |   |
| Commercial  | —                  | 2         |       |   |
| Installment & credit card                                 | 8                  | 4         |       |   |
| Total recoveries  | 35                 | 89        |       |   |
| Net loan charge offs (recoveries)                         | 12                 | (38 )     |       |   |
| Provision for loan losses                                 | 202                | 116       |       |   |
| Balance at period end                                     | \$5,986            | \$5,368   |       |   |
| Net charge offs (recoveries) to average loans             | 0.00               | %         | -0.01 | % |
| Allowance as percent of total loans                       | 0.90               | %         | 0.96  | % |
| Non-performing assets as% of total assets                 | 0.47               | %         | 0.52  | % |
| Allowance as% of non-performing loans                     | 190.0              | %         | 150.2 | % |

The following allocation of the allowance to specific components is not necessarily indicative of future losses or future allocations. The entire allowance is available to absorb losses in the portfolio.

### Composition of the Allowance for Loan Losses

| (Dollars in thousands)                 | March 31, 2018 |                        | December 31, 2017 |                        |   |
|--|----------------|------------------------|-------------------|------------------------|---|
|  | Amount         | % of loans in Category | Amount            | % of loans in Category |   |
| Commercial, Financial and Agricultural | \$210          | 6.7                    | % \$221           | 7.9                    | % |
| Real Estate – Construction             | 98             | 6.6                    | % 101             | 7.0                    | % |
| Real Estate Mortgage:                  |                |                        |                   |                        |   |
| Residential                            | 716            | 7.0                    | % 461             | 7.2                    | % |
| Commercial                             | 3,117          | 73.1                   | % 3,077           | 71.2                   | % |
| Consumer:                              |                |                        |                   |                        |   |
| Home Equity                            | 479            | 4.9                    | % 308             | 5.0                    | % |
| Other                                  | 63             | 1.7                    | % 35              | 1.7                    | % |
| Unallocated                            | 1,303          | N/A                    | 1,594             | N/A                    |   |
| Total                                  | \$5,986        | 100.0                  | % \$5,797         | 100.0                  | % |

Accrual of interest is discontinued on loans when management believes, after considering economic and business conditions and collection efforts that a borrower's financial condition is such that the collection of interest is doubtful. A delinquent loan is generally placed in nonaccrual status when it becomes 90 days or more past due. At the time a loan is placed in nonaccrual status, all interest, which has been accrued on the loan but remains unpaid is reversed and deducted from earnings as a reduction of reported interest income. No additional interest is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain.

### Non-interest Income and Non-interest Expense

Non-interest income during the first quarter of 2018 was \$2.6 million as compared to \$2.0 million during the same period in 2017. Deposit service charges increased \$143 thousand during the first quarter of 2018 as compared to the same period in 2017. This is primarily a result of the Cornerstone acquisition in October 2017 as well as organic increases in transaction deposit account balances. Mortgage banking income and investment advisory fees accounted for \$281 thousand and \$125 thousand, respectively, of the increase in the first quarter of 2018 as compared to the same period in 2017. The increase in mortgage banking income is a result of a continued focus on this source of revenue. Prior to the first quarter of 2018, we did not have mortgage originators located in our Augusta or Greenville markets. We have recently added an originator in each of these markets. An increase in assets under management has contributed to the increase in investment advisory fee income. At March 31, 2018, we had \$271.5 million in assets under management as compared to \$214.0 million at March 31, 2017. Management continues to focus on increasing both the mortgage banking income as well as the investment advisory fees and commissions.

Non-interest income, other increased \$209 thousand in the first quarter of 2018 as compared to the same period in 2017. This increase results primarily from additional miscellaneous fees and income on bank owned life insurance ("BOLI") as a result of the Cornerstone transaction. In addition, we sold excess real estate and wrote down the balance

of another excess real estate lot which resulted in a net increase of approximately \$80 thousand and which is included in Non-interest Income "Other" for the quarter ended March 31, 2018.

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Total non-interest expense increased \$874 thousand in first quarter of 2018 to \$7.6 million as compared to \$6.7 million in the first quarter of 2017. Salary and benefit expense increased \$491 thousand from \$4.1 million in the first quarter of 2017 to \$4.6 million in the first quarter of 2018. This increase is primarily a result of the normal salary adjustments, as well as the addition of the employees as a result of the Cornerstone acquisition. In addition to the increase in mortgage banking income between the two quarters, there was an increase in mortgage commissions paid to the mortgage originators. At March 31, 2018 and 2017, we had 230 and 196 full time equivalent employees, respectively. Marketing and public relations expense decreased from \$221 thousand in the first quarter of 2017 to \$89 thousand in the first quarter of 2018. The timing of a media campaign impacts the recognition of marketing expense, and it is expected that the overall 2018 annual media cost will not vary substantially from the annual cost incurred in 2017. Amortization of intangibles increased to \$142 thousand in the first quarter of 2018 from \$75 thousand in the same quarter of 2017. This increase is a result of the amortization of core deposit intangible acquired in the Cornerstone transaction. Total core deposit intangible in this transaction amounted to approximately \$1.8 million. The amortization is being recognized on a 150% declining balance method over ten years. As noted in prior periods, in June of 2017, the Company moved its core data processing system from an in-house environment to an outsourcing environment with a different vendor. As a result, some costs associated with data processing prior to this conversion were captured in the furniture fixtures and equipment category, postage as well as other categories. The data processing and related cost are now all primarily included in this one category which accounts for substantially all of the increase. In addition, growth in accounts resulting from organic growth as well as the acquisition of Cornerstone increased data processing costs.

The following is a summary of the components of other non-interest expense for the periods indicated:

| (Dollars in thousands)               | Three months ended |          |
|--------------------------------------|--------------------|----------|
|                                      | March 31,          |          |
|                                      | 2018               | 2017     |
| Data processing                      | \$ 574             | \$ 167   |
| Supplies                             | 36                 | 30       |
| Telephone                            | 116                | 89       |
| Courier                              | 38                 | 25       |
| Correspondent services               | 70                 | 53       |
| Insurance                            | 60                 | 111      |
| Postage                              | 18                 | 47       |
| Legal and professional fees          | 253                | 253      |
| Loss on limited partnership interest | 12                 | 48       |
| Director fees                        | 94                 | 71       |
| Shareholder expense                  | 50                 | 56       |
| Dues                                 | 35                 | 30       |
| Subscriptions                        | 50                 | 49       |
| Loan closing costs/fees              | 4                  | 53       |
| Other                                | 282                | 178      |
|                                      | \$ 1,692           | \$ 1,260 |

### Income Tax Expense

Our effective tax rate was 19.6% and 20.3% in the first quarter of 2018 and 2017, respectively. The effective rate in 2018 is impacted by the passing of the Tax Cut and Jobs Act on December 22, 2017. The federal tax rate prior to this change was 34%, and beginning January 1, 2018, the rate was lowered to 21%. In 2017, the accounting for share-based compensation changed the recognition of the tax effects of deductions for tax purposes of compensation cost not recognized in the income statement. Previously, the income tax effects of these deductions were recorded directly to equity. Beginning in 2017, all of the tax effects of share-based compensation are recognized in the income statement. The tax benefit is recognized at the time of settlement of the share-based payments. During the first quarter of 2017, the recognition of settled share-based payments reduced tax expense by approximately \$115 thousand or 5.2%. In 2018, the impact of these share-based payments was approximately \$14 thousand. This change may increase the volatility of income tax expense in future periods when share-based compensation is settled or vests. As a result, of our current level of tax exempt securities in our investment portfolio and our BOLI holdings, the effective tax rate is expected to be 19.5% to 20.0% throughout the remainder of 2018. There are no share based payments scheduled to vest or settle during the remainder of 2018.

## Financial Position

Assets totaled \$1.1 billion at March 31, 2018 and at 2017. Loans increased by approximately \$21.8 million during the quarter ended March 31, 2018. Loans (excluding loans held for sale) at March 31, 2018 were \$668.6 million as compared to \$646.8 million at December 31, 2017. Total loan production was \$32.4 million during the first quarter of 2018. At March 31, 2018 and December 31, 2017, loans (excluding loans held for sale) accounted for 68.6% and 67.9% of earning assets, respectively. The loan-to-deposit ratio at March 31, 2018 and December 31, 2017 was 73.5% and 73.4%, respectively. Investment securities decreased to \$272.6 million at March 31, 2018 from \$284.4 million at December 31, 2017. Deposits increased \$31.6 million to \$919.9 million at March 31, 2018 as compared to \$888.3 million at December 31, 2017. This \$31.6 million increase was primarily used to fund the \$21.8 million in loan growth and pay down approximately \$14.0 million in short-term FHLB advances. Pure deposits (deposits less time deposits) represented 82.5% of total deposits as of March 31, 2018 as compared to 82.1% at December 31, 2017. We continue to focus on growing our pure deposits as a percentage of total deposits in order to better manage our overall cost of funds. One of our goals as a community bank has been, and continues to be, to grow our assets through quality loan growth by providing credit to small and mid-size businesses and individuals within the markets we serve. We remain committed to meeting the credit needs of our local markets. A slow-down in the national or local economic conditions as well as deterioration of asset quality within our Company could significantly impact our ability to continue to grow our loan portfolio.

The following table shows the composition of the loan portfolio by category at the dates indicated:

| (In thousands)                       | March 31, 2018 |         | December 31, 2017 |         |  |  |
|--------------------------------------|----------------|---------|-------------------|---------|--|--|
|                                      | Amount         | Percent | Amount            | Percent |  |  |
| Commercial, financial & agricultural | \$44,724       | 6.7 %   | \$51,040          | 7.9 %   |  |  |
| Real estate:                         |                |         |                   |         |  |  |
| Construction                         | 44,273         | 6.6 %   | 45,401            | 7.0 %   |  |  |
| Mortgage – residential               | 46,801         | 7.0 %   | 46,901            | 7.2 %   |  |  |
| Mortgage – commercial                | 488,597        | 73.1 %  | 460,276           | 71.2 %  |  |  |
| Consumer:                            |                |         |                   |         |  |  |
| Home Equity                          | 32,544         | 4.9 %   | 32,451            | 5.0 %   |  |  |
| Other                                | 11,644         | 1.7 %   | 10,736            | 1.7 %   |  |  |
| Total gross loans                    | 668,583        | 100.0 % | 646,805           | 100.0 % |  |  |
| Allowance for loan losses            | (5,986 )       |         | (5,797 )          |         |  |  |
| Total net loans                      | \$662,597      |         | \$641,008         |         |  |  |

In the context of this discussion, a real estate mortgage loan is defined as any loan, other than loans for construction purposes and advances on home equity lines of credit, secured by real estate, regardless of the purpose of the loan. Advances on home equity lines of credit are included in consumer loans. We follow the common practice of financial institutions in our market areas of obtaining a security interest in real estate whenever possible, in addition to any other available collateral. This collateral is taken to reinforce the likelihood of the ultimate repayment of the loan and tends to increase the magnitude of the real estate loan components. Generally we limit the loan-to-value ratio to 80%.

## Market Risk Management

The effective management of market risk is essential to achieving our strategic financial objectives. Our most significant market risk is interest rate risk. We have established an Asset/Liability Management Committee (“ALCO”) to monitor and manage interest rate risk. The ALCO monitors and manages the pricing and maturity of assets and liabilities in order to diminish the potential adverse impact that changes in interest rates could have on net interest income. The ALCO has established policy guidelines and strategies with respect to interest rate risk exposure and liquidity.

A monitoring technique employed by the ALCO is the measurement of interest sensitivity “gap,” which is the positive or negative dollar difference between assets and liabilities that are subject to interest rate repricing within a given period of time. Simulation modeling is performed to assess the impact varying interest rates and balance sheet mix assumptions will have on net interest income. We model the impact on net interest income for several different changes, to include a flattening, steepening and parallel shift in the yield curve. For each of these scenarios, we model the impact on net interest income in an increasing and decreasing rate environment of 100 and 200 basis points. Policies have been established in an effort to maintain the maximum anticipated negative impact of these modeled changes in net interest income at no more than 10% and 15% in a 100 and 200 basis point change in interest rates, respectively, over a twelve month period. Interest rate sensitivity can be managed by repricing assets or liabilities, selling securities available-for-sale, replacing an asset or liability at maturity or by adjusting the interest rate during the life of an asset or liability. Managing the amount of assets and liabilities repricing in the same time interval helps to hedge the risk and minimize the impact on net interest income of rising or falling interest rates.

We are currently asset sensitive within one year. However, neither the “gap” analysis nor asset/liability simulation modeling is a precise indicator of our interest sensitivity position due to the many factors that affect net interest income, including changes in the volume and mix of earning assets and interest-bearing liabilities.

Based on the many factors and assumptions used in simulating the effect of changes in interest rates, the following table estimates the percentage change in net interest income at March 31, 2018 and December 31, 2017 over twelve months.

### *Net Interest Income Sensitivity*

| Change in short-term interest rates | Hypothetical percentage change in net interest income |                   |   |
|-------------------------------------|---|-------------------|---|
|                                     | March 31, 2018  | December 31, 2017 |   |
| +200bp                              | -2.40 %   | -2.26             | % |
| +100bp                              | -1.23 %   | -0.85             | % |
| Flat                                | —   | —                 |   |
| -100bp                              | -1.36 %   | -2.54             | % |

-200bp                      -6.86 %      -7.71                      %

The decrease in net interest income in a down 200 basis point environment primarily results from the current level of interest rates being paid on our interest bearing transaction accounts as well as money market accounts. The interest rates on these accounts are at a level where they may not be repriced in proportion to the change in interest rates. At the current low interest rate levels, we believe that a downward shift of 200 basis points across the entire yield curve is unlikely.

We also perform a valuation analysis projecting future cash flows from assets and liabilities to determine the Present Value of Equity (“PVE”) over a range of changes in market interest rates. The sensitivity of PVE to changes in interest rates is a measure of the sensitivity of earnings over a longer time horizon. At March 31, 2018, the PVE exposure in a plus 200 basis point increase in market interest rates was estimated to be (0.39)% as compared to (0.09)% at December 31, 2017.



## Liquidity and Capital Resources

We believe our liquidity remains adequate to meet operating and loan funding requirements. Interest-bearing bank balances, federal funds sold, and investment securities available-for-sale represent 26.3% of total assets at March 31, 2018. We believe that our existing stable base of core deposits along with continued growth in this deposit base will enable us to meet our long-term and short-term liquidity needs successfully. These needs include the ability to respond to short-term demand for funds caused by the withdrawal of deposits, maturity of repurchase agreements, extensions of credit and the payment of operating expenses. Other sources of liquidity, in addition to deposit gathering activities, include maturing loans and investments, purchase of federal funds from other financial institutions and selling securities under agreements to repurchase. We monitor closely the level of large certificates of deposits in amounts of \$100 thousand or more as they tend to be more sensitive to interest rate changes and, thus, less reliable sources of funding for liquidity purposes. At March 31, 2018, the amount of time deposits of \$100 thousand or more represented 9.0% of total deposits and the amount of time deposits of \$250 thousand or more represented 4.0% of deposits. The majority of these deposits are issued to local customers many of whom have other product relationships with the Bank.

Through the operations of our Bank, we have made contractual commitments to extend credit in the ordinary course of our business activities. These commitments are legally binding agreements to lend money to our customers at predetermined interest rates for a specified period of time. At March 31, 2018, we had issued commitments to extend credit of \$121.4 million, including \$39 million in unused home equity lines of credit, through various types of lending arrangements. We evaluate each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by us upon extension of credit, is based on our credit evaluation of the borrower. Collateral varies but may include accounts receivable, inventory, property, plant and equipment, commercial and residential real estate. We manage the credit risk on these commitments by subjecting them to normal underwriting and risk management processes.

Other than as described elsewhere in this report, we are not aware of any trends, events or uncertainties that we expect to result in a significant adverse effect on our liquidity position. However, no assurances can be given in this regard, as rapid growth, deterioration in loan quality, and poor earnings, or a combination of these factors, could change the liquidity position in a relatively short period of time.

The Company has generally maintained a high level of liquidity and adequate capital, which along with continued retained earnings, we believe will be sufficient to fund the operations of the Bank for at least the next 12 months. Shareholders' equity was 9.9% of total assets at March 31, 2018 and 10.1% at December 31, 2017. The Bank maintains federal funds purchased lines in the total amount of \$20.0 million with two financial institutions, although these were not utilized in the first quarter of 2018. The FHLB of Atlanta has approved a line of credit of up to 25% of the Bank's assets, which when utilized is collateralized by a pledge against specific investment securities and/or eligible loans. We regularly review the liquidity position of the Company and have implemented internal policies establishing guidelines for sources of asset based liquidity and evaluate and monitor the total amount of purchased funds used to support the balance sheet and funding from noncore sources. We believe that our existing stable base of core deposits along with continued growth in this deposit base will enable us to meet our long term liquidity needs successfully.

Regulatory capital rules released by the federal bank regulatory agencies in July 2013 to implement capital standards, referred to as Basel III and developed by an international body known as the Basel Committee on Banking Supervision, impose higher minimum capital requirements for bank holding companies and banks. The regulatory capital rules became effective for the Company and the Bank on January 1, 2015 (subject to a phase-in period for certain provisions), and all of the requirements in the rules will be fully phased in by January 1, 2019.

The final rule includes certain new and higher risk-based capital and leverage requirements than those previously in place. Specifically, the following minimum capital requirements apply to us:

- a new Common Equity Tier 1 risk-based capital ratio of 4.5%;
- a Tier 1 risk-based capital ratio of 6% (increased from the former 4% requirement);
- a total risk-based capital ratio of 8% (unchanged from former requirements); and
- a leverage ratio of 4% (also unchanged from the former requirement).

Under the rules, Tier 1 capital is redefined to include two components: Common Equity Tier 1 capital and additional Tier 1 capital. The new and highest form of capital, Common Equity Tier 1 capital, consists solely of common stock (plus related surplus), retained earnings, accumulated other comprehensive income, and limited amounts of minority interests that are in the form of common stock. Additional Tier 1 capital includes other perpetual instruments historically included in Tier 1 capital, such as noncumulative perpetual preferred stock. The rules permit bank holding companies with less than \$15 billion in total consolidated assets to continue to include trust preferred securities and cumulative perpetual preferred stock issued before May 19, 2010 in Tier 1 capital, but not in Common Equity Tier 1 capital, subject to certain restrictions. Tier 2 capital consists of instruments that currently qualify in Tier 2 capital plus instruments that the rules have disqualified from Tier 1 capital treatment. Cumulative perpetual preferred stock, formerly includable in Tier 1 capital, is now included only in Tier 2 capital. Accumulated other comprehensive income (“AOCI”) is presumptively included in Common Equity Tier 1 capital and often would operate to reduce this category of capital. The rules provided a one-time opportunity at the end of the first quarter of 2015 for covered banking organizations to opt out of much of this treatment of AOCI. We elected to opt out from the inclusion of AOCI in Common Equity Tier 1 capital.

In addition, in order to avoid restrictions on capital distributions or discretionary bonus payments to executives, a covered banking organization must maintain a “capital conservation buffer” on top of its minimum risk-based capital requirements. This buffer must consist solely of Tier 1 Common Equity, but the buffer applies to all three measurements (Common Equity Tier 1, Tier 1 capital and total capital). The capital conservation buffer will be phased in incrementally over time, becoming fully effective on January 1, 2019, and will consist of an additional amount of common equity equal to 2.5% of risk-weighted assets. As of January 1, 2018, we are required to hold a capital conservation buffer of 1.875%, increasing to 2.5% effective January 1, 2019.

In general, the rules have had the effect of increasing capital requirements by increasing the risk weights on certain assets, including high volatility commercial real estate, certain loans past due 90 days or more or in nonaccrual status, mortgage servicing rights not includable in Common Equity Tier 1 capital, equity exposures, and claims on securities firms, that are used in the denominator of the three risk-based capital ratios.

As of March 31, 2018, the Company and the Bank meet all capital adequacy requirements under the rules on a fully phased-in basis if such requirements had been effective at that time. The Bank’s risk-based capital ratios of leverage ratio, Tier 1, and total capital were 9.7%, 13.3% and 14.1%, respectively, at March 31, 2018 as compared to 9.7%, 13.4%, and 14.2%, respectively, at December 31, 2017. The Bank’s CET1 ratio at March 31, 2018 was 13.3% and 13.4% at December 31, 2017. The Company’s risk-based capital ratios of leverage ratio, Tier 1, and total capital were

10.2%, 13.9% and 14.7%, respectively, at March 31, 2018 as compared to 10.1%, 14.0% and 14.8%, respectively, at December 31, 2017. The Company's CET1 ratio at March 31, 2018 and December 31, 2017 was 12.0% and 12.1%, respectively. Our management anticipates that the Bank and the Company will remain a well-capitalized institution for at least the next 12 months.

Since the Company is a bank holding company, its ability to declare and pay dividends is dependent on certain federal and state regulatory considerations, including the guidelines of the Federal Reserve Board. The Federal Reserve Board has issued a policy statement regarding the payment of dividends by bank holding companies. In general, the Federal Reserve Board's policies provide that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the bank holding company appears consistent with the organization's capital needs, asset quality and overall financial condition. The Federal Reserve Board's policies also require that a bank holding company serve as a source of financial strength to its subsidiary banks by standing ready to use available resources to provide adequate capital funds to those banks during periods of financial stress or adversity and by maintaining the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks where necessary. In addition, under the prompt corrective action regulations, the ability of a bank holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. These regulatory policies could affect the ability of the Company to pay dividends or otherwise engage in capital distributions.

In addition, since the Company is a legal entity separate and distinct from the Bank and does not conduct stand-alone operations, its ability to pay dividends depends on the ability of the Bank to pay dividends to it, which is also subject to regulatory restrictions. As a South Carolina chartered bank, the Bank is subject to limitations on the amount of dividends that it is permitted to pay. Unless otherwise instructed by the South Carolina Board of Financial Institutions, the Bank is generally permitted under South Carolina State banking regulations to pay cash dividends of up to 100% of net income in any calendar year without obtaining the prior approval of the South Carolina Board of Financial Institutions. The FDIC also has the authority under federal law to enjoin a bank from engaging in what in its opinion constitutes an unsafe or unsound practice in conducting its business, including the payment of a dividend under certain circumstances.

**FIRST COMMUNITY CORPORATION****Yields on Average Earning Assets and Rates****on Average Interest-Bearing Liabilities**

|   | Three months ended March 31,<br>2018 |                         |                | Three months ended March 31,<br>2017 |                         |                |
|---|--------------------------------------|-------------------------|----------------|--------------------------------------|-------------------------|----------------|
|   | Average<br>Balance                   | Interest<br>Earned/Paid | Yield/<br>Rate | Average<br>Balance                   | Interest<br>Earned/Paid | Yield/<br>Rate |
| <b>Assets</b>                                   |                                      |                         |                |                                      |                         |                |
| <b>Earning assets</b>                           |                                      |                         |                |                                      |                         |                |
| Loans   | \$658,227                            | \$ 7,617                | 4.69 %         | \$557,512                            | \$ 6,326                | 4.60 %         |
| Securities:                                     | 278,666                              | 1,643                   | 2.39 %         | 268,121                              | 1,418                   | 2.14 %         |
| Other short-term investments                    | 21,019                               | 71                      | 1.37 %         | 12,869                               | 29                      | 0.91 %         |
| Total earning assets                            | 957,912                              | 9,331                   | 3.95 %         | 838,502                              | 7,773                   | 3.76 %         |
| Cash and due from banks                         | 13,671                               |                         |                | 10,965                               |                         |                |
| Premises and equipment                          | 35,566                               |                         |                | 30,168                               |                         |                |
| Intangibles                                     | 17,083                               |                         |                | 6,142                                |                         |                |
| Other assets                                    | 36,141                               |                         |                | 32,181                               |                         |                |
| Allowance for loan losses                       | (5,868 )                             |                         |                | (5,274 )                             |                         |                |
| Total assets                                    | \$1,054,505                          |                         |                | \$912,684                            |                         |                |
| <b>Interest-bearing liabilities</b>             |                                      |                         |                |                                      |                         |                |
| Interest-bearing transaction accounts           | 186,042                              | 68                      | 0.15 %         | 156,165                              | 43                      | 0.11 %         |
| Money market accounts                           | 177,692                              | 144                     | 0.33 %         | 168,036                              | 105                     | 0.25 %         |
| Savings deposits                                | 106,541                              | 38                      | 0.14 %         | 72,141                               | 21                      | 0.12 %         |
| Time deposits                                   | 193,221                              | 297                     | 0.62 %         | 178,235                              | 273                     | 0.62 %         |
| Other borrowings                                | 50,087                               | 250                     | 2.02 %         | 65,662                               | 270                     | 1.67 %         |
| Total interest-bearing liabilities              | 713,583                              | 797                     | 0.45 %         | 640,239                              | 712                     | 0.45 %         |
| Demand deposits                                 | 227,785                              |                         |                | 182,790                              |                         |                |
| Other liabilities                               | 7,546                                |                         |                | 7,125                                |                         |                |
| Shareholders' equity                            | 105,591                              |                         |                | 82,530                               |                         |                |
| Total liabilities and shareholders' equity      | \$1,054,505                          |                         |                | \$912,684                            |                         |                |
| <b>Cost of funds including demand deposits</b>  |                                      |                         |                |                                      |                         |                |
| Net interest spread                             |                                      |                         | 0.34 %         |                                      |                         | 0.35 %         |
| Net interest income/margin                      |                                      | \$ 8,534                | 3.50 %         |                                      | \$ 7,061                | 3.31 %         |
| Net interest income/margin (taxable equivalent) |                                      | \$ 8,652                | 3.61 %         |                                      | \$ 7,279                | 3.42 %         |
|   |                                      |                         | 3.66 %         |                                      |                         | 3.52 %         |

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

There have been no material changes in our quantitative and qualitative disclosures about market risk as of March 31, 2018 from that presented in our Annual Report on Form 10-K for the year ended December 31, 2017. See the "Market Risk Management" subsection in Item 2, Management's Discussion and Analysis of Financial Condition and Results of

Operations, for quantitative and qualitative disclosures about market risk, which information is incorporated herein by reference.

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Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports we file and submit under the Exchange Act is (i) recorded, processed, summarized and reported as and when required and (ii) accumulated and communicated to our management, including our Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

The design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of future events. There can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

*Changes in Internal Control over Financial Reporting*

There has been no change in the Company's internal control over financial reporting during the three months ended March 31, 2018 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.**

We are a party to claims and lawsuits arising in the course of normal business activities. Management is not aware of any material pending legal proceedings against the Company which, if determined adversely, the Company believes would have a material adverse impact on the Company's financial position, results of operations or cash flows.

**Item 1A. Risk Factors.**

Not Applicable.

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

Not Applicable.

**Item 3. Defaults Upon Senior Securities.**

Not Applicable.

**Item 4. Mine Safety Disclosures.**

Not Applicable.

**Item 5. Other Information.**



As set forth in the Company’s proxy statement filed with the SEC on April 6, 2018, on February 20, 2018, the Compensation Committee of the Board of Directors of the Company adopted the 2018 Management Incentive Plan for Key Executives (the “Plan”) to provide for the payment of cash bonuses to the Company’s named executive officers upon the Company’s achievement of certain plan criteria goals during 2018. The Plan was designed to be consistent with the Company’s philosophy that executive compensation should be linked with the Company’s financial performance. In order for any bonus to be paid to any executive officer under the Plan, the Company must achieve at least 80% of budgeted net income for the year and maintain a specified regulatory rating. Upon meeting certain goals for return on average assets, efficiency ratio, non-performing asset ratio, loan portfolio growth and deposit growth, the executive officers are eligible to receive a 20% cash payout at the target and a maximum of 30%. The chief executive officer is eligible to receive 30% at the target level and 45% at the maximum level. Payouts are pro-rated if actual results fall between the threshold, target and maximum levels.

The following sets forth the pre-established performance goals for which the annual cash incentive awards for the year ended December 31, 2018 will be based:

|  | Weight as<br>percent<br>of Salary | Threshold                   | Target                      | Maximum                     |
|--|-----------------------------------|-----------------------------|-----------------------------|-----------------------------|
| <b>CEO – total opportunity</b>             |                                   | 0%                          | 30%                         | 45%                         |
| <b>All Other NEO’s – total opportunity</b> |                                   | 0%                          | 20%                         | 30%                         |
| Return on average assets (1)               | 25%                               | 35 <sup>th</sup> percentile | 50 <sup>th</sup> percentile | 75 <sup>th</sup> percentile |
| Efficiency ratio (1)                       | 15%                               | 35 <sup>th</sup> percentile | 50 <sup>th</sup> percentile | 75 <sup>th</sup> percentile |
| Net interest margin (1)                    | 15%                               | 35 <sup>th</sup> percentile | 50 <sup>th</sup> percentile | 75 <sup>th</sup> percentile |
| Loan portfolio growth (2)                  | 30%                               | 97% of budget               | Budget                      | 105% of budget              |
| Pure deposit growth (2) (3)                | 15%                               | 97% of budget               | Budget                      | 105% of budget              |

(1) Performance compared to peer group. Data is compiled from each of the Company’s peer group institution’s 2017 regulatory reports as reported publicly.

(2) Base on internal 2018 budget.

(3) Pure deposits include total deposits less certificates of deposits.

**Item 6. Exhibits.**

Exhibit Description

31.1 Rule 13a-14(a) Certification of the Principal Executive Officer.

31.2 Rule 13a-14(a) Certification of the Principal Financial Officer.

32 Section 1350 Certifications

101 The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2018, formatted in eXtensible Business Reporting Language (XBRL); (i) Consolidated Balance Sheets at March 31, 2018 and December 31, 2017, (ii) Consolidated Statements of Income for the three months ended March 31, 2018 and 2017, (iii) Consolidated Statements of Comprehensive Income for the three months ended March 31, 2018 and 2017 (iv) Consolidated Statements of Changes in Shareholders' Equity for the three months ended March 31, 2018 and 2017, (v) Consolidated Statements of Cash Flows for the three months ended March 31, 2018 and 2017, and (vi) Notes to Consolidated Financial Statements.

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SIGNATURES

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

FIRST COMMUNITY CORPORATION

(REGISTRANT)

Date: May 9, 2018 By: /s/ Michael C. Crapps  
Michael C. Crapps  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: May 9, 2018 By: /s/ Joseph G. Sawyer  
Joseph G. Sawyer  
Executive Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)

INDEX TO EXHIBITS

Exhibit  
Number

Description

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