

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Financial Statements
December 31, 2018 and 2017
(With Independent Auditors' Report Thereon)

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KPMG LLP
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Independent Auditors' Report

The Board of Directors
BNCCORP, INC.:

We have audited the accompanying consolidated financial statements of BNCCORP, INC. and subsidiaries, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive (loss) income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of BNCCORP, INC. and subsidiaries as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

March 26, 2019

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

As of December 31

(In thousands, except share data)

	<u>2018</u>	<u>2017</u>
ASSETS		
CASH AND CASH EQUIVALENTS	\$ 25,185	\$ 25,830
INVESTMENT SECURITIES AVAILABLE FOR SALE	411,509	411,917
FEDERAL RESERVE BANK AND FEDERAL HOME LOAN BANK STOCK	2,941	2,897
LOANS HELD FOR SALE-MORTGAGE BANKING	22,788	36,601
LOANS AND LEASES HELD FOR INVESTMENT	468,468	428,325
ALLOWANCE FOR CREDIT LOSSES	(7,692)	(7,861)
Net loans and leases held for investment	460,776	420,464
PREMISES AND EQUIPMENT, net	16,761	19,403
ACCRUED INTEREST RECEIVABLE	5,079	4,848
OTHER	25,988	24,190
Total assets	<u>\$ 971,027</u>	<u>\$ 946,150</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
DEPOSITS:		
Non-interest-bearing	\$ 157,663	\$ 164,401
Interest-bearing –		
Savings, interest checking and money market	542,735	498,044
Time deposits	148,207	155,361
Total deposits	848,605	817,806
SHORT-TERM BORROWINGS	11,494	18,043
LONG-TERM BORROWINGS	10,000	10,000
GUARANTEED PREFERRED BENEFICIAL INTERESTS IN COMPANY'S SUBORDINATED DEBENTURES	15,009	15,011
ACCRUED INTEREST PAYABLE	1,277	950
ACCRUED EXPENSES	5,700	6,107
OTHER	1,189	607
Total liabilities	893,274	868,524
STOCKHOLDERS' EQUITY:		
Common stock, \$.01 par value – Authorized 11,300,000 shares; 3,493,298 and 3,465,992 shares issued and outstanding	35	35
Capital surplus – common stock	25,990	26,072
Retained earnings	61,042	54,206
Treasury stock (175,355 and 202,661 shares, respectively)	(2,386)	(2,741)
Accumulated other comprehensive income, net	(6,928)	54
Total stockholders' equity	77,753	77,626
Total liabilities and stockholders' equity	<u>\$ 971,027</u>	<u>\$ 946,150</u>

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Income

For the Years Ended December 31

(In thousands, except per share data)

	2018	2017
INTEREST INCOME:		
Interest and fees on loans	\$ 23,286	\$ 20,786
Interest and dividends on investments		
Taxable	9,339	7,838
Tax-exempt	1,699	2,695
Dividends	154	124
Total interest income	<u>34,478</u>	<u>31,443</u>
INTEREST EXPENSE:		
Deposits	4,761	2,509
Short-term borrowings	74	27
Federal Home Loan Bank advances	95	16
Long-term borrowings	635	635
Subordinated debentures	543	391
Total interest expense	<u>6,108</u>	<u>3,578</u>
Net interest income	28,370	27,865
PROVISION FOR CREDIT LOSSES	<u>-</u>	<u>350</u>
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	<u>28,370</u>	<u>27,515</u>
NON-INTEREST INCOME:		
Bank charges and service fees	2,687	2,719
Wealth management revenues	1,810	1,717
Mortgage banking revenues, net	10,032	11,301
Gains on sales of loans, net	187	736
Gains on sales of securities, net	2,293	745
Other	2,008	2,281
Total non-interest income	<u>19,017</u>	<u>19,499</u>
NON-INTEREST EXPENSE:		
Salaries and employee benefits	20,074	20,494
Professional services	3,378	3,928
Data processing fees	4,027	3,716
Marketing and promotion	4,212	3,447
Occupancy	2,408	2,436
Regulatory costs	540	556
Depreciation and amortization	1,545	1,627
Office supplies and postage	574	629
Other real estate costs	-	(31)
Other	2,255	2,314
Total non-interest expense	<u>39,013</u>	<u>39,116</u>
Income before income taxes	8,374	7,898
Income tax expense	1,538	3,020
Net income	<u>\$ 6,836</u>	<u>\$ 4,878</u>
Basic earnings per common share	<u>\$ 1.96</u>	<u>\$ 1.40</u>
Diluted earnings per common share	<u>\$ 1.93</u>	<u>\$ 1.38</u>

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive (Loss) Income
For the Years Ended December 31
(In thousands)

	<u>2018</u>		<u>2017</u>
NET INCOME	\$ 6,836		\$ 4,878
Unrealized loss on investment securities available for sale	\$ (6,966)		\$ (1,857)
Reclassification adjustment for gains on sales of securities, net, included in net income	<u>(2,293)</u>		<u>(745)</u>
Other comprehensive loss before tax	(9,259)		(2,602)
Income tax benefit related to items of other comprehensive loss	<u>2,277</u>		<u>973</u>
Other comprehensive loss	<u>\$ (6,982)</u>	<u>(6,982)</u>	<u>\$ (1,629)</u>
TOTAL COMPREHENSIVE (LOSS) INCOME	<u>\$ (146)</u>		<u>\$ 3,249</u>

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity
For the Years Ended December 31
(In thousands, except share data)

			Capital Surplus		Accumulated Other Comprehensive		
	Common Stock		Common	Retained	Treasury		
	Shares	Amount	Stock	Earnings	Stock	Income (Loss), net	Total
BALANCE, December 31, 2016	3,456,008	\$ 35	\$ 25,996	\$ 49,328	\$ (2,847)	\$ 1,683	\$ 74,195
Net income	-	-	-	4,878	-	-	4,878
Other comprehensive loss	-	-	-	-	-	(1,629)	(1,629)
Share-based compensation	9,984		76	-	106	-	182
BALANCE, December 31, 2017	3,465,992	\$ 35	\$ 26,072	\$ 54,206	\$ (2,741)	\$ 54	\$ 77,626
Net income	-	-	-	6,836	-	-	6,836
Other comprehensive loss	-	-	-	-	-	(6,982)	(6,982)
Share-based compensation	27,306	-	(82)	-	355	-	273
BALANCE, December 31, 2018	3,493,298	\$ 35	\$ 25,990	\$ 61,042	\$ (2,386)	\$ (6,928)	\$ 77,753

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

For the Years Ended December 31

(In thousands)

	<u>2018</u>	<u>2017</u>
OPERATING ACTIVITIES:		
Net income	\$ 6,836	\$ 4,878
Adjustments to reconcile net income to net cash provided by operating activities -		
Provision for credit losses	-	350
Provision (reduction) for other real estate losses	-	(10)
Depreciation and amortization	1,545	1,627
Net amortization of premiums and (discounts) on investment securities and subordinated debentures	7,778	7,743
Share-based compensation	273	182
Change in accrued interest receivable and other assets, net	355	(1,019)
Gain on sale of bank premises and equipment	21	(8)
Gain on sale of bank branch	-	(864)
Net realized gains on sales of investment securities	(2,293)	(745)
(Increase) decrease in deferred taxes	(88)	1,518
Change in other liabilities, net	248	110
Funding of loans held for sale, mortgage banking	(642,695)	(686,302)
Proceeds from sales of loans held for sale, mortgage banking	656,003	689,017
Fair value adjustment for loans held for sale, mortgage banking	505	326
Fair value adjustment on mortgage banking derivatives	233	170
Proceeds from sales of loans	2,209	7,191
Gains on sales of loans, net	(187)	(736)
Net cash provided by operating activities	<u>30,743</u>	<u>23,428</u>
INVESTING ACTIVITIES:		
Purchases of investment securities available for sale	(129,930)	(157,034)
Proceeds from sales of investment securities available for sale	62,516	99,910
Proceeds from maturities of investment securities available for sale	53,077	36,369
Purchases of Federal Reserve and Federal Home Loan Bank Stock	(15,456)	(2,633)
Sales of Federal Reserve and Federal Home Loan Bank Stock	15,412	4,147
Net increase in loans and leases held for investment	(42,334)	(20,923)
Proceeds from sales of other real estate	-	264
Proceeds from sales of premises and equipment	2,307	205
Purchases of premises and equipment	(1,230)	(1,728)
Net cash used in investing activities	<u>(55,638)</u>	<u>(41,423)</u>

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows, continued
For the Years Ended December 31
(In thousands)

	<u>2018</u>	<u>2017</u>
FINANCING ACTIVITIES:		
Net increase in deposits	\$ 30,799	\$ 65,179
Net (decrease) increase in short-term borrowings	(6,549)	5,533
Repayments of Federal Home Loan Bank advances	(395,000)	(101,450)
Proceeds from Federal Home Loan Bank advances	<u>395,000</u>	<u>63,450</u>
Net cash provided by financing activities	<u>24,250</u>	<u>32,712</u>
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(645)	14,717
CASH AND CASH EQUIVALENTS, beginning of period	<u>25,830</u>	<u>11,113</u>
CASH AND CASH EQUIVALENTS, end of period	<u>\$ 25,185</u>	<u>\$ 25,830</u>
 SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	<u>\$ 3,945</u>	<u>\$ 3,405</u>
Income taxes paid	<u>\$ 1,102</u>	<u>\$ 821</u>
 SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Additions to other real estate in the settlement of loans	<u>\$ -</u>	<u>\$ 40</u>

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

NOTE 1. Description of Business and Significant Accounting Policies

Description of Business

BNCCORP, INC. (BNCCORP or BNC) is a registered bank holding company incorporated under the laws of Delaware. It is the parent company of BNC National Bank (the Bank or BNC Bank). BNC Bank operates community banking and wealth management businesses in North Dakota, Arizona and Minnesota from 13 locations. The Bank also conducts mortgage banking through a consumer-direct channel complimented by retail channels from 12 locations in Arizona, North Dakota, Illinois, Kansas and Missouri. The consumer direct channel emphasizes technology (internet leads and call center) to originate mortgage loans throughout the United States. The retail channel is primarily relationship driven and originations are generally near mortgage banking locations.

With respect to group concentrations of credit risk, most of the Company's business activity is with customers in North Dakota. At December 31, 2018, the Company did not have any significant credit concentrations in any particular industry.

The consolidated financial statements included herein are for BNCCORP and subsidiaries. The accounting and reporting policies of BNCCORP and subsidiaries (collectively, the Company) conform to U.S. generally accepted accounting principles and general practices within the financial services industry. The more significant accounting policies are summarized below.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of BNCCORP and its wholly owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the allowance for credit losses, valuation of other real estate, reserves for mortgage banking reimbursement obligations, fair value measurements for financial instruments (including derivatives), impairment of long-lived assets, contingencies, and income taxes. Ultimate results could materially differ from those estimates.

SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, cash due from banks and federal funds sold.

Investment Securities

Investment securities that the Bank intends to hold indefinitely as part of its asset/liability strategy, or that may be sold in response to changes in interest rates or prepayment risk are classified as available for sale. Available for sale securities are carried at fair value. Net unrealized gains and losses, net of deferred income taxes, on securities available for sale are reported as a separate component of stockholders' equity until realized (see Comprehensive (Loss) Income). All securities were classified as available for sale as of December 31, 2018 and 2017, except for Federal Reserve Bank (FRB) and Federal Home Loan Bank (FHLB) stocks, which have indeterminable maturities.

Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using the effective interest method. Dividend and interest income is recognized when earned. Realized gains and losses on the sale of investment securities are determined using the specific-identification method and recognized in non-interest income on the trade date.

Other-Than-Temporary Impairment

Declines in the fair value of individual available-for-sale securities below amortized cost, which are deemed other-than-temporary, result in a charge to earnings and establishment of a new cost basis. The Company assesses available information about its securities to determine whether impairment is other-than-temporary. The information the Company considers includes, but is not limited to, the following:

- Recent and expected performance of the securities;
- Financial condition of issuers or guarantors;
- Recent cash flows;
- Seniority of invested tranches and subordinated credit support;
- Vintage of origination;
- Location of collateral;
- Ratings of securities;
- Value of underlying collateral;
- Delinquency and foreclosure data;
- Historical losses and estimated severity of future losses;
- Credit surveillance data which summarize retrospective performance; and
- Anticipated future cash flows and prospective performance assessments.

Determining whether other-than-temporary impairment has occurred requires judgment of factors that may indicate an impairment loss has incurred. The Company follows the guidance on other-than-temporary impairments Accounting Standards Codification (ASC) 320, *Investments – Debt Securities*. Any credit-related impairments are recognized through a charge to earnings. The amount of non-credit related impairments is recognized through comprehensive (loss) income, net of income taxes.

Note 2 to these consolidated financial statements includes a summary of investment securities in a loss position at December 31, 2018 and 2017.

Federal Reserve Bank and Federal Home Loan Bank

Investments in Federal Reserve Bank and Federal Home Loan Bank stock are carried at cost, which approximates fair value.

Loans Held For Sale-Mortgage Banking

Loans held for sale-mortgage banking are accounted for at fair value pursuant to the fair value option permitted by ASC 825, *Financial Instruments*. Gains and losses from the changes in fair value are included in mortgage banking revenues, net.

Loans and Leases Held For Investment

Loans and leases held for investment are stated at their outstanding principal amount net of unearned income, unamortized deferred fees and costs, and an allowance for credit losses. Interest income is recognized on the accrual basis using the interest method prescribed in the loan agreement except when collectability is in doubt.

Loans and leases are reviewed regularly by management and are placed on non-accrual status when the collection of interest or principal is 90 days or more past due, unless the loan or lease is adequately secured and in the process of collection. When a loan or lease is placed on non-accrual status, uncollected interest accrued in prior years is charged off against the allowance for credit losses, unless collection of the principal and interest is assured. Interest accrued in the current year is reversed against interest income in the current period. Interest payments received on non-accrual loans and leases are generally applied to principal unless the remaining principal balance has been determined to be fully collectible. Accrual of interest may be resumed when it is determined that all amounts due are expected to be collected and the loan has exhibited a sustained level of performance, generally at least six months.

A loan is considered impaired when it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans are reviewed for impairment on an individual basis. Impaired loans are measured at the present value of expected future cash flows discounted at the loan's initial effective

interest rate. The fair value of collateral of an impaired collateral-dependent loan or an observable market price of the loan is also used as an alternative to discounting cash flows. If the measure of the impaired loan is less than the recorded investment in the loan, impairment will be recognized as a charge-off through the allowance for credit losses or a valuation allowance is established for the difference.

Troubled debt restructured loans are loans for which concessions, including a reduced interest rate or a deferral of interest or principal, have been granted due to the borrower's weakened financial condition. Once a loan is restructured, interest is accrued at the restructured rates when no loss of principal is anticipated. A loan that has performed in accordance with restructured terms for one year is no longer reported as a restructured loan, but will continue to be reported as impaired.

Loan Origination Fees and Costs; Other Lending Fees

For Loans and Leases Held for Investment, origination fees and costs incurred to extend credit are deferred and amortized over the term of the loan as an adjustment to yield using the interest method, except where the net amount is deemed to be immaterial.

The Company occasionally originates lines of credit where the customer is charged a non-usage fee if the line of credit is not used. In such instances, the Company periodically reviews use of lines on a retrospective basis and recognizes non-usage fees in non-interest income.

Loan Servicing and Transfers of Financial Assets

The Bank sells commercial business loans to third parties. The loans are generally sold on a non-recourse basis. Sold loans are not included in the accompanying consolidated balance sheets.

The sales of loans are accounted for pursuant to ASC 860, *Transfers and Servicing*.

Allowance for Credit Losses

The Bank maintains its allowance for credit losses at a level considered adequate to provide for probable losses related to the loan and lease portfolio as of the consolidated balance sheet dates. The loan and lease portfolio and other credit exposures are reviewed regularly to evaluate the adequacy of the allowance for credit losses.

The methodology used to establish the allowance for credit losses incorporates quantitative and qualitative risk considerations. Quantitative factors include the Bank's historical loss experience, delinquency information, charge-off trends, collateral values, changes in nonperforming loans and other factors. Quantitative factors also incorporate known information about individual borrowers, including sensitivity to interest rate movements or other quantifiable external factors.

Qualitative factors include the general economic environment, the state of certain industries and factors unique to the Bank's market areas. Size, complexity of individual credits, loan structure, variances from loan policies and pace of portfolio growth are other qualitative factors that are considered when the Bank estimates the allowance for credit losses.

The Bank's methodology has been consistently applied. However, the Bank enhances its methodology as circumstances dictate.

The allowance for credit losses has three components as follows:

Specific Reserves. The amount of specific reserves is determined through a loan-by-loan analysis of problematic loans over a minimum size. Included in problem loans are non-accrual or restructured loans that meet the impairment criteria in ASC 310, *Receivables*. A loan is impaired when, based on current information, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. Any allowance on impaired loans is generally based on one of three methods: the present value of expected cash flows at the loan's effective interest rate, the loan's observable market price or the fair value of the collateral of the loan. Specific reserves may also be established for credits that have been internally classified as credits requiring management's attention due to underlying problems in the borrower's business or collateral concerns.

Reserves for Homogeneous Loan Pools. The Bank makes a significant number of loans and leases that, due to their underlying similar characteristics, are assessed for loss as “homogeneous” pools. Included in the homogeneous pools are loans which have been excluded from the specific reserve allocation. The Company’s methodology incorporates an estimated loss emergence period for each risk group. The loss emergence period is the period of time from when a borrower experiences a loss event and when the actual loss is recognized in the consolidated financial statements, generally at the time of initial charge-off of the loan balance.

Qualitative Reserve. Management also allocates reserves for other circumstances pertaining to the measurement period. The factors considered include, but are not limited to, prevailing trends, economic conditions, geographic influence, industry segments within the portfolio, management’s assessment of credit risk inherent in the loan portfolio, delinquency data, historical loss experience and peer-group information.

Monitoring loans and analysis of loss components are the principal means by which management determines estimated credit losses are reflected in the Bank’s allowance for credit losses on a timely basis. Management also considers regulatory guidance in addition to the Bank’s own experience. Various regulatory agencies, as an integral part of their examination process, periodically review the allowance for credit losses. Such agencies may require additions to the allowance based on their judgment about information available to them at the time of their examination.

Loans, leases and other extensions of credit deemed uncollectible are charged off against the allowance for credit losses. Subsequent recoveries, if any, are credited to the allowance.

The allowance for credit losses is highly dependent upon variables affecting valuation, including appraisals of collateral, evaluations of performance as well as the amounts and timing of future cash flows expected to be received on impaired loans. These variables are reviewed periodically. Actual credit losses may materially vary from the current estimated allowance for credit losses. For nonperforming or impaired loans, appraisals are generally performed annually or whenever circumstances warrant a new appraisal. Management regularly evaluates the appraised value and costs to liquidate in order to estimate fair value. A provision for credit losses is made to adjust the allowance for credit losses to the amount determined appropriate through application of the above processes.

Other Real Estate Owned and Repossessed Assets, net

Real estate properties and other assets acquired through loan foreclosures are recorded at fair value less estimated costs to sell. If the carrying amount of an asset acquired through foreclosure is in excess of the fair value less estimated costs to sell, the excess amount is charged to the allowance for credit losses. Fair value is primarily determined based upon appraisals of the assets involved and management periodically assesses appraised values to ascertain continued relevancy of the valuation. Net operating income from and gains on disposition of these assets are included in other non-interest income. Net operating expenses, losses on disposition, and subsequent declines in the estimated fair value of these assets are charged to other non-interest expense.

Premises and Equipment

Land is carried at cost. Premises and equipment are reported at cost less accumulated depreciation and amortization. Depreciation and amortization for financial reporting purposes is charged to non-interest expense using the straight-line method over the estimated useful lives of the assets. Estimated useful lives are up to 40 years for buildings and three to 10 years for furniture and equipment. Leasehold improvements are capitalized and amortized over the shorter of the lease term or the estimated useful life of the improvement. Maintenance and repairs, as well as gains and losses on dispositions of premises and equipment, are included in non-interest income or expense as incurred.

Impairment of Long-Lived Assets

The Company reviews long-lived assets for impairment periodically or whenever events or changes in circumstances indicate that the carrying amount of any such asset may not be recoverable. The impairment review includes a comparison of future cash flows (undiscounted and without interest charges) expected to be generated by the assets to their current carrying value. If impairment is identified, the assets are written down to their fair value through a charge to non-interest expense.

Securities Sold Under Agreements to Repurchase

From time to time, the Bank enters into sales of securities under agreements to repurchase, generally for periods of less than 90 days. These agreements are treated as financings, and the obligations to repurchase securities sold are reflected as a liability in the consolidated balance sheets as short-term borrowings. The costs of securities underlying the agreements remain in the asset accounts.

Fair Value

Several accounting standards require recording assets and liabilities based on their fair values. Determining the fair value of assets and liabilities can be highly subjective. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. The Company determines fair value based on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market.

ASC 820, *Fair Value Measurement*, defines fair value and establishes a framework for measuring fair value of assets and liabilities using a hierarchy system consisting of three levels based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets that the Company has the ability to access.

Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are less active, and model-based valuation techniques for which significant assumptions are observable in the market.

Level 3: Valuation is generated from model-based techniques that use significant assumptions not observable in the market and are used only to the extent that observable inputs are not available. These unobservable assumptions reflect the Company's own estimates of assumptions that market participants would use in pricing the asset or liability.

Management assigns levels to assets and liabilities accounted for at fair value.

Fair Values of Financial Instruments

The Company is required to disclose the estimated fair value of financial instruments. Fair value estimates are subjective in nature, involving uncertainties and matters of significant judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates. The following methods and assumptions are used by the Company in estimating fair value disclosures for its financial instruments.

Investment Securities Available for Sale. The fair value of the Company's securities, other than U.S. Treasury securities, are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are less active, and model-based valuation techniques for which significant assumptions are observable in the market. U.S. Treasury securities are based upon quoted prices for identical instruments traded in active markets.

Loans Held for Sale-Mortgage Banking. Loans held for sale-mortgage banking are accounted for at fair value pursuant to the fair value option permitted by ASC 825, *Financial Instruments*. Fair value measurements on loans held for sale are based on quoted market prices for similar loans in the secondary market, market quotes from anticipated sales contracts and commitments, or contract prices from firm sales commitments.

Derivative Financial Instruments. The fair value of the Company's derivatives are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are less active, and model-based valuation techniques for which significant assumptions are observable in the market.

Financial Instruments with Off-Balance-Sheet Risk. The fair values of the Company's commitments to extend credit and commercial and standby letters of credit are estimated using fees currently charged to enter into similar agreements.

Derivative Financial Instruments

ASC 815, *Derivatives and Hedging*, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. Accordingly, the Company records all derivatives at fair value.

The Company enters into interest rate lock commitments on certain mortgage loans related to mortgage banking operations on a best efforts basis, which are commitments to originate loans whereby the interest rate on the loan is determined prior to funding. The Company also has corresponding forward sales contracts related to these interest rate lock commitments. Both the mortgage loan commitments and the related forward sales contracts are accounted for as derivatives and carried at fair value in other assets with changes in fair value recorded in mortgage banking revenues, net.

The Company also commits to originate and sell certain loans related to mortgage banking operations on a mandatory delivery basis. To hedge interest rate risk the Company sells short positions in mortgage backed securities related to the loans sold on a mandatory delivery basis. The commitments to originate and short positions are accounted for as derivatives and carried at fair value in other liabilities with changes in fair value recorded in mortgage banking revenues, net.

Share-Based Compensation

ASC 718, *Compensation – Stock Compensation*, requires the Company to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the grant date.

At December 31, 2018, the Company had four stock-based compensation plans, which are described more fully in Note 24 and Note 25 to these consolidated financial statements.

Income Taxes

The Company files consolidated federal and unitary state income tax returns where allowed.

The determination of current and deferred income taxes is based on analyses of many factors including interpretation of federal and state income tax laws, differences between tax and financial reporting basis of assets and liabilities, expected reversals of temporary differences, estimates of amounts due or owed and current financial accounting standards. Actual results could differ significantly from the estimates and interpretations used in determining the current and deferred income taxes.

Deferred income taxes are accounted for using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effects of changes in tax rates on deferred tax assets and liabilities are recognized in income in the period of enactment regardless of the balance sheet classification of the underlying deferred tax asset or liability.

Management evaluates deferred tax assets to determine whether they are realizable based upon accounting standards and specific facts and circumstances. A valuation allowance is established to reduce deferred tax assets to amounts that are more likely than not expected to be realized.

Earnings Per Share

Basic earnings per share (EPS) excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding during the applicable period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. Such potential dilutive instruments include stock options and contingently issuable stock. Note 22 to these consolidated financial statements includes disclosure of the Company's EPS calculations.

Comprehensive (Loss) Income

Comprehensive income is the total of net income and other comprehensive (loss) income, which for the Company, is generally comprised of unrealized losses and gains on securities available for sale, net of corresponding tax effects.

RECENTLY ISSUED OR ADOPTED ACCOUNTING PRONOUNCEMENTS

The Company adopted Accounting Standards Update (ASU) No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*, on January 1, 2018 using the modified retrospective approach. This amendment addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The adoption of this amended guidance did not materially impact the Company's consolidated financial statements.

The Company adopted ASC 606, *Revenue from Contracts with Customers* (ASC 606), on January 1, 2018 using the full retrospective approach. ASC 606 amends the revenue recognition guidance for contracts with customers for goods and services and specifically excludes interest income, as well as other revenues associated with financial assets and liabilities, including loans, leases, and derivatives. The adoption of ASC 606 had no impact on the Company's consolidated financial statements, except for additional consolidated financial statement disclosures, which are included in Note 16 to these consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases*. The amended guidance changes the accounting treatment of leases, in that lessees will recognize most leases on-balance sheet. This will increase reported assets and liabilities, as lessees will be required to recognize a right-of-use asset along with a lease liability, measured on a discounted basis. Lessees are allowed to account for short-term leases (those with a term of twelve months or less) off-balance sheet. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The amended guidance allows an entity to choose either the effective date, or the beginning of the earliest comparative period presented in the consolidated financial statements, as its date of initial application. The Company will adopt the amended guidance on January 1, 2019 and use the effective date as the date of initial application. The Company does not anticipate that there will be a cumulative effect adjustment made to retained earnings as a result of adopting the amended guidance. The most significant effects of the adoption of this guidance will be additional consolidated financial statement disclosures. The adoption of this accounting pronouncement did not have a material impact on the Company's consolidated financial statements.

ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*, replaces the current incurred loss methodology for recognizing credit losses with a current expected credit loss model, which requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. This amended guidance broadens the information that an entity must consider in developing its expected credit loss estimates. Additionally, this update amends the accounting for credit losses for available-for-sale debt securities and purchased financial assets with a more-than-insignificant amount of credit deterioration since origination. This update requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of a company's loan portfolio. This update is effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years, and early adoption in fiscal years beginning after December 15, 2018 is permitted. This update requires the use of the modified retrospective adoption approach and the Company is currently evaluating the impact that this amended guidance will have on its consolidated financial statements and disclosures.

NOTE 2. Investment Securities Available For Sale

Investment securities have been classified in the consolidated balance sheets according to management's intent. The Company had no securities designated as trading or held-to-maturity in its portfolio at December 31, 2018 or 2017. The carrying amount of investment securities available for sale securities and their estimated fair values were as follows as of December 31 (in thousands):

	2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities	\$ 59,710	\$ -	\$ (916)	\$ 58,794
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	10,221	32	(121)	10,132
U.S. government agency small business administration pools guaranteed by SBA	158,430	-	(7,464)	150,966
Collateralized mortgage obligations guaranteed by GNMA	63,149	274	(1,166)	62,257
Collateralized mortgage obligations issued by FNMA or FHLMC	52,635	47	(903)	51,779
Asset-backed securities	24,170	-	(125)	24,045
State and municipal bonds	53,862	434	(760)	53,536
	<u>\$ 422,177</u>	<u>\$ 787</u>	<u>\$ (11,455)</u>	<u>\$ 411,509</u>
	2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities	\$ 40,002	\$ -	\$ (536)	\$ 39,466
U.S. government sponsored entity mortgage-backed securities issued by FNMA	4,522	-	(10)	4,512
U.S. government agency small business administration pools guaranteed by SBA	141,837	20	(2,465)	139,392
Collateralized mortgage obligations guaranteed by GNMA/VA	69,296	337	(1,717)	67,916
Collateralized mortgage obligations issued by FNMA or FHLMC	51,550	90	(1,123)	50,517
Asset-backed securities	16,071	-	(61)	16,010
State and municipal bonds	90,048	4,220	(164)	94,104
	<u>\$ 413,326</u>	<u>\$ 4,667</u>	<u>\$ (6,076)</u>	<u>\$ 411,917</u>

The amortized cost and estimated fair value of investment securities available for sale classified according to their contractual maturities at December 31, 2018, were as follows (in thousands):

	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ -	\$ -
Due after one year through five years	35,160	34,764
Due after five years through ten years	94,162	92,269
Due after ten years	292,855	284,476
Total	<u>\$ 422,177</u>	<u>\$ 411,509</u>

The table above is not intended to reflect actual maturities, cash flows, or interest rate risk. Actual maturities may differ from the contractual maturities shown above as a result of prepayments.

Investment securities available for sale with estimated fair values of \$113.9 million and \$118.8 million at December 31, 2018 and 2017, respectively, were pledged as collateral for public and trust deposits and borrowings, including borrowings from the FHLB and repurchase agreements with customers.

Sales proceeds and gross realized gains and losses on available for sale securities were as follows for the years ended December 31 (in thousands):

	2018	2017
Sales proceeds	\$ 62,516	\$ 99,910
Gross realized gains	2,513	1,398
Gross realized losses	(220)	(653)
Net realized gains	<u>\$ 2,293</u>	<u>\$ 745</u>

The following table shows the Company's gross unrealized losses and fair value of investment securities available for sale aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31 (in thousands):

Description of Securities	2018								
	Less than 12 months			12 months or more			Total		
	#	Fair	Unrealized	#	Fair	Unrealized	#	Fair	Unrealized
		Value	Loss		Value	Loss		Value	Loss
U.S. Treasury securities	2	\$ 19,652	\$ (55)	2	\$ 39,142	\$ (861)	4	\$ 58,794	\$ (916)
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	-	-	-	3	4,132	(121)	3	4,132	(121)
U.S. government agency small business administration pools guaranteed by SBA	5	28,836	(1,444)	40	122,130	(6,020)	45	150,966	(7,464)
Collateralized mortgage obligations guaranteed by GNMA	-	-	-	5	40,146	(1,166)	5	40,146	(1,166)
Collateralized mortgage obligations issued by FNMA or FHLMC	3	13,965	(88)	8	34,583	(815)	11	48,548	(903)
Asset-backed securities	4	14,752	(46)	4	9,293	(79)	8	24,045	(125)
State and municipal bonds	9	30,441	(402)	6	16,575	(358)	15	47,016	(760)
Total temporarily impaired securities	23	\$ 107,646	\$ (2,035)	68	\$ 266,001	\$ (9,420)	91	\$ 373,647	\$ (11,455)

Description of Securities	2017								
	Less than 12 months			12 months or more			Total		
	#	Fair	Unrealized	#	Fair	Unrealized	#	Fair	Unrealized
		Value	Loss		Value	Loss		Value	Loss
U.S. Treasury securities	2	\$ 39,466	\$ (536)	-	\$ -	\$ -	2	\$ 39,466	\$ (536)
U.S. government sponsored entity mortgage-backed securities issued by FNMA	3	4,512	(10)	-	-	-	3	4,512	(10)
U.S. government agency small business administration pools guaranteed by SBA	32	117,695	(1,870)	5	15,670	(595)	37	133,365	(2,465)
Collateralized mortgage obligations guaranteed by GNMA/VA	4	2,046	(15)	4	42,326	(1,702)	8	44,372	(1,717)
Collateralized mortgage obligations issued by FNMA or FHLMC	5	25,320	(630)	4	17,287	(493)	9	42,607	(1,123)
Asset-backed securities	4	16,010	(61)	-	-	-	4	16,010	(61)
State and municipal bonds	5	12,185	(164)	-	-	-	5	12,185	(164)
Total temporarily impaired securities	55	\$ 217,234	\$ (3,286)	13	\$ 75,283	\$ (2,790)	68	\$ 292,517	\$ (6,076)

Management regularly evaluates each security with unrealized losses to determine whether losses are other-than-temporary. When determining whether a security is other-than-temporarily impaired, management assesses whether it has the intent to sell the security or whether it is more likely than not that it will be required to sell the security before a recovery of amortized cost. When evaluating a security, management considers several factors including, but not limited to, the amount of the unrealized loss, the length of time the security has been in a loss position, guarantees provided by third parties, ratings on the security, cash flow from the security, the level of credit support provided by subordinate tranches, and the collateral underlying the security.

There were no securities that management concluded were other-than-temporarily impaired during 2018 or 2017.

NOTE 3. Federal Reserve Bank and Federal Home Loan Bank Stock

The carrying amounts of FRB and FHLB stock, which approximate their fair values, consisted of the following as of December 31 (in thousands):

	<u>2018</u>	<u>2017</u>
Federal Reserve Bank Stock, at cost	\$ 1,807	\$ 1,807
Federal Home Loan Bank, at cost	1,134	1,090
Total	<u>\$ 2,941</u>	<u>\$ 2,897</u>

There is no contractual maturity on these investments; the investments are required by counterparties.

NOTE 4. Loans and Leases

The composition of loans and leases is as follows at December 31 (in thousands):

	<u>2018</u>	<u>2017</u>
Loans held for sale-mortgage banking	<u>\$ 22,788</u>	<u>\$ 36,601</u>
Commercial and industrial	\$ 149,886	\$ 126,169
Commercial real estate	174,868	177,429
SBA	32,505	25,064
Consumer	78,055	71,876
Land and land development	11,398	14,168
Construction	<u>21,257</u>	<u>13,167</u>
Gross loans and leases held for investment	467,969	427,873
Unearned income and net unamortized deferred fees and costs	<u>499</u>	<u>452</u>
Loans, net of unearned income and unamortized fees and costs	468,468	428,325
Allowance for credit losses	<u>(7,692)</u>	<u>(7,861)</u>
Net loans and leases held for investment	<u>\$ 460,776</u>	<u>\$ 420,464</u>

To accommodate customers whose financing needs exceed the Bank's lending limits, BNC sells loan participations on a nonrecourse basis to outside financial institutions and derecognizes the portion of the loan balance sold. At December 31, 2018 and 2017, loan participations sold on a nonrecourse basis to outside financial institutions totaled \$166.3 million and \$176.7 million, respectively.

Loans to Related Parties

Note 23 to these consolidated financial statements includes information relating to loans to executive officers, directors, principal shareholders and associates of such persons.

Loans Pledged as Collateral

The table below presents loans pledged as collateral to the FHLB, FRB, and the Bank of North Dakota as of December 31 (in thousands):

	<u>2018</u>	<u>2017</u>
Commercial and industrial	\$ 43,130	\$ 39,274
Commercial real estate	97,788	98,647
Consumer	<u>32,357</u>	<u>33,123</u>
	<u>\$ 173,275</u>	<u>\$ 171,044</u>

NOTE 5. Allowance for Credit Losses

Transactions in the allowance for credit losses were as follows for the years ended December 31 (in thousands):

	2018						
	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	\$ 2,158	\$ 3,471	\$ 834	\$ 914	\$ 358	\$ 126	\$ 7,861
Provision (reduction)	(190)	72	66	112	(133)	73	-
Loans charged off	(71)	(1)	(59)	(129)	-	-	(260)
Loan recoveries	40	16	4	31	-	-	91
Balance, end of period	<u>\$ 1,937</u>	<u>\$ 3,558</u>	<u>\$ 845</u>	<u>\$ 928</u>	<u>\$ 225</u>	<u>\$ 199</u>	<u>\$ 7,692</u>

	2017						
	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	\$ 2,323	\$ 3,231	\$ 1,433	\$ 772	\$ 413	\$ 113	\$ 8,285
Provision (reduction)	(81)	228	(81)	225	46	13	350
Loans charged off	(84)	-	(566)	(123)	(103)	-	(876)
Loan recoveries	-	12	48	40	2	-	102
Balance, end of period	<u>\$ 2,158</u>	<u>\$ 3,471</u>	<u>\$ 834</u>	<u>\$ 914</u>	<u>\$ 358</u>	<u>\$ 126</u>	<u>\$ 7,861</u>

The following table shows the balance in the allowance for credit losses at December 31, 2018, and December 31, 2017, and the related loan balances, segregated on the basis of impairment methodology (in thousands). Impaired loans are loans on nonaccrual status and troubled debt restructurings, which are individually evaluated for impairment, and other loans deemed to have similar risk characteristics. All other loans are collectively evaluated for impairment.

	Allowance For Credit Losses			Gross Loans and Leases Held for Investment		
	Impaired	Other	Total	Impaired	Other	Total
December 31, 2018						
Commercial and industrial	\$ 246	\$ 1,691	\$ 1,937	\$ 1,758	\$ 148,128	\$ 149,886
Commercial real estate	73	3,485	3,558	1,496	173,372	174,868
SBA	62	783	845	104	32,401	32,505
Consumer	6	922	928	80	77,975	78,055
Land and land development	-	225	225	28	11,370	11,398
Construction	-	199	199	-	21,257	21,257
Total	<u>\$ 387</u>	<u>\$ 7,305</u>	<u>\$ 7,692</u>	<u>\$ 3,466</u>	<u>\$ 464,503</u>	<u>\$ 467,969</u>
December 31, 2017						
Commercial and industrial	\$ 407	\$ 1,751	\$ 2,158	\$ 1,737	\$ 124,432	\$ 126,169
Commercial real estate	87	3,384	3,471	1,510	175,919	177,429
SBA	64	770	834	143	24,921	25,064
Consumer	10	904	914	311	71,565	71,876
Land and land development	-	358	358	52	14,116	14,168
Construction	-	126	126	-	13,167	13,167
Total	<u>\$ 568</u>	<u>\$ 7,293</u>	<u>\$ 7,861</u>	<u>\$ 3,753</u>	<u>\$ 424,120</u>	<u>\$ 427,873</u>

Performing and non-accrual loans

The Bank's key credit quality indicator is the loan's performance status, defined as accrual or non-accrual. Performing loans are considered to have a lower risk of loss and are on accrual status. Accrual of interest on loans is discontinued when the Bank believes that the borrower's financial condition is such that the collection of principal and interest is doubtful. A delinquent loan is generally placed on non-accrual status when it becomes 90 days or more past due unless the loan is well secured and in the process of collection. When a loan is placed on non-accrual status, accrued but uncollected interest income applicable to the current reporting period is reversed against interest income. Accrued but uncollected interest income applicable to previous reporting periods is charged against the allowance for credit losses. No additional interest is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain. Delinquent balances are determined based on the contractual terms of the loan adjusted for charge-offs and payments applied to principal.

The following table sets forth information regarding the Bank's performing and non-accrual loans at December 31 (in thousands):

	2018					
	Current	31-89 Days Past Due	90 Days or More Past Due And Accruing	Total Performing	Non-accrual	Total
Commercial and industrial:						
Business loans	\$ 64,437	\$ 644	\$ -	\$ 65,081	\$ 1,464	\$ 66,545
Agriculture	26,425	-	-	26,425	-	26,425
Owner-occupied commercial real estate	56,916	-	-	56,916	-	56,916
Commercial real estate	174,868	-	-	174,868	-	174,868
SBA	32,343	47	-	32,390	115	32,505
Consumer:						
Automobile	22,377	10	-	22,387	55	22,442
Home equity	8,567	-	-	8,567	-	8,567
1st mortgage	12,505	229	-	12,734	-	12,734
Other	34,265	23	-	34,288	24	34,312
Land and land development	11,370	-	-	11,370	28	11,398
Construction	21,257	-	-	21,257	-	21,257
Total loans held for investment	465,330	953	-	466,283	1,686	467,969
Loans held for sale	22,788	-	-	22,788	-	22,788
Total gross loans	<u>\$ 488,118</u>	<u>\$ 953</u>	<u>\$ -</u>	<u>\$ 489,071</u>	<u>\$ 1,686</u>	<u>\$ 490,757</u>

	2017					
	Current	31-89 Days Past Due	90 Days or More Past Due And Accruing	Total Performing	Non-accrual	Total
Commercial and industrial:						
Business loans	\$ 49,686	\$ 75	\$ 26	\$ 49,787	\$ 1,737	\$ 51,524
Agriculture	23,773	-	-	23,773	-	23,773
Owner-occupied commercial real estate	50,872	-	-	50,872	-	50,872
Commercial real estate	177,212	217	-	177,429	-	177,429
SBA	24,505	416	-	24,921	143	25,064
Consumer:						
Automobile	16,631	11	-	16,642	20	16,662
Home equity	9,276	14	-	9,290	-	9,290
1st mortgage	14,401	-	-	14,401	-	14,401
Other	31,474	49	-	31,523	-	31,523
Land and land development	14,116	-	-	14,116	52	14,168
Construction	13,167	-	-	13,167	-	13,167
Total loans held for investment	425,113	782	26	425,921	1,952	427,873
Loans held for sale	36,600	1	-	36,601	-	36,601
Total gross loans	<u>\$ 461,713</u>	<u>\$ 783</u>	<u>\$ 26</u>	<u>\$ 462,522</u>	<u>\$ 1,952</u>	<u>\$ 464,474</u>

The following table indicates the effect on interest income on loans if interest on non-accrual loans outstanding at year end had been recognized at original contractual rates during the year ended December 31 (in thousands):

	2018	2017
Interest income that would have been recorded	\$ 123	\$ 161
Interest income recorded	-	-
Effect on interest income on loans	<u>\$ 123</u>	<u>\$ 161</u>

Credit Risk by Internally Assigned Grade

The Company maintains an internal risk rating process in order to increase the precision and effectiveness of credit risk management. Loans are assigned one of the following four internally assigned grades: pass, watch list, substandard, and doubtful.

At December 31, 2018, the Company had \$452.0 million of loans categorized as pass rated loans. This compares to \$415.1 million at December 31, 2017.

Loans designated as watch list are loans that possess some credit deficiency that deserves close attention due to emerging problems. Such loans pose unwarranted financial risk that, if left uncorrected, may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. At December 31, 2018, the Company had \$5.2 million of loans categorized as watch list loans compared to \$1.7 million at December 31, 2017.

Loans graded as Substandard or Doubtful are considered "Classified" loans for regulatory purposes. Loans classified as substandard are loans that are generally inadequately protected by the current net worth and paying capacity of the obligor, or by the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the loan. Substandard loans are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loans classified as doubtful have the weaknesses of those classified as substandard, with additional characteristics that make collection

in full on the basis of currently existing facts, conditions and values questionable, and there is a higher probability of loss. At December 31, 2018, the Company had \$9.2 million of substandard loans and \$1.6 million of doubtful loans. This compares to \$9.1 million of substandard loans and \$1.9 million doubtful loans as of December 31, 2017.

Impaired loans

Impaired loans include loans the Bank will not be able to collect all amounts due in accordance with the terms of the loan agreement. Impaired loans include non-accrual loans and loans that have been modified in a troubled debt restructuring. All loans are individually reviewed for impairment.

The following table summarizes impaired loans and related allowances as of and for the years ended December 31, 2018 and 2017 (in thousands):

	2018				
	Unpaid Principal	Recorded Investment	Related Allowance	Average Recorded Balance	Interest Income Recognized (12 months)
Impaired loans with an allowance recorded:					
Commercial and industrial:					
Business loans	\$ 1,996	\$ 1,454	\$ 246	\$ 1,484	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	1,795	1,496	73	1,497	76
SBA	143	115	62	117	-
Consumer:					
Automobile	16	12	6	15	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans with an allowance recorded	\$ 3,950	\$ 3,077	\$ 387	\$ 3,113	\$ 76
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	\$ 1,915	\$ 294	\$ -	\$ 305	\$ 12
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	-	-	-	-	-
SBA	-	-	-	-	-
Consumer:					
Automobile	62	43	-	44	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	45	24	-	26	-
Land and land development	150	28	-	40	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans without an allowance recorded	\$ 2,172	\$ 389	\$ -	\$ 415	\$ 12
TOTAL IMPAIRED LOANS	\$ 6,122	\$ 3,466	\$ 387	\$ 3,528	\$ 88

2017					
	Unpaid Principal	Recorded Investment	Related Allowance	Average Recorded Balance	Interest Income Recognized (12 months)
Impaired loans with an allowance recorded:					
Commercial and industrial:					
Business loans	\$ 2,678	\$ 1,737	\$ 407	\$ 1,821	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	1,809	1,510	87	1,526	77
SBA	121	107	64	111	-
Consumer:					
Automobile	23	20	10	24	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans with an allowance recorded	\$ 4,631	\$ 3,374	\$ 568	\$ 3,482	\$ 77
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	\$ -	\$ -	\$ -	\$ -	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	-	-	-	-	-
SBA	134	36	-	108	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	1,878	291	-	295	12
Other	-	-	-	-	-
Land and land development	155	52	-	52	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans without an allowance recorded	\$ 2,167	\$ 379	\$ -	\$ 455	\$ 12
TOTAL IMPAIRED LOANS	\$ 6,798	\$ 3,753	\$ 568	\$ 3,937	\$ 89

Troubled Debt Restructuring (TDR)

Included in net loans and leases held for investment, are certain loans that have been modified in order to maximize collection of loan balances. If the Company, for legal or economic reasons related to the borrower's financial difficulties, grants a concession that would not otherwise be considered, compared to the original terms and conditions of the loan, the modified loan is considered a troubled debt restructuring.

The table below summarizes the amounts of restructured loans as of December 31 (in thousands):

	2018			
	Accrual	Non-accrual	Total	Allowance
Commercial and industrial:				
Business loans	\$ 284	\$ 1,454	\$ 1,738	\$ 244
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-
Commercial real estate	1,496	-	1,496	73
SBA	-	115	115	63
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	-	-	-	-
Other	-	-	-	-
Land and land development	-	-	-	-
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	<u>\$ 1,780</u>	<u>\$ 1,569</u>	<u>\$ 3,349</u>	<u>\$ 380</u>
	2017			
	Accrual	Non-accrual	Total	Allowance
Commercial and industrial:				
Business loans	\$ -	\$ -	\$ -	\$ -
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-
Commercial real estate	1,510	-	1,510	87
SBA	-	107	107	64
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	291	-	291	-
Other	-	-	-	-
Land and land development	-	-	-	-
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	<u>\$ 1,801</u>	<u>\$ 107</u>	<u>\$ 1,908</u>	<u>\$ 151</u>

TDR concessions can include reduction of interest rates, extension of maturity dates, forgiveness of principal and/or interest due, or acceptance of real estate or other assets in full or partial satisfaction of the debt. Loan modifications are not reported as TDR's after 12 months if the loan was modified at a market rate of interest for comparable risk loans, and the loan is performing in accordance with the terms of the restructured agreement for at least six months.

When a loan is modified as a TDR, there may be a direct, material impact on the loan balances, as principal balances may be partially forgiven. For the year ended December 31, 2018, there were three new TDRs with a pre-

modification and post modification balance of \$1.5 million. For the year ended December 31, 2017, there were no new TDRs.

Loans that were non-accrual prior to modification remain on non-accrual for at least six months following modification. Non-accrual TDR loans that have performed according to the modified terms for six months may be returned to accruing status. Loans that were accruing prior to modification remain on accrual status after the modification as long as the loan continues to perform under the new terms.

The following table indicates the effect on interest income on loans if interest on restructured loans outstanding at year end had been recognized at original contractual rates during the year ended December 31 (in thousands):

	<u>2018</u>	<u>2017</u>
Interest income that would have been recorded	\$ 313	\$ 211
Interest income recorded	<u>88</u>	<u>89</u>
Effect on interest income on loans	<u>\$ 225</u>	<u>\$ 122</u>

There were no additional funds committed to borrowers who are in TDR status at December 31, 2018 and December 31, 2017.

TDRs are evaluated separately in the Bank's allowance methodology based on the expected cash flows or collateral values for loans in this status.

As of December 31, 2018 and December 31, 2017, the Bank had no restructured loans that were modified in a troubled-debt restructuring within the previous 12 months for which there was a payment default (i.e. 90 days delinquent).

NOTE 6. Other Real Estate, net

Other real estate (ORE), net includes property acquired through foreclosure, property in judgment and in-substance foreclosures. ORE is carried at fair value less estimated selling costs. Each property is evaluated regularly and the amounts provided to decrease the carrying amount are included in non-interest expense. A summary of the activity related to ORE is presented below for the years ended December 31 (in thousands):

	<u>2018</u>	<u>2017</u>
Balance, beginning of period	\$ -	\$ 214
Transfers from nonperforming loans	-	40
Real estate sold	-	(264)
Net gains on sale of assets	-	-
(Provision) reduction	<u>-</u>	<u>10</u>
Balance, end of period	<u>\$ -</u>	<u>\$ -</u>

NOTE 7. Premises and Equipment, net

Premises and equipment, net consisted of the following at December 31 (in thousands):

	<u>2018</u>	<u>2017</u>
Land and improvements	\$ 2,853	\$ 4,949
Buildings and improvements	17,534	16,973
Leasehold improvements	543	525
Furniture, fixtures, and equipment	9,825	9,987
Total cost	<u>30,755</u>	<u>32,434</u>
Less accumulated depreciation and amortization	<u>(13,994)</u>	<u>(13,031)</u>
Net premises and equipment	<u>\$ 16,761</u>	<u>\$ 19,403</u>

Depreciation and amortization expense totaled \$1.545 million and \$1.627 million for the years ended December 31, 2018 and 2017, respectively.

NOTE 8. Deposits

The scheduled maturities of time deposits as of December 31, 2018 are as follows (in thousands):

2019	\$ 77,824
2020	45,434
2021	17,108
2022	4,041
2023	3,608
Thereafter	<u>192</u>
	<u>\$ 148,207</u>

At December 31, 2018 and 2017, the Bank had no time deposits that had been acquired through a traditional broker channel. In addition, the Company had \$101.3 million and \$152.9 million of interest-bearing deposits that meet the regulatory definition of a brokered deposit as of December 31, 2018 and 2017, respectively.

At December 31, 2018 and 2017, the Bank had \$34.2 million and \$28.9 million, respectively, in time deposits greater than \$250 thousand.

The following table shows a summary of interest expense by product type as of December 31 (in thousands):

	<u>2018</u>	<u>2017</u>
Savings	\$ 19	\$ 11
Interest checking	160	64
Money market	2,279	889
Time deposits	<u>2,303</u>	<u>1,545</u>
	<u>\$ 4,761</u>	<u>\$ 2,509</u>

Deposits Received from Related Parties

Note 23 to these consolidated financial statements includes information relating to deposits received from executive officers, directors, principal shareholders and associates of such persons.

NOTE 9. Short-Term Borrowings

The following table sets forth selected information for short-term borrowings (borrowings with an original maturity of less than one year) as of December 31 (in thousands):

	<u>2018</u>	<u>2017</u>
Federal reserve borrowings	\$ -	\$ -
Repurchase agreements with customers, renewable daily, interest payable monthly, rates ranging from 0.20% to 1.50% and 0.10% to 0.40%, respectively, secured by U.S. Treasury securities and general obligations of municipalities	11,494	18,043
	<u>\$ 11,494</u>	<u>\$ 18,043</u>

The weighted average interest rate on short-term borrowings outstanding as of December 31, 2018 and 2017 was 0.84% and 0.25%, respectively.

Customer repurchase agreements are used by the Bank to acquire funds from customers where the customers are required, or desire, to have their funds supported by collateral consisting of U.S. government, U.S. government agency or other types of securities. The repurchase agreement is a promise to sell these securities to a customer at a certain price and repurchase them at a future date at that same price plus interest accrued at an agreed upon rate. The Bank uses customer repurchase agreements in its liquidity plan as well as an accommodation to customers. At December 31, 2018, \$11.5 million of securities sold under repurchase agreements, with a weighted average interest rate of 0.84%, were collateralized by U.S. Treasury securities having a fair value of \$32.0 million and unamortized principal balances of \$32.7 million. At December 31, 2017, \$18.0 million of securities sold under repurchase agreements, with a weighted average interest rate of 0.25%, were collateralized by U.S. Treasury securities and general obligations of municipalities having a fair value of \$32.1 million and unamortized principal balances of \$31.3 million.

NOTE 10. Federal Home Loan Bank Advances

As of December 31, 2018, the Bank had no FHLB advances outstanding. At December 31, 2018, the Bank had loans with unamortized principal balances of approximately \$170.3 million and securities with unamortized principal balances of approximately \$32.9 million pledged as collateral to the FHLB.

As of December 31, 2017, the Bank had no FHLB advances outstanding. At December 31, 2017, the Bank had loans with unamortized principal balances of approximately \$168.5 million and securities with unamortized principal balances of approximately \$35.5 million pledged as collateral to the FHLB.

As of December 31, 2018, the Bank has the ability to draw advances up to approximately \$147.0 million based upon the aggregate collateral that is currently pledged, subject to a requirement to purchase additional FHLB stock, based upon collateral pledged.

NOTE 11. Long-Term Borrowings

The following table sets forth selected information for long-term borrowings (borrowings with an original maturity of greater than one year) as of December 31 (in thousands):

	<u>2018</u>	<u>2017</u>
Note payable, interest due quarterly, beginning on April 1, 2016 ending October 19, 2025, interest payable at a fixed rate of 6.35%	<u>\$ 10,000</u>	<u>\$ 10,000</u>

The long term borrowing is subordinated debt that qualifies as Tier 2 capital for the Company and the borrowing may be repaid by the Company at par in whole or in part beginning October 19, 2020. The loan agreement includes

various covenants that are primarily financial in nature. As of December 31, 2018, the Company was in compliance with these covenants.

NOTE 12. Other Borrowings

The following table presents selected information regarding other borrowings at December 31 (in thousands):

2018				
Unsecured Borrowing Lines:				
		Line	Outstanding	Available
BNC National Bank Lines (1)		\$ 34,500	\$ -	\$ 34,500
Secured Borrowing Lines:				
	Collateral Pledged	Line	Outstanding	Available
BNC National Bank Line	\$ 2,377	\$ 2,162	\$ -	\$ 2,162
BNC Line	92,633	10,000	-	10,000
Total	\$ 95,010	\$ 12,162	\$ -	\$ 12,162
(1) The unsecured BNC National Bank Lines consists of three separate lines with three institutions in individual amounts of \$12.5 million, \$10 million, and \$12 million.				

At December 31, 2018, the pledged collateral for the secured BNC National Bank Line was comprised of collateralized mortgage obligations and the pledged collateral for the secured BNC Line is the common stock of BNC National Bank.

2017				
Unsecured Borrowing Lines:				
		Line	Outstanding	Available
BNC National Bank Lines (1)		\$ 34,500	\$ -	\$ 34,500
Secured Borrowing Lines:				
	Collateral Pledged	Line	Outstanding	Available
BNC Line	\$ 93,838	\$ 10,000	\$ -	\$ 10,000
Total	\$ 93,838	\$ 10,000	\$ -	\$ 10,000
(1) The unsecured BNC National Bank Lines consists of three separate lines with three institutions in individual amounts of \$12.5 million, \$10 million, and \$12 million.				

At December 31, 2017, the pledged collateral for the secured BNC Line is the common stock of BNC National Bank.

NOTE 13. Guaranteed Preferred Beneficial Interests in Company's Subordinated Debentures

In July 2007, BNC issued \$15.0 million of floating rate subordinated debentures. The interest rate paid on the securities is equal to the three month LIBOR plus 1.40%. The interest rate at December 31, 2018 and 2017 was 3.80% and 2.74%, respectively. The subordinated debentures mature on October 1, 2037. The subordinated debentures may be redeemed at par and the corresponding debentures may be prepaid at the option of BNC, subject to approval by the Federal Reserve Board. The payment of interest and ultimate redemption of these debentures is primarily dependent upon the ability of the Bank to transfer funds to BNC in the form of cash dividends, which are subject to regulatory restrictions disclosed in Note 14 to these consolidated financial statements. Pursuant to the subordinated debentures agreement, BNC may defer the payment of interest on the subordinated debentures for up to 20 consecutive quarterly periods. BNC did not defer the payment of interest on the subordinated debentures during the years ended December 31, 2018 and 2017.

BNC fully and unconditionally guarantees the Company's subordinated debentures.

NOTE 14. Stockholders' Equity

Regulatory restrictions exist regarding the ability of the Bank to transfer funds to BNCCORP in the form of cash dividends. Approval of the Office of the Comptroller of the Currency (OCC), the Bank's principal regulator, is required for the Bank to pay dividends to BNCCORP in excess of the Bank's net profits from the current year plus retained net profits for the preceding two years.

On May 30, 2001, BNCCORP's Board of Directors adopted a rights plan intended to protect stockholder interests in the event BNCCORP becomes the subject of a takeover initiative that BNCCORP's Board believes could deny BNCCORP's stockholders the full value of their investment. This plan does not prohibit the Board from considering any offer that it deems advantageous to its stockholders.

Pursuant to the rights plan, the rights are issued to each common stockholder of record, and are exercisable only if a person acquires, or announces a tender offer, that would result in ownership of 15% or more of BNCCORP's outstanding common stock. The rights plan was amended in 2011 such that it now expires on May 30, 2021.

NOTE 15. Regulatory Capital and Current Operating Environment

BNC and BNC Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet capital requirements mandated by regulators can trigger certain mandatory and discretionary actions by regulators. Such actions, if undertaken, could have a direct material adverse effect on the Company's financial condition and results of operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, BNC and BNC Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Regulators continue to impose capital requirements that are specific to individual institutions. The requirements are generally above the statutory ratios.

At December 31, 2018, the capital ratios exceeded all regulatory capital thresholds and maintained sufficient capital conservation buffers to avoid limitations on certain types of capital distributions.

The capital amounts and ratios presented below for December 31, 2018 and December 31, 2017 were as follows (dollars in thousands):

	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>To be Well Capitalized</u>		<u>Amount in Excess of Well Capitalized</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
2018								
Total Risk Based Capital:								
Consolidated	\$ 116,734	20.26 %	\$ 46,091	≥8.00 %	\$ N/A	N/A %	\$ N/A	N/A %
BNC National Bank	106,154	18.44	46,053	≥8.00	57,566	10.00	48,588	8.44
Tier 1 Risk Based Capital:								
Consolidated	99,527	17.28	34,568	≥6.00	N/A	N/A	N/A	N/A
BNC National Bank	98,952	17.19	34,540	≥6.00	46,053	8.00	52,899	9.19
Common Equity Tier 1 Risk Based Capital:								
Consolidated	84,518	14.67	25,926	≥4.50	N/A	N/A	N/A	N/A
BNC National Bank	98,952	17.19	25,905	≥4.50	37,418	6.50	61,534	10.69
Tier 1 Leverage Capital:								
Consolidated	99,527	9.97	39,930	≥4.00	N/A	N/A	N/A	N/A
BNC National Bank	98,952	9.92	39,890	≥4.00	49,862	5.00	49,090	4.92
Tangible Common Equity (to total assets): (a)								
Consolidated	77,611	7.99	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	92,490	9.53	N/A	N/A	N/A	N/A	N/A	N/A
2017								
Total Risk Based Capital:								
Consolidated	\$ 109,187	19.98 %	\$ 43,717	≥8.00 %	\$ N/A	N/A %	\$ N/A	N/A %
BNC National Bank	99,933	18.31	43,657	≥8.00	54,572	10.00	45,361	8.31
Tier 1 Risk Based Capital:								
Consolidated	92,344	16.90	32,788	≥6.00	N/A	N/A	N/A	N/A
BNC National Bank	93,098	17.06	32,743	≥6.00	43,657	8.00	49,441	9.06
Common Equity Tier 1 Risk Based Capital:								
Consolidated	77,333	14.15	24,591	≥4.50	N/A	N/A	N/A	N/A
BNC National Bank	93,098	17.06	24,557	≥4.50	35,472	6.50	57,626	10.56
Tier 1 Leverage Capital:								
Consolidated	92,344	9.53	38,749	≥4.00	N/A	N/A	N/A	N/A
BNC National Bank	93,098	9.62	38,713	≥4.00	48,392	5.00	44,706	4.62
Tangible Common Equity (to total assets): (a)								
Consolidated	77,407	8.18	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	93,618	9.91	N/A	N/A	N/A	N/A	N/A	N/A

(a) Tangible common equity is calculated by dividing common equity, less intangible assets, by total period end assets.

The most recent notifications from the OCC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. Management believes the Bank remains well capitalized through the date for which subsequent events have been evaluated.

NOTE 16. Revenue from Contracts with Customers

Accounting for revenue within the scope of ASC 606 is consistent with the policies and practices prior to adoption of ASC 606. The majority of the Company's performance obligations for revenue from contracts with customers are satisfied at a point in time and are typically collected from customers at the time of the transaction or shortly thereafter.

The following is a description of the principal activities from which the Company generates revenue that are within the scope of ASC 606:

Service charges on deposits – Service charges on deposit accounts represent daily and monthly analysis fees recognized for the services related to customer deposit accounts, including account maintenance, overdraft fees, and depository transactions processing fees. Depository accounts charge fees in accordance with the customer's pricing schedule or may be assessed a flat service fee per month. The Company satisfies the performance obligation related to providing depository accounts daily as transactions are processed and deposit service charge revenue is recognized daily.

Bankcard fees – Bankcard fees primarily represent income earned from interchange revenue from Visa for the Company's processing of debit card transactions. The performance obligation for interchange revenue is the processing of each transaction through the Company's access to the banking system. This performance obligation is completed for each individual transaction and revenue is recognized per transaction in accordance with interchange rates established by Visa.

Wealth management revenue – Wealth management revenue consists of fees earned on personal trust accounts, retirement plan administration, and wealth management services. The performance obligations related to this revenue include items such as performing trustee service administration, investment management services, custody and record-keeping services, retirement plan administration, and tax services. These fees are part of contractual agreements and the performance obligations are satisfied upon completion of services. The fees are generally a fixed flat annual rate or based on a percentage of the account's market value per the contract with the customer and revenue is recognized over time as earned.

Other income – The Company recognizes other miscellaneous income through a variety of other revenue streams, the most material of which include revenue from investments in Small Business Investment Companies (SBIC), gains on sales of financial assets, and bank-owned life insurance income. These revenue streams are outside of the scope of ASC 606 and are recognized in accordance with the applicable U.S. generally accepted accounting principles. The remainder of Other income is primarily earned through transactions with personal banking customers, including stop payment charges and fees for cashier's checks. The performance obligations of these types of fees are satisfied as transactions are completed and revenue is recognized upon transaction execution according to established fee schedules with the customers.

The Company had no material contract assets or remaining performance obligations as of December 31, 2018. Total receivables from revenue recognized under the scope of ASC 606 were \$417 thousand and \$393 thousand as of December 31, 2018 and December 31, 2017, respectively. These receivables are included as part of the Other assets line on the Company's Consolidated Balance Sheets.

The following table disaggregates non-interest income subject to ASC 606 (in thousands):

	<u>2018</u>	<u>2017</u>
Service charges on deposits	\$ 727	\$ 775
Bankcard fees	1,031	950
Bank charges and service fees not within scope of ASC 606	929	994
Total bank charges and service fees	<u>2,687</u>	<u>2,719</u>
Wealth management revenue	1,810	1,697
Wealth management revenue not within the scope of ASC 606	-	20
Total wealth management revenues	<u>1,810</u>	<u>1,717</u>
Other	53	55
Other not within the scope of ASC 606 (a)	1,955	2,226
Total other	<u>2,008</u>	<u>2,281</u>
Other non-interest income not within the scope of ASC 606 (a)	12,512	12,782
Total non-interest income	<u>\$ 19,017</u>	<u>\$ 19,499</u>

(a) This revenue is not within the scope of ASC 606, and includes fees related to mortgage banking operations, gains on sale of loans, gains on sale of securities, revenue from investments in SBIC, and various other transactions.

NOTE 17. Fair Value Measurements

The following table summarizes the financial assets and liabilities of the Company for which fair values are determined on a recurring basis as of December 31 (in thousands):

	<u>Carrying Value at December 31, 2018</u>				<u>Twelve Months Ended December 31, 2018</u>
	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total gains/(losses)</u>
ASSETS					
Investment securities available for sale	\$ 411,509	\$ 58,794	\$ 352,715	\$ -	\$ 2,293
Loans held for sale	22,788	-	22,788	-	(505)
Commitments to originate mortgage loans	1,479	-	1,479	-	71
Total assets at fair value	<u>\$ 435,776</u>	<u>\$ 58,794</u>	<u>\$ 376,982</u>	<u>\$ -</u>	<u>\$ 1,859</u>
LIABILITIES					
Commitments to sell mortgage loans	\$ 148	\$ -	\$ 148	\$ -	\$ (198)
Mortgage banking short positions	210	-	210	-	(106)
Total liabilities at fair value	<u>\$ 358</u>	<u>\$ -</u>	<u>\$ 358</u>	<u>\$ -</u>	<u>\$ (304)</u>

	Carrying Value at December 31, 2017				Twelve Months Ended December 31, 2017
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
ASSETS					
Investment securities available for sale	\$ 411,917	\$ 39,466	\$ 372,451	\$ -	\$ 745
Loans held for sale	36,601	-	36,601	-	(326)
Commitments to originate mortgage loans	1,457	-	1,457	-	90
Total assets at fair value	<u>\$ 449,975</u>	<u>\$ 39,466</u>	<u>\$ 410,509</u>	<u>\$ -</u>	<u>\$ 509</u>
LIABILITIES					
Commitments to sell mortgage loans	\$ 42	\$ -	\$ 42	\$ -	\$ (301)
Mortgage banking short positions	12	-	12	-	41
Total liabilities at fair value	<u>\$ 54</u>	<u>\$ -</u>	<u>\$ 54</u>	<u>\$ -</u>	<u>\$ (260)</u>

The Company sells short positions in mortgage-backed securities to manage interest rate risk on the loans committed for mandatory delivery. The commitments to originate and sell mortgage banking loans and the short positions are derivatives and are recorded at fair value.

For the periods presented, U.S. Treasury Securities were considered to be Level 1 while all other assets and liabilities recorded at fair value were considered to be Level 2. There were no transfers into or out of the respective levels during the periods presented.

The Company may also be required from time to time to measure certain other assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These adjustments to fair value usually result from the application of the lower of cost or market accounting or write-down of individual assets. For assets measured at fair value on a nonrecurring basis the following table provides the level of valuation assumptions used to determine the carrying value at December 31 (in thousands):

	2018				
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
Impaired loans ⁽¹⁾	\$ 3,079	\$ -	\$ 3,079	\$ -	\$ 36
Other real estate ⁽²⁾	-	-	-	-	-
Total	<u>\$ 3,079</u>	<u>\$ -</u>	<u>\$ 3,079</u>	<u>\$ -</u>	<u>\$ 36</u>
	2017				
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
Impaired loans ⁽¹⁾	\$ 3,185	\$ -	\$ 3,185	\$ -	\$ (20)
Other real estate ⁽²⁾	-	-	-	-	10
Total	<u>\$ 3,185</u>	<u>\$ -</u>	<u>\$ 3,185</u>	<u>\$ -</u>	<u>\$ (10)</u>

(1) The carrying value represents the book value less allocated reserves. The gain or loss reported is the change in the reserve balances allocated on individual impaired loans in addition to the actual write-downs for the period presented.

(2) The carrying value represents the fair value of the collateral less estimated selling costs and is based upon appraised values. The gain or loss reported is a combination of gains and/or losses on sales of other real estate and provisions for other real estate losses.

At the beginning of the period, all assets and liabilities valued at fair value on a nonrecurring basis were considered to be Level 2. There were no transfers into or out of Level 2 during the periods presented.

NOTE 18. Fair Value of Financial Instruments

The estimated fair values of the Company's financial instruments are as follows as of December 31 (in thousands):

	Level in Fair Value Measurement Hierarchy	December 31, 2018		December 31, 2017	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:					
Cash and cash equivalents	Level 1	\$ 25,185	\$ 25,185	\$ 25,830	\$ 25,830
Investment securities available for sale	Level 1	58,794	58,794	39,466	39,466
Investment securities available for sale	Level 2	352,715	352,715	372,451	372,451
Federal Reserve Bank and Federal Home Loan Bank stock	Level 2	2,941	2,941	2,897	2,897
Loans held for sale-mortgage banking	Level 2	22,788	22,788	36,601	36,601
Commitments to originate mortgage loans	Level 2	1,479	1,479	1,457	1,457
Loans and leases held for investment, net	Level 2	460,776	456,586	420,464	417,497
Accrued interest receivable	Level 2	5,079	5,079	4,848	4,848
		<u>\$ 929,757</u>	<u>\$ 925,567</u>	<u>\$ 904,014</u>	<u>\$ 901,047</u>
Liabilities and Stockholders' Equity:					
Deposits, noninterest-bearing	Level 2	\$ 157,663	\$ 157,663	\$ 164,401	\$ 164,401
Deposits, interest-bearing	Level 2	690,942	689,213	653,405	651,923
Borrowings and advances	Level 2	21,494	21,467	28,043	28,284
Accrued interest payable	Level 2	1,277	1,277	950	950
Accrued expenses	Level 2	5,700	5,700	6,107	6,107
Commitments to sell mortgage loans	Level 2	148	148	42	42
Mortgage banking short positions	Level 2	210	210	12	12
Guaranteed preferred beneficial interests in Company's subordinated debentures	Level 2	15,009	10,208	15,011	10,691
		<u>\$ 892,443</u>	<u>\$ 885,886</u>	<u>\$ 867,971</u>	<u>\$ 862,410</u>
Financial instruments with off-balance-sheet risk:					
Commitments to extend credit	Level 2	\$ -	\$ 169	\$ -	\$ 181
Standby and commercial letters of credit	Level 2	\$ -	\$ 9	\$ -	\$ 11

The Company is required to disclose the estimated fair value of financial instruments. Fair value estimates are subjective in nature, involving uncertainties and matters of significant judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

NOTE 19. Financial Instruments with Off-Balance-Sheet Risk

In the normal course of business, the Company is a party to various financial instruments with off-balance-sheet risk, primarily to meet the needs of customers as well as to manage interest rate risk. These instruments, which are issued by the Company for purposes other than trading, carry varying degrees of credit, interest rate or liquidity risk in excess of the amounts reflected in the consolidated balance sheets.

Commitments to Extend Credit

Commitments to extend credit are agreements to lend to a customer, which are binding, provided there is no violation of any condition in the contract, and generally have fixed expiration dates or other termination clauses. The contractual amount represents the Bank's exposure to credit losses in the event of default by the borrower. At December 31, 2018, based on current information, no losses were anticipated as a result of these commitments. The Bank manages this credit risk by using the same credit policies it applies to loans. Collateral is obtained to secure commitments based on management's credit assessment of the borrower. The collateral may include marketable securities, receivables, inventory, equipment or real estate. Since the Bank expects many of the commitments to expire without being drawn, total commitment amounts do not necessarily represent the Bank's future liquidity requirements related to such commitments.

In the mortgage banking operations, the Bank commits to extend credit for purposes of originating residential loans. The Bank underwrites these commitments to determine whether each loan meets criteria established by the secondary market for residential loans. See Note 1 and 17 to these consolidated financial statements for more information on financial instruments and derivatives related to mortgage banking operations.

Standby and Commercial Letters of Credit

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Commercial letters of credit are issued on behalf of customers to ensure payment or collection in connection with trade transactions. In the event of a customer's nonperformance, the Bank's credit loss exposure is up to the letter's contractual amount. At December 31, 2018, based on current information, no losses were anticipated as a result of these commitments. Management assesses the borrower's creditworthiness to determine the necessary collateral, which may include marketable securities, real estate, accounts receivable and inventory. Since the conditions requiring the Bank to fund letters of credit may not occur, the Bank expects the liquidity requirements related to such letters of credit to be less than the total outstanding commitments.

The contractual amounts of these financial instruments were as follows as of December 31 (in thousands):

	2018		2017	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Commitments to extend credit	\$ 10,407	\$ 67,894	\$ 15,573	\$ 62,052
Standby and commercial letters of credit	18	877	220	829

In addition to the amounts in the table above, mortgage banking commitments to fund loans totaled \$70.8 million at December 31, 2018 and \$75.9 million at December 31, 2017. Mortgage banking commitments to sell loans totaled \$93.3 million at December 31, 2018 and \$111.7 million at December 31, 2017.

Performance and Financial Standby Letters of Credit

As of December 31, 2018 and 2017, the Bank had outstanding \$13 thousand and \$238 thousand, respectively, of performance standby letters of credit and \$3.7 million and \$4.1 million, respectively, of financial standby letters of credit. Performance standby letters of credit are irrevocable obligations to the beneficiary on the part of the Bank to make payment on account in an event of default by the account party in the performance of a nonfinancial or commercial obligation. Financial standby letters of credit are irrevocable obligations to the beneficiary on the part of the Bank to repay money for the account of the account party or to make payment on account of any indebtedness undertaken by the account party, in the event that the account party fails to fulfill its obligation to the beneficiary.

Under these arrangements, the Bank could, in the event of the account party's nonperformance, be required to pay a maximum of the amount of issued letters of credit. The Bank has recourse against the account party up to and including the amount of the performance standby letter of credit. The Bank evaluates each account party's creditworthiness on a case-by-case basis and the amount of collateral obtained varies and is based on management's credit evaluation of the account party.

Mortgage Banking Obligations

Through its mortgage banking operations, the Company originates and sells residential mortgage loans servicing released to third parties. These loans are sold without recourse to the Company. Although the Company sells mortgage banking loans without recourse, industry standards require standard representations and warranties which require sellers to reimburse investors for economic losses if loans default or prepay after the sale. Repurchase risk is also evident within the mortgage banking industry as continued disputes arise between lenders and investors. Such requests for repurchase are commonly due to faulty representation and generally emerge at varied timeframes subsequent to the original sale of the loan. To estimate the contingent obligation, the Company tracks historical reimbursements and calculates the ratio of reimbursement to loan production volumes. Using reimbursement ratios and recent production levels, the Company estimates the future reimbursement amounts and records the estimated obligation. The following is a summary of activity related to mortgage banking reimbursement obligations at December 31 (in thousands):

	<u>2018</u>	<u>2017</u>
Balance, beginning of period	\$ 1,103	\$ 1,339
Provision	-	-
Write offs, net	(121)	(236)
Balance, end of period	<u>\$ 982</u>	<u>\$ 1,103</u>

NOTE 20. Commitments and Contingencies

Leases

The Bank has entered into operating lease agreements for certain facilities and equipment used in its operations. Rent expense for the years ended December 31, 2018 and 2017 was \$1.3 million and \$1.2 million, respectively, for facilities, and \$20 thousand and \$25 thousand, respectively, for equipment and other items. At December 31, 2018, the total minimum annual base lease payments for operating leases were as follows (in thousands):

2019	\$ 1,155
2020	998
2021	820
2022	725
2023	682
Thereafter	855

Small Business Investment Companies (SBIC)

The Bank has made investments in the Small Business Administration's SBIC program to enhance small business access to venture capital. At December 31, 2018, the Bank may be required to fund \$1.4 million of additional capital calls related to its SBIC investments.

Legal Proceedings

From time to time, the Company may be a party to legal proceedings arising from lending, deposit operations or other activities. While the Company is not aware of any such actions or allegations that should reasonably give rise to any material adverse effect, it is possible that the Company could be subject to such a claim in an amount that could be material. Based upon a review with legal counsel, the Company believes that the ultimate disposition of any such litigation will not have a material effect on the Company's financial condition, results of operations or cash flows.

NOTE 21. Income Taxes

Income tax expense (benefit) consists of the following for the years ended December 31 (in thousands):

	<u>2018</u>	<u>2017</u>
Current:		
Federal	\$ 1,281	\$ 1,232
State	345	270
	<u>1,626</u>	<u>1,502</u>
Deferred:		
Federal	(72)	1,459
State	(16)	59
	<u>(88)</u>	<u>1,518</u>
Total	<u>\$ 1,538</u>	<u>\$ 3,020</u>

On December 22, 2017 the Tax Cuts and Jobs Act was signed into Federal law (2017 Tax Act). The 2017 Tax Act restructured the corporate tax rates from a graduated schedule with a maximum enacted tax rate of 35.0% to a flat enacted income tax rate of 21.0% for tax years beginning after December 31, 2017. As a result of this enactment, 2017 includes a \$1.208 million income tax charge to revalue net deferred tax assets.

The reconciliation between income tax expense computed by applying the statutory federal income tax rate of 21.0% for the year ended December 31, 2018 and 34.0% for the year ended December 31, 2017 is as follows (in thousands):

	<u>2018</u>	<u>2017</u>
Statutory federal income tax expense	\$ 1,759	\$ 2,686
Impact related to the 2017 Tax Act	-	1,208
State income taxes, net of federal income tax benefit	260	217
Tax-exempt interest income	(325)	(895)
Tax-exempt life insurance	(91)	(147)
Other, net	(65)	(49)
Total	<u>\$ 1,538</u>	<u>\$ 3,020</u>

Temporary differences between the financial statement carrying amounts and tax bases of assets and liabilities that result in significant portions of the Company's deferred tax assets and liabilities are as follows as of December 31 (in thousands):

	<u>2018</u>	<u>2017</u>
Deferred tax assets:		
Loans, primarily due to credit losses	\$ 1,975	\$ 2,045
Compensation	446	406
Unrealized loss on investment securities available for sale	2,624	347
Acquired intangibles	122	125
Net operating loss carryforwards	19	19
Other	174	144
Deferred tax assets	<u>5,360</u>	<u>3,086</u>
Deferred tax liabilities:		
Discount accretion on securities	47	15
Premises and equipment	395	499
Other	134	154
Deferred tax liabilities	<u>576</u>	<u>668</u>
	4,784	2,418
Valuation allowance	<u>(14)</u>	<u>(14)</u>
Net deferred tax assets	<u>\$ 4,770</u>	<u>\$ 2,404</u>

Subject to certain limiting statutes, the Company is able to carry forward state tax net operating losses aggregating \$431 thousand as of December 31, 2018. The state net operating losses expire between 2024 and 2031.

Tax years ended December 31, 2015 through 2018 remain open to federal examination. Tax years ended December 31, 2014 through 2018 remain open to state examinations.

The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by taxing authorities, based upon the technical merits of the position. The tax benefit recognized in the consolidated financial statements from such a position is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Also, interest and penalties expense is recognized on the full amount of deferred benefits for uncertain tax positions. The Company's policy is to include interest and penalties related to unrecognized tax benefits in income tax expense within the consolidated statements of income. At December 31, 2018 and 2017, the Company did not have any uncertain tax positions.

NOTE 22. Earnings Per Share

The following table shows the amounts used in computing per share results (in thousands, except share and per share data):

	<u>2018</u>	<u>2017</u>
Denominator for basic earnings per share:		
Average common shares outstanding	3,487,846	3,474,988
Dilutive effect of share-based compensation	<u>51,909</u>	<u>65,710</u>
Denominator for diluted earnings per share	3,539,755	3,540,698
Numerator (in thousands):		
Net income	<u>\$ 6,836</u>	<u>\$ 4,878</u>
Basic earnings per common share	<u>\$ 1.96</u>	<u>\$ 1.40</u>
Diluted earnings per common share	<u>\$ 1.93</u>	<u>\$ 1.38</u>

NOTE 23. Related-Party Transactions

The Bank has entered into transactions with related parties, such as opening deposit accounts for and extending credit to employees of the Company. The related party transactions have been made under terms substantially the same as those offered by the Bank to unrelated parties.

In the normal course of business, loans are granted to, and deposits are received from, executive officers, directors, principal stockholders and associates of such persons. The aggregate dollar amount of these loans was \$897 thousand and \$1.1 million at December 31, 2018 and 2017, respectively. Advances of loans to related parties in 2018 and 2017 totaled \$247 thousand and \$170 thousand, respectively. Loan pay downs and other reductions by related parties in 2018 and 2017 were \$475 thousand and \$561 thousand, respectively. Commitments to extend credit to related parties increased to \$289 thousand at December 31, 2018 from \$239 thousand at December 31, 2017. The total amount of deposits received from these parties was \$1.0 million at December 31, 2018 and \$930 thousand at December 31, 2017. Loans to, and deposits received from, these parties were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collection.

In 2017, the Company purchased a \$500 thousand death benefit right on a split dollar life insurance policy from a director for \$250 thousand.

The Federal Reserve Act limits amounts of, and requires collateral on, extensions of credit by the Bank to BNCCORP, and with certain exceptions, its non-bank affiliates. There are also restrictions on the amounts of investment by the Bank in stocks and other subsidiaries of BNCCORP and such affiliates and restrictions on the acceptance of their securities as collateral for loans by the Bank. As of December 31, 2018, BNCCORP and its affiliates were in compliance with these requirements.

NOTE 24. Benefit Plans

BNCCORP has a qualified 401(k) savings plan covering all employees of BNCCORP and subsidiaries who meet specified age and service requirements. Under the plan, eligible employees may elect to defer up to 75% of compensation each year not to exceed the dollar limits set by law. At their discretion, BNCCORP and its subsidiaries may provide matching contributions to the plan. In 2018 and 2017, BNCCORP and subsidiaries made matching contributions of up to 50% of eligible employee deferrals up to a maximum employer contribution of 5% of employee compensation. Generally, all participant contributions and earnings are fully and immediately vested. The Company makes its matching contribution during the first calendar quarter following the last day of each calendar year and an employee must be employed by the Company on the last day of the calendar year in order to receive

the current year's employer matching contribution. The anticipated matching contribution is expensed monthly over the course of the calendar year based on employee contributions made throughout the year. The Company made matching contributions of \$646,000 and \$620,000 for 2018 and 2017, respectively. Under the investment options available under the 401(k) savings plan, prior to January 28, 2008, employees could elect to invest their salary deferrals in BNCCORP common stock. At December 31, 2018, the assets in the plan totaled \$25.4 million and included \$544,000 (27,000 shares) invested in BNCCORP common stock. At December 31, 2017, the assets in the plan totaled \$26.2 million and included \$869,000 (28,000 shares) invested in BNCCORP common stock. On January 28, 2008, the Company voluntarily delisted from the NASDAQ Global Market and deregistered its common stock under the Securities Exchange Act of 1934 (as amended). As a result, the participants are prohibited from making new investments of the Company's common stock in the plan.

During 2015, the Company adopted a non-qualified deferred compensation plan for the benefit of select employees. The plan structure permits the Company to make discretionary awards into an in-service account or a retirement account of a plan participant established under the plan. BNC recognizes the expense for discretionary awards in the period it commits to such awards. Additionally, plan participants may defer some or all of their annual cash incentive awards into their in-service accounts. Company discretionary awards to the participant's in-service account are generally vested 50% upon initial participation with the remainder vesting ratably over 5 years. A participant's retirement account generally vests 50% upon an initial contribution and ratably thereafter over 10 years. Participants may allocate their in-service account balance among a fixed number of investment options. The value of the payout from the in-service account will depend on the performance of such investment options. Company discretionary awards into a participant's retirement account are denominated in shares of BNC common stock and upon retirement, the plan participant will receive the number of shares of BNC common stock credited to the participant's retirement account at that time. A separate Rabbi Trust has been established by the Company to offset the change in value of this liability. Assets in the trust offsetting in-service liabilities are recorded in other assets. BNC common stock held in the trust related to the Company's retirement account obligation is recorded in treasury stock and equates to 27,192 shares as of December 31, 2018 and 22,800 shares as of December 31, 2017. As of December 31, 2018, the plan obligation totaled \$985 thousand and \$878 thousand as of December 31, 2017.

In December of 2015, the Company adopted a non-qualified deferred compensation plan for directors of BNCCORP. Effective with 2016 service, a director may voluntarily make contributions of earned director compensation to a deferred account that is ultimately payable with BNC common stock at the time of separation from service with the Company. The deferred shares of BNC common stock were 8,298 shares and 6,464 shares as of December 31, 2018 and 2017, respectively.

NOTE 25. Share-Based Compensation

The Company has four share-based plans for certain key employees and directors whereby shares of BNC common stock have been reserved for awards in the form of stock options, restricted stock, or common stock equivalent awards. Pursuant to each plan, the compensation committee may grant options at prices equal to the fair value of BNC common stock at the grant date. The company generally issues shares held in treasury when options are exercised and restricted stock is granted.

Total shares in plan and total shares available as of December 31, 2018 are as follows:

	<u>1995</u>	<u>2002</u>	<u>2010</u>	<u>2015</u>	<u>Total</u>
Total Shares in Plan	250,000	125,000	250,000	50,000	675,000
Total Shares Available	45,951	-	250,000	39,415	335,366

The Company recognized share-based compensation expense of \$21,000 and \$18,000 for the years ended December 31, 2018 and 2017, respectively, related to restricted stock.

The tax benefits associated with share-based compensation was approximately \$7,000 for the year ended December 31, 2018 and was approximately \$26,000 for the year ended December 31, 2017.

At December 31, 2018, the Company had \$60,000 of unamortized restricted stock compensation, which is expected to be recognized over a period of three years. Restricted shares of stock granted generally have vesting and amortization periods of at least three years.

Following is a summary of restricted stock activities for the years ended December 31:

	2018		2017	
	Number Restricted Stock Shares	Weighted Average Grant Date Fair Value	Number Restricted Stock Shares	Weighted Average Grant Date Fair Value
Non-vested, beginning of year	3,467	\$ 26.45	3,334	\$ 14.57
Granted	-	-	2,800	28.78
Vested	(1,367)	22.86	(2,667)	14.06
Forfeited	-	-	-	-
Non-vested, end of year	<u>2,100</u>	<u>28.78</u>	<u>3,467</u>	<u>26.45</u>

Following is a summary of vested stock options and options expected to vest as of December 31, 2018:

	Stock Options Outstanding	Stock Options Currently Exercisable	Stock Options Vested and Expected to Vest
Number	42,600	42,600	42,600
Weighted-average exercise price	\$3.00	\$3.00	\$3.00
Weighted-average remaining contractual term	1.20 years	1.20 years	1.20 years

Following is a summary of stock option transactions for the years ended December 31:

	2018		2017	
	Options to Purchase Shares	Weighted Average Exercise Price	Options to Purchase Shares	Weighted Average Exercise Price
Outstanding, beginning of year	68,600	\$ 3.00	75,600	\$ 3.00
Granted	-	-	-	-
Exercised	(26,000)	3.00	(7,000)	3.00
Forfeited	-	-	-	-
Outstanding, end of year	<u>42,600</u>	<u>3.00</u>	<u>68,600</u>	<u>3.00</u>
Exercisable, end of year	<u>42,600</u>	<u>3.00</u>	<u>68,600</u>	<u>3.00</u>

The total intrinsic value of options exercised during the year ended December 31, 2018 and 2017 was \$585 thousand and \$171 thousand, respectively. The aggregate intrinsic value of options exercisable as of December 31, 2018 was \$746 thousand.

NOTE 26. Condensed Financial Information-Parent Company Only

Condensed financial information of BNCCORP, INC. on a parent company only basis is as follows:

Parent Company Only
Condensed Balance Sheets
As of December 31
(In thousands, except per share data)

	<u>2018</u>	<u>2017</u>
Assets:		
Cash and cash equivalents	\$ 10,442	\$ 6,550
Investment in subsidiaries	93,098	93,838
Receivable from subsidiaries	481	2,528
Other	437	714
Total assets	<u>\$ 104,458</u>	<u>\$ 103,630</u>
Liabilities and stockholders' equity:		
Subordinated debentures	\$ 15,009	\$ 15,011
Long-term borrowings	10,000	10,000
Payable to subsidiaries	69	76
Accrued expenses and other liabilities	1,627	917
Total liabilities	<u>26,705</u>	<u>26,004</u>
Common stock, \$.01 par value – Authorized 11,300,000 shares; 3,493,298 and 3,465,992 shares issued and outstanding	35	35
Capital surplus – common stock	25,990	26,072
Retained earnings	61,042	54,206
Treasury stock (175,355 and 202,661 shares, respectively)	(2,386)	(2,741)
Accumulated other comprehensive (loss) income, net	(6,928)	54
Total stockholders' equity	<u>77,753</u>	<u>77,626</u>
Total liabilities and stockholders' equity	<u>\$ 104,458</u>	<u>\$ 103,630</u>

Parent Company Only
Condensed Statements of Income
For the Years Ended December 31
(In thousands)

	<u>2018</u>	<u>2017</u>
Income:		
Management fee income	\$ 1,990	\$ 2,075
Interest	24	8
Other	<u>4</u>	<u>28</u>
Total income	<u>2,018</u>	<u>2,111</u>
Expenses:		
Interest	1,195	1,038
Salaries and benefits	1,345	1,388
Legal and other professional	678	729
Other	<u>718</u>	<u>757</u>
Total expenses	<u>3,936</u>	<u>3,912</u>
Loss before income tax benefit and equity in earnings of subsidiaries	(1,918)	(1,801)
Income tax benefit	<u>476</u>	<u>649</u>
Loss before equity in earnings of subsidiaries	(1,442)	(1,152)
Equity in earnings of subsidiaries	<u>8,278</u>	<u>6,030</u>
Net income	<u><u>\$ 6,836</u></u>	<u><u>\$ 4,878</u></u>

Parent Company Only
Condensed Statements of Cash Flows
For the Years Ended December 31
(In thousands)

	<u>2018</u>	<u>2017</u>
Operating activities:		
Net income	\$ 6,836	\$ 4,878
Adjustments to reconcile net income to net cash provided by operating activities -		
Equity in earnings of subsidiaries	(8,278)	(6,030)
Dividend paid by subsidiaries	2,500	2,000
Share-based compensation	273	182
Change in other assets	2,325	1,199
Change in other liabilities	236	156
Net cash provided by operating activities	<u>3,892</u>	<u>2,385</u>
Net increase in cash and cash equivalents	3,892	2,385
Cash and cash equivalents, beginning of year	<u>6,550</u>	<u>4,165</u>
Cash and cash equivalents, end of year	<u>\$ 10,442</u>	<u>\$ 6,550</u>
Supplemental cash flow information:		
Interest paid	<u>\$ 1,151</u>	<u>\$ 1,019</u>
Income taxes paid	<u>\$ 990</u>	<u>\$ 707</u>

NOTE 27. Subsequent Events

The Company has evaluated subsequent events from December 31, 2018 through March 26, 2019, which is the date the consolidated financial statements were issued, and determined there are no other items to record or disclose related to subsequent events.