

MIDDLEFIELD BANC CORP  
Form 10-Q  
November 14, 2017  
**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 September 30, 2017

or

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

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

Commission file number 001-36613

**Middlefield Banc Corp.**

(Exact Name of Registrant as Specified in its Charter)

Ohio 34-1585111  
State or Other Jurisdiction of I.R.S. Employer Identification No.  
Incorporation or Organization

15985 East High Street, Middlefield, Ohio 44062-0035  
Address of Principal Executive Offices Zip Code

440-632-1666  
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, 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  Accelerated filer   
Non-accelerated filer (Do not check if a smaller reporting company)  Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 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 Act). Yes  No

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No

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

**Class: Common Stock, without par value**  
Outstanding at November 14, 2017: 3,214,784

MIDDLEFIELD BANC CORP.

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## MIDDLEFIELD BANC CORP.

## CONSOLIDATED BALANCE SHEET

(Dollar amounts in thousands, except share data)

(Unaudited)

|   | September<br>30,<br>2017 | December<br>31,<br>2016 |
|---|--------------------------|-------------------------|
| <b>ASSETS</b>   |                          |                         |
| Cash and due from banks   | \$47,731                 | \$31,395                |
| Federal funds sold  | 1,200                    | 1,100                   |
| Cash and cash equivalents   | 48,931                   | 32,495                  |
| Investment securities available for sale, at fair value   | 98,334                   | 114,376                 |
| Loans held for sale   | 5,930                    | 634                     |
| Loans   | 878,541                  | 609,140                 |
| Less allowance for loan and lease losses  | 6,852                    | 6,598                   |
| Net loans   | 871,689                  | 602,542                 |
| Premises and equipment, net   | 11,768                   | 11,203                  |
| Goodwill  | 15,299                   | 4,559                   |
| Core deposit intangibles  | 2,848                    | 36                      |
| Bank-owned life insurance   | 15,542                   | 13,540                  |
| Other real estate owned   | 557                      | 934                     |
| Accrued interest and other assets   | 9,928                    | 7,502                   |
| <b>TOTAL ASSETS</b>   | <b>\$1,080,826</b>       | <b>\$787,821</b>        |
| <b>LIABILITIES</b>  |                          |                         |
| Deposits:   |                          |                         |
| Noninterest-bearing demand  | \$181,550                | \$133,630               |
| Interest-bearing demand   | 91,184                   | 59,560                  |
| Money market  | 161,101                  | 74,940                  |
| Savings   | 212,371                  | 172,370                 |
| Time  | 251,449                  | 189,434                 |
| Total deposits  | 897,655                  | 629,934                 |
| Short-term borrowings   | 20,274                   | 68,359                  |
| Other borrowings  | 39,273                   | 9,437                   |
| Accrued interest and other liabilities  | 5,130                    | 3,131                   |
| <b>TOTAL LIABILITIES</b>  | <b>962,332</b>           | <b>710,861</b>          |
| <b>STOCKHOLDERS' EQUITY</b>   |                          |                         |
| Common stock, no par value; 10,000,000 shares authorized, 3,600,902 and 2,640,418 shares issued; 3,214,737 and 2,254,253 shares outstanding | 84,722                   | 47,943                  |

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|  |             |           |
|--|-------------|-----------|
| Retained earnings                          | 45,913      | 41,334    |
| Accumulated other comprehensive income     | 1,377       | 1,201     |
| Treasury stock, at cost; 386,165 shares    | (13,518 )   | (13,518 ) |
| TOTAL STOCKHOLDERS' EQUITY                 | 118,494     | 76,960    |
| <br>                                       |             |           |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$1,080,826 | \$787,821 |

See accompanying notes to unaudited consolidated financial statements.

## MIDDLEFIELD BANC CORP.

## CONSOLIDATED STATEMENT OF INCOME

(Dollar amounts in thousands, except per share data)

(Unaudited)

|  | Three Months<br>Ended<br>September 30,<br>2017 |              | Nine Months<br>Ended<br>September 30,<br>2016 |               |
|--|--|--------------|---|---------------|
| <b>INTEREST AND DIVIDEND INCOME</b>                        |  |              |   |               |
| Interest and fees on loans                                 | \$ 10,443                                      | \$ 6,459     | \$ 29,539                                     | \$ 18,949     |
| Interest-bearing deposits in other institutions            | 107  | 15           | 248   | 42            |
| Federal funds sold   | 5  | 7            | 9   | 16            |
| Investment securities:                                     |  |              |   |               |
| Taxable interest   | 159  | 235          | 600   | 865           |
| Tax-exempt interest  | 579  | 687          | 1,846   | 2,227         |
| Dividends on stock   | 37   | 17           | 189   | 74            |
| Total interest and dividend income                         | 11,330   | 7,420        | 32,431  | 22,173        |
| <b>INTEREST EXPENSE</b>                                    |  |              |   |               |
| Deposits   | 1,468  | 921          | 3,820   | 2,665         |
| Short-term borrowings                                      | 202  | 49           | 652   | 288           |
| Other borrowings   | 148  | 56           | 413   | 164           |
| Total interest expense                                     | 1,818  | 1,026        | 4,885   | 3,117         |
| <b>NET INTEREST INCOME</b>                                 | <b>9,512</b>                                   | <b>6,394</b> | <b>27,546</b>                                 | <b>19,056</b> |
| Provision for loan losses                                  | 280  | 105          | 615   | 315           |
| <b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b> | <b>9,232</b>                                   | <b>6,289</b> | <b>26,931</b>                                 | <b>18,741</b> |
| <b>NONINTEREST INCOME</b>                                  |  |              |   |               |
| Service charges on deposit accounts                        | 479  | 505          | 1,397   | 1,443         |
| Investment securities gains, net                           | 398  | -            | 886   | 303           |
| Earnings on bank-owned life insurance                      | 109  | 101          | 316   | 297           |
| Gain on sale of loans                                      | 255  | 129          | 720   | 322           |
| Other income   | 200  | 242          | 622   | 694           |
| Total noninterest income                                   | 1,441  | 977          | 3,941   | 3,059         |
| <b>NONINTEREST EXPENSE</b>                                 |  |              |   |               |
| Salaries and employee benefits                             | 3,725  | 2,677        | 10,624  | 7,740         |
| Occupancy expense  | 476  | 306          | 1,397   | 933           |
| Equipment expense  | 242  | 221          | 789   | 700           |

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|                                      |         |         |         |         |
|--------------------------------------|---------|---------|---------|---------|
| Data processing costs                | 468     | 334     | 1,376   | 928     |
| Ohio state franchise tax             | 186     | 186     | 558     | 448     |
| Federal deposit insurance expense    | 165     | 132     | 368     | 396     |
| Professional fees                    | 434     | 547     | 1,230   | 1,057   |
| Net loss on other real estate owned  | 18      | 48      | 88      | 247     |
| Advertising expense                  | 248     | 206     | 660     | 604     |
| Core deposit intangible amortization | 101     | 10      | 276     | 30      |
| Merger expense                       | 338     | -       | 1,032   | -       |
| Other expense                        | 896     | 995     | 2,870   | 2,832   |
| Total noninterest expense            | 7,297   | 5,662   | 21,268  | 15,915  |
| Income before income taxes           | 3,376   | 1,604   | 9,604   | 5,885   |
| Income taxes                         | 914     | 261     | 2,535   | 1,129   |
| NET INCOME                           | \$2,462 | \$1,343 | \$7,069 | \$4,756 |
| EARNINGS PER SHARE                   |         |         |         |         |
| Basic                                | \$0.77  | \$0.60  | \$2.38  | \$2.31  |
| Diluted                              | 0.76    | 0.60    | 2.37    | 2.30    |
| DIVIDENDS DECLARED PER SHARE         | \$0.27  | \$0.27  | \$0.81  | \$0.81  |

See accompanying notes to unaudited consolidated financial statements.

## MIDDLEFIELD BANC CORP.

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(Dollar amounts in thousands)

(Unaudited)

|   | Three Months<br>Ended<br>September 30,<br>2017 |         | Nine Months<br>Ended<br>September 30,<br>2017 |         |
|---|--|---------|---|---------|
|   | 2016   |         | 2016  |         |
| Net income  | \$2,462  | \$1,343 | \$7,069                                       | \$4,756 |
| Other comprehensive income:   |  |         |   |         |
| Net unrealized holding gain (loss) on available-for-sale securities               | (264 )   | (400 )  | 1,153   | 2,153   |
| Tax effect  | 89   | 137     | (392 )  | (732 )  |
| Reclassification adjustment for investment securities gain included in net income | (398 )   | -       | (886 )  | (303 )  |
| Tax effect  | 135  | -       | 301   | 103     |
| Total other comprehensive income (loss)   | (438 )   | (263 )  | 176   | 1,221   |
| Comprehensive income  | \$2,024  | \$1,080 | \$7,245                                       | \$5,977 |

See accompanying notes to unaudited consolidated financial statements.

## MIDDLEFIELD BANC CORP.

## CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

(Dollar amounts in thousands, except share and per share data)

(Unaudited)

|  | Common<br>Stock | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Treasury<br>Stock | Total<br>Stockholders'<br>Equity |
|--|-----------------|----------------------|---|-------------------|----------------------------------|
| Balance, December 31, 2016   | \$47,943        | \$41,334             | \$ 1,201  | \$(13,518)        | \$ 76,960                        |
| Net income   |                 | 7,069                |   |                   | 7,069                            |
| Other comprehensive income   |                 |                      | 176   |                   | 176                              |
| Common stock issued in business combination<br>(544,610 shares)        | 20,995          |                      |   |                   | 20,995                           |
| Other common stock issuances, net of offering cost<br>(399,008 shares) | 15,164          |                      |   |                   | 15,164                           |
| Dividend reinvestment and purchase plan (8,917<br>shares)              | 407             |                      |   |                   | 407                              |
| Stock options exercised (7,126 shares)                                 | 180             |                      |   |                   | 180                              |
| Stock issued in connection with equity awards, net<br>(823 shares)     | 33              |                      |   |                   | 33                               |
| Cash dividends declared (\$0.81 per share)                             |                 | (2,490 )             |   |                   | (2,490 )                         |
| Balance, September 30, 2017  | \$ 84,722       | \$ 45,913            | \$ 1,377  | \$(13,518)        | \$ 118,494                       |

See accompanying notes to unaudited consolidated financial statements.

## MIDDLEFIELD BANC CORP.

## CONSOLIDATED STATEMENT OF CASH FLOWS

(Dollar amounts in thousands)

(Unaudited)

|   | Nine Months Ended<br>September 30, |          |
|---|------------------------------------|----------|
|   | 2017                               | 2016     |
| <b>OPERATING ACTIVITIES</b>   |                                    |          |
| Net income  | \$7,069                            | \$4,756  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |          |
| Provision for loan losses   | 615                                | 315      |
| Investment securities gain, net   | (886 )                             | (303 )   |
| Depreciation and amortization of premises and equipment, net                      | 797                                | 744      |
| Amortization of premium and discount on investment securities, net                | 343                                | 352      |
| Accretion of deferred loan fees, net  | (246 )                             | (150 )   |
| Amortization of core deposit intangibles  | 275                                | 30       |
| Equity-based compensation   | 33                                 | -        |
| Origination of loans held for sale  | (13,345 )                          | (15,497) |
| Proceeds from sale of loans   | 7,811                              | 16,046   |
| Gain on sale of loans   | (239 )                             | (322 )   |
| Origination of student loans held for sale  | (321,942)                          | -        |
| Proceeds from sale of student loans   | 328,853                            | -        |
| Gain on sale of student loans   | (481 )                             | -        |
| Earnings on bank-owned life insurance   | (316 )                             | (297 )   |
| Deferred income tax   | (532 )                             | 224      |
| Net (gain) loss on other real estate owned  | (211 )                             | 247      |
| (Increase) in accrued interest receivable   | (311 )                             | (139 )   |
| Increase (decrease) in accrued interest payable                                   | 124                                | (4 )     |
| Other, net  | (2,193 )                           | 253      |
| Net cash provided by operating activities   | 5,218                              | 6,255    |
| <b>INVESTING ACTIVITIES</b>   |                                    |          |
| Investment securities available for sale:   |                                    |          |
| Proceeds from repayments and maturities   | 9,560                              | 17,896   |
| Proceeds from sale of securities  | 6,474                              | 9,115    |
| Purchases   | (250 )                             | (1,744 ) |
| Increase in loans, net  | (75,307 )                          | (53,430) |
| Proceeds from the sale of other real estate owned                                 | 1,767                              | 555      |
| Purchase of bank-owned life insurance   | (5 )                               | -        |
| Purchase of premises and equipment  | (1,037 )                           | (679 )   |
| Purchase of restricted stock  | (899 )                             | -        |
| Redemption of restricted stock  | 795                                | -        |

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|   |                 |                 |
|---|-----------------|-----------------|
| Acquisition, net of cash paid                           | 5,431           | -               |
| Net cash used in investing activities                   | (53,471 )       | (28,287)        |
| <b>FINANCING ACTIVITIES</b>                             |                 |                 |
| Net increase in deposits                                | 69,677          | 14,895          |
| (Decrease) in short-term borrowings, net                | (48,085 )       | (3,022 )        |
| Repayment of other borrowings                           | (164 )          | (226 )          |
| Proceeds from other borrowings                          | 30,000          | -               |
| Proceeds from common stock issued                       | 15,164          | 11,239          |
| Net cash from common stock transactions                 | 180             | -               |
| Proceeds from dividend reinvestment and purchase plan   | 407             | 382             |
| Cash dividends  | (2,490 )        | (1,710 )        |
| Net cash provided by financing activities               | 64,689          | 21,558          |
| Increase (decrease) in cash and cash equivalents        | 16,436          | (474 )          |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b> | <b>32,495</b>   | <b>23,750</b>   |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>       | <b>\$48,931</b> | <b>\$23,276</b> |

See accompanying notes to unaudited consolidated financial statements.

## SUPPLEMENTAL INFORMATION

## Cash paid during the year for:

|                                     |         |         |
|-------------------------------------|---------|---------|
| Interest on deposits and borrowings | \$4,761 | \$3,121 |
| Income taxes                        | 4,455   | 475     |

## Noncash investing transactions:

|   |         |       |
|---|---------|-------|
| Transfers from loans to other real estate owned | \$1,179 | \$595 |
| Common stock issued in business acquisition     | 20,995  | -     |

## Acquisition of Liberty Bank

## Noncash assets acquired

|                             |           |
|-----------------------------|-----------|
| Loans                       | \$195,388 |
| Loans held for sale         | 5,953     |
| Premises and equipment, net | 325       |
| Accrued interest receivable | 440       |
| Bank-owned life insurance   | 1,681     |
| Core deposit intangible     | 3,087     |
| Other assets                | 997       |
| Goodwill                    | 10,740    |
|                             | 218,611   |

## Liabilities assumed

|                                   |           |
|-----------------------------------|-----------|
| Time deposits                     | (30,744 ) |
| Deposits other than time deposits | (167,300) |
| Accrued interest payable          | (47 )     |
| Deferred taxes                    | (1,134 )  |
| Other liabilities                 | (2,754 )  |
|                                   | (201,979) |

Liberty stock acquired in business combination (1,068 )

Net noncash assets acquired \$15,564

Cash and cash equivalents acquired, net \$5,431

See accompanying notes to unaudited consolidated financial statements.

MIDDLEFIELD BANC CORP.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 1 - BASIS OF PRESENTATION**

The consolidated financial statements of Middlefield Banc Corp. ("Company") include its bank subsidiary, The Middlefield Banking Company ("MBC" or "Middlefield Bank"), and a nonbank asset resolution subsidiary EMORECO, Inc. All significant inter-company items have been eliminated.

On January 12, 2017, the Company completed its acquisition of Liberty Bank, N.A. ("Liberty"), pursuant to a previously announced definitive merger agreement. Under the terms of the merger agreement, Liberty shareholders received \$37.96 in cash or 1.1934 shares of the Company's common stock in exchange for each share of Liberty common stock they owned immediately prior to the merger. The Company issued 544,610 shares of its common stock in the merger and the aggregate merger consideration was approximately \$42.2 million. Upon closing, Liberty was merged into MBC, and its three full-service bank offices, in Twinsburg in northern Summit County and in Beachwood and Solon in eastern Cuyahoga County, became offices of MBC. The systems integration of Liberty into MBC was completed in February.

The accompanying unaudited financial statements have been prepared in accordance with U.S. generally accepted accounting principles and the instructions for Form 10-Q and Article 10 of Regulation S-X. In management's opinion, the financial statements include all adjustments, consisting of normal recurring adjustments, that the Company considers necessary to fairly state the Company's financial position and the results of operations and cash flows. The consolidated balance sheet at December 31, 2016, has been derived from the audited financial statements at that date but does not include all of the necessary informational disclosures and footnotes as required by U.S. generally accepted accounting principles. The accompanying financial statements should be read in conjunction with the financial statements and notes thereto included with the Company's Form 10-K for the year ended December 31, 2016. The results of the Company's operations for any interim period are not necessarily indicative for the results of the Company's operations for any other interim period or for a full fiscal year.

Recent Accounting Pronouncements –

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which will supersede the revenue recognition requirements in Topic 605, *Revenue Recognition*, and most industry-specific revenue recognition guidance throughout the Accounting Standards Codification. Under ASU No. 2014-09, revenue should be recognized to depict the transfer of goods or services to customers in an amount that reflects the

consideration to which the entity expects to be entitled in exchange for those goods or services. In applying the guidance, an entity should 1) identify the contract(s) with a customer, 2) identify the performance obligation in the contract, 3) determine the transaction price, 4) allocate the transaction price to the performance obligations in the contract, and 5) recognize revenue when the entity satisfies a performance obligation. For public entities, the amendments in this update are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. In August 2015, the FASB issued ASU No. 2015-14 delaying the effective date of ASU No. 2014-09. Public business entities, certain not-for profit entities, and certain employee benefit plans should apply the guidance in ASU No. 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Because this guidance does not apply to revenue associated with financial instruments, including loans or securities, the new guidance is not expected to have a material impact on the components of income most closely associated with financial instruments, including securities gains/losses and interest income. The Company is currently evaluating this guidance to determine the impact on components of noninterest income. Although management has not completed its evaluation of the impact of adoption of the ASU on noninterest income, management does not expect the amount or timing of the recognition of such revenue to be materially impacted and does not expect adoption to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The standard requires lessees to recognize the assets and liabilities that arise from leases on the balance sheet. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. A short-term lease is defined as one in which (a) the lease term is 12 months or less and (b) there is not an option to purchase the underlying asset that the lessee is reasonably certain to exercise. For short-term leases, lessees may elect to recognize lease payments over the lease term on a straight-line basis. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within those years. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, and for interim periods within fiscal years beginning after December 15, 2020. The amendments should be applied at the beginning of the earliest period presented using a modified retrospective approach with earlier application permitted as of the beginning of an interim or annual reporting period. The Company is currently assessing the practical expedients it may elect at adoption, but does not anticipate the amendments will have a significant impact on the financial statements. Based on the Company's preliminary analysis of its current portfolio, the impact to the Company's balance sheet is estimated to result in less than a 1 percent increase in assets and liabilities. The Company also anticipates additional disclosures to be provided at adoption.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments*, which changes the impairment model for most financial assets. This Update is intended to improve financial reporting by requiring timelier recoding of credit losses on loans and other financial instruments held by financial institutions and other organizations. The underlying premise of the Update is that financial assets measured at amortized cost should be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The allowance for credit losses should reflect management’s current estimate of credit losses that are expected to occur over the remaining life of a financial asset. The income statement will be effected for the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2019, and early adoption is permitted for annual and interim periods beginning after December 15, 2018. With certain exceptions, transition to the new requirements will be through a cumulative effect adjustment to opening retained earnings as of the beginning of the first reporting period in which the guidance is adopted. We expect to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective, but cannot yet determine the magnitude of any such one-time adjustment or the overall impact of the new guidance on the consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, *Business Combinations (Topic 805), Clarifying the Definition of a Business*, which provides a more robust framework to use in determining when a set of assets and activities (collectively referred to as a “set”) is a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. This screen reduces the number of transactions that need to be further evaluated. Public business entities should apply the amendments in this Update to annual periods beginning after December 15, 2017, including interim periods within those periods. All other entities should apply the amendments to annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. The amendments in this Update should be applied prospectively on or after the effective date. This Update is not expected to have a significant impact on the Company’s financial statements.

In January 2017, the FASB issued ASU 2017-04, *Simplifying the Test for Goodwill Impairment*. To simplify the subsequent measurement of goodwill, the FASB eliminated Step 2 from the goodwill impairment test. In computing the implied fair value of goodwill under Step 2, an entity had to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities (including unrecognized assets and liabilities) following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, under the amendments in this Update, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. A public business entity that is a U.S. Securities and Exchange Commission (“SEC”) filer should adopt the amendments in this Update for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. A public business entity that is not an SEC filer should adopt the amendments in this Update for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2020. All other entities, including not-for-profit entities that are adopting the amendments in this Update should do so for their annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2021. This Update is not expected to have a significant impact on the Company’s financial statements.

In March 2017, the FASB issued ASU 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20)*. The amendments in this Update shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. For public business entities, the amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity should apply the amendments in this Update on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Additionally, in the period of adoption, an entity should provide disclosures about a change in accounting principle. This Update is not expected to have a significant impact on the Company's financial statements.

In May 2017, the FASB issued ASU 2017-09, *Compensation – Stock Compensation (Topic 718)*, which affects any entity that changes the terms or conditions of a share-based payment award. This Update amends the definition of modification by qualifying that modification accounting does not apply to changes to outstanding share-based payment awards that do not affect the total fair value, vesting requirements, or equity/liability classification of the awards. The amendments in this Update are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period, for (1) public business entities for reporting periods for which financial statements have not yet been issued and (2) all other entities for reporting periods for which financial statements have not yet been made available for issuance. The amendments in this Update should be applied prospectively to an award modified on or after the adoption date. The Company is currently evaluating the impact the adoption of the standard will have on its financial position or results of operations.

**NOTE 2 - STOCK-BASED COMPENSATION**

The Company had no unvested stock options outstanding or unrecognized stock-based compensation costs outstanding as of September 30, 2017 and 2016.

Stock option activity during the nine months ended September 30 is as follows:

|                           | 2017     | Weighted-<br>average<br>Exercise<br>Price | 2016   | Weighted-<br>average<br>Exercise<br>Price |
|---------------------------|----------|---|--------|---|
| Outstanding, January 1    | 29,324   | \$ 23.67                                  | 31,949 | \$ 25.03                                  |
| Exercised                 | (7,949 ) | 29.87                                     | -      | -   |
| Outstanding, September 30 | 21,375   | \$ 21.37                                  | 31,949 | \$ 25.03                                  |
| Exercisable, September 30 | 21,375   | \$ 21.37                                  | 31,949 | \$ 25.03                                  |

**NOTE 3 - EARNINGS PER SHARE**

The Company provides dual presentation of basic and diluted earnings per share. Basic earnings per share is calculated by dividing net income by the average shares outstanding. Diluted earnings per share adds the dilutive effects of stock options to average shares outstanding.

The following table sets forth the composition of the weighted-average common shares (denominator) used in the basic and diluted earnings per share computation.

|  | For the Three<br>Months Ended<br>September 30, |           | For the Nine<br>Months Ended<br>September 30, |           |
|--|--|-----------|---|-----------|
|  | 2017   | 2016      | 2017  | 2016      |
| Weighted-average common shares outstanding | 3,598,500                                      | 2,633,752 | 3,352,316                                     | 2,445,821 |

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|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Average treasury stock shares  | (386,165 ) | (386,165 ) | (386,165 ) | (386,165 ) |
| Weighted-average common shares and common stock equivalents used to calculate basic earnings per share   | 3,212,335  | 2,247,587  | 2,966,151  | 2,059,656  |
| Additional common stock equivalents (stock options) used to calculate diluted earnings per share         | 11,418     | 8,643      | 12,592     | 8,876      |
| Weighted-average common shares and common stock equivalents used to calculate diluted earnings per share | 3,223,753  | 2,256,230  | 2,978,743  | 2,068,532  |

Options to purchase 21,375 shares of common stock, at prices ranging from \$17.55 to \$37.00, were outstanding during the three and nine months ended September 30, 2017. Of those options, 21,375 were considered dilutive for the three and nine month periods based on the market price exceeding the strike price and no options were anti-dilutive.

Options to purchase 31,949 shares of common stock, at prices ranging from \$17.55 to \$40.24, were outstanding during the three and nine months ended September 30, 2016. Of those options, 24,700 were considered dilutive for the three and nine month periods based on the market price exceeding the strike price and 7,249 options were anti-dilutive.

#### NOTE 4 - FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants at the measurement date. GAAP established a fair value hierarchy that prioritizes the use of inputs used in valuation methodologies into the following levels:

Level I: Quoted prices are available in active markets for identical assets or liabilities as of the reported date.

Level II: Pricing inputs are other than the quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities includes items for which quoted prices are available but traded less frequently and items that are fair valued using other financial instruments, the parameters of which can be directly observed.

Level III: Assets and liabilities that have little to no pricing observability as of the reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

The following tables present the assets measured on a recurring basis on the Consolidated Balance Sheet at their fair value by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

| (Dollar amounts in thousands) | September 30,<br>2017 |          |              | Total |
|-------------------------------|-----------------------|----------|--------------|-------|
|                               | Level<br>I            | Level II | Level<br>III |       |

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Assets measured on a recurring basis:

|   |      |          |      |          |
|---|------|----------|------|----------|
| U.S. government agency securities                           | \$ - | \$9,094  | \$ - | \$9,094  |
| Obligations of states and political subdivisions            | -    | 72,094   | -    | 72,094   |
| Mortgage-backed securities in government-sponsored entities | -    | 16,579   | -    | 16,579   |
| Total debt securities                                       | -    | 97,767   | -    | 97,767   |
| Equity securities in financial institutions                 | -    | 567      | -    | 567      |
| Total   | \$ - | \$98,334 | \$ - | \$98,334 |

December 31,  
2016

(Dollar amounts in thousands)

|   | Level<br>I | Level II  | Level<br>III | Total     |
|---|------------|-----------|--------------|-----------|
| Assets measured on a recurring basis:                       |            |           |              |           |
| U.S. government agency securities                           | \$ -       | \$10,236  | \$ -         | \$10,236  |
| Obligations of states and political subdivisions            | -          | 81,223    | -            | 81,223    |
| Mortgage-backed securities in government-sponsored entities | -          | 20,069    | -            | 20,069    |
| Private-label mortgage-backed securities                    | -          | 1,709     | -            | 1,709     |
| Total debt securities                                       | -          | 113,237   | -            | 113,237   |
| Equity securities in financial institutions                 | -          | 1,139     | -            | 1,139     |
| Total   | \$ -       | \$114,376 | \$ -         | \$114,376 |

The Company obtains fair values from an independent pricing service which represent either quoted market prices for the identical securities (Level I inputs) or fair values determined by pricing models using a market approach that considers observable market data, such as interest rate volatilities, LIBOR yield curve, credit spreads and prices from market makers and live trading systems (Level II).

The Company uses prices compiled by third party vendors.

**Impaired Loans** – The Company has measured impairment on collateral-dependent impaired loans generally based on the fair value of the loan’s collateral. Fair value is generally determined based upon independent third-party appraisals of the properties. In some cases, management may adjust the appraised value due to the age of the appraisal, changes in market conditions, or observable deterioration of the property since the appraisal was completed. Additionally, management makes estimates about expected costs to sell the property which are also included in the net realizable value. If the fair value of the collateral dependent loan is less than the carrying amount of the loan, a specific reserve for the loan is made in the allowance for loan losses or a charge-off is taken to reduce the loan to the fair value of the collateral (less estimated selling costs) and the loan is included in the following table as a Level III measurement. If the fair value of the collateral exceeds the carrying amount of the loan, then the loan is not included in the following table as it is not currently being carried at its fair value. The fair values in the following table exclude estimated selling costs of \$437,000 at September 30, 2017.

**Other Real Estate Owned (OREO)** – OREO is carried at the lower of cost or fair value, which is measured at the date of foreclosure. If the fair value of the collateral exceeds the carrying amount of the loan, no charge-off or adjustment is necessary, the loan is not considered to be carried at fair value, and is therefore not included in the following table. If the fair value of the collateral is less than the carrying amount of the loan, management will charge the loan down to its estimated realizable value. The fair value of OREO is based on the appraised value of the property, which is generally unadjusted by management and is based on comparable sales for similar properties in the same geographic region as the subject property, and is included in the following table as a Level II measurement. In some cases, management may adjust the appraised value due to the age of the appraisal, changes in market conditions, or observable deterioration of the property since the appraisal was completed. In these cases, the loans are categorized in the following table as Level III measurement since these adjustments are considered to be unobservable inputs. Income and expenses from operations and further declines in the fair value of the collateral subsequent to foreclosure are included in net expenses from OREO.

The following tables present the assets measured on a nonrecurring basis on the Consolidated Balance Sheet at their fair value by level within the fair value hierarchy. Collateral-dependent impaired loans are carried at fair value if they have been charged down to fair value or if a specific valuation allowance has been established. A new cost basis is established at the time a property is initially recorded in OREO. OREO properties are carried at fair value if a devaluation has been taken to the property’s value subsequent to the initial measurement.

| (Dollar amounts in thousands)            | September<br>30, 2017 |             |              | Total   |
|--|-----------------------|-------------|--------------|---------|
|  | Level<br>I            | Level<br>II | Level<br>III |         |
| Assets measured on a nonrecurring basis: |                       |             |              |         |
| Impaired loans                           | \$ -                  | \$-         | \$1,620      | \$1,620 |
| Other real estate owned                  | -                     | -           | 81           | 81      |

December  
31, 2016

| (Dollar amounts in thousands)            | Level<br>I | Level<br>II | Level<br>III | Total   |
|--|------------|-------------|--------------|---------|
| Assets measured on a nonrecurring basis: |            |             |              |         |
| Impaired loans                           | \$ -       | \$-         | \$6,498      | \$6,498 |
| Other real estate owned                  | -          | -           | 511          | 511     |

The following tables present additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Company uses Level III inputs to determine fair value:

| Quantitative Information about Level III Fair Value Measurements |                     |                             |                           |                          |
|--|---------------------|-----------------------------|---------------------------|--------------------------|
| <i>(Dollar amounts in thousands)</i>                             |                     |                             |                           |                          |
|  | Fair Value Estimate | Valuation Techniques        | Unobservable Input        | Range (Weighted Average) |
| September 30, 2017   |                     |                             |                           |                          |
| Impaired loans   | \$1,620             | Appraisal of collateral (1) | Appraisal adjustments (2) | 3.3% to 8.3% (5.3%)      |
| Other real estate owned  | \$81                | Appraisal of collateral (1) | Appraisal adjustments (2) | 0.0% to 10.0%            |

| Quantitative Information about Level III Fair Value Measurements |                     |                             |                           |                          |
|--|---------------------|-----------------------------|---------------------------|--------------------------|
| <i>(Dollar amounts in thousands)</i>                             |                     |                             |                           |                          |
|  | Fair Value Estimate | Valuation Techniques        | Unobservable Input        | Range (Weighted Average) |
| December 31, 2016  |                     |                             |                           |                          |
| Impaired loans   | \$ 1,570            | Appraisal of collateral (1) | Appraisal adjustments (2) | 0.0% to 59.7% (28.2%)    |
| Other real estate owned  | \$ 511              | Appraisal of collateral (1) | Appraisal adjustments (2) | 0% to 10.0%              |

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various level III inputs which are not identifiable, less any associated allowance.

Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated (2) liquidation expenses. The range and weighted average of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

The estimated fair value of the Company's financial instruments is as follows:

| September 30, 2017                   |         |          |           |                  |
|--------------------------------------|---------|----------|-----------|------------------|
| Carrying Value                       | Level I | Level II | Level III | Total Fair Value |
| <i>(Dollar amounts in thousands)</i> |         |          |           |                  |

## Financial assets:

|                              |          |          |        |         |          |
|------------------------------|----------|----------|--------|---------|----------|
| Cash and cash equivalents    | \$48,931 | \$48,931 | \$-    | \$-     | \$48,931 |
| Investment securities        |          |          |        |         |          |
| Available for sale           | 98,334   | -        | 98,334 | -       | 98,334   |
| Loans held for sale          | 5,930    | 4,995    | 935    | -       | 5,930    |
| Net loans                    | 871,689  | -        | -      | 879,206 | 879,206  |
| Bank-owned life insurance    | 15,542   | 15,542   | -      | -       | 15,542   |
| Federal Home Loan Bank stock | 3,589    | 3,589    | -      | -       | 3,589    |
| Accrued interest receivable  | 3,177    | 3,177    | -      | -       | 3,177    |

## Financial liabilities:

|                          |           |           |     |           |           |
|--------------------------|-----------|-----------|-----|-----------|-----------|
| Deposits                 | \$897,655 | \$646,206 | \$- | \$252,112 | \$898,318 |
| Short-term borrowings    | 20,274    | 20,274    | -   | -         | 20,274    |
| Other borrowings         | 39,273    | -         | -   | 39,306    | 39,306    |
| Accrued interest payable | 566       | 566       | -   | -         | 566       |

|                               | December 31, 2016 |            |          |            | Total      |
|-------------------------------|-------------------|------------|----------|------------|------------|
|                               | Carrying          |            |          |            | Fair       |
|                               | Value             | Level I    | Level II | Level III  | Value      |
| (Dollar amounts in thousands) |                   |            |          |            |            |
| Financial assets:             |                   |            |          |            |            |
| Cash and cash equivalents     | \$ 32,495         | \$ 32,495  | \$ -     | \$ -       | \$ 32,495  |
| Investment securities         |                   |            |          |            |            |
| Available for sale            | 114,376           | -          | 114,376  | -          | 114,376    |
| Loans held for sale           | 634               | -          | 634      | -          | 634        |
| Net loans                     | 602,542           | -          | -        | 604,447    | 604,447    |
| Bank-owned life insurance     | 13,540            | 13,540     | -        | -          | 13,540     |
| Restricted stock              | 2,204             | 2,204      | -        | -          | 2,204      |
| Accrued interest receivable   | 2,426             | 2,426      | -        | -          | 2,426      |
| Financial liabilities:        |                   |            |          |            |            |
| Deposits                      | \$ 629,934        | \$ 440,500 | \$ -     | \$ 189,871 | \$ 630,371 |
| Short-term borrowings         | 68,359            | 68,359     | -        | -          | 68,359     |
| Other borrowings              | 9,437             | -          | -        | 9,512      | 9,512      |
| Accrued interest payable      | 395               | 395        | -        | -          | 395        |

Financial instruments are defined as cash, evidence of ownership interest in an entity, or a contract which creates an obligation or right to receive or deliver cash or another financial instrument from/to a second entity on potentially favorable or unfavorable terms.

Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing parties other than in a forced liquidation sale. If a quoted market price is available for a financial instrument, the estimated fair value would be calculated based upon the market price per trading unit of the instrument.

If no readily available market exists, the fair value estimates for financial instruments should be based upon management's judgment regarding current economic conditions, interest rate risk, expected cash flows, future estimated losses, and other factors as determined through various option pricing formulas or simulation modeling. Since many of these assumptions result from judgments made by management based upon estimates which are inherently uncertain, the resulting estimated fair values may not be indicative of the amount realizable in the sale of a particular financial instrument. In addition, changes in assumptions on which the estimated fair values are based may have a significant impact on the resulting estimated fair values.

As certain assets such as deferred tax assets and premises and equipment are not considered financial instruments, the estimated fair value of financial instruments would not represent the full value of the Company.

The Company employed simulation modeling in determining the estimated fair value of financial instruments for which quoted market prices were not available based upon the following assumptions:

**Cash and Cash Equivalents, Federal Home Loan Bank Stock, Accrued Interest Receivable, Accrued Interest Payable, and Short-Term Borrowings**

The fair value is equal to the current carrying value.

**Bank-Owned Life Insurance**

The fair value is equal to the cash surrender value of the life insurance policies.

**Investment Securities Available for Sale**

The fair value of investment securities is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities.

**Loans Held for Sale**

Loans held for sale are carried at lower of cost or fair value. The fair value of loans held for sale is based on secondary market pricing on portfolios with similar characteristics. The changes in fair value of the assets are largely driven by changes in interest rates subsequent to loan funding and changes in the fair value of servicing associated with the mortgage loan held for sale. Within this total are student loans held for sale for which the fair value is based on readily determinable market prices, which is a level I Price.

**Net Loans**

The fair value is estimated by discounting future cash flows using current market inputs at which loans with similar terms and qualities would be made to borrowers of similar credit quality. Where quoted market prices were available, primarily for certain residential mortgage loans, such market rates were used as estimates for fair value.

**Deposits and Other Borrowings**

The fair values of certificates of deposit and other borrowings are based on the discounted value of contractual cash flows. The discount rates are estimated using rates currently offered for similar instruments with similar remaining maturities. Demand, savings, and money market deposits are valued at the amount payable on demand as of period end.

**Commitments to Extend Credit**

These financial instruments are generally not subject to sale, and estimated fair values are not readily available. The carrying value, represented by the net deferred fee arising from the unrecognized commitment or letter of credit, and the fair value, determined by discounting the remaining contractual fee over the term of the commitment using fees currently charged to enter into similar agreements with similar credit risk, are not considered material for disclosure.

**NOTE 5 – ACCUMULATED OTHER COMPREHENSIVE INCOME**

The following tables present the changes in accumulated other comprehensive income by component net of tax for the three and nine months ended September 30, 2017 and 2016, respectively:

| (Dollars in thousands)  | Unrealized gains<br>on<br>available-for-sale<br>securities |
|---|--|
| Balance as of June 30, 2017                                     | \$ 1,815   |
| Other comprehensive income before reclassification              | (175 )   |
| Amount reclassified from accumulated other comprehensive income | (263 )   |
| Period change   | (438 )   |
| Balance at September 30, 2017                                   | \$ 1,377   |
| Balance as of December 31, 2016                                 | \$ 1,201   |
| Other comprehensive income before reclassification              | 761  |
| Amount reclassified from accumulated other comprehensive income | (585 )   |

|   |          |                    |
|---|----------|--------------------|
| Period change   | 176      |                    |
| Balance at September 30, 2017                                   | \$ 1,377 |                    |
|   |          | Unrealized gains   |
|   |          | on                 |
|   |          | available-for-sale |
| (Dollars in thousands)  |          | securities         |
| Balance as of June 30, 2016                                     | \$ 3,879 |                    |
| Other comprehensive loss before reclassification                | (263     | )                  |
| Amount reclassified from accumulated other comprehensive income | -        |                    |
| Period change   | (263     | )                  |
| Balance at September 30, 2016                                   | \$ 3,616 |                    |
| Balance as of December 31, 2015                                 | \$ 2,395 |                    |
| Other comprehensive income before reclassification              | 1,421    |                    |
| Amount reclassified from accumulated other comprehensive income | (200     | )                  |
| Period change   | 1,221    |                    |
| Balance at September 30, 2016                                   | \$ 3,616 |                    |

(a) All amounts are net of tax. Amounts in parentheses indicate debits to accumulated other comprehensive income.

The following tables present significant amounts reclassified out of each component of accumulated other comprehensive income:

| (Dollars in thousands)                            | Amount Reclassified<br>from Accumulated<br>Other Comprehensive<br>Income (a)<br>For the Three Months<br>Ended |                       | Affected Line Item in<br>the Statement Where<br>Net Income is<br>Presented |
|---|---|-----------------------|--|
| Details about other comprehensive income          | September<br>30, 2017   | September<br>30, 2016 |  |
| Unrealized gains on available-for-sale securities | \$ 398  | \$ -                  | Investment securities gains, net   |
|   | (135 )  | -                     | Income taxes   |
|   | \$ 263  | \$ -                  |  |

| (Dollars in thousands)                            | Amount<br>Reclassified from<br>Accumulated Other<br>Comprehensive<br>Income (a)<br>For the Nine<br>Months Ended |                       | Affected Line Item in<br>the Statement Where<br>Net Income is<br>Presented |
|---|---|-----------------------|--|
| Details about other comprehensive income          | September<br>30,<br>2017  | September<br>30, 2016 |  |
| Unrealized gains on available-for-sale securities | \$ 886  | \$ 303                | Investment securities gains, net   |
|   | (301 )  | (103 )                | Income taxes   |
|   | \$ 585  | \$ 200                |  |

(a) Amounts in parentheses indicate expenses and other amounts indicate income.

#### NOTE 6 - INVESTMENT SECURITIES AVAILABLE FOR SALE

The amortized cost and fair values of securities available for sale are as follows:

September 30, 2017

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| (Dollar amounts in thousands)                               | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|---|-------------------|------------------------------|-------------------------------|---------------|
| U.S. government agency securities                           | \$9,004           | \$ 146                       | \$ (56                        | ) \$9,094     |
| Obligations of states and political subdivisions:           |                   |                              |                               |               |
| Taxable   | 505               | 12                           | -                             | 517           |
| Tax-exempt  | 69,750            | 1,886                        | (59                           | ) 71,577      |
| Mortgage-backed securities in government-sponsored entities | 16,574            | 175                          | (170                          | ) 16,579      |
| Total debt securities                                       | 95,833            | 2,219                        | (285                          | ) 97,767      |
| Equity securities in financial institutions                 | 415               | 152                          | -                             | 567           |
| Total   | \$96,248          | \$ 2,371                     | \$ (285                       | ) \$98,334    |

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|   | December 31, 2016 |                        |                         |             |
|---|-------------------|------------------------|-------------------------|-------------|
|   | Amortized Cost    | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value  |
| U.S. government agency securities                           | \$10,158          | \$ 174                 | \$ (96                  | ) \$10,236  |
| Obligations of states and political subdivisions:           |                   |                        |                         |             |
| Taxable   | 1,615             | 129                    | (4                      | ) 1,740     |
| Tax-exempt  | 78,327            | 1,678                  | (522                    | ) 79,483    |
| Mortgage-backed securities in government-sponsored entities | 20,128            | 202                    | (261                    | ) 20,069    |
| Private-label mortgage-backed securities                    | 1,579             | 130                    | -                       | 1,709       |
| Total debt securities                                       | 111,807           | 2,313                  | (883                    | ) 113,237   |
| Equity securities in financial institutions                 | 750               | 389                    | -                       | 1,139       |
| Total   | \$112,557         | \$ 2,702               | \$ (883                 | ) \$114,376 |

The amortized cost and fair value of debt securities at September 30, 2017, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| (Dollar amounts in thousands)          | Amortized Cost | Fair Value |
|--|----------------|------------|
| Due in one year or less                | \$ 4,689       | \$4,742    |
| Due after one year through five years  | 9,884          | 10,193     |
| Due after five years through ten years | 9,643          | 9,783      |
| Due after ten years                    | 71,617         | 73,049     |
| Total                                  | \$ 95,833      | \$97,767   |

Proceeds from the sales of securities available for sale and the gross realized gains and losses are as follows:

| (Dollar amounts in thousands) | For the Three Months     |                          | For the Nine Months      |                          |
|-------------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
|                               | Ended September 30, 2017 | Ended September 30, 2016 | Ended September 30, 2017 | Ended September 30, 2016 |
| Proceeds from sales           | \$3,787                  | \$ -                     | \$6,474                  | \$9,115                  |
| Gross realized gains          | 430                      | -                        | 918 *                    | 306                      |
| Gross realized losses         | (32 )                    | -                        | (32 )                    | (3 )                     |

\*Prior to the acquisition of Liberty Bank, N.A., the Company had a previously held equity interest in Liberty which was re-measured at fair value on the acquisition date and resulted in a gain of \$488,000, which was recorded in Investment Securities Gains on the consolidated Income Statement for the nine months ended September 30, 2017.

Investment securities with an approximate carrying value of \$64.9 million and \$60.3 million at September 30, 2017 and December 31, 2016, respectively, were pledged to secure deposits and other purposes as required by law. Cash of \$4.5 million at September 30, 2017 was also pledged to secure deposits and other purposes as required by law.

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

| (Dollar amounts in thousands)                               | September 30, 2017      |                         |                          |                         |            |                         |
|---|-------------------------|-------------------------|--------------------------|-------------------------|------------|-------------------------|
|   | Less than Twelve Months |                         | Twelve Months or Greater |                         | Total      |                         |
|   | Fair Value              | Gross Unrealized Losses | Fair Value               | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| U.S. government agency securities                           | \$952                   | \$ (9 )                 | \$3,211                  | \$ (47 )                | \$4,163    | \$ (56 )                |
| Obligations of states and political subdivisions            |                         |                         |                          |                         |            |                         |
| Tax-exempt  | 3,008                   | (18 )                   | 2,112                    | (41 )                   | 5,120      | (59 )                   |
| Mortgage-backed securities in government-sponsored entities | 7,997                   | (57 )                   | 3,798                    | (113 )                  | 11,795     | (170 )                  |
| Total   | \$11,957                | \$ (84 )                | \$9,121                  | \$ (201 )               | \$21,078   | \$ (285 )               |

|   | December 31, 2016       |                         |                          |                         |            |                         |
|---|-------------------------|-------------------------|--------------------------|-------------------------|------------|-------------------------|
|   | Less than Twelve Months |                         | Twelve Months or Greater |                         | Total      |                         |
|   | Fair Value              | Gross Unrealized Losses | Fair Value               | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| U.S. government agency securities                           | \$3,803                 | \$ (47 )                | \$1,316                  | \$ (49 )                | \$5,119    | \$ (96 )                |
| Obligations of states and political subdivisions            |                         |                         |                          |                         |            |                         |
| Taxable   | 502                     | (4 )                    | -                        | -                       | 502        | (4 )                    |
| Tax-exempt  | 23,554                  | (522 )                  | -                        | -                       | 23,554     | (522 )                  |
| Mortgage-backed securities in government-sponsored entities | 9,066                   | (126 )                  | 4,438                    | (135 )                  | 13,504     | (261 )                  |
| Total   | \$36,925                | \$ (699 )               | \$5,754                  | \$ (184 )               | \$42,679   | \$ (883 )               |

There were 28 securities considered temporarily impaired at September 30, 2017.

On a quarterly basis, the Company performs an assessment to determine whether there have been any events or economic circumstances indicating that a security with an unrealized loss has suffered other-than-temporary impairment ("OTTI"). A debt security is considered impaired if the fair value is less than its amortized cost basis at the reporting date. The Company assesses whether the unrealized loss is other than temporary.

OTTI losses are recognized in earnings when the Company has the intent to sell the debt security or it is more likely than not that it will be required to sell the debt security before recovery of its amortized cost basis. However, even if the Company does not expect to sell a debt security, it must evaluate expected cash flows to be received and determine if a credit loss has occurred.

An unrealized loss is generally deemed to be other than temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. As a result the credit loss component of an OTTI is recorded as a component of investment securities gains (losses) in the accompanying Consolidated Statement of Income, while the remaining portion of the impairment loss is recognized in other comprehensive income, provided the Company does not intend to sell the underlying debt security and it is “more likely than not” that the Company will not have to sell the debt security prior to recovery.

Debt securities issued by U.S. government agencies, U.S. government-sponsored enterprises, and state and political subdivisions accounted for 99% of the total available-for-sale portfolio as of September 30, 2017 and no credit losses are expected, given the explicit and implicit guarantees provided by the U.S. federal government and the lack of prolonged unrealized loss positions within the obligations of state and political subdivisions security portfolio. The Company considers the following factors in determining whether a credit loss exists and the period over which the debt security is expected to recover:

- The length of time and the extent to which the fair value has been less than the amortized cost basis.
- Changes in the near-term prospects of the underlying collateral of a security such as changes in default rates, loss severity given default and significant changes in prepayment assumptions;

• The level of cash flows generated from the underlying collateral supporting the principal and interest payments of the debt securities; and

• Any adverse change to the credit conditions and liquidity of the issuer, taking into consideration the latest information available about the overall financial condition of the issuer, credit ratings, recent legislation and government actions affecting the issuer's industry and actions taken by the issuer to deal with the present economic climate.

For the nine months ended September 30, 2017 and 2016, there were no available-for-sale debt securities with an unrealized loss that suffered OTTI. Management does not believe any individual unrealized loss as of September 30, 2017 or December 31, 2016 represented an other-than-temporary impairment. The unrealized losses on debt securities are primarily the result of interest rate changes. These conditions will not prohibit the Company from receiving its contractual principal and interest payments on these debt securities. The fair value of these debt securities is expected to recover as payments are received on these securities and they approach maturity. Should the impairment of any of these securities become other than temporary, the cost basis of the investment will be reduced and the resulting loss recognized in net income in the period the other-than-temporary impairment is identified.

#### **NOTE 7 - LOANS AND RELATED ALLOWANCE FOR LOAN AND LEASE LOSSES**

Major classifications of loans are summarized as follows (in thousands):

|   | September<br>30,<br>2017 | December<br>31,<br>2016 |
|---|--------------------------|-------------------------|
| Commercial and industrial                 | \$ 99,314                | \$ 60,630               |
| Real estate - construction                | 40,760                   | 23,709                  |
| Real estate - mortgage:                   |                          |                         |
| Residential                               | 316,191                  | 270,830                 |
| Commercial                                | 403,135                  | 249,490                 |
| Consumer installment                      | 19,141                   | 4,481                   |
|   | 878,541                  | 609,140                 |
| Less: Allowance for loan and lease losses | 6,852                    | 6,598                   |
| Net loans                                 | \$ 871,689               | \$ 602,542              |

The amounts above include deferred loan origination costs of \$2.0 million and \$1.7 million at September 30, 2017 and December 31, 2016, respectively.

The Company's primary business activity is with customers located within its local Northeastern Ohio trade area, eastern Geauga County, and contiguous counties to the north, east, and south. The Company also serves the central Ohio market with offices in Dublin, Sunbury and Westerville, Ohio. The Northeastern Ohio trade area includes the newly acquired Liberty locations in Beachwood, Twinsburg, and Solon, Ohio. Commercial, residential, consumer, and agricultural loans are granted. Although the Company has a diversified loan portfolio, loans outstanding to individuals and businesses are dependent upon the local economic conditions in the Company's immediate trade area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff generally are reported at their outstanding unpaid principal balances net of the allowance for loan and lease losses. Interest income is recognized as income when earned on the accrual method. The accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions, the borrower's financial condition is such that collection of interest is doubtful. Interest received on nonaccrual loans is recorded as income or applied against principal according to management's judgment as to the collectability of such principal.

Loan origination fees and certain direct loan origination costs are being deferred and the net amount amortized as an adjustment of the related loan's yield. Management is amortizing these amounts over the contractual life of the related loans.

The following tables summarize the primary segments of the loan portfolio and allowance for loan and lease losses (in thousands):

| September 30, 2017                    | Commercial and industrial | Real estate-construction | Real Estate- Mortgage |            | Consumer installment | Total      |
|---------------------------------------|---------------------------|--------------------------|-----------------------|------------|----------------------|------------|
|                                       |                           |                          | Residential           | Commercial |                      |            |
| <b>Loans:</b>                         |                           |                          |                       |            |                      |            |
| Individually evaluated for impairment | \$ 3,038                  | \$ 185                   | \$ 2,844              | \$ 5,788   | \$ 4                 | \$ 11,859  |
| Collectively evaluated for impairment | 96,276                    | 40,575                   | 313,347               | 397,347    | 19,137               | 866,682    |
| Total loans                           | \$ 99,314                 | \$ 40,760                | \$ 316,191            | \$ 403,135 | \$ 19,141            | \$ 878,541 |

| December 31, 2016                     | Commercial and industrial | Real estate-construction | Real estate- Mortgage |            | Consumer installment | Total      |
|---------------------------------------|---------------------------|--------------------------|-----------------------|------------|----------------------|------------|
|                                       |                           |                          | Residential           | Commercial |                      |            |
| <b>Loans:</b>                         |                           |                          |                       |            |                      |            |
| Individually evaluated for impairment | \$ 1,190                  | \$ 913                   | \$ 3,135              | \$ 7,187   | \$ 5                 | \$ 12,430  |
| Collectively evaluated for impairment | 59,440                    | 22,796                   | 267,695               | 242,303    | 4,476                | 596,710    |
| Total loans                           | \$ 60,630                 | \$ 23,709                | \$ 270,830            | \$ 249,490 | \$ 4,481             | \$ 609,140 |

| September 30, 2017                              | Commercial and industrial | Real estate-construction | Real Estate- Mortgage |            | Consumer installment | Total    |
|---|---------------------------|--------------------------|-----------------------|------------|----------------------|----------|
|   |                           |                          | Residential           | Commercial |                      |          |
| <b>Allowance for loan and lease losses:</b>     |                           |                          |                       |            |                      |          |
| Ending allowance balance attributable to loans: |                           |                          |                       |            |                      |          |
| Individually evaluated for impairment           | \$ 436                    | \$ -                     | \$ 132                | \$ 692     | \$ -                 | \$ 1,260 |
| Collectively evaluated for impairment           | 291                       | 259                      | 1,704                 | 2,991      | 347                  | 5,592    |
| Total ending allowance balance                  | \$ 727                    | \$ 259                   | \$ 1,836              | \$ 3,683   | \$ 347               | \$ 6,852 |

| December 31, 2016                           | Commercial and industrial | Real estate-construction | Real Estate- Mortgage |            | Consumer installment | Total |
|---|---------------------------|--------------------------|-----------------------|------------|----------------------|-------|
|   |                           |                          | Residential           | Commercial |                      |       |
| <b>Allowance for loan and lease losses:</b> |                           |                          |                       |            |                      |       |

Ending allowance balance attributable to loans:

|                                       |        |        |         |          |       |         |
|---------------------------------------|--------|--------|---------|----------|-------|---------|
| Individually evaluated for impairment | \$ 90  | \$ -   | \$251   | \$ 186   | \$ -  | \$527   |
| Collectively evaluated for impairment | 358    | 172    | 2,567   | 2,949    | 25    | 6,071   |
| Total ending allowance balance        | \$ 448 | \$ 172 | \$2,818 | \$ 3,135 | \$ 25 | \$6,598 |

The Company's loan portfolio is segmented to a level that allows management to monitor risk and performance. The portfolio is segmented into Commercial and Industrial ("C&I"), Real Estate Construction, Real Estate - Mortgage which is further segmented into Residential and Commercial real estate ("CRE"), and Consumer Installment Loans. The C&I loan segment consists of loans made for the purpose of financing the activities of commercial customers. The residential mortgage loan segment consists of loans made for the purpose of financing the activities of residential homeowners. The commercial mortgage loan segment consists of loans made for the purpose of financing the activities of commercial real estate owners and operators. The consumer loan segment consists primarily of installment loans and overdraft lines of credit connected with customer deposit accounts. The increase in the allowance for loan loss for C&I, Real Estate Construction, CRE, and Consumer Installment loan portfolios were partially offset by a decrease in the allowance for the Residential loan portfolio.

Management evaluates individual loans in all of the commercial segments for possible impairment based on guidance established by the Board of Directors. Loans are considered to be impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. The Company does not separately evaluate individual consumer and residential mortgage loans for impairment, unless such loans are part of a larger relationship that is impaired, or the loan was modified in a troubled debt restructuring.

Once the determination has been made that a loan is impaired, the determination of whether a specific allocation of the allowance is necessary is measured by comparing the recorded investment in the loan to the fair value of the loan using one of the following methods: (a) the present value of expected future cash flows discounted at the loan's effective interest rate; (b) the loan's observable market price; or (c) the fair value of the collateral less selling costs. The method is selected on a loan-by-loan basis, with management primarily utilizing the fair value of collateral method. The evaluation of the need and amount of a specific allocation of the allowance and whether a loan can be removed from impairment status is made on a quarterly basis. The Company's policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition.

The following tables present impaired loans by class, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary (in thousands):

September 30, 2017

Impaired Loans

|                                     | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance |
|-------------------------------------|------------------------|--------------------------------|----------------------|
| With no related allowance recorded: |                        |                                |                      |
| Commercial and industrial           | \$ 1,368               | \$ 1,550                       | \$ -                 |
| Real estate - construction          | 185                    | 185                            | -                    |
| Real estate - mortgage:             |                        |                                |                      |
| Residential                         | 1,875                  | 2,092                          | -                    |
| Commercial                          | 2,969                  | 3,108                          | -                    |
| Total                               | \$ 6,397               | \$ 6,935                       | \$ -                 |
| With an allowance recorded:         |                        |                                |                      |
| Commercial and industrial           | \$ 1,670               | \$ 2,115                       | \$ 436               |
| Real estate - mortgage:             |                        |                                |                      |
| Residential                         | 969                    | 1,005                          | 132                  |
| Commercial                          | 2,819                  | 2,984                          | 692                  |
| Consumer installment                | 4                      | 4                              | -                    |
| Total                               | \$ 5,462               | \$ 6,108                       | \$ 1,260             |
| Total:                              |                        |                                |                      |
| Commercial and industrial           | \$ 3,038               | \$ 3,665                       | \$ 436               |
| Real estate - construction          | 185                    | 185                            | -                    |
| Real estate - mortgage:             |                        |                                |                      |
| Residential                         | 2,844                  | 3,097                          | 132                  |
| Commercial                          | 5,788                  | 6,092                          | 692                  |
| Consumer installment                | 4                      | 4                              | -                    |
| Total                               | \$ 11,859              | \$ 13,043                      | \$ 1,260             |



December 31, 2016

## Impaired Loans

|                                     | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance |
|-------------------------------------|------------------------|--------------------------------|----------------------|
| With no related allowance recorded: |                        |                                |                      |
| Commercial and industrial           | \$ 319                 | \$ 318                         | \$ -                 |
| Real estate - construction          | 913                    | 909                            | -                    |
| Real estate - mortgage:             |                        |                                |                      |
| Residential                         | 2,142                  | 2,140                          | -                    |
| Commercial                          | 2,031                  | 2,027                          | -                    |
| Total                               | \$ 5,405               | \$ 5,394                       | \$ -                 |
| With an allowance recorded:         |                        |                                |                      |
| Commercial and industrial           | \$ 871                 | \$ 868                         | \$ 90                |
| Real estate - mortgage:             |                        |                                |                      |
| Residential                         | 993                    | 991                            | 251                  |
| Commercial                          | 5,156                  | 5,147                          | 186                  |
| Consumer installment                | 5                      | 5                              | -                    |
| Total                               | \$ 7,025               | \$ 7,011                       | \$ 527               |
| Total:                              |                        |                                |                      |
| Commercial and industrial           | \$ 1,190               | \$ 1,186                       | \$ 90                |
| Real estate - construction          | 913                    | 909                            | -                    |
| Real estate - mortgage:             |                        |                                |                      |
| Residential                         | 3,135                  | 3,131                          | 251                  |
| Commercial                          | 7,187                  | 7,174                          | 186                  |
| Consumer installment                | 5                      | 5                              | -                    |
| Total                               | \$ 12,430              | \$ 12,405                      | \$ 527               |

The tables above include troubled debt restructuring totaling \$2.4 million at September 30, 2017 and \$2.7 million as of December 31, 2016.

The following tables present the average balance and interest income by class, recognized on impaired loans (in thousands):

|  | For the Three Months<br>Ended |          | For the Nine Months<br>Ended |          |
|--|-------------------------------|----------|------------------------------|----------|
|  | September 30, 2017            |          | September 30, 2017           |          |
|  | Average                       | Interest | Average                      | Interest |
|  | Recorded Income               |          | Recorded Income              |          |

|                            | InvestmenRecognized |        | InvestmenRecognized |        |
|----------------------------|---------------------|--------|---------------------|--------|
| Total:                     |                     |        |                     |        |
| Commercial and industrial  | \$2,633             | \$ 69  | \$1,962             | \$ 210 |
| Real estate - construction | 431                 | -      | 738                 | 1      |
| Real estate - mortgage:    |                     |        |                     |        |
| Residential                | 2,988               | 19     | 3,149               | 69     |
| Commercial                 | 7,216               | 48     | 7,223               | 231    |
| Consumer installment       | 5                   | 1      | 5                   | 1      |
|                            | \$13,273            | \$ 137 | \$13,077            | \$ 512 |

|                            | For the Three Months<br>Ended |            | For the Nine Months<br>Ended |            |
|----------------------------|-------------------------------|------------|------------------------------|------------|
|                            | September 30, 2016            |            | September 30, 2016           |            |
|                            | Average                       | Interest   | Average                      | Interest   |
|                            | Recorded Income               |            | Recorded Income              |            |
|                            | Investmen                     | Recognized | Investmen                    | Recognized |
| Total:                     |                               |            |                              |            |
| Commercial and industrial  | \$ 864                        | \$ 4       | \$ 1,218                     | \$ 9       |
| Real estate - construction | 1,105                         | 3          | 1,404                        | 22         |
| Real estate - mortgage:    |                               |            |                              |            |
| Residential                | 3,389                         | -          | 3,660                        | 36         |
| Commercial                 | 7,939                         | 8          | 7,449                        | 115        |
| Consumer installment       | 5                             | -          | 6                            | -          |
|                            | \$ 13,302                     | \$ 15      | \$ 13,737                    | \$ 182     |

Management uses a nine-point internal risk-rating system to monitor the credit quality of the overall loan portfolio. The first five categories are considered not criticized and are aggregated as Pass rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due are considered Substandard. Any portion of a loan that has been charged off is placed in the Loss category.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Company has a structured loan-rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as bankruptcy, repossession, or death, occurs to raise awareness of a possible credit event. The Company's Commercial Loan Officers are responsible for the timely and accurate risk rating of the loans in their portfolios at origination and on an ongoing basis with the Chief Credit Officer ultimately responsible for accurate and timely risk ratings. The Credit Department performs an annual review of all commercial relationships with loan balances of \$1,000,000 or greater. Confirmation of the appropriate risk grade is included in the review on an ongoing basis. The Company engages an external consultant to conduct loan reviews on a semiannual basis. Generally, the external consultant reviews commercial relationships greater than \$250,000 and/or criticized relationships greater than \$125,000. Detailed reviews, including plans for resolution, are performed on loans classified as Substandard on a quarterly basis. Loans in the Special Mention and Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

The primary risk of commercial and industrial loans is the current economic uncertainties. C&I loans are, by nature, secured by less substantial collateral than real estate-secured loans. The primary risk of real estate construction loans

is potential delays and /or disputes during the completion process. The primary risk of residential real estate loans is current economic uncertainties along with the slow recovery in the housing market. The primary risk of commercial real estate loans is loss of income of the owner or occupier of the property and the inability of the market to sustain rent levels. Consumer installment loans historically have experienced higher delinquency rates. Consumer installments are typically secured by less substantial collateral than other types of credits.

The following tables present the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention, Substandard and Doubtful within the internal risk-rating system (in thousands):

|                            | Pass      | Special<br>Mention | Substandard | Doubtful | Total<br>Loans |
|----------------------------|-----------|--------------------|-------------|----------|----------------|
| September 30, 2017         |           |                    |             |          |                |
| Commercial and industrial  | \$92,855  | \$ 2,188           | \$ 4,271    | \$ -     | \$99,314       |
| Real estate - construction | 40,737    | -                  | 23          | -        | 40,760         |
| Real estate - mortgage:    |           |                    |             |          |                |
| Residential                | 310,086   | 744                | 5,361       | -        | 316,191        |
| Commercial                 | 393,538   | 4,477              | 5,120       | -        | 403,135        |
| Consumer installment       | 18,909    | -                  | 232         | -        | 19,141         |
| Total                      | \$856,125 | \$ 7,409           | \$ 15,007   | \$ -     | \$878,541      |

| December 31, 2016          | Pass      | Special<br>Mention | Substandard | Doubtful | Total<br>Loans |
|----------------------------|-----------|--------------------|-------------|----------|----------------|
| Commercial and industrial  | \$58,539  | \$ 663             | \$ 1,428    | \$ -     | \$60,630       |
| Real estate - construction | 23,541    | 144                | 24          | -        | 23,709         |
| Real estate - mortgage:    |           |                    |             |          |                |
| Residential                | 264,481   | 428                | 5,921       | -        | 270,830        |
| Commercial                 | 240,678   | 4,422              | 4,390       | -        | 249,490        |
| Consumer installment       | 4,467     | -                  | 14          | -        | 4,481          |
| Total                      | \$591,706 | \$ 5,657           | \$ 11,777   | \$ -     | \$609,140      |

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due.

Nonperforming assets include nonaccrual loans, troubled debt restructurings (TDRs), loans 90 days or more past due, EMORECO assets, other real estate owned, and repossessed assets. A loan is classified as nonaccrual when, in the opinion of management, there are serious doubts about collectability of interest and principal. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions, the borrower's financial condition is such that collection of principal and interest is doubtful. Payments received on nonaccrual loans are applied against the principal balance.

The following tables present the classes of the loan portfolio summarized by the aging categories of performing loans (in thousands):

|                            | Current   | 30-59<br>Days<br>Past<br>Due | 60-89<br>Days<br>Past<br>Due | 90<br>Days+<br>Past<br>Due | Total<br>Past<br>Due | Total<br>Loans |
|----------------------------|-----------|------------------------------|------------------------------|----------------------------|----------------------|----------------|
| September 30, 2017         |           |                              |                              |                            |                      |                |
| Commercial and industrial  | \$98,449  | \$632                        | \$-                          | \$233                      | \$865                | \$99,314       |
| Real estate - construction | 40,760    | -                            | -                            | -                          | -                    | 40,760         |
| Real estate - mortgage:    |           |                              |                              |                            |                      |                |
| Residential                | 313,720   | 1,101                        | 37                           | 1,333                      | 2,471                | 316,191        |
| Commercial                 | 400,497   | 1,236                        | 1,037                        | 365                        | 2,638                | 403,135        |
| Consumer installment       | 19,128    | 10                           | 3                            | -                          | 13                   | 19,141         |
| Total                      | \$872,554 | \$2,979                      | \$1,077                      | \$1,931                    | \$5,987              | \$878,541      |

|  | 30-59<br>Days | 60-89<br>Days | 90<br>Days+ | Total | Total |
|--|---------------|---------------|-------------|-------|-------|
|--|---------------|---------------|-------------|-------|-------|

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|                            | Current   | Past<br>Due | Past<br>Due | Past<br>Due | Past<br>Due | Loans     |
|----------------------------|-----------|-------------|-------------|-------------|-------------|-----------|
| December 31, 2016          |           |             |             |             |             |           |
| Commercial and industrial  | \$60,407  | \$17        | \$2         | \$204       | \$223       | \$60,630  |
| Real estate - construction | 23,709    | -           | -           | -           | -           | 23,709    |
| Real estate - mortgage:    |           |             |             |             |             |           |
| Residential                | 268,041   | 1,909       | 207         | 673         | 2,789       | 270,830   |
| Commercial                 | 249,081   | 92          | -           | 317         | 409         | 249,490   |
| Consumer installment       | 4,465     | -           | 10          | 6           | 16          | 4,481     |
| Total                      | \$605,703 | \$2,018     | \$219       | \$1,200     | \$3,437     | \$609,140 |

The following tables present the classes of the loan portfolio summarized by nonaccrual loans (in thousands):

| September 30, 2017        | Nonaccrual | 90+ Days<br>Past<br>Due and<br>Accruing |
|---------------------------|------------|---|
| Commercial and industrial | \$ 1,367   | \$ 20                                   |
| Real estate - mortgage:   |            |   |
| Residential               | 3,802      | 248                                     |
| Commercial                | 3,356      | -                                       |
| Total                     | \$ 8,525   | \$ 268                                  |

| December 31, 2016         | Nonaccrual | 90+ Days<br>Past<br>Due and<br>Accruing |
|---------------------------|------------|---|
| Commercial and industrial | \$ 454     | \$ -                                    |
| Real estate - mortgage:   |            |   |
| Residential               | 4,034      | -                                       |
| Commercial                | 1,409      | -                                       |
| Consumer installment      | 6          | -                                       |
| Total                     | \$ 5,903   | \$ -                                    |

Interest income that would have been recorded had these loans not been placed on nonaccrual status was \$398,000 for the nine months ended September 30, 2017 and \$309,000 for the year ended December 31, 2016.

An allowance for loan and lease losses (“ALLL”) is maintained to absorb losses from the loan portfolio. The ALLL is based on management’s continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of nonperforming loans.

The Company’s methodology for determining the ALLL is based on the requirements of ASC Section 310-10-35 for loans individually evaluated for impairment (discussed above) and ASC Subtopic 450-20 for loans collectively evaluated for impairment, as well as the Interagency Policy Statements on the Allowance for Loan and Lease Losses and other bank regulatory guidance. The total of the two components represents the Company’s ALLL. Management also performs impairment analyses on TDRs, which may result in specific reserves.

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are modified by other qualitative factors.

The classes described above, which are based on the purpose code assigned to each loan, provide the starting point for the ALLL analysis. Management tracks the historical net charge-off activity at the purpose code level. The historical charge-off factor was calculated using the last twelve consecutive historical quarters.

Management has identified a number of additional qualitative factors which it uses to supplement the historical charge-off factor because these factors are likely to cause estimated credit losses associated with the existing loan pools to differ from historical loss experience. The additional factors that are evaluated quarterly and updated using information obtained from internal, regulatory, and governmental sources are: national and local economic trends and conditions; levels of and trends in delinquency rates and nonaccrual loans; trends in volumes and terms of loans; effects of changes in lending policies; experience, ability, and depth of lending staff; value of underlying collateral; and concentrations of credit from a loan type, industry and/or geographic standpoint.

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALLL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALLL.

The following tables summarize the primary segments of the loan portfolio (in thousands):

|                                    | Commercial<br>and<br>industrial | Real estate-<br>construction | Real<br>estate-<br>residential<br>mortgage | Real estate-<br>commercial<br>mortgage | Consumer<br>installment | Total   |
|------------------------------------|---------------------------------|------------------------------|--|--|-------------------------|---------|
| ALLL balance at December 31, 2016  | \$ 448                          | \$ 172                       | \$ 2,818                                   | \$ 3,135                               | \$ 25                   | \$6,598 |
| Charge-offs                        | (439 )                          | -                            | (74 )                                      | (39 )                                  | (384 )                  | (936 )  |
| Recoveries                         | 189                             | 34                           | 59   | 111                                    | 182                     | 575     |
| Provision                          | 529                             | 53                           | (967 )                                     | 476                                    | 524                     | 615     |
| ALLL balance at September 30, 2017 | \$ 727                          | \$ 259                       | \$ 1,836                                   | \$ 3,683                               | \$ 347                  | \$6,852 |

|                                    | Commercial<br>and<br>industrial | Real estate-<br>construction | Real<br>estate-<br>residential<br>mortgage | Real estate-<br>commercial<br>mortgage | Consumer<br>installment | Total   |
|------------------------------------|---------------------------------|------------------------------|--|--|-------------------------|---------|
| ALLL balance at December 31, 2015  | \$ 867                          | \$ 276                       | \$ 3,139                                   | \$ 2,078                               | \$ 25                   | \$6,385 |
| Charge-offs                        | (197 )                          | -                            | (394 )                                     | (70 )                                  | (18 )                   | (679 )  |
| Recoveries                         | 51                              | -                            | 113  | 140                                    | 9                       | 313     |
| Provision                          | (208 )                          | (138 )                       | (97 )                                      | 747                                    | 11                      | 315     |
| ALLL balance at September 30, 2016 | \$ 513                          | \$ 138                       | \$ 2,761                                   | \$ 2,895                               | \$ 27                   | \$6,334 |

|                                    | Commercial<br>and<br>industrial | Real estate-<br>construction | Real<br>estate-<br>residential<br>mortgage | Real estate-<br>commercial<br>mortgage | Consumer<br>installment | Total   |
|------------------------------------|---------------------------------|------------------------------|--|--|-------------------------|---------|
| ALLL balance at June 30, 2017      | \$ 613                          | \$ 202                       | \$ 1,767                                   | \$ 4,012                               | \$ 11                   | \$6,605 |
| Charge-offs                        | (4 )                            | -                            | -  | (20 )                                  | (229 )                  | (253 )  |
| Recoveries                         | 46                              | 11                           | 45   | 111                                    | 7                       | 220     |
| Provision                          | 72                              | 46                           | 24   | (420 )                                 | 558                     | 280     |
| ALLL balance at September 30, 2017 | \$ 727                          | \$ 259                       | \$ 1,836                                   | \$ 3,683                               | \$ 347                  | \$6,852 |

|                                    | Commercial<br>and<br>industrial | Real estate-<br>construction | Real<br>estate-<br>residential<br>mortgage | Real estate-<br>commercial<br>mortgage | Consumer<br>installment | Total   |
|------------------------------------|---------------------------------|------------------------------|--|--|-------------------------|---------|
| ALLL balance at June 30, 2016      | \$ 484                          | \$ 159                       | \$ 2,788                                   | \$ 2,909                               | \$ 26                   | \$6,366 |
| Charge-offs                        | (74 )                           | -                            | (149 )                                     | -                                      | (3 )                    | (226 )  |
| Recoveries                         | 4                               | -                            | 82   | -                                      | 3                       | 89      |
| Provision                          | 99                              | (21 )                        | 40   | (14 )                                  | 1                       | 105     |
| ALLL balance at September 30, 2016 | \$ 513                          | \$ 138                       | \$ 2,761                                   | \$ 2,895                               | \$ 27                   | \$6,334 |

The negative provision allocated to residential real estate loans in the amount of \$967,000 for the three-month period ended September 30, 2017 is due to the payoff of a large commercial credit during that period.

The negative provision allocated to commercial real estate loans in the amount of \$420,000 for the nine-month period ended September 30, 2017 is due to changes in qualitative factors during that period.

The following tables summarize troubled debt restructurings (in thousands):

| For the Three Months Ended<br>September 30, 2017 |                        |             |       |                  |                   |
|--|------------------------|-------------|-------|------------------|-------------------|
| Term   | Number of<br>Contracts |             |       | Pre-Modification | Post-Modification |
|  | Modification           | Outstanding | Total | Recorded         | Recorded          |
| Troubled Debt Restructurings                     |                        |             |       | Investment       | Investment        |
| Residential real estate                          | 1                      | -           | 1     | \$ 29            | \$ 29             |

| For the Nine Months Ended<br>September 30, 2017 |                        |             |       |                  |                   |
|---|------------------------|-------------|-------|------------------|-------------------|
| Term  | Number of<br>Contracts |             |       | Pre-Modification | Post-Modification |
|   | Modification           | Outstanding | Total | Recorded         | Recorded          |
| Troubled Debt Restructurings                    |                        |             |       | Investment       | Investment        |
| Commercial and industrial                       | 1                      | 1           | 2     | \$ 954           | \$ 955            |
| Residential real estate                         | 3                      | -           | 3     | 39               | 39                |

| For the Nine Months Ended<br>September 30, 2016 |                        |             |       |                  |                   |
|---|------------------------|-------------|-------|------------------|-------------------|
| Term  | Number of<br>Contracts |             |       | Pre-Modification | Post-Modification |
|   | Modification           | Outstanding | Total | Recorded         | Recorded          |
| Troubled Debt Restructurings                    |                        |             |       | Investment       | Investment        |
| Commercial and industrial                       | 2                      | -           | 2     | \$ 169           | \$ 169            |
| Residential real estate                         | 1                      | -           | 1     | 58               | 58                |
| Commercial real estate                          | 1                      | -           | 1     | 311              | 311               |

For the three months ended September 30, 2016 there were no troubled debt restructurings.

One contract, with a recorded investment of \$33,000, subsequently defaulted during 2017. This contract was paid off as of September 30, 2017. There were no other subsequent defaults of troubled debt restructurings for the three and nine months ended September 30, 2017.

The following tables summarize subsequent defaults of troubled debt restructurings (in thousands) for the three and nine-month periods ended September 30, 2016:

|   | For the Three<br>Months Ended<br>September 30,<br>2016 |
|---|--|
| Troubled Debt Restructurings subsequently defaulted | Number<br>of Recorded                                  |
|   | Investment<br>Contracts                                |
| Commercial and industrial                           | 1 \$ 3   |
| Residential real estate                             | 1 58   |

|   | For the Nine<br>Months Ended<br>September 30,<br>2016 |
|---|---|
| Troubled Debt Restructurings subsequently defaulted | Number<br>of Recorded                                 |
|   | Investment<br>Contracts                               |
| Commercial and industrial                           | 2 \$ 273  |
| Real estate construction                            | 1 58  |

#### **NOTE 8 -OTHER REAL ESTATE OWNED (“OREO”)**

OREO comprises foreclosed assets acquired in settlement of loans and is carried at fair value less estimated cost to sell and is presented on the Consolidated Balance Sheet. At September 30, 2017 and December 31, 2016, there was \$557,000 and \$934,000 of OREO, respectively. The recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings are in process according to local requirements of the applicable jurisdiction totaled \$1.0 million at September 30, 2017.

#### **NOTE 9 -BUSINESS ACQUISITION**

In the second quarter of 2016, the Company announced the signing of a definitive merger agreement to acquire 100% of the outstanding equity interest of Liberty Bank for cash and stock. Liberty was an Ohio bank that conducted its business from a main office in Beachwood, Ohio with branches in Twinsburg and Solon, Ohio.

The transaction closed on January 12, 2017, with Liberty having been merged into Middlefield Bank, with Middlefield Bank as the surviving entity. The acquisition established the Company’s presence in Cuyahoga and Summit Counties.

Under the terms of the merger agreement, the Company acquired all of the outstanding shares of Liberty for a total purchase price of \$42.2 million. As a result of the acquisition, the Company issued 544,610 common shares and \$21.2 million in cash to the former shareholders of Liberty Bank. The shares were issued with a value of \$38.55 per share, which was the closing price of the Company’s stock on January 12, 2017. Prior to the acquisition the Company had a previously held equity interest in Liberty Bank which was re-measured at fair value on the acquisition date and resulted in a gain of \$488,000, which was recorded in the Investment Securities Gains – Taxable Interest line on the consolidated Income Statement for the nine months ended September 30, 2017.

The acquired assets and assumed liabilities were measured at estimated fair values. The Company relied on the income approach to estimate the value of the loans. The loans’ underlying characteristics (account types, remaining terms (in months), annual interest rates or coupons, interest types, past delinquencies, timing of principal and interest payments, current market rates, loan-to-value ratios, loss exposures and remaining balance) were considered. Various assumptions were applied regarding credit, interest, and prepayment risks for the loans based on loan types, payment types and fixed or variable classifications.

The Company also recorded an identifiable intangible asset representing the core deposit base of Liberty Bank. The discounted cash flow method was used in valuing this intangible. This method is based upon the principle of future benefits; economic value is based on anticipated future benefits as measured by cash flows expected to occur in the future. The estimated future cash flows are converted to a value indicator by determining the present value of the cash flows using a discount rate. The discount rate is based upon the nature of the business, the level of risk, and the expected stability of the estimated future cash flows. The higher the risk, the higher the discount rate, and the lower the value indicator.

Time deposit fair values were estimated using an income approach. The methodology entailed discounting the contractual cash flows of the instruments over their remaining contractual lives at prevailing market rates. Interest and principal payments were projected for each category of CDs over the period from the valuation date to the maturity dates. These payments represent future cash flows to be paid to depositors until maturity. Using appropriate market interest rates for each category of CDs, the future cash flows were discounted to their present value equivalents. The market interest rates were selected based on peer rates in Ohio from Bankrate as of the valuation date.

The following table summarizes the purchase of Liberty Bank as of January 12, 2017:

(In Thousands, Except Per Share Data)

|   |          |          |
|---|----------|----------|
| Purchase Price Consideration in Common Stock  |          |          |
| Middlefield Banc Corp. shares issued  | 544,610  |          |
| Value assigned to Middlefield Banc Corp. common share   | \$38.55  |          |
| Purchase price assigned to Liberty Bank common shares exchanged for Middlefield Banc Corp. shares |          | 20,995   |
| Purchase Price Consideration in Cash  |          |          |
| Purchase price assigned to Liberty Bank common shares exchanged for cash                          |          | 21,173   |
| Total Purchase Price  |          | 42,168   |
| Previously held equity interest in Liberty Bank   |          | 1,068    |
| Net Assets Acquired:  |          |          |
| Liberty Bank shareholders equity  | \$30,474 |          |
| Adjustments to reflect assets acquired at fair value:   |          |          |
| Loans   |          |          |
| Allowance for loan loss   | 3,257    |          |
| Core deposit intangible   | 3,087    |          |
| Loans - interest rate   | 578      |          |
| Loans - general credit  | (2,161 ) |          |
| Other   | 254      |          |
| Adjustments to reflect liabilities acquired at fair value:  |          |          |
| Time deposits   | (141 )   |          |
| Deferred taxes  | (1,134 ) |          |
| Change in control   | (1,718 ) |          |
|   |          | 32,496   |
| Goodwill resulting from merger  |          | \$10,740 |

The following condensed statement reflects the amounts recognized as of the acquisition date for each major class of asset acquired and liability assumed, at fair value:

(In Thousands)

|   |          |
|---|----------|
| Total purchase price                            | \$42,168 |
| Previously held equity interest in Liberty Bank | 1,068    |
| Assets (liabilities) acquired:                  |          |
| Net assets acquired:                            |          |
| Cash  | 26,604   |
| Loans and loans held for sale                   | 201,341  |
| Premises and equipment, net                     | 325      |
| Accrued interest receivable                     | 440      |
| Bank-owned life insurance                       | 1,681    |
| Core deposit intangible                         | 3,087    |
| Other assets                                    | 997      |

|   |           |          |
|---|-----------|----------|
| Time deposits                                   | (30,744 ) |          |
| Non-time deposits                               | (167,300) |          |
| Accrued interest payable                        | (47 )     |          |
| Deferred taxes                                  | (1,134 )  |          |
| Other liabilities                               | (2,754 )  |          |
|   |           | 32,496   |
| Goodwill resulting from the Liberty Bank merger |           | \$10,740 |

Middlefield recorded goodwill and intangibles associated with the purchase of Liberty Bank totaling \$10,740,000. Goodwill is not amortized, but is periodically evaluated for impairment. Middlefield Bank did not recognize any impairment during the nine months ended September 30, 2017. Management made adjustments to goodwill subsequent to the acquisition of \$347,000 due to refinements in a purchase accounting adjustment.

Identifiable intangibles are amortized to their estimated residual values over the expected useful lives. Such lives are also periodically reassessed to determine if any amortization period adjustments are required. During the nine months ended September 30, 2017, no such adjustments were recorded. The identifiable intangible assets consist of a core deposit intangible which is being amortized over the estimated useful life. The gross carrying amount of the core deposit intangible at September 30, 2017 was \$2,838,000 with \$249,000 accumulated amortization as of that date.

As of September 30, 2017, the current year and estimated future amortization expense for the core deposit intangible is as follows:

|                |       |
|----------------|-------|
| Remaining 2017 | 93    |
| 2018           | 348   |
| 2019           | 341   |
| 2020           | 332   |
| 2021           | 321   |
| 2022           | 309   |
| 2023           | 296   |
| 2024           | 281   |
| 2025           | 264   |
| 2026           | 253   |
|                | 2,838 |

Results of operations for Liberty prior to the acquisition date are not included in the Consolidated Statement of Income for the three-month period and nine-month period ended September 30, 2017. The results of activities from the former Liberty Bank operations that are included in the Consolidated Statement of Income from the date of acquisition through September 30, 2017 are broken out in the following table:

|  |                                    |
|--|------------------------------------|
| Actual from<br>Acquisition<br>Date<br>Through<br>September<br>30, 2017 | Actual<br>Third<br>Quarter<br>2017 |
|--|------------------------------------|

|                     | (in<br>thousands) | (in<br>thousands) |
|---------------------|-------------------|-------------------|
| Net interest income | \$ 7,810          | \$ 2,566          |
| Noninterest income  | 744               | 219               |
| Net income          | \$ 2,625          | \$ 1,323          |

The table below presents unaudited pro forma information as if the acquisition of Liberty Bank had occurred on January 1, 2016. This has been prepared for comparative purposes only and is not necessarily indicative of the actual results that would have been attained had the acquisition occurred as of the beginning of the periods presented, nor is it indicative of future results. Furthermore, the unaudited pro forma information does not reflect management's estimate of any revenue-enhancing opportunities nor anticipated cost savings as a result of the integration and consolidation of the acquisition. Merger and acquisition integration costs and amortization of fair value adjustments are included in the amounts below.

|                               | Pro Formas<br>Nine-month<br>period ended<br>September 30,<br>2017 |          | Pro Formas<br>Three-month<br>period ended<br>September 30,<br>2016 |         |
|-------------------------------|---|----------|--|---------|
|                               | 2017  | 2016     | 2017   | 2016    |
|                               | (in thousands,<br>except per share<br>data)                       |          | (in thousands,<br>except per share<br>data)                        |         |
| Net interest income           | \$27,844  | \$25,790 | \$9,214  | \$8,868 |
| Noninterest income            | 4,002   | 4,141    | 1,380  | 1,538   |
| Net income                    | \$6,052   | \$6,416  | \$3,479  | \$2,691 |
| Pro forma earnings per share: |   |          |  |         |
| Basic                         | \$2.04  | \$3.12   | \$1.17   | \$1.31  |
| Diluted                       | \$2.03  | \$3.10   | \$1.17   | \$1.30  |

Included in the above net income amount for the three and nine months ended September 30, 2017 are \$338,000 and \$1,032,000 of nonrecurring merger expenses, respectively.

#### **NOTE 10 – SUBSEQUENT EVENTS**

Management has evaluated subsequent events through November 14, 2017, which is the date the consolidated financial statements were available to be issued. Management determined there were no subsequent events that required adjustments to or disclosure in the consolidated financial statements as of September 30, 2017.

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

The following discussion and analysis provides further detail to the financial condition and results of operations of the Company. The MD&A should be read in conjunction with the notes and financial statements presented in this report.

The information contained or incorporated by reference in this current report on Form 10-Q contain forward-looking statements, including certain plans, expectations, goals, and projections, which are subject to numerous assumptions, risks, and uncertainties. Actual results could differ materially from those contained or implied by such statements for a variety of factors, including: changes in economic conditions; movements in interest rates; competitive pressures on product pricing and services; success and timing of business strategies; the nature, extent, and timing of government actions and reforms; and extended disruption of vital infrastructure. All forward-looking statements included in this current report on Form 10-Q are based on information available at the time of the report. Middlefield Banc Corp. assumes no obligation to update any forward-looking statement.

### CHANGES IN FINANCIAL CONDITION

**General.** The Company's total assets ended the September 30, 2017 quarter at \$1.1 billion, an increase of \$293.0 million or 37.2% from December 31, 2016. For the same time period, cash and cash equivalents increased \$16.4 million, or 50.6% while net loans increased \$269.1 million, or 44.7%. Total liabilities increased \$251.5 million, or 35.4% while stockholders' equity increased \$41.5 million, or 54.0%.

On January 12, 2017, the Company completed its acquisition of Liberty Bank, N.A. ("Liberty"), pursuant to a previously announced definitive merger agreement. Under the terms of the merger agreement, Liberty shareholders received \$37.96 in cash or 1.1934 shares of Middlefield's common stock in exchange for each share of Liberty common stock they owned immediately prior to the merger. Middlefield issued 544,610 shares of its common stock in the merger and the aggregate merger consideration was approximately \$42.2 million.

Pursuant to its private placement, on May 10, 2017, the Company sold 400,000 shares of its common stock, without par value, at a purchase price of \$40.00 per share. The offering was to accredited investors only, without the use of a general solicitation or general advertising. The gross proceeds of the offering were \$16,000,000 before compensation of \$760,000 payable to the investment bank acting as placement agent. The offer and sale of the Company's common stock in the private placement was exempt from the registration requirements of the Securities Act of 1933, as amended (the "Securities Act") pursuant to Section 4(a)(2) of, and Rule 506 of Regulation D under, the Securities Act. The Company used the proceeds of the private placement to repay outstanding borrowings of approximately \$12 million, for general corporate purposes, and for future cash flows.

**Cash and cash equivalents.** Cash and due from banks and Federal funds sold represent cash and cash equivalents. Cash and cash equivalents increased \$16.4 million or 50.6% to \$48.9 million at September 30, 2017 from \$32.5 million at December 31, 2016. Deposits from customers into savings and checking accounts, loan and securities repayments and proceeds from borrowed funds typically increase these accounts. Decreases result from customer withdrawals, new loan originations, purchases of investment securities and repayments of borrowed funds.

**Investment securities.** Investment securities available for sale on September 30, 2017 totaled \$98.3 million, a decrease of \$16.0 million or 14.0% from \$114.4 million at December 31, 2016. During this period the Company recorded repayments, calls, and maturities of \$9.6 million. Securities purchases were \$250,000 during this period, and sales of securities were \$6.5 million. The Company recorded \$886,000 in security gains as of September 30, 2017 on the Company's consolidated statement of income and consolidated statement of cash flows, \$488,000 of which resulted from the liquidation of the Company's investment in Liberty stock due to the acquisition.

**Loans receivable.** The loans receivable category consists primarily of single-family mortgage loans used to purchase or refinance personal residences located within the Company's market area and commercial real estate loans used to finance properties that are used in the borrowers' businesses or to finance investor-owned rental properties, and to a lesser extent, construction and consumer loans. Net loans receivable increased \$269.1 million or 44.7% to \$871.7 million as of September 30, 2017 from \$602.5 million at December 31, 2016 due to the Liberty acquisition as well as strategic growth goals. The Liberty acquisition resulted in a net increase of loans receivable of \$195.4 million as of the date of acquisition. Included in the total increase to loans receivable were increases in the commercial real estate, residential real estate, commercial and industrial, construction, and consumer installment portfolios of \$153.6 million, or 61.6%, \$45.4 million, or 16.7%, \$38.7 million or 63.8%, \$17.1 million or 71.9%, and \$14.7 million, or 327.2%, respectively.

The Company's Mortgage Banking operation generates loans for sale to FHLMC. Loans held for sale on September 30, 2017 totaled \$5.9 million, an increase of \$5.3 million, or 835.3%, from December 31, 2016. This increase is largely the result of the acquisition of Liberty's Student Lending loans which are classified as Loans Held for Sale. The amount of loans under this Student Lending program was \$5.0 million as of September 30, 2017.

**Student Lending.** Through its merger with Liberty Bank, N.A., on January 12, 2017, MBC acquired Liberty's private student loan business, which provides qualified borrowers nationwide with the ability to finance the costs associated with obtaining their undergraduate or graduate degrees and to refinance their existing student loans. Pursuant to loan origination agreements with student loan origination and servicing companies, MBC will make student loans to qualified students and sell those loans, without recourse and with servicing released, into the secondary market. This "originate-to-sell" model allows the Bank to enhance its liquidity, making credit more widely available while transferring the risk of non-payment to third parties. Gains on the sales of these loans as well as interest income earned while held by MBC are included in the Consolidated Statement of Income. During the nine-month period ended September 30, 2017, the Company originated \$327.9 million in student loans. The Company anticipates continuing the student loan program but can give no assurance that MBC will originate student loans at equivalent levels.

**Allowance for Loan and Lease Losses and Asset Quality.** The allowance for loan and lease losses increased \$254,000 or 3.8% to \$6.9 million at September 30, 2017 from \$6.6 million at December 31, 2016. For the three months ended September 30, 2017, net loan charge-offs totaled \$33,000, or 0.02% of average loans, compared to net charge-offs of \$137,000, or 0.09%, for the same period in 2016. To maintain the allowance for loan and lease losses, the Company recorded a provision for loan loss of \$280,000 in the three-month period ending September 30, 2017. For the nine months ended September 30, 2017, net loan charge-offs totaled \$361,000, or 0.06% of average loans, compared to net charge-offs of \$366,000, or 0.09%, for the same period in 2016. To maintain the allowance for loan and lease losses, the Company recorded a provision for loan loss of \$615,000 in the nine-month period ending September 30, 2017.

MBC recorded loans acquired through the Liberty acquisition without carrying over any allowance. As such, the acquisition of these loans had a negligible effect on the determination of the allowance for loans and lease losses as of September 30, 2017. However, these assets have been considered in the determination of the allowance for loan and lease losses for any subsequent deterioration after the acquisition date.

Management analyzes the adequacy of the allowance for loan and lease losses regularly through reviews of the performance of the loan portfolio considering economic conditions, changes in interest rates and the effect of such changes on real estate values and changes in the amount and composition of the loan portfolio. The allowance for loan and lease losses is a significant estimate that is particularly susceptible to changes in the near term. Such evaluation includes a review of all loans designated as impaired, historical loan loss experience, the estimated fair value of the underlying collateral, economic conditions, current interest rates, trends in the borrower's industry and other factors that management believes warrant recognition in providing for an appropriate allowance for loan and lease losses. Future additions or reductions to the allowance for loan and lease losses will be dependent on these factors. Additionally, the Company uses an outside party to conduct an independent review of commercial and commercial real estate loans that is designed to validate management conclusions of risk ratings and the appropriateness of the allowance allocated to these loans. The Company uses the results of this review to help determine the effectiveness of policies and procedures and to assess the adequacy of the allowance for loan and lease losses allocated to these types of loans. Management believes the allowance for loan and lease losses is appropriately stated at September 30, 2017. Based on the variables involved and management's judgments about uncertain outcomes, the determination of the allowance for loan and lease losses is considered a critical accounting policy.



**Nonperforming assets.** Nonperforming assets includes nonaccrual loans, troubled debt restructurings (TDRs), loans 90 days or more past due, EMORECO assets, other real estate, and repossessed assets. Real estate owned is written down to fair value at its initial recording and continually monitored for changes in fair value. A loan is classified as nonaccrual when, in the opinion of management, there are serious doubts about collectability of interest and principal. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions, the borrower's financial condition is such that collection of principal and interest is doubtful. Payments received on nonaccrual loans are applied against principal until doubt about collectability ceases. TDRs are those loans which the Company, for economic or legal reasons related to a borrower's financial difficulties, grants a concession to the borrower that the Company would not otherwise consider. The Company has 22 TDRs accruing interest with a balance of \$2.2 million as of September 30, 2017. A TDR that yields market interest rate at the time of restructuring and is in compliance with its modified terms is no longer reported as TDR in calendar years after the year in which the restructuring took place. To be in compliance with its modified terms, a loan that is a TDR must not be in nonaccrual status and must be current or less than 30 days past due on its contractual principal and interest payments under the modified repayment terms. Nonperforming loans secured by real estate totaled \$10.0 million as of September 30, 2017, an increase of \$2.9 million from \$7.1 million at December 31, 2016.

## Asset Quality History

| (Dollar amounts in thousands)                              | 9/30/2017 | 6/30/2017 | 3/31/2017 | 12/31/2016 | 9/30/2016 |
|--|-----------|-----------|-----------|------------|-----------|
| Nonperforming loans  | \$ 11,004 | \$ 12,581 | \$ 8,019  | \$ 7,075   | \$ 8,329  |
| Other real estate owned                                    | 557       | 650       | 1,634     | 934        | 1,205     |
| Nonperforming assets                                       | \$ 11,561 | \$ 13,231 | \$ 9,653  | \$ 8,009   | \$ 9,534  |
| Allowance for loan and lease losses                        | 6,852     | 6,605     | 6,720     | 6,598      | 6,334     |
| Ratios   |           |           |           |            |           |
| Nonperforming loans to total loans                         | 1.25 %    | 1.45 %    | 0.96 %    | 1.16 %     | 1.42 %    |
| Nonperforming assets to total assets                       | 1.07 %    | 1.24 %    | 0.90 %    | 1.02 %     | 1.25 %    |
| Allowance for loan and lease losses to total loans         | 0.78 %    | 0.76 %    | 0.80 %    | 1.08 %     | 1.08 %    |
| Allowance for loan and lease losses to nonperforming loans | 62.27 %   | 52.50 %   | 83.80 %   | 93.26 %    | 76.05 %   |

A major factor in determining the appropriateness of the allowance for loan and lease losses is the type of collateral which secures the loans. Of the total nonperforming loans at September 30, 2017, 91.1% were secured by real estate. Although this does not insure against all losses, the real estate typically provides for at least partial recovery, even in a distressed-sale and declining-value environment. The Company's objective is to minimize the future loss exposure to the Company.

The allowance for loan and lease losses to total loans ratio decreased from 1.08% as of December 31, 2016 to 0.78% as of September 30, 2017. This decrease is primarily due to the increase in total loans resulting from the Liberty acquisition as legacy Liberty loans and investments have required no additional reserves.

**Deposits.** The Company considers various sources when evaluating funding needs, including but not limited to deposits, which are a significant source of funds totaling \$897.7 million or 93.8% of the Company's total funding sources at September 30, 2017. Total deposits increased \$267.7 million or 42.5% at September 30, 2017 from \$629.9 million at December 31, 2016. The Liberty acquisition resulted in a net increase of deposits of \$198.0 million as of the date of acquisition. The total increase in deposits is primarily related to increases in noninterest-bearing demand, interest-bearing demand, money market, savings, and time deposits of \$47.9 million or 35.9%, \$31.6 million or 53.1%, \$86.2 million or 115.0%, \$40.0 million or 23.2%, and \$62.0 million or 32.7%, respectively, at September 30, 2017.

**Borrowed funds.** The Company uses short-term and long-term borrowings as another source of funding for asset growth and liquidity needs. These borrowings primarily include FHLB advances, junior subordinated debt, short-term borrowings from other banks, federal funds purchased, and repurchase agreements. Short-term borrowings decreased \$48.1 million, or 70.3%, to \$20.3 million as of September 30, 2017. Other borrowings increased \$29.8 million, or 316.2%, to \$39.3 million as of September 30, 2017 from \$9.4 million as of December 31, 2016. This increase is due to new FHLB borrowings during the nine-month period ending September 30, 2017 used primarily to fund loan growth.

**Stockholders' equity.** Stockholders' equity increased \$41.5 million, or 54.0%, to \$118.5 million at September 30, 2017 from \$77.0 million at December 31, 2016. This growth was largely the result of an increase in common stock in relation to the Liberty Bank, N.A. acquisition (Note 9), and of the proceeds from the private placement discussed above. This growth was also the result of increases in retained earnings of \$4.6 million. The change in retained earnings is due to the year-to-date net income offset by dividends paid. The increase in stockholders' equity is also attributable to an increase in accumulated other comprehensive income ("AOCI") of \$176,000 due to fair value adjustments of available-for-sale securities.

## RESULTS OF OPERATIONS

**General.** Net income for the three months ended September 30, 2017, was \$2.5 million, a \$1.1 million, or 83.3% increase from the amount earned during the same period in 2016. Diluted earnings per share for the quarter increased to \$0.76, compared to \$0.60 from the same period in 2016. Net income for the nine months ended September 30, 2017, was \$7.1 million, a \$2.3 million, or 48.6% increase from the amount earned during the same period in 2016. Diluted earnings per share increased to \$2.37, compared to \$2.30 from the same period in 2016.

The Company's annualized return on average assets (ROA) and return on average equity (ROE) for the quarter were 0.90% and 8.12%, respectively, compared with 0.69% and 6.84% for the same period in 2016. The Company's ROA and ROE for the nine-month period were 0.89% and 8.82%, respectively, compared with 0.85% and 9.07% for the same period in 2016.

**Net interest income.** Net interest income, the primary source of revenue for the Company, is determined by the Company's interest rate spread, which is defined as the difference between income on earning assets and the cost of funds supporting those assets, and the relative amounts of interest-earning assets and interest-bearing liabilities. Management periodically adjusts the mix of assets and liabilities, as well as the rates earned or paid on those assets and liabilities in order to manage and improve net interest income. The level of interest rates and changes in the amount and composition of interest-earning assets and liabilities affect the Company's net interest income. Historically from an interest rate risk perspective, it has been management's goal to maintain a balance between steady net interest income growth and the risks associated with interest rate fluctuations.

Net interest income for the three months ended September 30, 2017 totaled \$9.5 million, an increase of 48.8% from that reported in the comparable period of 2016. The net interest margin was 3.81% for the third quarter of 2017, up from the 3.68% reported for the same quarter of 2016. Net interest income for the nine months ended September 30, 2017 totaled \$27.5 million, an increase of 44.6% from that reported in the comparable period of 2016. The net interest margin was 3.82% for the nine-month period ended September 30, 2017, up from the 3.78% reported in the comparable period of 2016.

**Interest and dividend income.** Interest and dividend income increased \$3.9 million, or 52.7%, for the three months ended September 30, 2017, compared to the same period in the prior year. This is attributable to an increase in interest and fees on loans (including the interest and fees on the loans acquired through the Liberty acquisition) of \$4.0 million, partially offset by a decrease in interest earned on investment securities of \$184,000. Interest and dividend income increased \$10.3 million, or 46.3%, for the nine months ended September 30, 2017, compared to the same period in the prior year. This is attributable to an increase in interest and fees on loans (including the interest and fees on the loans acquired through the Liberty acquisition) of \$10.6 million, partially offset by a decrease in interest earned on investment securities of \$646,000.

Interest earned on loans receivable increased \$4.0 million, or 61.7%, for the three months ended September 30, 2017, compared to the same period in the prior year. The total increase is comprised of a \$3.3 million increase due to an increase in average loan balances of \$293.4 million, accompanied by an increase of \$715,000 attributable to a 32 basis point increase in the average yield, to 4.74%. Interest earned on loans receivable increased \$10.6 million or 55.9%, for the nine months ended September 30, 2017, compared to the same period in the prior year. This total increase is comprised of a \$9.7 million increase due to an increase in average loan balances of \$285.2 million, accompanied by an increase of \$885,000 attributable to a 14 basis point increase in the average yield, to 4.69%. The net increase in interest and fees earned on loans receivable attributed to the Liberty acquisition is \$7.5 million for the nine months ended September 30, 2017.

Net interest earned on securities decreased by \$184,000 for the three months ended September 30, 2017 when compared to the same period in the prior year. The average balance of investment securities decreased \$24.6 million, or 19.7%, while the 4.09% yield on the investment portfolio increased by 3 basis points, from 4.06%, for the same period in the prior year. Net interest earned on securities decreased by \$646,000 for the nine months ended September 30, 2017 when compared to the same period in the prior year. The average balance of investment securities decreased \$29.0 million, or 21.3% while the 4.25% yield on the investment portfolio increased by 8 basis points, from 4.17%, for the same period in the prior year.

**Interest expense.** Interest expense increased \$792,000, or 77.2%, for the three months ended September 30, 2017, compared to the same period in the prior year. The increase is largely attributable to increases in the average balances of money market deposits, certificates of deposit, and borrowings of \$78.2 million, or 94.6%, \$62.5 million, or 34.1%, and \$37.7 million, or 83.3%, respectively. This increase was accompanied by increases in costs of 75 and 37 basis points for the average balances of borrowings and savings deposits, respectively. Interest expense increased \$1.8 million, or 56.7%, for the nine months ended September 30, 2017, compared to the same period in the prior year. The increase is largely attributable to increases in the average balances of money market deposits, borrowings, and certificates of deposits of \$77.2 million, or 95.2%, \$56.2 million, or 125.2%, and \$53.1 million, or 28.5%, respectively. This increase was partially offset by a decrease in cost of 4 basis points for the average balance of interest-bearing demand deposits, and accompanied by an increase in cost of 16, 7, and 5 basis points for the average balances of money market deposits, borrowings, and certificates of deposits, respectively. The Liberty acquisition resulted in a net increase of interest expense of \$967,000 as of September 30, 2017.

**Provision for loan losses.** The provision for loan losses represents the charge to income necessary to adjust the allowance for loan and lease losses to an amount that represents management's assessment of the estimated probable incurred credit losses inherent in the loan portfolio. Each quarter management performs a review of estimated probable incurred credit losses in the loan portfolio. Based on this review, a provision for loan losses of \$280,000 was recorded for the quarter ended September 30, 2017, an increase of \$175,000, or 166.7% from the quarter ended September 30, 2016. A provision for loan losses of \$615,000 was recorded for the nine month period ended September 30, 2017, compared to \$315,000 in the same period in 2016. Nonperforming loans were \$12.1 million, or 1.4% of total loans at September 30, 2017 compared with \$8.3 million, or 1.4% at September 30, 2016. For the three months ended September 30, 2017, net loan charge-offs totaled \$33,000, or 0.02% of average loans, compared to net charge-offs of \$137,000, or 0.09%, for the third quarter of 2016. For the nine months ended September 30, 2017, net loan charge-offs totaled \$361,000, or 0.06% of average loans, compared to net charge-offs of \$366,000, or 0.09%, for the same period in 2016.

**Noninterest income.** Noninterest income increased \$464,000 for the three months ended September 30, 2017 over the comparable 2016 period. This increase was largely the result of increases in net investment security gains of \$398,000 and gains on sales of loans of \$126,000. Noninterest income increased \$882,000 for the nine months ended September 30, 2017 over the comparable 2016 period. This increase was largely the result of an increase in net investment security gains of \$583,000 and gains on sales of loans of \$398,000.

**Noninterest expense.** Noninterest expense of \$7.3 million for the third quarter 2017 was 28.9%, or \$1.6 million more than the third quarter of 2016. Salaries and employee benefits, data processing costs, and occupancy expense increased \$1.0 million or 39.1%, \$134,000, or 40.1%, and \$170,000 or 55.6%, respectively. These increases were partially offset by a decrease in professional fees of \$113,000, or 20.7%. The salary increase is mostly due to annual pay adjustments and the increase of employees due to the acquisition of Liberty Bank, N.A. Data processing costs and occupancy expenses are also higher due to additional ongoing services provided and property maintenance costs related to the acquisition. The decrease in professional fees is due to nonrecurring merger expenses incurred due to the acquisition of Liberty Bank, N.A. in the third quarter 2016 amounting to \$115,000. Nonrecurring merger expense due to the acquisition of Liberty Bank, N.A. included in noninterest expense for the third quarter 2017 was \$338,000. Noninterest expense of \$21.3 million for the nine month period ended September 30, 2017 was 33.6% or \$5.4 million more than the same period in 2016. Salaries and employee benefits, data processing costs, and occupancy expense increased \$2.9 million, or 37.3%, \$448,000, or 48.3%, and \$464,000, or 49.7%, respectively. These increases were partially offset by a decrease in net loss on other real estate owned of \$159,000. The salary increase is mostly due to annual pay adjustments and the increase of employees due to the acquisition of Liberty Bank, N.A. Data processing and occupancy expenses are also higher due to additional ongoing services provided and property maintenance costs related to the acquisition. Nonrecurring merger expense due to the acquisition of Liberty Bank, N.A. included in noninterest expense for the nine month period ended September 30, 2017 was \$1.0 million.

**Provision for income taxes.** The Company recognized \$914,000 in income tax expense, which reflected an effective tax rate of 27.1% for the three months ended September 30, 2017, as compared to \$261,000 with an effective tax rate of 16.3% for the comparable 2016 period. The Company recognized \$2.5 million in income tax expense, which reflected an effective tax rate of 26.4% for the nine months ended September 30, 2017, as compared to \$1.1 million with an effective tax rate of 19.2% for the comparable 2016 period. The provision is directly correlated to the increase

in net income before taxes. The increase in the effective tax rate is due to a lower level of nontaxable income and certain non-deductible merger expenses.

**Average Balance Sheet and Yield/Rate Analysis.** The following table sets forth, for the periods indicated, information concerning the total dollar amounts of interest income from interest-earning assets and the resultant average yields, the total dollar amounts of interest expense on interest-bearing liabilities and the resultant average costs, net interest income, interest rate spread and the net interest margin earned on average interest-earning assets. For purposes of this table, average balances are calculated using monthly averages and the average loan balances include nonaccrual loans and exclude the allowance for loan and lease losses, and interest income includes accretion of net deferred loan fees. Yields on tax-exempt securities (tax exempt for federal income tax purposes) are shown on a fully tax-equivalent basis utilizing a federal tax rate of 34%. Yields and rates have been calculated on an annualized basis utilizing monthly interest amounts.

| (Dollar amounts in thousands)  | For the Three Months Ended September 30, |          |                       |   |                    |          |                       |   |
|--|--|----------|-----------------------|---|--------------------|----------|-----------------------|---|
|  | 2017                                     |          |                       |   | 2016               |          |                       |   |
|  | Average<br>Balance                       | Interest | Average<br>Yield/Cost |   | Average<br>Balance | Interest | Average<br>Yield/Cost |   |
| Interest-earning assets:   |  |          |                       |   |                    |          |                       |   |
| Loans receivable   | \$874,190                                | \$10,443 | 4.74                  | % | \$580,798          | \$6,459  | 4.42                  | % |
| Investment securities (3)  | 100,400                                  | 738      | 4.09                  | % | 124,998            | 922      | 4.06                  | % |
| Interest-bearing deposits with other banks                                       | 46,636                                   | 149      | 1.27                  | % | 23,824             | 39       | 0.65                  | % |
| Total interest-earning assets  | 1,021,226                                | 11,330   | 4.52                  | % | 729,620            | 7,420    | 4.24                  | % |
| Noninterest-earning assets   | 65,759                                   |          |                       |   | 39,683             |          |                       |   |
| Total assets   | \$1,086,985                              |          |                       |   | \$769,303          |          |                       |   |
| Interest-bearing liabilities:  |  |          |                       |   |                    |          |                       |   |
| Interest-bearing demand deposits   | \$92,127                                 | \$74     | 0.32                  | % | \$69,666           | \$54     | 0.31                  | % |
| Money market deposits  | 160,955                                  | 311      | 0.77                  | % | 82,718             | 84       | 0.40                  | % |
| Savings deposits   | 201,307                                  | 176      | 0.35                  | % | 173,311            | 106      | 0.24                  | % |
| Certificates of deposit  | 245,823                                  | 907      | 1.46                  | % | 183,340            | 677      | 1.47                  | % |
| Borrowings   | 83,016                                   | 350      | 1.67                  | % | 45,281             | 105      | 0.92                  | % |
| Total interest-bearing liabilities   | 783,228                                  | 1,818    | 0.92                  | % | 554,316            | 1,026    | 0.74                  | % |
| Noninterest-bearing liabilities  |  |          |                       |   |                    |          |                       |   |
| Other liabilities  | 183,447                                  |          |                       |   | 136,913            |          |                       |   |
| Stockholders' equity   | 120,310                                  |          |                       |   | 78,074             |          |                       |   |
| Total liabilities and stockholders' equity                                       | \$1,086,985                              |          |                       |   | \$769,303          |          |                       |   |
| Net interest income  |  | \$9,512  |                       |   |                    | \$6,394  |                       |   |
| Interest rate spread (1)   |  |          | 3.60                  | % |                    |          | 3.50                  | % |
| Net interest margin (2)  |  |          | 3.81                  | % |                    |          | 3.68                  | % |
| Ratio of average interest-earning assets to average interest-bearing liabilities |  |          | 130.39                | % |                    |          | 131.63                | % |

(1) Interest rate spread represents the difference between the average yield on

interest-earning assets and the average cost of interest-bearing liabilities

(2) Net interest margin represents net interest income as a percentage of average interest-earning assets.

(3) Tax-equivalent adjustments to calculate the yield on tax-exempt securities were \$298 and \$354 for the three months ended September 30, 2017 and 2016, respectively.

**Analysis of Changes in Net Interest Income.** The following table analyzes the changes in interest income and interest expense, between the three month periods ended September 30, 2017 and 2016, in terms of: (1) changes in volume of interest-earning assets and interest-bearing liabilities and (2) changes in yields and rates. The table reflects the extent to which changes in the Company's interest income and interest expense are attributable to changes in rate (change in rate multiplied by prior period volume), changes in volume (changes in volume multiplied by prior period rate) and changes attributable to the combined impact of volume/rate (change in rate multiplied by change in volume). The changes attributable to the combined impact of volume/rate are allocated on a consistent basis between the volume and rate variances.

| (Dollar amounts in thousands)              | 2017 versus 2016           |       |         |
|--|----------------------------|-------|---------|
|  | Increase (decrease) due to |       |         |
|  | Volume                     | Rate  | Total   |
| Interest-earning assets:                   |                            |       |         |
| Loans receivable                           | \$3,269                    | \$715 | \$3,984 |
| Investment securities                      | (252 )                     | 68    | (184 )  |
| Interest-bearing deposits with other banks | 37                         | 73    | 110     |
| Total interest-earning assets              | 3,054                      | 856   | 3,910   |
| Interest-bearing liabilities:              |                            |       |         |
| Interest-bearing demand deposits           | 18                         | 2     | 20      |
| Money market deposits                      | 79                         | 148   | 227     |
| Savings deposits                           | 17                         | 53    | 70      |
| Certificates of deposit                    | 232                        | (2 )  | 230     |
| Borrowings                                 | 88                         | 157   | 245     |
| Total interest-bearing liabilities         | 434                        | 358   | 792     |
| Net interest income                        | \$2,620                    | \$498 | \$3,118 |

**Average Balance Sheet and Yield/Rate Analysis.** The following table sets forth, for the periods indicated, information concerning the total dollar amounts of interest income from interest-earning assets and the resultant average yields, the total dollar amounts of interest expense on interest-bearing liabilities and the resultant average costs, net interest income, interest rate spread and the net interest margin earned on average interest-earning assets. For purposes of this table, average balances are calculated using monthly averages and the average loan balances include nonaccrual loans and exclude the allowance for loan and lease losses, and interest income includes accretion of net deferred loan fees. Yields on tax-exempt securities (tax exempt for federal income tax purposes) are shown on a fully tax-equivalent basis utilizing a federal tax rate of 34%. Yields and rates have been calculated on an annualized basis utilizing monthly interest amounts.

| (Dollars in thousands)   | For the Nine Months Ended September 30, |          |                    |   |                 |          |                    |   |
|--|---|----------|--------------------|---|-----------------|----------|--------------------|---|
|  | 2017                                    |          |                    |   | 2016            |          |                    |   |
|  | Average Balance                         | Interest | Average Yield/Cost |   | Average Balance | Interest | Average Yield/Cost |   |
| Interest-earning assets:   |   |          |                    |   |                 |          |                    |   |
| Loans receivable   | \$841,938                               | \$29,539 | 4.69               | % | \$556,764       | \$18,949 | 4.55               | % |
| Investment securities (3)  | 106,849                                 | 2,446    | 4.25               | % | 135,836         | 3,092    | 4.17               | % |
| Interest-bearing deposits with other banks                                       | 49,287                                  | 446      | 1.21               | % | 22,254          | 132      | 0.79               | % |
| Total interest-earning assets  | 998,074                                 | 32,431   | 4.47               | % | 714,854         | 22,173   | 4.36               | % |
| Noninterest-earning assets   | 61,305                                  |          |                    |   | 36,850          |          |                    |   |
| Total assets   | \$1,059,379                             |          |                    |   | \$751,704       |          |                    |   |
| Interest-bearing liabilities:  |   |          |                    |   |                 |          |                    |   |
| Interest-bearing demand deposits   | \$88,217                                | \$174    | 0.26               | % | \$66,045        | \$147    | 0.30               | % |
| Money market deposits  | 158,280                                 | 669      | 0.57               | % | 81,091          | 250      | 0.41               | % |
| Savings deposits   | 187,399                                 | 393      | 0.28               | % | 175,725         | 323      | 0.25               | % |
| Certificates of deposit  | 239,327                                 | 2,584    | 1.44               | % | 186,268         | 1,945    | 1.39               | % |
| Borrowings   | 101,183                                 | 1,065    | 1.41               | % | 44,940          | 452      | 1.34               | % |
| Total interest-bearing liabilities   | 774,406                                 | 4,885    | 0.84               | % | 554,069         | 3,117    | 0.75               | % |
| Noninterest-bearing liabilities  |   |          |                    |   |                 |          |                    |   |
| Other liabilities  | 177,861                                 |          |                    |   | 127,554         |          |                    |   |
| Stockholders' equity   | 107,112                                 |          |                    |   | 70,081          |          |                    |   |
| Total liabilities and stockholders' equity                                       | \$1,059,379                             |          |                    |   | \$751,704       |          |                    |   |
| Net interest income  |   | \$27,546 |                    |   |                 | \$19,056 |                    |   |
| Interest rate spread (1)   |   |          | 3.63               | % |                 |          | 3.61               | % |
| Net interest margin (2)  |   |          | 3.82               | % |                 |          | 3.78               | % |
| Ratio of average interest-earning assets to average interest-bearing liabilities |   |          | 128.88             | % |                 |          | 129.02             | % |

(1) Interest rate spread represents the difference

between the average yield on interest-earning assets and the average cost of interest-bearing liabilities

(2) Net interest margin represents net interest income as a percentage of average interest-earning assets.

(3) Tax-equivalent adjustments to calculate the yield on tax-exempt securities were \$951 and \$1,147 for the nine months ended September 30, 2017 and 2016, respectively.

**Analysis of Changes in Net Interest Income.** The following table analyzes the changes in interest income and interest expense, between the nine month periods ended September 30, 2017 and 2016, in terms of: (1) changes in volume of interest-earning assets and interest-bearing liabilities and (2) changes in yields and rates. The table reflects the extent to which changes in the Company's interest income and interest expense are attributable to changes in rate (change in rate multiplied by prior period volume), changes in volume (changes in volume multiplied by prior period rate) and changes attributable to the combined impact of volume/rate (change in rate multiplied by change in volume). The changes attributable to the combined impact of volume/rate are allocated on a consistent basis between the volume and rate variances.

| (Dollars in thousands)                     | 2017 versus 2016           |       |          |
|--|----------------------------|-------|----------|
|  | Increase (decrease) due to |       |          |
|  | Volume                     | Rate  | Total    |
| <b>Interest-earning assets:</b>            |                            |       |          |
| Loans receivable                           | \$9,705                    | \$885 | \$10,590 |
| Investment securities                      | (904 )                     | 258   | (646 )   |
| Interest-bearing deposits with other banks | 160                        | 154   | 314      |
| Total interest-earning assets              | 8,961                      | 1,297 | 10,258   |
| <b>Interest-bearing liabilities:</b>       |                            |       |          |
| Interest-bearing demand deposits           | 50                         | (23 ) | 27       |
| Money market deposits                      | 237                        | 182   | 419      |
| Savings deposits                           | 22                         | 48    | 70       |
| Certificates of deposit                    | 552                        | 87    | 639      |
| Borrowings                                 | 564                        | 49    | 613      |
| Total interest-bearing liabilities         | 1,425                      | 343   | 1,768    |
| <br>                                       |                            |       |          |
| Net interest income                        | \$7,536                    | \$954 | \$8,490  |

## LIQUIDITY

Management's objective in managing liquidity is maintaining the ability to continue meeting the cash flow needs of banking customers, such as borrowings or deposit withdrawals, as well as the Company's own financial commitments. The principal sources of liquidity are net income, loan payments, maturing and principal reductions on securities and sales of securities available for sale, federal funds sold and cash and deposits with banks. Along with its liquid assets, the Company has additional sources of liquidity available to ensure that adequate funds are available as needed. These include, but are not limited to, the purchase of federal funds, and the ability to borrow funds under line of credit agreements with correspondent banks and a borrowing agreement with the Federal Home Loan Bank of Cincinnati,

Ohio and the adjustment of interest rates to obtain depositors. Management believes the Company has the capital adequacy, profitability and reputation to meet the current and projected needs of its customers.

For the nine months ended September 30, 2017, the adjustments to reconcile net income to net cash from operating activities consisted mainly of depreciation and amortization of premises and equipment, the provision for loan losses, net amortization of securities and net changes in other assets and liabilities. For a more detailed illustration of sources and uses of cash, refer to the Condensed Consolidated Statements of Cash Flows.

## **INFLATION**

Substantially all of the Company's assets and liabilities relate to banking activities and are monetary in nature. The consolidated financial statements and related financial data are presented in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"). GAAP currently requires the Company to measure the financial position and results of operations in terms of historical dollars, with the exception of securities available for sale, impaired loans and other real estate loans that are measured at fair value. Changes in the value of money due to rising inflation can cause purchasing power loss.

Management's opinion is that movements in interest rates affect the financial condition and results of operations to a greater degree than changes in the rate of inflation. It should be noted that interest rates and inflation do affect each other, but do not always move in correlation with each other. The Company's ability to match the interest sensitivity of its financial assets to the interest sensitivity of its liabilities in its asset/liability management may tend to minimize the effect of changes in interest rates on the Company's performance.

## **REGULATORY MATTERS**

The Company is subject to the regulatory requirements of the Federal Reserve System as a bank holding company. The bank subsidiary is subject to regulations of the Federal Deposit Insurance Corporation ("FDIC") and the State of Ohio, Division of Financial Institutions.

The Federal Reserve Board and the FDIC have extensive authority to prevent and to remedy unsafe and unsound practices and violations of applicable laws and regulations by institutions and holding companies. The agencies may assess civil money penalties, issue cease-and-desist or removal orders, seek injunctions, and publicly disclose those actions. In addition, the Ohio Division of Financial Institutions possesses enforcement powers to address violations of Ohio banking law by Ohio-chartered banks.

## **REGULATORY CAPITAL REQUIREMENTS**

Financial institution regulators have established guidelines for minimum capital ratios for banks, thrifts and bank holding companies. The net unrealized gain or loss on available-for-sale securities is generally not included in computing regulatory capital. In order to avoid limitations on capital distributions, including dividend payments, Middlefield Bank and the Company must each hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2017 to 2.50% by 2019. Within the tabular presentation that follows is the adequately capitalized ratio plus capital conservation buffer that includes the fully phased-in 2.50% buffer.

Middlefield Bank and the Company met each of the well-capitalized ratio guidelines at September 30, 2017. The following table indicates the capital ratios for Middlefield Bank and Company at September 30, 2017 and December 31, 2016.

As of September 30, 2017

|   | Tier 1<br>Risk |         | Common<br>Equity<br>Tier 1 | Total<br>Risk |
|---|----------------|---------|----------------------------|---------------|
|   | Leverage Based |         | Based                      | Based         |
| The Middlefield Banking Company                               | 9.29 %         | 10.95 % | 10.95 %                    | 11.71 %       |
| Middlefield Banc Corp.  | 10.06 %        | 11.93 % | 11.05 %                    | 12.69 %       |
| Adequately capitalized ratio                                  | 4.00 %         | 6.00 %  | 4.50 %                     | 8.00 %        |
| Adequately capitalized ratio plus capital conservation buffer | 4.00 %         | 8.50 %  | 7.00 %                     | 10.50 %       |
| Well-capitalized ratio  | 5.00 %         | 8.00 %  | 6.50 %                     | 10.00 %       |

As of December 31, 2016

|   | Tier 1<br>Risk |         | Common<br>Equity<br>Tier 1 | Total<br>Risk |
|---|----------------|---------|----------------------------|---------------|
|   | Leverage Based |         | Based                      | Based         |
| The Middlefield Banking Company                               | 9.46 %         | 13.03 % | 13.03 %                    | 14.25 %       |
| Middlefield Banc Corp.  | 9.27 %         | 13.07 % | 13.07 %                    | 15.75 %       |
| Adequately capitalized ratio                                  | 4.00 %         | 6.00 %  | 4.50 %                     | 8.00 %        |
| Adequately capitalized ratio plus capital conservation buffer | 4.00 %         | 8.50 %  | 7.00 %                     | 10.50 %       |
| Well-capitalized ratio  | 5.00 %         | 8.00 %  | 6.50 %                     | 10.00 %       |

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

#### **ASSET AND LIABILITY MANAGEMENT**

The primary objective of the Company's asset and liability management function is to maximize the Company's net interest income while simultaneously maintaining an acceptable level of interest rate risk given the Company's operating environment, capital and liquidity requirements, performance objectives and overall business focus. The principal determinant of the exposure of the Company's earnings to interest rate risk is the timing difference between the re-pricing or maturity of interest-earning assets and the re-pricing or maturity of its interest-bearing liabilities. The Company's asset and liability management policies are designed to decrease interest rate sensitivity primarily by shortening the maturities of interest-earning assets while at the same time extending the maturities of interest-bearing liabilities. The Board of Directors of the Company continues to believe in a strong asset/liability management process in order to insulate the Company from material and prolonged increases in interest rates. Mortgage-backed securities generally increase the quality of the Company's assets by virtue of the insurance or guarantees that back them, are more liquid than individual mortgage loans and may be used to collateralize borrowings or other obligations of the Company.

The Company's Board of Directors has established an Asset and Liability Management Committee consisting of outside directors and senior management. This committee, which meets quarterly, generally monitors various asset and liability management policies and strategies.

#### **Interest Rate Sensitivity Simulation Analysis**

The Company engages an external consultant to facilitate income simulation modeling on a quarterly basis. This modeling measures interest rate risk and sensitivity. The Asset and Liability Management Committee of the Company believes the various rate scenarios of the simulation modeling enables the Company to more accurately evaluate and manage the exposure of interest rate fluctuations on net interest income, the yield curve, various loan and mortgage-backed security prepayments, and deposit decay assumptions.

Earnings simulation modeling and assumptions about the timing and volatility of cash flows are critical in net portfolio equity valuation analysis. Particularly important are the assumptions driving mortgage prepayments and expected attrition of the core deposit portfolios. These assumptions are based on the Company's historical experience and industry standards and are applied consistently across all rate risk measures.

The Company has established the following guidelines for assessing interest rate risk:

Net interest income simulation- Projected net interest income over the next twelve months will not be reduced by more than 10% given a gradual shift (i.e., over 12-months) in interest rates of up to 200 basis points (+ or -) and assuming no balance sheet growth.

Portfolio equity simulation- Portfolio equity is the net present value of the Company's existing assets and liabilities. Given a 200 basis point immediate and permanent increase in market interest rates, portfolio equity may not correspondingly decrease or increase by more than 20% of stockholders' equity. Given a 100 basis point immediate and permanent decrease in market interest rates, portfolio equity may not correspondingly decrease or increase by more than 10% of stockholders' equity.

The following table presents the simulated impact of a 200 basis point upward or 100 basis point downward shift of market interest rates on net interest income, and the change in portfolio equity. This analysis was done assuming the interest-earning asset and interest-bearing liability levels at September 30, 2017 remained constant. The impact of the market rate movements was developed by simulating the effects of rates changing gradually over a one-year period from the September 30, 2017 levels for net interest income and portfolio equity. The impact of market rate movements was developed by simulating the effects of an immediate and permanent change in rates at September 30, 2017 for portfolio equity:

|   | Increase | Decrease  |
|---|----------|-----------|
|   | 200      | 100       |
|   | Basis    | Basis     |
|   | Points   | Points    |
| Net interest income - increase (decrease) | (0.56 %) | (3.30 %)  |
| Portfolio equity - increase (decrease)    | 15.30 %  | (24.70 %) |

## CRITICAL ACCOUNTING ESTIMATES

The Company's critical accounting estimates involving the more significant judgments and assumptions used in the preparation of the consolidated financial statements as of September 30, 2017, have remained unchanged from December 31, 2016.

### Item 4. Controls and Procedures

#### Controls and Procedures Disclosure

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Corporation's reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

As of the end of the period covered by this quarterly report, an evaluation was carried out under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Based on their evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are, to the best of their knowledge, effective to ensure that information required to be disclosed by the Corporation in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. Subsequent to the date of their evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that there were no significant changes in internal control or in other factors that could significantly affect the Company's internal controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

A material weakness is a significant deficiency (as defined in Public Company Accounting Oversight Board Auditing Standard No. 2), or a combination of significant deficiencies, that results in there being more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis by management or employees in the normal course of performing their assigned functions.

Changes in Internal Control over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) that occurred during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 1a. There are no material changes to the risk factors set forth in Part I, Item 1A, "Risk Factors," of the Company's Annual Report on Form 10-K for the year ended December 31, 2016. Please refer to that section for disclosures regarding the risks and uncertainties related to the Company's business.

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

Information relating to the Company's sale, on May 10, 2017, of 400,000 shares of its common stock in a private placement exempt from the registration requirements of the Securities Act may be found above in *Management's Discussion and Analysis of Financial Condition and Results of Operations – Changes in Financial Condition – General* and in the Company's current report on Form 8-K filed with the Commission on May 10, 2017 (SEC File No. 001-36613).

Item 3. Defaults by the Company on its Senior Securities

None

Item 4. Mine Safety Disclosures

N/A

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Item 5. Other information

None

Item 6. Exhibits

**Exhibit list for Middlefield Banc Corp.'s Form 10-Q Quarterly Report for the Period Ended September 30, 2017**

|         |   |  |
|---------|---|--|
| 3.1     | <u>Second Amended and Restated Articles of Incorporation of Middlefield Banc Corp., as amended</u>  | Incorporated by reference to Exhibit 3.1 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Fiscal Year Ended December 31, 2005, filed on March 29, 2006 |
| 3.2     | <u>Regulations of Middlefield Banc Corp.</u>  | Incorporated by reference to Exhibit 3.2 of Middlefield Banc Corp.'s registration statement on Form 10 filed on April 17, 2001                                       |
| 4.0     | <u>Specimen stock certificate</u>   | Incorporated by reference to Exhibit 4 of Middlefield Banc Corp.'s registration statement on Form 10 filed on April 17, 2001   |
| 4.1     | <u>Amended and Restated Trust Agreement, dated as of December 21, 2006, between Middlefield Banc Corp., as Depositor, Wilmington Trust Company, as Property trustee, Wilmington Trust Company, as Delaware Trustee, and Administrative Trustees</u> | Incorporated by reference to Exhibit 4.1 of Middlefield Banc Corp.'s Form 8-K Current Report filed on December 27, 2006  |
| 4.2     | <u>Junior Subordinated Indenture, dated as of December 21, 2006, between Middlefield Banc Corp. and Wilmington Trust Company</u>  | Incorporated by reference to Exhibit 4.2 of Middlefield Banc Corp.'s Form 8-K Current Report filed on December 27, 2006  |
| 4.3     | <u>Guarantee Agreement, dated as of December 21, 2006, between Middlefield Banc Corp. and Wilmington Trust Company</u>  | Incorporated by reference to Exhibit 4.3 of Middlefield Banc Corp.'s Form 8-K Current Report filed on December 27, 2006  |
| 10.1.0* | <u>2017 Omnibus Equity Plan</u>   | Incorporated by reference to Middlefield Banc Corp.'s definitive proxy statement for the 2017 Annual Meeting of Shareholders, Appendix A, filed on April 4, 2017     |

- 10.1.1\* 2007 Omnibus Equity Plan Incorporated by reference to Middlefield Banc Corp.'s definitive proxy statement for the 2008 Annual Meeting of Shareholders, Appendix A, filed on April 7, 2008
- 10.2\* Severance Agreement between Middlefield Banc Corp. and Thomas G. Caldwell, dated January 7, 2008 Incorporated by reference to Exhibit 10.2 of Middlefield Banc Corp.'s Form 8-K Current Report filed on January 9, 2008
- 10.3\* Severance Agreement between Middlefield Banc Corp. and James R. Heslop, II, dated January 7, 2008 Incorporated by reference to Exhibit 10.3 of Middlefield Banc Corp.'s Form 8-K Current Report filed on January 9, 2008
- 10.4.1\* Severance Agreement between Middlefield Banc Corp. and Teresa M. Hetrick, dated January 7, 2008 Incorporated by reference to Exhibit 10.4.1 of Middlefield Banc Corp.'s Form 8-K Current Report filed on January 9, 2008
- 10.4.2 [reserved]
- 10.4.3\* Severance Agreement between Middlefield Banc Corp. and Donald L. Stacy, dated January 7, 2008 Incorporated by reference to Exhibit 10.4.3 of Middlefield Banc Corp.'s Form 8-K Current Report filed on January 9, 2008
- 10.4.4\* Severance Agreement between Middlefield Banc Corp. and Alfred F. Thompson Jr., dated January 7, 2008 Incorporated by reference to Exhibit 10.4.4 of Middlefield Banc Corp.'s Form 8-K Current Report filed on January 9, 2008

|        |  |   |
|--------|--|---|
| 10.5   | <u>Federal Home Loan Bank of Cincinnati Agreement for Advances and Security Agreement dated September 14, 2000</u> | Incorporated by reference to Exhibit 10.4 of Middlefield Banc Corp.'s registration statement on Form 10 filed on April 17, 2001                                 |
| 10.6*  | <u>Amended Director Retirement Agreement with Richard T. Coyne</u>   | Incorporated by reference to Exhibit 10.6 of Middlefield Banc Corp.'s Form 8-K Current Report filed on January 9, 2008  |
| 10.7*  | <u>Amended Director Retirement Agreement with Frances H. Frank</u>   | Incorporated by reference to Exhibit 10.7 of Middlefield Banc Corp.'s Form 8-K Current Report filed on January 9, 2008  |
| 10.8*  | [reserved]   |   |
| 10.9*  | [reserved]   |   |
| 10.10* | <u>Director Retirement Agreement with Donald D. Hunter</u>   | Incorporated by reference to Exhibit 10.10 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2001, filed on March 28, 2002 |
| 10.11* | <u>Director Retirement Agreement with Martin S. Paul</u>   | Incorporated by reference to Exhibit 10.11 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2001, filed on March 28, 2002 |
| 10.12* | <u>Amended Director Retirement Agreement with Donald E. Villers</u>  | Incorporated by reference to Exhibit 10.12 of Middlefield Banc Corp.'s Form 8-K Current Report filed on January 9, 2008   |
| 10.13* | <u>Executive Survivor Income Agreement (aka DBO agreement [death benefit only]) with Donald L. Stacy</u>           | Incorporated by reference to Exhibit 10.14 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2003, filed on March 30, 2004 |
| 10.14* | <u>DBO Agreement with Jay P. Giles</u>   | Incorporated by reference to Exhibit 10.15 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2003, filed on March 30, 2004 |
| 10.15* | <u>DBO Agreement with Alfred F. Thompson Jr.</u>   | Incorporated by reference to Exhibit 10.16 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2003, filed on March 30, 2004 |
| 10.16  | [reserved]   |   |
| 10.17* | <u>DBO Agreement with Teresa M. Hetrick</u>  | Incorporated by reference to Exhibit 10.18 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2003, filed on March 30, 2004 |
| 10.18* | <u>Executive Deferred Compensation Agreement with Jay P. Giles</u>   | Incorporated by reference to Exhibit 10.18 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year  |

Ended December 31, 2011, filed on March 20, 2012

10.19\* DBO Agreement with James R. Heslop, II

Incorporated by reference to Exhibit 10.20 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2003, filed on March 30, 2004

10.20\* DBO Agreement with Thomas G. Caldwell

Incorporated by reference to Exhibit 10.21 of Middlefield Banc Corp.'s Annual Report on Form 10-K for the Year Ended December 31, 2003, filed on March 30, 2004

|           |   |  |
|-----------|---|--|
| 10.21*    | <u>Form of Indemnification Agreement with directors of Middlefield Banc Corp. and with executive officers of Middlefield Banc Corp. and The Middlefield Banking Company</u> | Incorporated by reference to Exhibit 99.1 of Middlefield Banc Corp.'s registration statement on Form 10, Amendment No. 1, filed on June 14, 2001 |
| 10.22*    | <u>Annual Incentive Plan</u>  | Incorporated by reference to Exhibit 10.22 of Middlefield Banc Corp.'s Form 8-K Current Report filed on June 12, 2012                            |
| 10.22.1*  | <u>Annual Incentive Plan 2017 Award Summary</u>   | Incorporated by reference to Middlefield Banc Corp.'s Form 8-K Current Report filed on March 14, 2017  |
| 10.23*    | <u>Amended Executive Deferred Compensation Agreement with Thomas G. Caldwell</u>  | Incorporated by reference to Exhibit 10.23 of Middlefield Banc Corp.'s Form 8-K Current Report filed on May 9, 2008                              |
| 10.24*    | <u>Amended Executive Deferred Compensation Agreement with James R. Heslop, II</u>   | Incorporated by reference to Exhibit 10.24 of Middlefield Banc Corp.'s Form 8-K Current Report filed on May 9, 2008                              |
| 10.25*    | <u>Amended Executive Deferred Compensation Agreement with Donald L. Stacy</u>   | Incorporated by reference to Exhibit 10.25 of Middlefield Banc Corp.'s Form 8-K Current Report filed on May 9, 2008                              |
| 10.26     | [reserved]  |  |
| 10.27     | [reserved]  |  |
| 10.28     | [reserved]  |  |
| 10.29*    | <u>Form of conditional stock award under the 2007 Omnibus Equity Plan</u>   | Incorporated by reference to Exhibit 10.29 of Middlefield Banc Corp.'s Form 8-K Current Report filed on March 4, 2016                            |
| 10.29.1   | <u>Form of conditional stock award under the 2017 Omnibus Equity Plan</u>   | Incorporated by reference to Exhibit 10.29 of Middlefield Banc Corp.'s Form 8-K Current Report filed on July 24, 2017                            |
| 31.1      | <u>Rule 13a-14(a) certification of Chief Executive Officer</u>  | filed herewith   |
| 31.2      | <u>Rule 13a-14(a) certification of Chief Financial Officer</u>  | filed herewith   |
| 32        | <u>Rule 13a-14(b) certification</u>   | filed herewith   |
| 101.INS** | XBRL Instance   | furnished herewith   |
| 101.SCH** | XBRL Taxonomy Extension Schema  | furnished herewith   |

|           |                                      |                    |
|-----------|--------------------------------------|--------------------|
| 101.CAL** | XBRL Taxonomy Extension Calculation  | furnished herewith |
| 101.DEF** | XBRL Taxonomy Extension Definition   | furnished herewith |
| 101.LAB** | XBRL Taxonomy Extension Labels       | furnished herewith |
| 101.PRE** | XBRL Taxonomy Extension Presentation | furnished herewith |

\* management contract or compensatory plan or arrangement

\*\* XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

**SIGNATURES**

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

MIDDLEFIELD BANC CORP.

Date: November 14, 2017

By: /s/Thomas G. Caldwell

Thomas G. Caldwell

President and Chief Executive Officer

Date: November 14, 2017

By: /s/Donald L. Stacy

Donald L. Stacy

Principal Financial and Accounting Officer

