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

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2019

Or

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

For the transition period from ______ to ______

Commission file number: 001-33033

LIMESTONE BANCORP, INC.

(Exact name of registrant as specified in its charter)

Kentucky **(State or other jurisdiction of incorporation or organization)**	**61-1142247** **(I.R.S. Employer Identification No.)**
2500 Eastpoint Parkway, Louisville, Kentucky **(Address of principal executive offices)**	**40223** **(Zip Code)**

(502) 499-4800
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common shares	LMST	Nasdaq

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

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

Large accelerated filer ☐	Accelerated filer ☒
Non-accelerated filer ☐	Smaller reporting company ☒
	Emerging growth company ☐

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

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

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

6,251,332 Common Shares and 1,220,000 Non-Voting Common Shares were outstanding at October 31, 2019.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

The following consolidated financial statements of Limestone Bancorp, Inc. and subsidiary, Limestone Bank, Inc. are submitted:

Unaudited Consolidated Balance Sheets for September 30, 2019 and December 31, 2018
Unaudited Consolidated Statements of Income for the three and nine months ended September 30, 2019 and 2018
Unaudited Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2019 and 2018
Unaudited Consolidated Statement of Changes in Stockholders’ Equity for the three and nine months ended September 30, 2019 and 2018
Unaudited Consolidated Statements of Cash Flows for the nine months ended September 30, 2019 and 2018
Notes to Unaudited Consolidated Financial Statements

LIMESTONE BANCORP, INC.
Unaudited Consolidated Balance Sheets
(dollars in thousands except share data)

	September 30, 2019	December 31, 2018
Assets		
Cash and due from banks	$ 7,680	$ 6,963
Interest bearing deposits in banks	50,327	28,398
Cash and cash equivalents	58,007	35,361
Securities available for sale	203,381	201,192
Loans, net of allowance of $8,904 and $8,880, respectively	794,665	756,364
Premises and equipment, net	15,098	14,655
Premises held for sale	935	1,050
Other real estate owned	3,225	3,485
Federal Home Loan Bank stock	6,467	7,233
Bank owned life insurance	15,946	15,646
Deferred taxes, net	28,029	29,282
Accrued interest receivable and other assets	6,411	5,424
Total assets	$ 1,132,164	$ 1,069,692
Liabilities and Stockholders' Equity		
Deposits		
Non-interest bearing	$ 151,524	$ 142,618
Interest bearing	771,910	751,613
Total deposits	923,434	894,231
Federal Home Loan Bank advances	56,430	46,549
Accrued interest payable and other liabilities	4,973	5,815
Junior subordinated debentures	21,000	21,000
Subordinated capital note	17,000	—
Senior debt	5,000	10,000
Total liabilities	1,027,837	977,595
Commitments and contingent liabilities (Note 13)	—	—
Stockholders' equity		
Common stock, no par, 39,000,000 shares authorized, 6,251,582 and 6,242,720 voting, and 1,220,000 and 1,220,000 non-voting issued and outstanding, respectively	140,639	140,639
Additional paid-in capital	24,328	24,287
Retained deficit	(57,447)	(66,201)
Accumulated other comprehensive loss	(3,193)	(6,628)
Total stockholders' equity	104,327	92,097
Total liabilities and stockholders' equity	$ 1,132,164	$ 1,069,692

See accompanying notes to unaudited consolidated financial statements.

LIMESTONE BANCORP, INC.
Unaudited Consolidated Statements of Income
(dollars in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Interest income				
Loans, including fees	$ 10,671	$ 9,539	$ 31,390	$ 27,423
Taxable securities	1,553	1,245	4,734	3,386
Tax exempt securities	76	95	257	287
Federal funds sold and other	185	241	666	624
	12,485	11,120	37,047	31,720
Interest expense				
Deposits	3,105	2,130	8,657	5,123
Federal Home Loan Bank advances	132	233	668	605
Senior debt	77	98	271	292
Junior subordinated debentures	251	247	772	694
Subordinated capital note	190	—	190	39
	3,755	2,708	10,558	6,753
Net interest income	8,730	8,412	26,489	24,967
Provision (negative provision) for loan losses	—	(350)	—	(500)
Net interest income after provision for loan losses	8,730	8,762	26,489	25,467
Non-interest income				
Service charges on deposit accounts	633	608	1,700	1,767
Bank card interchange fees	623	411	1,727	1,258
Income from bank owned life insurance	97	100	314	337
Net loss on sales and calls of investment securities	—	—	(5)	(6)
Other	181	390	528	751
	1,534	1,509	4,264	4,107
Non-interest expense				
Salaries and employee benefits	4,202	3,893	12,032	11,566
Occupancy and equipment	880	896	2,632	2,671
Professional fees	254	186	598	613
Marketing expense	251	259	690	867
FDIC Insurance	—	118	211	439
Data processing expense	315	281	943	912
State franchise and deposit tax	315	282	945	846
Deposit account related expense	300	213	891	653
Other real estate owned expense	25	271	333	590
Litigation and loan collection expense	32	61	112	162
Other	877	770	2,569	2,485
	7,451	7,230	21,956	21,804
Income before income taxes	2,813	3,041	8,797	7,770
Income tax expense	531	604	43	1,416
Net income	2,282	2,437	8,754	6,354
Basic and diluted income per common share	$ 0.31	$ 0.33	$ 1.17	$ 0.90

See accompanying notes to unaudited consolidated financial statements.

LIMESTONE BANCORP, INC.
Unaudited Consolidated Statements of Comprehensive Income (Loss)
(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Net income	$ 2,282	$ 2,437	$ 8,754	$ 6,354
Other comprehensive income (loss):				
Unrealized gain (loss) on securities:				
Unrealized gain (loss) arising during the period	588	(1,006)	4,465	(3,234)
Reclassification adjustment for gains (losses) included in net income	—	—	(5)	—
Net unrealized gain (loss) recognized in comprehensive income	588	(1,006)	4,470	(3,234)
Tax effect	(146)	211	(1,035)	680
Other comprehensive income (loss)	442	(795)	3,435	(2,554)
Comprehensive income	$ 2,724	$ 1,642	$ 12,189	$ 3,800

See accompanying notes to unaudited consolidated financial statements.

LIMESTONE BANCORP, INC.
Unaudited Consolidated Statements of Changes in Stockholders' Equity
For Three and Nine Months Ended September 30, 2019 and 2018
(Dollar amounts in thousands except share and per share data)

	Shares					Amount						
	Preferred		Common			Preferred		Common				
	Series E	Series F	Common	Non-Voting Common	Total Common	Series E	Series F	Common and Non-Voting Common	Additional Paid-In Capital	Retained Deficit	Accumulated Other Comprehensive Income (Loss)	Total
Balances, January 1, 2019	—	—	6,242,720	1,220,000	7,462,720	$ —	$ —	$ 140,639	$ 24,287	$ (66,201)	$ (6,628)	$ 92,097
Stock issued for share-based awards, net of withholdings to satisfy employee tax obligations upon award	—	—	1,642	—	1,642	—	—	—	(276)	—	—	(276)
Forfeited unvested stock	—	—	(3,748)	—	(3,748)	—	—	—	—	—	—	—
Stock-based compensation expense	—	—	—	—	—	—	—	—	82	—	—	82
Net income	—	—	—	—	—	—	—	—	—	2,839	—	2,839
Net change in accumulated other comprehensive income, net of taxes	—	—	—	—	—	—	—	—	—	—	1,577	1,577
Balances, March 31, 2019	—	—	6,240,614	1,220,000	7,460,614	$ —	$ —	$ 140,639	$ 24,093	$ (63,362)	$ (5,051)	$ 96,319
Stock issued for share-based awards, net of withholdings to satisfy employee tax obligations upon award	—	—	(2,532)	—	(2,532)	—	—	—	(39)	—	—	(39)
Forfeited unvested stock	—	—	(250)	—	(250)	—	—	—	—	—	—	—
Stock-based compensation expense	—	—	—	—	—	—	—	—	93	—	—	93
Net income	—	—	—	—	—	—	—	—	—	3,633	—	3,633
Net change in accumulated other comprehensive income, net of taxes	—	—	—	—	—	—	—	—	—	—	1,416	1,416
Balances, June 30, 2019	—	—	6,237,832	1,220,000	7,457,832	$ —	$ —	$ 140,639	$ 24,147	$ (59,729)	$ (3,635)	$ 101,422
Stock issued for share-based awards, net of withholdings to satisfy employee tax obligations upon award	—	—	13,750	—	13,750	—	—	—	—	—	—	—
Forfeited unvested stock	—	—	—	—	—	—	—	—	—	—	—	—
Stock-based compensation expense	—	—	—	—	—	—	—	—	181	—	—	181
Net income	—	—	—	—	—	—	—	—	—	2,282	—	2,282
Net change in accumulated other comprehensive income, net of taxes	—	—	—	—	—	—	—	—	—	—	442	442
Balances, September 30, 2019	—	—	6,251,582	1,220,000	7,471,582	$ —	$ —	$ 140,639	$ 24,328	$ (57,447)	$ (3,193)	$ 104,327

See accompanying notes to unaudited consolidated financial statements.

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LIMESTONE BANCORP, INC.
Unaudited Consolidated Statements of Changes in Stockholders' Equity
For Three and Nine Months Ended September 30, 2019 and 2018
(Dollar amounts in thousands except share and per share data)

	Shares					Amount						
	Preferred		Common			Preferred		Common				
	Series E	Series F	Common	Non-Voting Common	Total Common	Series E	Series F	Common and Non-Voting Common	Additional Paid-In Capital	Retained Deficit	Accumulated Other Comprehensive Income (Loss)	Total
Balances, January 1, 2018	6,198	4,304	6,039,864	220,000	6,259,864	$ 1,644	$ 1,127	$ 125,729	$ 24,497	$ (75,108)	$ (5,216)	$ 72,673
Stock issued for share-based awards, net of withholdings to satisfy employee tax obligations upon award	—	—	—	—	—	—	—	—	—	—	—	—
Forfeited unvested stock	—	—	—	—	—	—	—	—	—	—	—	—
Issuance of stock	—	—	150,000	1,000,000	1,150,000	—	—	14,910	—	—	—	14,910
Stock-based compensation expense	—	—	—	—	—	—	—	—	64	—	—	64
Net income	—	—	—	—	—	—	—	—	—	1,934	—	1,934
Reclassification of disproportionate tax effect due to change in federal tax rate	—	—	—	—	—	—	—	—	—	113	(113)	—
Net change in accumulated other comprehensive income, net of taxes	—	—	—	—	—	—	—	—	—	—	(1,351)	(1,351)
Balances, March 31, 2018	6,198	4,304	6,189,864	1,220,000	7,409,864	$ 1,644	$ 1,127	$ 140,639	$ 24,561	$ (73,061)	$ (6,680)	$ 88,230
Stock issued for share-based awards, net of withholdings to satisfy employee tax obligations upon award	—	—	45,129	—	45,129	—	—	—	—	—	—	—
Forfeited unvested stock	—	—	—	—	—	—	—	—	—	—	—	—
Redemption and retirement of preferred shares	(6,198)	(4,304)	—	—	—	(1,644)	(1,127)	—	(734)	—	—	(3,505)
Stock-based compensation expense	—	—	—	—	—	—	—	—	99	—	—	99
Net income	—	—	—	—	—	—	—	—	—	1,983	—	1,983
Net change in accumulated other comprehensive income, net of taxes	—	—	—	—	—	—	—	—	—	—	(408)	(408)
Balances, June 30, 2018	—	—	6,234,993	1,220,000	7,454,993	$ —	$ —	$ 140,639	$ 23,926	$ (71,078)	$ (7,088)	$ 86,399
Stock issued for share-based awards, net of withholdings to satisfy employee tax obligations upon award	—	—	1,597	—	1,597	—	—	—	—	—	—	—
Forfeited unvested stock	—	—	—	—	—	—	—	—	—	—	—	—
Redemption and retirement of preferred shares	—	—	—	—	—	—	—	—	—	—	—	—
Stock-based compensation expense	—	—	—	—	—	—	—	—	171	—	—	171
Net income	—	—	—	—	—	—	—	—	—	2,437	—	2,437
Net change in accumulated other comprehensive income, net of taxes	—	—	—	—	—	—	—	—	—	—	(795)	(795)
Balances, September 30, 2018	—	—	6,236,590	1,220,000	7,456,590	$ —	$ —	$ 140,639	$ 24,097	$ (68,641)	$ (7,883)	$ 88,212

See accompanying notes to unaudited consolidated financial statements.

LIMESTONE BANCORP, INC.
Unaudited Consolidated Statements of Cash Flows
For Nine Months Ended September 30, 2019 and 2018
(dollars in thousands)

	2019	2018
Cash flows from operating activities		
Net income	$ 8,754	$ 6,354
Adjustments to reconcile net income to net cash from operating activities		
Depreciation and amortization	1,310	739
Provision (negative provision) for loan losses	—	(500)
Net amortization on securities	530	669
Stock-based compensation expense	356	334
Deferred taxes, net	215	1,762
Net gain on sales of loans held for sale	—	(1)
Proceeds from sales of loans held for sale	—	71
Net gain on sales of other real estate owned	—	(72)
Net write-down of other real estate owned	260	585
Net gain on sales of premises and equipment	(1)	(46)
Net realized loss on sales and calls of investment securities	5	6
Net write-down on premises held for sale	115	—
Earnings on bank owned life insurance, net of premium expense	(300)	(322)
Net change in accrued interest receivable and other assets	(987)	(950)
Net change in accrued interest payable and other liabilities	(1,165)	(395)
Net cash from operating activities	9,092	8,234
Cash flows from investing activities		
Purchases of available for sale securities	(14,894)	(58,965)
Sales and calls of available for sale securities	3,452	6,054
Maturities and prepayments of available for sale securities	13,190	16,852
Proceeds from mandatory redemptions of FHLB stock	766	90
Proceeds from sale of other real estate owned	—	876
Loan originations and payments, net	(38,986)	(44,823)
Purchases of premises and equipment, net	(744)	(982)
Proceeds from sale of premises and equipment	1	141
Net cash from investing activities	(37,215)	(80,757)
Cash flows from financing activities		
Net change in deposits	29,203	27,002
Repayment of Federal Home Loan Bank advances	(105,119)	(85,206)
Advances from Federal Home Loan Bank	115,000	125,000
Repayment of subordinated capital note	—	(2,250)
Proceeds from issuance of subordinated capital note	17,000	—
Repayment of senior debt	(5,000)	—
Issuance of common stock	—	14,910
Common shares withheld for taxes	(315)	—
Redemption of preferred stock	—	(3,505)
Net cash from financing activities	50,769	75,951
Net change in cash and cash equivalents	22,646	3,428
Beginning cash and cash equivalents	35,361	34,103
Ending cash and cash equivalents	$ 58,007	$ 37,531
Supplemental cash flow information:		
Interest paid	$ 10,364	$ 7,631
Supplemental non-cash disclosure:		
Transfer from loans to other real estate	—	730
Initial recognition of right-of-use lease assets	507	—

See accompanying notes to unaudited consolidated financial statements.

LIMESTONE BANCORP, INC.
Notes to Unaudited Consolidated Financial Statements

Note 1 – Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation – The consolidated financial statements include Limestone Bancorp, Inc. (Company) and its subsidiary, Limestone Bank (Bank). The Company owns a 100% interest in the Bank. All significant inter-company transactions and accounts have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, the financial statements do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2019 are not necessarily indicative of the results that may be expected for the entire year. A description of other significant accounting policies is presented in the notes to the Consolidated Financial Statements for the year ended December 31, 2018 included in the Company's Annual Report on Form 10-K.

Use of Estimates – To prepare financial statements in conformity with U.S. generally accepted accounting principles, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ.

Reclassifications – Some items in the prior year financial statements were reclassified to conform to the current presentation. The reclassifications did not impact net income or stockholders' equity.

New Accounting Standards – In February 2016, the FASB issued an update ASU No. 2016-02, Leases (Topic 842). Under the new guidance, lessees are required to recognize the following for all leases, with the exception of short-term leases, at the commencement date: a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. The amendments in this update became effective for annual periods and interim periods within those annual periods beginning after December 15, 2018. Based on the Company's existing lease agreements, the impact of adopting the new guidance on the consolidated financial statements was the recording of a $507,000 lease liability and a right of use asset, which is included in other liabilities and premises and equipment, respectively, on the consolidated balance sheet. The adoption of this ASU did not have a meaningful impact on the Company's performance metrics, including regulatory capital ratios and return on average assets. The Company's leases mature through 2024 and have a weighted average discount rate of 6%. The operating lease cost was approximately $65,000 and $195,000 for the three and nine months ended September 30, 2019. At September 30, 2019, the Company had entered into one lease that has yet to commence. The right of use asset and lease liability for the lease yet to commence are estimated to be approximately $1.1 million and are expected to be recorded in the fourth quarter of 2019.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The final standard will change estimates for credit losses related to financial assets measured at amortized cost such as loans, held-to-maturity debt securities, and certain other contracts. For estimating credit losses, the FASB is replacing the incurred loss model with an expected loss model, which is referred to as the current expected credit loss (CECL) model. Under the CECL model, certain financial assets that are carried at amortized cost, such as loans held for investment and held-to-maturity debt securities, are required to be presented at the net amount expected to be collected. The measurement of expected credit losses is to be based on information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This measurement will take place at the time the financial asset is first added to the balance sheet and periodically thereafter. This differs significantly from the "incurred loss" model required under current GAAP, which delays recognition until it is probable a loss has been incurred. The change could materially affect how the allowance for loan losses is determined. The impact of CECL model implementation is being evaluated, but it is expected that a one-time cumulative-effect adjustment to the allowance for loan losses will be recognized in retained earnings on the consolidated balance sheet as of the beginning of the first reporting period in which the new standard is effective, as is consistent with regulatory expectations set forth in interagency guidance. In December 2018, the OCC, The Board of Governors of the Federal Reserve System, and the FDIC approved a final rule to address changes to the credit loss accounting under GAAP, including banking organizations' implementation of CECL. The final rule provides banking organizations the option to phase in over a three-year period the day-one adverse effects on regulatory capital that may result from adoption of the new accounting standard. In October 2019, the FASB voted to delay implementation for smaller reporting companies, private companies, and not-for-profit entities. The Company currently qualifies as a smaller reporting company. Companies qualifying for the delay will be required to implement CECL for fiscal year and interim periods beginning after December 15, 2022.

In March 2017, the FASB issued ASU No. 2017-08, Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization of Purchased Callable Debt Securities. The final standard will shorten the amortization period for premiums on callable debt securities by requiring that premiums be amortized to the first (or earliest) call date instead of as an adjustment to the yield over the contractual life. The standard was effective for public companies for fiscal years beginning after December 15, 2018. Adoption of this new guidance did not have a material impact on the consolidated financial statements.

Note 2 – Securities

Securities are classified as available for sale (AFS). AFS securities may be sold if needed for liquidity, asset liability management, or other reasons. AFS securities are reported at fair value, with unrealized gains or losses included as a separate component of equity, net of tax.

The amortized cost and fair value of securities and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(in thousands)		
September 30, 2019				
Available for sale				
U.S. Government and federal agency	$ 22,674	$ 317	$ (56)	$ 22,935
Agency mortgage-backed: residential	88,884	1,387	(169)	90,102
Collateralized loan obligations	49,851	5	(260)	49,596
State and municipal	29,026	609	(2)	29,633
Corporate bonds	10,926	189	—	11,115
Total available for sale	$ 201,361	$ 2,507	$ (487)	$ 203,381

December 31, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
U.S. Government and federal agency	$ 23,280	$ 2	$ (722)	$ 22,560
Agency mortgage-backed: residential	87,689	192	(1,891)	85,990
Collateralized loan obligations	49,942	—	(103)	49,839
State and municipal	32,841	230	(259)	32,812
Corporate bonds	9,890	127	(26)	9,991
Total available for sale	$ 203,642	$ 551	$ (3,001)	$ 201,192

Sales and calls of securities were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(in thousands)		(in thousands)	
Proceeds	$ 1,000	$ —	$ 3,452	$ 6,054
Gross gains	—	—	1	—
Gross losses	—	—	6	6

The amortized cost and fair value of our debt securities are shown by contractual maturity. Expected maturities may differ from actual maturities when borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities not due at a single maturity date are shown separately.

	September 30, 2019	
	Amortized Cost	Fair Value
	(in thousands)	
Maturity		
Available for sale		
Within one year	$ 47,700	$ 47,548
One to five years	37,548	38,168
Five to ten years	26,229	26,563
Beyond ten years	1,000	1,000
Agency mortgage-backed: residential	88,884	90,102
Total	$ 201,361	$ 203,381

Securities pledged at September 30, 2019 and December 31, 2018 had carrying values of approximately $74.6 million and $64.4 million, respectively, and were pledged to secure public deposits.

At September 30, 2019 and December 31, 2018, the Bank held securities issued by the Commonwealth of Kentucky or Kentucky municipalities having a book value of $14.7 million and $15.3 million, respectively. At September 30, 2019 and December 31, 2018, there were no other holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of stockholders' equity.

The Bank owns Collateralized Loan Obligations (CLOs), which are debt securities secured by professionally managed portfolios of senior-secured loans to corporations. CLO managers are typically large non-bank financial institutions or banks and are typically $300 million to $1 billion in size, contain one hundred or more loans, have five to six credit tranches ranging from AAA, AA, A, BBB, BB, B and equity tranche. Interest and principal are paid first to the AAA tranche then to the next lower rated tranche. Losses are borne first by the equity tranche then by the subsequently higher rated tranche. CLOs may be less liquid than government securities from time to time and volatility in the CLO market may cause the value of these investments to decline.

The market value of CLOs may be affected by, among other things, changes in composition of the underlying loans, changes in the cash flows from the underlying loans, defaults and recoveries on the underlying loans, capital gains and losses on the underlying loans, and prepayments on the underlying loans.

At September 30, 2019, $33.0 million and $16.6 million of our CLOs were AA and A rated, respectively. There were no CLOs rated below A and none of the CLOs were subject to ratings downgrade in the nine months ended September 30, 2019. All of the Bank's CLOs are floating rate, with rates set on a quarterly basis at three-month LIBOR plus a spread.

The Company evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, underlying credit quality of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, the Company may consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, the sector or industry trends and cycles affecting the issuer, and the results of reviews of the issuer's financial condition. As of September 30, 2019, management does not believe any securities in the portfolio with unrealized losses should be classified as other than temporarily impaired.

Securities with unrealized losses at September 30, 2019 and December 31, 2018, aggregated by investment category and length of time the individual securities have been in a continuous unrealized loss position, are as follows:

Description of Securities	Less than 12 Months Fair Value	Less than 12 Months Unrealized Loss	12 Months or More Fair Value	12 Months or More Unrealized Loss	Total Fair Value	Total Unrealized Loss
			(in thousands)			
September 30, 2019						
Available for sale						
U.S. Government and federal agency	$ 9,128	$ (56)	$ —	$ —	$ 9,128	$ (56)
Agency mortgage-backed: residential	11,701	(34)	12,315	(135)	24,016	(169)
Collateralized loan obligations	19,893	(178)	15,568	(82)	35,461	(260)
State and municipal	—	—	934	(2)	934	(2)
Corporate bonds	—	—	—	—	—	—
Total temporarily impaired	$ 40,722	$ (268)	$ 28,817	$ (219)	$ 69,539	$ (487)
December 31, 2018						
Available for sale						
U.S. Government and federal agency	$ 3,431	$ (57)	$ 17,212	$ (665)	$ 20,643	$ (722)
Agency mortgage-backed: residential	30,229	(343)	40,932	(1,548)	71,161	(1,891)
Collateralized loan obligations	48,294	(103)	—	—	48,294	(103)
State and municipal	6,133	(29)	7,252	(230)	13,385	(259)
Corporate Bonds	3,569	(26)	—	—	3,569	(26)
Total temporarily impaired	$ 91,656	$ (558)	$ 65,396	$ (2,443)	$ 157,052	$ (3,001)

Note 3 – Loans

Loans net of unearned income, deferred loan origination costs, and net premiums on acquired loans by class were as follows:

	September 30, 2019	December 31, 2018
	(in thousands)	
Commercial	$ 135,981	$ 129,368
Commercial Real Estate:		
Construction	66,351	86,867
Farmland	82,593	77,937
Nonfarm nonresidential	194,660	172,177
Residential Real Estate:		
Multi-family	59,385	49,757
1-4 Family	166,412	175,761
Consumer	52,347	39,104
Agriculture	45,357	33,737
Other	483	536
Subtotal	803,569	765,244
Less: Allowance for loan losses	(8,904)	(8,880)
Loans, net	$ 794,665	$ 756,364

The following table presents the activity in the allowance for loan losses by portfolio segment for the three months ended September 30, 2019 and 2018:

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer (in thousands)	Agriculture	Other	Total
September 30, 2019:							
Beginning balance	$ 1,492	$ 4,453	$ 2,327	$ 153	$ 405	$ 2	$ 8,832
Provision (negative provision)	(68)	341	(686)	354	60	(1)	–
Loans charged off	(10)	(32)	(73)	(184)	–	–	(299)
Recoveries	6	7	345	9	3	1	371
Ending balance	$ 1,420	$ 4,769	$ 1,913	$ 332	$ 468	$ 2	$ 8,904
September 30, 2018:							
Beginning balance	$ 1,133	$ 4,234	$ 2,778	$ 66	$ 367	$ 2	$ 8,580
Provision (negative provision)	65	(48)	(393)	21	5	–	(350)
Loans charged off	(50)	–	(78)	(15)	–	–	(143)
Recoveries	10	295	231	9	2	–	547
Ending balance	$ 1,158	$ 4,481	$ 2,538	$ 81	$ 374	$ 2	$ 8,634

The following table presents the activity in the allowance for loan losses by portfolio segment for the nine months ended September 30, 2019 and 2018:

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer (in thousands)	Agriculture	Other	Total
September 30, 2019:							
Beginning balance	$ 1,299	$ 4,676	$ 2,452	$ 130	$ 321	$ 2	$ 8,880
Provision (negative provision)	30	130	(838)	531	148	(1)	–
Loans charged off	(10)	(47)	(190)	(398)	(4)	–	(649)
Recoveries	101	10	489	69	3	1	673
Ending balance	$ 1,420	$ 4,769	$ 1,913	$ 332	$ 468	$ 2	$ 8,904
September 30, 2018:							
Beginning balance	$ 892	$ 4,032	$ 2,900	$ 64	$ 313	$ 1	$ 8,202
Provision (negative provision)	61	(68)	(557)	7	60	(3)	(500)
Loans charged off	(50)	(198)	(166)	(49)	(12)	(8)	(483)
Recoveries	255	715	361	59	13	12	1,415
Ending balance	$ 1,158	$ 4,481	$ 2,538	$ 81	$ 374	$ 2	$ 8,634

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on the impairment method as of September 30, 2019:

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer (in thousands)	Agriculture	Other	Total
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$ 1	$ 32	$ –	$ –	$ –	$ –	$ 33
Collectively evaluated for impairment	1,419	4,737	1,913	332	468	2	8,871
Total ending allowance balance	$ 1,420	$ 4,769	$ 1,913	$ 332	$ 468	$ 2	$ 8,904
Loans:							
Loans individually evaluated for impairment	$ 75	$ 723	$ 1,739	$ 153	$ 65	$ –	$ 2,755
Loans collectively evaluated for impairment	135,906	342,881	224,058	52,194	45,292	483	800,814
Total ending loans balance	$ 135,981	$ 343,604	$ 225,797	$ 52,347	$ 45,357	$ 483	$ 803,569

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on the impairment method as of December 31, 2018:

	Commercial	Commercial Real Estate	Residential Real Estate	Consumer (in thousands)	Agriculture	Other	Total
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$ –	$ 35	$ 168	$ –	$ –	$ –	$ 203
Collectively evaluated for impairment	1,299	4,641	2,284	130	321	2	8,677
Total ending allowance balance	$ 1,299	$ 4,676	$ 2,452	$ 130	$ 321	$ 2	$ 8,880
Loans:							
Loans individually evaluated for impairment	$ 53	$ 510	$ 2,348	$ –	$ –	$ –	$ 2,911
Loans collectively evaluated for impairment	129,315	336,471	223,170	39,104	33,737	536	762,333
Total ending loans balance	$ 129,368	$ 336,981	$ 225,518	$ 39,104	$ 33,737	$ 536	$ 765,244

Impaired Loans

Impaired loans include restructured loans and loans on nonaccrual or classified as doubtful, whereby collection of the total amount is improbable, or loss, whereby all or a portion of the loan has been written off or a specific allowance for loss has been provided.

The following tables present information related to loans individually evaluated for impairment by class of loans as of September 30, 2019 and December 31, 2018 and for the three and nine months ended September 30, 2019 and 2018:

	As of September 30, 2019			Three Months Ended September 30, 2019		Nine Months Ended September 30, 2019	
	Unpaid Principal Balance	Recorded Investment	Allowance For Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(in thousands)						
With No Related Allowance Recorded:							
Commercial	$ 138	$ 50	$ —	$ 66	$ 2	$ 59	$ 2
Commercial real estate:							
Construction	—	—	—	—	—	—	—
Farmland	340	198	—	202	2	150	10
Nonfarm nonresidential	689	234	—	237	2	247	9
Residential real estate:							
Multi-family	—	—	—	—	—	—	—
1-4 Family	2,641	1,739	—	1,588	132	1,566	182
Consumer	332	153	—	76	2	45	4
Agriculture	65	65	—	65	—	49	—
Other	—	—	—	—	—	—	—
Subtotal	4,205	2,439	—	2,234	140	2,116	207
With An Allowance Recorded:							
Commercial	25	25	1	26	1	13	2
Commercial real estate:							
Construction	—	—	—	—	—	—	—
Farmland	291	291	32	292	7	225	7
Nonfarm nonresidential	—	—	—	—	—	—	—
Residential real estate:							
Multi-family	—	—	—	—	—	—	—
1-4 Family	—	—	—	356	7	537	28
Consumer	—	—	—	—	—	—	—
Agriculture	—	—	—	—	—	—	—
Other	—	—	—	—	—	—	—
Subtotal	316	316	33	674	15	775	37
Total	$ 4,521	$ 2,755	$ 33	$ 2,908	$ 155	$ 2,891	$ 244

	As of December 31, 2018			Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	Unpaid Principal Balance	Recorded Investment	Allowance For Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(in thousands)						
With No Related Allowance Recorded:							
Commercial	$ 120	$ 53	$ —	$ 33	$ —	$ 143	$ 1
Commercial real estate:							
Construction	—	—	—	—	—	—	—
Farmland	1,860	89	—	974	27	1,423	308
Nonfarm nonresidential	402	262	—	259	11	343	19
Residential real estate:							
Multi-family	—	—	—	—	—	—	—
1-4 Family	2,678	1,628	—	1,591	116	2,048	151
Consumer	12	—	—	—	—	1	—
Agriculture	—	—	—	—	—	—	—
Other	—	—	—	—	—	—	—
Subtotal	5,072	2,032	—	2,857	154	3,958	479
With An Allowance Recorded:							
Commercial	—	—	—	50	—	75	4
Commercial real estate:							
Construction	—	—	—	—	—	—	—
Farmland	—	—	—	171	—	86	—
Nonfarm nonresidential	159	159	35	—	—	—	—
Residential real estate:							
Multi-family	—	—	—	—	—	—	—
1-4 Family	720	720	168	1,102	—	1,208	32
Consumer	—	—	—	—	—	—	—
Agriculture	—	—	—	—	—	—	—
Other	—	—	—	—	—	—	—
Subtotal	879	879	203	1,323	—	1,369	36
Total	$ 5,951	$ 2,911	$ 203	$ 4,180	$ 154	$ 5,327	$ 515

Cash basis income recognized for the three and nine months ended September 30, 2019 was $137,000 and $197,000, respectively, compared to $93,000 and $410,000 for the three and nine months ended September 30, 2018, respectively.

Troubled Debt Restructuring

A troubled debt restructuring (TDR) occurs when the Bank has agreed to a loan modification in the form of a concession for a borrower who is experiencing financial difficulty. The Bank's TDRs may involve a reduction in interest rate, a deferral of principal for a stated period of time, or an interest only period. All TDRs are considered impaired and the Bank has allocated reserves for these loans to reflect the present value of the concessionary terms granted to the borrower.

The following table presents the types of TDR loan modifications by portfolio segment outstanding as of September 30, 2019 and December 31, 2018:

	TDRs Performing to Modified Terms	TDRs Not Performing to Modified Terms	Total TDRs
		(in thousands)	
September 30, 2019			
Commercial Real Estate:			
Nonfarm nonresidential			
Rate reduction	$ 188	—	$ 188
Total TDRs	$ 188	$ —	$ 188

	TDRs Performing to Modified Terms	TDRs Not Performing to Modified Terms	Total TDRs
		(in thousands)	
December 31, 2018			
Commercial Real Estate:			
Nonfarm nonresidential			
Rate reduction	$ 190	$ —	$ 190
Residential Real Estate:			
1-4 Family			
Rate reduction	720	—	720
Total TDRs	$ 910	$ —	$ 910

At September 30, 2019 and December 31, 2018, 100% of the Company's TDRs were performing according to their modified terms. There were no allocated reserves and $168,000 in reserves to borrowers whose loan terms have been modified in TDRs as of September 30, 2019, and December 31, 2018, respectively. The Company has committed to lend no additional amounts as of September 30, 2019 and December 31, 2018 to borrowers with outstanding loans classified as TDRs.

No TDR loan modifications occurred during the three or nine months ended September 30, 2019 or September 30, 2018. During the first nine months of 2019 and 2018, no TDRs defaulted on their restructured loan within the 12-month period following the loan modification. A default is considered to have occurred once the TDR is past due 90 days or more or it has been placed on nonaccrual.

Non-performing Loans

Non-performing loans include impaired loans and smaller balance homogeneous loans, such as residential mortgage and consumer loans, that are collectively evaluated for impairment. The following table presents the recorded investment in nonaccrual and loans past due 90 days and still on accrual by class of loan as of September 30, 2019, and December 31, 2018:

	Nonaccrual		Loans Past Due 90 Days And Over Still Accruing	
	September 30, 2019	December 31, 2018	September 30, 2019	December 31, 2018
	(in thousands)			
Commercial	$ 50	$ 53	$ —	$ —
Commercial Real Estate:				
Construction	—	—	—	—
Farmland	337	249	—	—
Nonfarm nonresidential	46	61	—	—
Residential Real Estate:				
Multi-family	—	—	—	—
1-4 Family	1,739	1,628	—	—
Consumer	152	—	—	—
Agriculture	65	—	—	—
Other	—	—	—	—
Total	$ 2,389	$ 1,991	$ —	$ —

The following table presents the aging of the recorded investment in past due loans as of September 30, 2019 and December 31, 2018:

	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days And Over Past Due	Nonaccrual	Total Past Due And Nonaccrual
			(in thousands)		
September 30, 2019					
Commercial	$ 27	$ —	$ —	$ 50	$ 77
Commercial Real Estate:					
Construction	—	—	—	—	—
Farmland	244	—	—	337	581
Nonfarm nonresidential	—	—	—	46	46
Residential Real Estate:					
Multi-family	—	—	—	—	—
1-4 Family	541	92	—	1,739	2,372
Consumer	167	70	—	152	389
Agriculture	—	395	—	65	460
Other	—	—	—	—	—
Total	$ 979	$ 557	$ —	$ 2,389	$ 3,925

	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days And Over Past Due	Nonaccrual	Total Past Due And Nonaccrual
			(in thousands)		
December 31, 2018					
Commercial	$ 39	$ —	$ —	$ 53	$ 92
Commercial Real Estate:					
Construction	—	—	—	—	—
Farmland	244	107	—	249	600
Nonfarm nonresidential	—	52	—	61	113
Residential Real Estate:					
Multi-family	—	—	—	—	—
1-4 Family	1,299	137	—	1,628	3,064
Consumer	8	35	—	—	43
Agriculture	3	—	—	—	3
Other	—	—	—	—	—
Total	$ 1,593	$ 331	$ —	$ 1,991	$ 3,915

Credit Quality Indicators

Management categorizes all loans into risk categories at origination based upon original underwriting. Thereafter, management categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends. Additionally, loans are analyzed through internal and external loan review processes. Borrower relationships in excess of $500,000 are routinely analyzed through credit administration processes which classify the loans as to credit risk. The following definitions are used for risk ratings:

Watch – Loans classified as watch are those loans which have or may experience a potentially adverse development which necessitates increased monitoring.

Special Mention – Loans classified as special mention do not have all of the characteristics of substandard or doubtful loans. They have one or more deficiencies which warrant special attention and which corrective action, such as accelerated collection practices, may remedy.

Substandard – Loans classified as substandard are those loans with clear and defined weaknesses such as a highly leveraged position, unfavorable financial ratios, uncertain repayment sources or poor financial condition which may jeopardize the repayment of the debt as contractually agreed. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful – Loans classified as doubtful are those loans which have characteristics similar to substandard loans but with an increased risk that collection or liquidation in full is highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be "Pass" rated loans. As of September 30, 2019, and December 31, 2018, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

	Pass	Watch	Special Mention	Substandard	Doubtful	Total
			(in thousands)			
September 30, 2019						
Commercial	$ 120,205	$ 11,461	$ —	$ 4,315	$ —	$ 135,981
Commercial Real Estate:						
Construction	66,351	—	—	—	—	66,351
Farmland	74,830	6,773	—	990	—	82,593
Nonfarm nonresidential	184,052	8,147	—	2,461	—	194,660
Residential Real Estate:						
Multi-family	59,385	—	—	—	—	59,385
1-4 Family	160,978	1,882	—	3,552	—	166,412
Consumer	52,124	20	—	203	—	52,347
Agriculture	35,642	9,254	—	461	—	45,357
Other	483	—	—	—	—	483
Total	$ 754,050	$ 37,537	$ —	$ 11,982	$ —	$ 803,569

	Pass	Watch	Special Mention	Substandard	Doubtful	Total
			(in thousands)			
December 31, 2018						
Commercial	$ 129,106	$ 141	$ —	$ 121	$ —	$ 129,368
Commercial Real Estate:						
Construction	86,867	—	—	—	—	86,867
Farmland	74,054	2,741	—	1,142	—	77,937
Nonfarm nonresidential	169,551	1,983	—	643	—	172,177
Residential Real Estate:						
Multi-family	44,697	5,060	—	—	—	49,757
1-4 Family	169,342	2,209	113	4,097	—	175,761
Consumer	38,768	11	—	325	—	39,104
Agriculture	32,683	1,019	—	35	—	33,737
Other	536	—	—	—	—	536
Total	$ 745,604	$ 13,164	$ 113	$ 6,363	$ —	$ 765,244

Note 4 – Other Real Estate Owned

Other real estate owned (OREO) is real estate acquired as a result of foreclosure or by deed in lieu of foreclosure. It is classified as real estate owned until such time as it is sold. When property is acquired as a result of foreclosure or by deed in lieu of foreclosure, it is recorded at its fair market value less estimated cost to sell. Any write-down of the property at the time of acquisition is charged to the allowance for loan losses.

Fair value of OREO is determined on an individual property basis. When foreclosed properties are acquired, management obtains a new appraisal of the subject property or has staff from the Bank's special assets group evaluate the latest in-file appraisal in connection with the transfer to OREO. Updated appraisals are typically obtained within five quarters of the anniversary date of ownership unless a sale is imminent. Subsequent reductions in fair value are recorded as non-interest expense when a new appraisal indicates a decline in value or in cases where a marketing price is lowered below the appraised amount.

The following table presents the major categories of OREO at the period-ends indicated:

	September 30, 2019	December 31, 2018
	(in thousands)	
Commercial Real Estate:		
Construction, land development, and other land	$ 3,225	$ 3,485
	$ 3,225	$ 3,485

Residential loans secured by 1-4 family residential properties in the process of foreclosure totaled $199,000 and $771,000 at September 30, 2019 and December 31, 2018, respectively.

Activity relating to OREO during the nine months ended September 30, 2019 and 2018 is as follows:

	For the Nine Months Ended September 30, 2019	For the Nine Months Ended September 30, 2018
	(in thousands)	
OREO Activity		
OREO as of January 1	$ 3,485	$ 4,409
Real estate acquired	—	730
Valuation adjustment write-downs	(260)	(585)
Net gain on sales	—	72
Proceeds from sales of properties	—	(876)
OREO as of September 30	$ 3,225	$ 3,750

Expenses related to other real estate owned include:

	Three Months Ended September 30, 2019	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2019	Nine Months Ended September 30, 2018
	(in thousands)		(in thousands)	
Net gain on sales	$ —	$ (22)	$ —	$ (72)
Valuation adjustment write-downs	—	260	260	585
Operating expense	25	33	73	77
Total	$ 25	$ 271	$ 333	$ 590

Note 5 – Deposits

The following table details deposits by category:

	September 30, 2019	December 31, 2018
	(in thousands)	
Non-interest bearing	$ 151,524	$ 142,618
Interest checking	95,508	94,269
Money market	153,663	171,924
Savings	34,618	34,534
Certificates of deposit	488,121	450,886
Total	$ 923,434	$ 894,231

Time deposits of $250,000 or more were $27.6 million and $28.1 million at September 30, 2019 and December 31, 2018, respectively.

Scheduled maturities of total time deposits at September 30, 2019 for each of the next five years and thereafter are as follows (in thousands):

Year 1	$ 432,275
Year 2	29,073
Year 3	6,078
Year 4	9,504
Year 5	10,875
Thereafter	316
	$ 488,121

Note 6 – Advances from the Federal Home Loan Bank

Advances from the Federal Home Loan Bank were as follows:

	September 30, 2019	December 31, 2018
	(in thousands)	
Short term advances (fixed rates 2.03% to 2.11%) maturing October 2019	$ 55,000	$ 45,000
Long term advances (fixed rates 0.00% to 5.24%) maturing April 2020 to August 2033	1,430	1,549
Total advances from the Federal Home Loan Bank	$ 56,430	$ 46,549

FHLB advances had a weighted-average rate of 2.05% at September 30, 2019 and 2.45% at December 31, 2018. Each advance is payable per terms on agreement, with a prepayment penalty. No prepayment penalties were incurred during 2019 or 2018. The advances were collateralized by approximately $123.9 million and $130.4 million of first mortgage loans, under a blanket lien arrangement at September 30, 2019 and December 31, 2018, respectively. At September 30, 2019, our additional borrowing capacity with the FHLB was $30.7 million.

Scheduled principal payments on the above during the next five years and thereafter (in thousands):

	Advances
Year 1	$ 55,490
Year 2	728
Year 3	99
Year 4	77
Year 5	26
Thereafter	10
	$ 56,430

Note 7 – Borrowings

Junior Subordinated Debentures – The junior subordinated debentures are redeemable at par prior to maturity at the option of the Company as defined within the trust indenture. The Company has the option to defer interest payments on the junior subordinated debentures from time to time for a period not to exceed 20 consecutive quarters. A deferral period may begin at the Company's discretion so long as interest payments are current. The Company is prohibited from paying dividends on preferred and common shares when interest payments are in deferral. At September 30, 2019, the Company is current on all interest payments.

Subordinated Capital Note – On July 23, 2019, the Company completed the issuance of a 10-year subordinated note for $17.0 million. The note carries interest at a fixed rate of 5.75% for the first five years and qualifies as Tier 2 regulatory capital. The Company contributed $10.0 million of the proceeds to the Bank as Tier 1 capital, used $5.0 million to reduce senior debt, and retained the remaining proceeds for general corporate purposes.

Senior Debt - The Company's $5.0 million senior secured loan matures on June 30, 2022. Interest is payable quarterly at a rate of three-month LIBOR plus 250 basis points through June 30, 2020, at which time quarterly principal payments of $250,000 plus interest will commence. The loan is secured by a first priority pledge of 100% of the issued and outstanding stock of the Bank. The Company may prepay any amount due under the promissory note at any time without premium or penalty.

The loan agreement contains customary representations, warranties, covenants and events of default, including the following financial covenants: (i) the Company must maintain minimum cash on hand of not less than $2,500,000, (ii) the Company must maintain a total risk based capital ratio at least equal to 10% of risk-weighted assets, (iii) the Bank must maintain a total risk based capital ratio at least equal to 11% of risk-weighted assets, and (iv) non-performing assets of the Bank may not exceed 2.5% of the Bank's total assets. Both the Company and Bank were in compliance with the covenants as of September 30, 2019.

Note 8 – Fair Values Measurement

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Various valuation techniques are used to determine fair value, including market, income and cost approaches. There are three levels of inputs that may be used to measure fair values:

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

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

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

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. When that occurs, the fair value hierarchy is classified on the lowest level of input that is significant to the fair value measurement. The following methods and significant assumptions are used to estimate fair value.

Securities: The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges, if available. This valuation method is classified as Level 1 in the fair value hierarchy. For securities where quoted prices are not available, fair values are calculated on market prices of similar securities, or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities. Matrix pricing relies on the securities' relationship to similarly traded securities, benchmark curves, and the benchmarking of like securities. Matrix pricing utilizes observable market inputs such as benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, and industry and economic events. In instances where broker quotes are used, these quotes are obtained from market makers or broker-dealers recognized to be market participants. This valuation method is classified as Level 2 in the fair value hierarchy. For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators. This valuation method is classified as Level 3 in the fair value hierarchy. Discounted cash flows are calculated using spread to swap and LIBOR curves that are updated to incorporate loss severities, volatility, credit spread and optionality. During times when trading is more liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations.

Impaired Loans: An impaired loan is evaluated at the time the loan is identified as impaired and is recorded at fair value less costs to sell. Fair value is measured based on the value of the collateral securing the loan and is classified as Level 3 in the fair value hierarchy. Fair value is determined using several methods. Generally, the fair value of real estate is determined based on appraisals by qualified licensed appraisers. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach.

Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. These routine adjustments are made to adjust the value of a specific property relative to comparable properties for variations in qualities such as location, size, and income production capacity relative to the subject property of the appraisal. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value.

Management routinely applies internal discounts to the value of appraisals used in the fair value evaluation of our impaired loans. The deductions to the appraisal take into account changing business factors and market conditions, as well as potential value impairment in cases where our appraisal date predates a likely change in market conditions. These deductions range from 10% for routine real estate collateral to 25% for real estate that is determined to have a thin trading market or to be specialized collateral. This is in addition to estimated discounts for cost to sell of six to ten percent.

Management also applies discounts to the expected fair value of collateral for impaired loans where the likely resolution involves litigation or foreclosure. Resolution of this nature generally results in receiving lower values for real estate collateral in a more aggressive sales environment. Discounts ranging from 10% to 33% have been utilized in our impairment evaluations when applicable.

Impaired loans are evaluated quarterly for additional impairment. Management obtains updated appraisals on properties securing our loans when circumstances are warranted such as at the time of renewal or when market conditions have significantly changed. This determination is made on a property-by-property basis in light of circumstances in the broader economic climate and the assessment of deterioration of real estate values in the market in which the property is located.

Other Real Estate Owned (OREO): OREO is evaluated at the time of acquisition and recorded at fair value as determined by independent appraisal or internal evaluation less estimated cost to sell. Quarterly evaluations of OREO for impairment are driven by property type. For smaller dollar single family homes, management consults with staff from the Bank's special assets group as well as external realtors and appraisers. Based on these consultations, management determines asking prices for OREO properties being marketed for sale. If the internally evaluated fair value or asking price is below the recorded investment in the property, appropriate write-downs are taken.

For larger dollar commercial real estate properties, management obtains a new appraisal of the subject property or has staff in the special assets group evaluate the latest in-file appraisal in connection with the transfer to OREO. Management generally obtains updated appraisals within five quarters of the anniversary date of ownership unless a sale is imminent. When an asking price is lowered below the most recent appraised value, appropriate write-downs are taken.

Financial assets measured at fair value on a recurring basis at September 30, 2019 and December 31, 2018 are summarized below:

		Fair Value Measurements at September 30, 2019 Using (in thousands)		
Description	**Carrying Value**	**Quoted Prices In Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Available for sale securities				
U.S. Government and federal agency	$ 22,935	$ —	$ 22,935	$ —
Agency mortgage-backed: residential	90,102	—	90,102	—
Collateralized loan obligations	49,596	—	49,596	—
State and municipal	29,633	—	29,633	—
Corporate bonds	11,115	—	11,115	—
Total	$ 203,381	$ —	$ 203,381	$ —

		Fair Value Measurements at December 31, 2018 Using (in thousands)		
Description	**Carrying Value**	**Quoted Prices In Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Available for sale securities				
U.S. Government and federal agency	$ 22,560	$ —	$ 22,560	$ —
Agency mortgage-backed: residential	85,990	—	85,990	—
Collateralized loan obligations	49,839	—	49,839	—
State and municipal	32,812	—	32,812	—
Corporate bonds	9,991	—	9,991	—
Total	$ 201,192	$ —	$ 201,192	$ —

There were no transfers between Level 1 and Level 2 during 2019 or 2018.

Financial assets measured at fair value on a non-recurring basis are summarized below:

		Fair Value Measurements at September 30, 2019 Using (in thousands)		
Description	**Carrying Value**	**Quoted Prices In Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Impaired loans:				
Commercial	$ 24	$ —	$ —	$ 24
Commercial real estate:				
Construction	—	—	—	—
Farmland	259	—	—	259
Nonfarm nonresidential	—	—	—	—
Residential real estate:				
Multi-family	—	—	—	—
1-4 Family	—	—	—	—
Consumer	—	—	—	—
Agriculture	—	—	—	—
Other	—	—	—	—
Other real estate owned:				
Commercial real estate:				
Construction, land development, and other land	3,225	—	—	3,225
Farmland	—	—	—	—
Nonfarm nonresidential	—	—	—	—
Residential real estate:				
Multi-family	—	—	—	—
1-4 Family	—	—	—	—

		Fair Value Measurements at December 31, 2018 Using (in thousands)		
Description	**Carrying Value**	**Quoted Prices In Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Impaired loans:				
Commercial	$ —	$ —	$ —	$ —
Commercial real estate:				
Construction	—	—	—	—
Farmland	—	—	—	—
Nonfarm nonresidential	124	—	—	124
Residential real estate:				
Multi-family	—	—	—	—
1-4 Family	552	—	—	552
Consumer	—	—	—	—
Agriculture	—	—	—	—
Other	—	—	—	—
Other real estate owned, net:				
Commercial real estate:				
Construction	3,485	—	—	3,485
Farmland	—	—	—	—
Nonfarm nonresidential	—	—	—	—
Residential real estate:				
Multi-family	—	—	—	—
1-4 Family	—	—	—	—

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of $316,000 at September 30, 2019 with a valuation allowance of $33,000, resulting in no additional provision for loan losses for the three and nine months ended September 30, 2019, respectively. Impaired loans had a carrying amount of $922,000 with a valuation allowance of $236,000, resulting in no additional provision for loan losses and an additional provision for loan losses of $18,000, respectively, for the three and nine months ended September 30, 2018. At December 31, 2018, impaired loans had a carrying amount of $879,000, with a valuation allowance of $203,000.

OREO, which is measured at the lower of carrying or fair value less costs to sell, had a net carrying amount of $3.2 million as of September 30, 2019, compared with $3.8 million at September 30, 2018 and $3.5 million at December 31, 2018. There were no fair value write-downs and $260,000 for the three and nine months ended September 30, 2019, respectively, compared to write-downs of $260,000 and $585,000 for the three and nine months ended September 30, 2018, respectively.

The following table presents qualitative information about level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at September 30, 2019:

	Fair Value (in thousands)	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Other real estate owned – Commercial real estate	$ 3,225	Sales comparison approach	Adjustment for differences between the comparable sales	0% - 35% (18%)
		Income approach	Discount or capitalization rate	25% (25%)

The following table presents qualitative information about level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2018:

	Fair Value (in thousands)	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Impaired loans – Residential real estate	$ 552	Sales comparison approach	Adjustment for differences between the comparable sales	0% - 26% (11%)
Other real estate owned – Commercial real estate	$ 3,485	Sales comparison approach	Adjustment for differences between the comparable sales	0% - 35% (18%)
		Income approach	Discount or capitalization rate	25% (25%)

Carrying amount and estimated fair values of financial instruments were as follows for the periods indicated:

	Carrying Amount	Fair Value Measurements at September 30, 2019 Using			
		Level 1	Level 2	Level 3	Total
			(in thousands)		
Financial assets					
Cash and cash equivalents	$ 58,007	$ 58,007	$ —	$ —	$ 58,007
Securities available for sale	203,381	—	203,381	—	203,381
Federal Home Loan Bank stock	6,467	N/A	N/A	N/A	N/A
Loans, net	794,665	—	—	800,007	800,007
Accrued interest receivable	4,005	—	1,140	2,865	4,005
Financial liabilities					
Deposits	$ 923,434	$ 151,524	$ 772,114	$ —	$ 923,638
Federal Home Loan Bank advances	56,430	—	56,432	—	56,432
Junior subordinated debentures	21,000	—	—	16,975	16,975
Subordinated capital note	17,000	—	—	17,222	17,222
Senior Debt	5,000	—	—	4,951	4,951
Accrued interest payable	852	—	612	240	852

	Carrying Amount	Fair Value Measurements at December 31, 2018 Using Level 1	Level 2	Level 3	Total
			(in thousands)		
Financial assets					
Cash and cash equivalents	$ 35,361	$ 35,361	$ —	$ —	$ 35,361
Securities available for sale	201,192	—	201,192	—	201,192
Federal Home Loan Bank stock	7,233	N/A	N/A	N/A	N/A
Loans, net	756,364	—	—	744,076	744,076
Accrued interest receivable	3,665	—	1,222	2,443	3,665
Financial liabilities					
Deposits	$ 894,231	$ 142,618	$ 750,015	$ —	$ 892,633
Federal Home Loan Bank advances	46,549	—	46,519	—	46,519
Junior subordinated debentures	21,000	—	—	16,226	16,226
Senior Debt	10,000	—	—	9,585	9,585
Accrued interest payable	658	—	598	60	658

In accordance with the Company's adoption of ASU 2016-01 as of January 1, 2018, the methods utilized to measure the fair value of financial instruments at September 30, 2019 and December 31, 2018 represent an approximation of exit price; however, an actual exit price may differ.

Note 9 – Income Taxes

Deferred tax assets and liabilities were due to the following as of:

	September 30, 2019	December 31, 2018
	(in thousands)	
Deferred tax assets:		
Net operating loss carry-forward	$ 23,165	$ 23,390
Allowance for loan losses	2,222	1,865
OREO write-down	2,665	2,611
Alternative minimum tax credit carry-forward	173	346
Net assets from acquisitions	268	290
Net unrealized loss on securities	—	515
New market tax credit carry-forward	208	208
Nonaccrual loan interest	295	235
Accrued expenses	112	239
Deferred compensation	—	267
Other	403	241
	29,511	30,207
Deferred tax liabilities:		
FHLB stock dividends	584	557
Fixed assets	43	94
Deferred loan costs	154	136
Net unrealized gain on securities	505	—
Other	196	138
	1,482	925
Net deferred tax asset	$ 28,029	$ 29,282

During the first quarter of 2019, the Company benefited $341,000, or approximately $0.05 per basic and diluted share, from the establishment of a net deferred tax asset related to a change in Kentucky tax law enacted during the first quarter. The new law eliminates the Kentucky bank franchise tax, which is assessed at a rate of 1.1% of average capital, and implements a state income tax for the Bank at a statutory rate of 5%. The new Kentucky income tax will go into effect on January 1, 2021.

In addition, the Company has state net operating loss carryforwards ("NOLs") of $30.9 million, which were previously subject to a full valuation allowance and will begin to expire in 2025. In April 2019, tax legislation was enacted which allowed for certain Kentucky NOLs to be utilized in a combined filing return. Therefore, the Company will begin filing a Kentucky combined filing in 2021 and, as a result, a state NOL tax benefit, net of federal impact, of $1.2 million, or approximately $0.16 per basic and diluted share, was recognized in the second quarter of 2019.

At September 30, 2019, the Company had net federal operating loss carryforwards of $104.5 million, which will begin to expire in 2032. As of September 30, 2019, a total of $173,000 in alternative minimum tax credit carryforward was reclassified to other assets as it is currently refundable for the 2019 tax year.

The Company does not have any beginning and ending unrecognized tax benefits. The Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months. There were no interest and penalties recorded in the income statement or accrued for the three or nine months ended September 30, 2019 or September 30, 2018 related to unrecognized tax benefits.

Under Section 382 of the Internal Revenue Code, as amended (“Section 382”), the Company’s net operating loss carryforwards and other deferred tax assets can generally be used to offset future taxable income and therefore reduce federal income tax obligations. However, the Company's ability to use its NOLs would be limited if there was an “ownership change” as defined by Section 382. This would occur if shareholders owning (or deemed to own under the tax rules) 5% or more of the Company's voting and non-voting common shares increase their aggregate ownership of the Company by more than 50 percentage points over a defined period of time.

In 2015, the Company took two measures to preserve the value of its NOLs. First, the Company adopted a tax benefits preservation plan designed to reduce the likelihood of an “ownership change” occurring as a result of purchases and sales of the Company's common shares. Upon adoption of this plan, the Company declared a dividend of one preferred stock purchase right for each common share outstanding as of the close of business on July 10, 2015. Any shareholder or group that acquires beneficial ownership of 5% or more of the Company (an “acquiring person”) could be subject to significant dilution in its holdings if the Company's Board of Directors does not approve such acquisition. Existing shareholders holding 5% or more of the Company will not be considered acquiring persons unless they acquire additional shares, subject to certain exceptions described in the plan. In addition, the Board of Directors has the discretion to exempt certain transactions and certain persons whose acquisition of securities is determined by the Board not to jeopardize the Company's deferred tax assets. The rights plan was extended in May 2018 to expire upon the earlier of (i) June 30, 2021, (ii) the beginning of a taxable year with respect to which the Board of Directors determines that no tax benefits may be carried forward, (iii) the repeal or amendment of Section 382 or any successor statute, if the Board of Directors determines that the plan is no longer needed to preserve the tax benefits, and (iv) certain other events as described in the plan.

On September 23, 2015, the Company’s shareholders approved an amendment to its articles of incorporation to further help protect the long-term value of the Company’s NOLs. The amendment provides a means to block transfers of our common shares that could result in an ownership change under Section 382. The transfer restrictions were extended in May 2018 by shareholder vote and will expire on the earlier of (i) May 23, 2021, (ii) the beginning of a taxable year with respect to which the Board of Directors determines that no tax benefit may be carried forward, (iii) the repeal of Section 382 or any successor statute if our Board determines that the transfer restrictions are no longer needed to preserve the tax benefits of our NOLs, or (iv) such date as the Board otherwise determines that the transfer restrictions are no longer necessary.

The Company and its subsidiaries are subject to U.S. federal income tax and the Company is subject to income tax in the Commonwealth of Kentucky. The Company is no longer subject to examination by taxing authorities for years before 2016.

Note 10 – Stock Plans and Stock Based Compensation

Shares available for issuance under the 2018 Omnibus Equity Compensation Plan (“2018 Plan”) total 292,890. Shares issued to employees under the plan vest annually on the anniversary date of the grant over three years. Shares issued annually to non-employee directors have a fair market value of $25,000 and vest on December 31 in the year of grant.

The fair value of the 2019 unvested shares issued was $501,000, or $14.80 per weighted-average share. The Company recorded $181,000 and $356,000 of stock-based compensation to salaries for the three and nine months ended September 30, 2019, respectively, and $171,000 and $334,000 for the three and nine months ended September 30, 2018, respectively. Management expects substantially all of the unvested shares outstanding at the end of the period to vest according to the vesting schedule. A deferred tax benefit of $38,000 and $75,000 was recognized related to this expense during the three and nine months ended September 30, 2019, respectively, and $36,000 and $70,000 for the three and nine months ended September 30, 2018.

The following table summarizes unvested share activity as of and for the periods indicated for the Stock Compensation Plan:

	Nine Months Ended September 30, 2019		Twelve Months Ended December 31, 2018	
	Shares	Weighted Average Grant Price	Shares	Weighted Average Grant Price
Outstanding, beginning	116,909	$ 8.69	142,334	$ 5.67
Granted	33,858	14.80	52,856	13.94
Vested	(75,981)	6.57	(78,281)	6.75
Forfeited	(3,998)	13.04	—	—
Outstanding, ending	70,788	$ 13.64	116,909	$ 8.69

Unrecognized stock based compensation expense related to unvested shares for the remainder of 2019 and beyond is estimated as follows (in thousands):

October 2019 – December 2019	$ 180
2020	306
2021	192
2022	17

Note 11 – Earnings per Share

The factors used in the basic and diluted earnings per share computations follow:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(in thousands, except share and per share data)			
Net income	$ 2,282	$ 2,437	$ 8,754	$ 6,354
Less:				
Earnings allocated to unvested shares	20	40	93	105
Net income available to common shareholders, basic and diluted	$ 2,262	$ 2,397	$ 8,661	$ 6,249
Basic				
Weighted average common shares including unvested common shares outstanding	7,471,582	7,455,316	7,467,048	7,059,472
Less:				
Weighted average unvested common shares	63,913	122,097	79,411	117,060
Weighted average common shares outstanding	7,407,669	7,333,219	7,387,637	6,942,412
Basic income per common share	$ 0.31	$ 0.33	$ 1.17	$ 0.90
Diluted				
Add: Dilutive effects of assumed exercises of common stock warrants	—	—	—	—
Weighted average common shares and potential common shares	7,407,669	7,333,219	7,387,637	6,942,412
Diluted income per common share	$ 0.31	$ 0.33	$ 1.17	$ 0.90

The Company had no outstanding stock options at September 30, 2019 or 2018. A warrant for the purchase of 66,113 shares of the Company's common stock at an exercise price of $79.41 was outstanding at September 30, 2018, but was not included in the diluted EPS computation as inclusion would have been anti-dilutive. The warrant expired on November 21, 2018.

Note 12 – Regulatory Capital Matters

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can result in regulatory action.

The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. Banks (Basel III rules) became effective for the Company and Bank on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule through January 1, 2019. The final rules allowed banks and their holding companies with less than $250 billion in assets a one-time opportunity to opt-out of a requirement to include unrealized gains and losses in accumulated other comprehensive income in their capital calculation. The Company and the Bank opted out of this requirement. The rules also establish a "capital conservation buffer" of 2.5% above the regulatory minimum risk-based capital ratios. With the capital conservation buffer fully phased in as of January 1, 2019, the minimum ratios are a common equity Tier 1 risk-based capital ratio of 7.0%, a Tier 1 risk-based capital ratio of 8.5%, and a total risk-based capital ratio of 10.5%. The capital conservation buffer for 2019 is 2.5% and was 1.875% for 2018. An institution is subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if capital levels fall below minimum levels plus the buffer amounts. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions without prior regulatory approval.

The Company's capital ratios were positively impacted by the $17.0 million of subordinated notes issued during the third quarter, as the subordinated notes meet the requirements to qualify as Tier 2 capital. The Bank's capital ratios also benefitted as the Company contributed $10.0 million of the proceeds to the Bank as Common Equity Tier 1 Capital.

As of September 30, 2019, Management believes the Company and Bank met all capital adequacy requirements to which they are subject. As of September 30, 2019, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since the notification that management believes have changed the institution's category.

The following tables show the ratios (excluding capital conservation buffer) and amounts of common equity Tier 1, Tier 1 capital, and total capital to risk-adjusted assets and the leverage ratios for the Bank at the dates indicated (dollars in thousands):

	Actual		Minimum Requirement for Capital Adequacy Purposes		Minimum Requirement to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2019:						
Total risk-based capital (to risk- weighted assets)	$ 130,363	14.89	$ 70,061	8.00	$ 87,576	10.00%
Total common equity Tier 1 risk- based capital (to risk-weighted assets)	121,459	13.87	39,409	4.50	56,924	6.50
Tier 1 capital (to risk-weighted assets)	121,459	13.87	52,545	6.00	70,061	8.00
Tier 1 capital (to average assets)	121,459	11.25	43,185	4.00	53,981	5.00

	Actual		Minimum Requirement for Capital Adequacy Purposes		Minimum Requirement to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2018:						
Total risk-based capital (to risk- weighted assets)	$ 109,309	12.88%	$ 67,920	8.00%	$ 84,900	10.00%
Total common equity Tier 1 risk- based capital (to risk-weighted assets)	100,429	11.83	38,205	4.50	55,185	6.50
Tier 1 capital (to risk-weighted assets)	100,429	11.83	50,940	6.00	67,920	8.00
Tier 1 capital (to average assets)	100,429	9.60	41,837	4.00	52,297	5.00

Kentucky banking laws limit the amount of dividends that may be paid to a holding company by its subsidiary banks without prior approval. These laws limit the amount of dividends that may be paid in any calendar year to current year's net income, as defined in the laws, combined with the retained net income of the preceding two years, less any dividends declared during those periods. In addition, a bank must have positive retained earnings.

Note 13 – Off Balance Sheet Risks, Commitments, and Contingent Liabilities

The Company, in the normal course of business, is party to financial instruments with off balance sheet risk. The financial instruments include commitments to extend credit and standby letters of credit. The contract or notional amounts of these instruments reflect the potential future obligations of the Company pursuant to those financial instruments. Creditworthiness for all instruments is evaluated on a case-by-case basis in accordance with the Company's credit policies. Collateral from the client may be required based on the Company's credit evaluation of the client and may include business assets of commercial clients, as well as personal property and real estate of individual clients or guarantors.

An approved but unfunded loan commitment represents a potential credit risk and a liquidity risk, since the Company's client(s) may demand immediate cash that would require funding. In addition, unfunded loan commitments represent interest rate risk as market interest rates may rise above the rate committed to the Company's client. Since a portion of these loan commitments normally expire unused, the total amount of outstanding commitments at any point in time may not require future funding. Commitments to make loans are generally made for periods of one year or less.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a client to a third party. The terms and risk of loss involved in issuing standby letters of credit are similar to those involved in issuing loan commitments and extending credit. In addition to credit risk, the Company also has liquidity risk associated with standby letters of credit because funding for these obligations could be required immediately. The Company does not deem this risk to be material. No liability is currently established for standby letters of credit.

The following table presents the contractual amounts of financial instruments with off-balance sheet risk for each period ended:

	September 30, 2019		December 31, 2018	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
	(in thousands)			
Commitments to make loans	$ 7,513	$ 14,881	$ 5,317	$ 11,236
Unused lines of credit	8,648	71,946	7,410	73,024
Standby letters of credit	21	2,163	541	1,752

Commitments to make loans are generally made for periods of one year or less.

In connection with the purchase of loan participations, the Bank entered into risk participation agreements, which had notional amounts totaling $26.6 million at September 30, 2019 and December 31, 2018. The risk participation agreements are not designated against specific assets or liabilities under ASC 815, Derivatives and Hedging, and, therefore, do not qualify for hedge accounting. The derivatives are recorded in other liabilities on the balance sheet at fair value and changes in fair value of both the borrower and the offsetting swap agreements are recorded (and essentially offset) in non-interest income.

In the normal course of business, the Company and its subsidiaries have been named, from time to time, as defendants in various legal actions. Certain of the actual or threatened legal actions may include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages.

The Company contests liability and/or the amount of damages as appropriate in each pending matter. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases where claimants seek substantial or indeterminate damages or where investigations and proceedings are in the early stages, the Company cannot predict with certainty the loss or range of loss, if any, related to such matters, how or if such matters will be resolved, when they will ultimately be resolved, or what the eventual settlement, or other relief, if any, might be. Subject to the foregoing, the Company believes, based on current knowledge and after consultation with counsel, that the outcome of such pending matters will not have a material adverse effect on the consolidated financial condition of the Company, although the outcome of such matters could be material to the Company's operating results and cash flows for a particular future period, depending on, among other things, the level of the Company's revenues or income for such period. The Company will accrue for a loss contingency if (1) it is probable that a future event will occur and confirm the loss and (2) the amount of the loss can be reasonably estimated. The Company is not currently involved in any material litigation.

Note 14 – Revenue from Contracts with Customers

All of the Company's revenue from customers within the scope of ASC 606 is recognized as non-interest income. A description of the Company's revenue streams accounted for under ASC 606 follows:

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

Bank Card Interchange Income: The Company earns interchange fees from bank cardholder transactions conducted through a third party payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. Prior to adopting ASC 606, the Company reported bank card interchange fees net of expenses. Under ASC 606, bank card interchange fees are reported gross.

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

Other Non-interest Income: Other non-interest income includes revenue from several sources that are within the scope of ASC 606, including title insurance commissions, income from secondary market loan sales, and other transaction-based revenue that is individually immaterial. Other non-interest income included approximately $133,000 and $388,000 of revenue for the three and nine months ended September 30, 2019, respectively, within the scope of ASC 606. Other non-interest income included approximately $301,000 and $546,000 of revenue for the three and nine months ended September 30, 2018, respectively, within the scope of ASC 606. The remaining other non-interest income for the three and nine months is excluded from the scope of ASC 606.

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

This item analyzes the Company's financial condition, change in financial condition and results of operations. It should be read in conjunction with the unaudited consolidated financial statements and accompanying notes presented in Part I, Item 1 of this report.

Preliminary Note Concerning Forward-Looking Statements

This report contains statements about the future expectations, activities and events that constitute forward-looking statements. Forward-looking statements express our beliefs, assumptions and expectations of our future financial and operating performance and growth plans, taking into account information currently available to us. These statements are not statements of historical fact. The words "believe," "may," "should," "anticipate," "estimate," "expect," "intend," "objective," "seek," "plan," "strive" or similar words, or the negatives of these words, identify forward-looking statements.

Forward-looking statements are not guarantees of performance or results. A forward-looking statement may include the assumptions or bases underlying the forward-looking statement. Management has made assumptions and bases in good faith and believe they are reasonable. However, that estimates based on such assumptions or bases frequently differ from actual results, and the differences can be material. The forward-looking statements included in this report speak only as of the date of the report. Management does not intend to update these statements unless required by applicable laws.

Forward-looking statements involve risks and uncertainties that may cause our actual results to differ materially from the expectations of future results we expressed or implied in any forward-looking statements. These risks and uncertainties can be difficult to predict and may be out of management's control. Factors that could contribute to differences in results include, but are not limited to the following:

- Changes in fiscal, monetary, regulatory and tax policies;
- Changes in political and economic conditions;
  - The magnitude and frequency of changes to the Federal Funds Target Rate implemented by the Federal Open Market Committee of the Federal Reserve Bank;
  - Long-term and short-term interest rate fluctuations as well as the overall steepness of the yield curve;
  - Competitive product and pricing pressures;
  - Equity and fixed income market fluctuations;
  - Client bankruptcies and loan defaults;
  - Inflation;
  - Recession;
  - Natural disasters impacting Company operations;
- Future acquisitions;
- Integrations and performance of acquired businesses;
- Changes in technology and regulations or the interpretation and enforcement thereof;
- Changes in accounting standards;
- Changes to the Company's overall internal control environment;
- Success in gaining regulatory approvals when required;

- Information security breaches or cyber security attacks involving either the Company or one of the Company's third-party service providers; and
- Other risks and uncertainties reported from time to time in the Company's filings with the Securities and Exchange Commission ("SEC"), including Part 1 Item 1A "*Risk Factors*" of the Company's December 31, 2018 Annual Report on Form 10-K for the year ended December 31, 2018.

Forward-looking statements are not guarantees of performance or results. A forward-looking statement may include the assumptions or bases underlying the forward-looking statement. Management has made assumptions and bases in good faith and believe they are reasonable. However, that estimates based on such assumptions or bases frequently differ from actual results, and the differences can be material. The forward-looking statements included in this report speak only as of the date of the report. Management does not intend to update these statements unless required by applicable laws.

Overview

The Company is a bank holding company headquartered in Louisville, Kentucky. The Company's common stock is traded on Nasdaq's Capital Market under the symbol LMST. The Company operates Limestone Bank (the Bank), our wholly owned subsidiary and the eleventh largest bank domiciled in the Commonwealth of Kentucky based on total assets. The Bank operates banking offices in twelve counties in Kentucky. The Bank's markets include metropolitan Louisville in Jefferson County and the surrounding counties of Henry and Bullitt. The Bank serves south central Kentucky and southern Kentucky from banking offices in Butler, Green, Hart, Edmonson, Barren, Warren, Ohio, and Daviess Counties. The Bank also has an office in Lexington, the second largest city in Kentucky. The Bank is a community bank with a wide range of commercial and personal banking products. As of September 30, 2019, the Company had total assets of $1.1 billion, total loans of $803.6 million, total deposits of $923.4 million and stockholders' equity of $104.3 million.

The Company reported net income of $2.3 million and $8.8 million for the three and nine months ended September 30, 2019, compared with net income of $2.4 million and $6.4 million for the same periods of 2018. Income tax expense was $531,000 and $43,000 for the third quarter of 2019 and for the first nine months of 2019, respectively, compared to income tax expense of $604,000 and $1.4 million for the third quarter of 2018 and for the first nine months of 2018, respectively.

Highlights for the nine months ended September 30, 2019 are as follows:

- Loan growth outpaced paydowns during the period. Average loans receivable increased approximately $50.9 million or 6.9% to $786.8 million for the nine months ended September 30, 2019, compared with $735.9 million for the first nine months of 2018. This resulted in an increase in interest revenue volume of approximately $2.0 million for the nine months September 30, 2019 compared with the nine months of 2018.

- Net interest margin decreased nine basis points to 3.46% in the first nine months of 2019 compared with 3.55% in the first nine months of 2018. The yield on earning assets increased to 4.83% for the first nine months of 2019, compared to 4.51% for the first nine months of 2018. The cost of interest-bearing liabilities increased from 1.14% in the first nine months of 2018 to 1.67% in the first nine months of 2019 as a result of increases in short-term interest rates during 2018.

- The Company recorded no provision for loan losses expense during the first nine months of 2019, compared to a negative provision for loan losses of $500,000 during the first nine months of 2018. Historical loss experience, risk grade classification metrics, charge-off levels, and past due trends remain at historically strong levels and were generally stable between periods. Net loan recoveries were $24,000 for the first nine months of 2019, compared to net recoveries of $932,000 for the first nine months of 2018.

- Loans past due 30-59 days decreased from $1.6 million at December 31, 2018 to $979,000 at September 30, 2019, and loans past due 60-89 days increased from $331,000 at December 31, 2018 to $557,000 at September 30, 2019. Total loans past due and nonaccrual loans remained unchanged at $3.9 million from December 31, 2018 to September 30, 2019.

- Loans graded pass increased $8.4 million, loans graded watch increased $24.4 million, loans graded special mention were flat, and loans graded substandard increased $5.6 million as compared to December 31, 2018.

- Foreclosed properties were $3.2 million at September 30, 2019, compared with $3.5 million at December 31, 2018, and $3.8 million at September 30, 2018. Operating expenses and fair value write downs totaled $333,000 for the first nine months of 2019 compared to operating expenses, fair value write downs, and net gain on sales of $590,000 for the first nine months of 2018.

- The ratio of non-performing assets to total assets decreased to 0.51% at September 30, 2019, compared with 0.60% at December 31, 2018, and 0.70% at September 30, 2018.

- Deposits were $923.4 million at September 30, 2019, compared with $894.2 million at December 31, 2018. Certificate of deposit balances increased $37.2 million during the first nine months of 2019 to $488.1 million at September 30, 2019, from $450.9 million at December 31, 2018. Interest checking accounts increased $1.2 million, non-interest bearing accounts increased $8.9 million, and money market declined $18.3 million during the first nine months of 2019 compared with December 31, 2018.

- On July 23, 2019, the Company completed the issuance of a $17.0 million 10-year subordinated note. The note carries interest at a fixed rate of 5.75% for the first five years and qualifies as Tier 2 regulatory capital. The Company contributed $10.0 million of the proceeds to the Bank as Tier 1 capital, used $5.0 million to reduce senior debt, and retained the remaining proceeds for general corporate purposes.

- In July 2019, the Bank entered into a Branch Purchase and Assumption Agreement to acquire four branch banking centers located in the Kentucky cities of Elizabethtown, Frankfort, and Owensboro from Louisville, Kentucky based Republic Bank and Trust Company ("Republic"). Under the terms of the agreement, the Bank will acquire the four branch offices, which includes $142 million in deposits and $131 million in loans. The $131 million of loan balances to be purchased include approximately $20 million of additional loans, primarily mortgage-related, that Republic and the Bank have further agreed to include in the transaction since the date of the original announcement and have been reduced by approximately $965,000 of credit card balances that Republic and the Bank have agreed to remove from the transaction. In addition, the Bank will acquire substantially all the fixed assets of these locations. The transaction has received regulatory approval. The transaction includes an all-in blended deposit premium of approximately 6%. Estimated tangible book value dilution is approximately 9%. The tangible book value earn back period based upon preliminary earnings estimates for the acquired branches is expected to be less than three years. The final calculated premium will be primarily based on the trailing 10-day average amount of the deposits as of the closing date, as well as the branch location for the deposits. The transaction is expected to close on or about November 15, 2019.

- During the first quarter of 2019, the Company benefited $341,000, or approximately $0.05 per basic and diluted share, from the establishment of a net deferred tax asset related to a change in Kentucky tax law enacted during the first quarter. The new law eliminates the Kentucky bank franchise tax, which is assessed at a rate of 1.1% of average capital, and implements a state income tax for the Bank at a statutory rate of 5%. The new Kentucky income tax will go into effect on January 1, 2021. In addition, the Company has state net operating loss carryforwards (“NOLs”) of $30.9 million, which were previously subject to a full valuation allowance and will begin to expire in 2025. In April 2019, tax legislation was enacted which allowed for certain Kentucky NOLs to be utilized in a combined filing return. Therefore, the Company will begin filing a Kentucky combined filing in 2021 and, as a result, a state NOL tax benefit, net of federal impact, of $1.2 million, or approximately $0.16 per basic and diluted share, was recognized in the second quarter of 2019.

Application of Critical Accounting Policies

Management continually reviews accounting policies and financial information disclosures. The Company’s more significant accounting policies that require the use of estimates and judgments in preparing the financial statements are summarized in “Application of Critical Accounting Policies” in Item 7 - Management’s Discussion and Analysis of Financial Condition and Results of Operation of our Annual Report on Form 10-K for the calendar year ended December 31, 2018. Management has discussed the development, selection, and application of our critical accounting policies with our Audit Committee. During the first nine months of 2019, there were no material changes in the critical accounting policies and assumptions.

Results of Operations

The following table summarizes components of income and expense and the change in those components for the three months ended September 30, 2019, compared with the same period of 2018:

	For the Three Months Ended September 30,		Change from Prior Period	
	2019	2018	Amount	Percent
	(dollars in thousands)			
Gross interest income	$ 12,485	$ 11,120	$ 1,365	12.3%
Gross interest expense	3,755	2,708	1,047	38.7
Net interest income	8,730	8,412	318	3.8
Provision (negative provision) for loan losses	—	(350)	350	(100.0)
Non-interest income	1,534	1,509	25	1.7
Non-interest expense	7,451	7,230	221	3.1
Net income before taxes	2,813	3,041	(228)	(7.5)
Income tax expense	531	604	(73)	(12.1)
Net income	2,282	2,437	(155)	(6.4)

Net income for the three months ended September 30, 2019 totaled $2.3 million, compared with $2.4 million for the comparable period of 2018. Net income before taxes and income tax expense was $2.8 million and $531,000, respectively, for the third quarter of 2019, compared with $3.0 million and income tax expense of $604,000, respectively for the third quarter of 2018.

Net interest income increased $318,000 from the 2018 third quarter as a result of an increase in earning assets. Net interest margin decreased 10 basis points to 3.35% in the third quarter of 2019 compared with 3.45% in the third quarter of 2018. The cost of interest-bearing liabilities increased from 1.32% for the third quarter of 2018 to 1.75% for the third quarter of 2019, while the yield on interest earning assets increased from 4.56% to 4.79% for the same period. Average earning assets increased from $968.9 million for the third quarter of 2018 to $1.0 billion for the third quarter of 2019. Non-interest income increased by $25,000 to $1.5 million from $1.5 million in the third quarter of 2018 primarily due to an increase in bankcard interchange fees of $212,000 partially offset by a decrease in other non-interest income primarily related to a $150,000 one-time gain on the sale of the Bank's secondary market residential mortgage servicing rights portfolio during the third quarter of 2018. Non-interest expense increased from $7.2 million in the third quarter of 2018 to $7.5 million in the third quarter of 2019 primarily due to an increase of $309,000 in salaries and employee benefits.

The following table summarizes components of income and expense and the change in those components for the nine months ended September 30, 2019, compared with the same period of 2018:

	For the Nine Months Ended September 30,		Change from Prior Period	
	2019	2018	Amount	Percent
	(dollars in thousands)			
Gross interest income	$ 37,047	$ 31,720	$ 5,327	16.8%
Gross interest expense	10,558	6,753	3,805	56.3
Net interest income	26,489	24,967	1,522	6.1
Provision (negative provision) for loan losses	—	(500)	500	(100.0)
Non-interest income	4,264	4,107	157	3.8
Non-interest expense	21,956	21,804	152	0.7
Net income before taxes	8,797	7,770	1,027	13.2
Income tax expense	43	1,416	(1,373)	(97.0)
Net income	8,754	6,354	2,400	37.8

Net income for the nine months ended September 30, 2019 totaled $8.8 million, compared with net income of $6.4 million for the comparable period of 2018. Net income before taxes and income tax expense was $8.8 million and $43,000, respectively, for the nine months ended September 30, 2019, compared with $7.8 million and income tax expense of $1.4 million, respectively, for the nine months ended September 30, 2018. Income tax expense for the first nine months of 2019 benefitted $1.6 million from the establishment of a state net deferred tax asset related to the 2019 tax law enactments discussed previously.

Net interest income increased $1.5 million from the first nine months of 2018 as a result of an increase in earning assets. Net interest margin decreased nine basis points to 3.46% in the first nine months of 2019 compared with 3.55% in the first nine months of 2018. The cost of interest-bearing liabilities increased from 1.14% for the first nine months of 2018 to 1.67% for the first nine months of 2019, while the yield on interest earning assets increased from 4.51% to 4.83% for the same period. Average earning assets increased from $942.7 million for the first nine months of 2018 to $1.0 billion for the first nine months of 2019. Non-interest income increased by $157,000 to $4.3 million from $4.1 million in the first nine months of 2018 primarily due to an increase in bankcard interchange fees of $469,000 partially offset by a decrease in other non-interest income primarily related to a $150,000 one-time gain on the sale of the secondary market residential servicing rights portfolio. Non-interest expense increased from $21.8 million in the first nine months of 2018 to $22.0 million in the first nine months of 2019 primarily due to an increase of $466,000 in salary and employee benefits, as the Bank added sales talent and customer facing associates during the second and third quarters of 2019, and $238,000 in deposit account related expense partially offset by decreases in OREO expenses of $257,000, and FDIC insurance expense of $228,000.

Net Interest Income – Net interest income was $8.7 million for the three months ended September 30, 2019, an increase of $318,000, or 3.8%, compared with $8.4 million for the same period in 2018. Net interest spread and margin were 3.04% and 3.35%, respectively, for the third quarter of 2019, compared with 3.24% and 3.45%, respectively, for the third quarter of 2018. Net average non-accrual loans were $2.4 million and $3.0 million for the third quarters of 2019 and 2018, respectively.

Average loans receivable increased approximately $51.8 million for the third quarter of 2019 compared with the third quarter of 2018. This resulted in an increase in interest revenue of approximately $678,000 attributable to volume and an increase of $454,000 attributable to increasing interest rates for the quarter ended September 30, 2019, compared with the third quarter of 2018. Interest foregone on non-accrual loans totaled $74,000 for the third quarter of 2019, compared with $59,000 for the third quarter of 2018.

Net interest margin decreased 10 basis points from 3.45% in the prior year third quarter to 3.35% for the third quarter of 2019. The yield on earning assets increased 23 basis points and rates paid on interest-bearing liabilities increased 43 basis points from the third quarter of 2018. Both the yield on earning assets and cost of interest-bearing liabilities were impacted by increases in short-term interest rates during 2018, as well as the two 25 basis point cuts by the Federal Reserve in its fed funds target rate on July 31, 2019 and September 18, 2019.

Net interest income was $26.5 million for the nine months ended September 30, 2019, an increase of $1.5 million, or 6.1%, compared with $25.0 million for the same period in 2018. Net interest spread and margin were 3.16% and 3.46%, respectively, for the first nine months of 2019, compared with 3.37% and 3.55%, respectively, for the first nine months of 2018. Net average non-accrual loans were $2.3 million and $4.0 million for the first nine months of 2019 and 2018, respectively.

Average loans receivable increased approximately $51.0 million for the nine months ended September 30, 2019 compared with the first nine months of 2018. This resulted in an increase in interest revenue of approximately $2.0 million attributable to volume and an increase of $2.0 million attributable to increasing in interest rates for the nine months ended September 30, 2019 compared with the prior year period. Interest foregone on non-accrual loans totaled $238,000 for the nine months ended September 30, 2019, compared with $220,000 for the nine months ended September 30, 2018.

Net interest margin decreased nine basis points to 3.46% for the first nine months of 2019 from 3.55% in the first nine months of 2018. The yield on earning assets increased 32 basis points for the first nine months of 2019 from the first nine months of 2018, compared with an increase in rates paid on interest-bearing liabilities of 53 basis points between the two periods. Both the yield on earning assets and cost of interest-bearing liabilities were impacted by increases in short-term interest rates during 2018, as well as the two 25 basis point rate cuts in July and September 2019.

Average Balance Sheets

The following table presents the average balance sheets for the three-month periods ended September 30, 2019 and 2018, along with the related calculations of tax-equivalent net interest income, net interest margin and net interest spread for the related periods.

	Three Months Ended September 30,					
	2019			2018		
	Average Balance	Interest Earned/Paid	Average Yield/Cost	Average Balance	Interest Earned/Paid	Average Yield/Cost
	(dollars in thousands)					
ASSETS						
Interest-earning assets:						
Loan receivables (1)(2)	$ 800,194	$ 10,671	5.29%	$ 748,444	$ 9,539	5.06%
Securities						
Taxable	193,133	1,553	3.19	167,280	1,245	2.95
Tax-exempt (3)	10,723	76	3.56	14,147	95	3.37
FHLB stock	6,593	76	4.57	7,243	110	6.03
Federal funds sold and other	24,879	109	1.74	31,762	131	1.64
Total interest-earning assets	1,035,522	12,485	4.79%	968,876	11,120	4.56%
Less: Allowance for loan losses	(8,884)			(8,742)		
Non-interest earning assets	78,794			77,502		
Total assets	$ 1,105,432			$ 1,037,636		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Interest-bearing liabilities:						
Certificates of deposit and other time deposits	$ 498,754	$ 2,571	2.05%	$ 450,125	$ 1,671	1.47%
NOW and money market deposits	256,373	518	0.80	251,020	445	0.70
Savings accounts	34,043	16	0.19	34,778	14	0.16
FHLB advances	23,238	132	2.25	43,995	233	2.10
Junior subordinated debentures	21,000	251	4.74	20,999	247	4.67
Subordinated capital note	12,935	190	5.83	—	—	—
Senior debt	6,196	77	4.93	10,000	98	3.89
Total interest-bearing liabilities	852,539	3,755	1.75%	810,917	2,708	1.32%
Non-interest-bearing liabilities:						
Non-interest-bearing deposits	144,378			133,784		
Other liabilities	4,697			5,449		
Total liabilities	1,001,614			950,150		
Stockholders' equity	103,818			87,486		
Total liabilities and stockholders' equity	$ 1,105,432			$ 1,037,636		
Net interest income		$ 8,730			$ 8,412	
Net interest spread			3.04%			3.24%
Net interest margin			3.35%			3.45%

(1) Includes loan fees in both interest income and the calculation of yield on loans.
(2) Calculations include non-accruing loans averaging $2.4 million and $3.0 million, respectively, in average loan amounts outstanding.
(3) Taxable equivalent yields are calculated assuming a federal income tax rate of 21%.

The following table presents the average balance sheets for the nine-month periods ended September 30, 2019 and 2018, along with the related calculations of tax-equivalent net interest income, net interest margin and net interest spread for the related periods.

	Nine Months Ended September 30,					
	2019			2018		
	Average Balance	Interest Earned/Paid	Average Yield/Cost	Average Balance	Interest Earned/Paid	Average Yield/Cost
	(dollars in thousands)					
ASSETS						
Interest-earning assets:						
Loan receivables (1)(2)	$ 786,843	$ 31,390	5.33%	$ 735,874	$ 27,423	4.98%
Securities						
Taxable	193,395	4,734	3.27	157,537	3,386	2.87
Tax-exempt (3)	12,305	257	3.53	14,184	287	3.42
FHLB stock	6,811	281	5.52	7,296	320	5.86
Federal funds sold and other	27,090	385	1.90	27,857	304	1.46
Total interest-earning assets	1,026,444	37,047	4.83%	942,748	31,720	4.51%
Less: Allowance for loan losses	(8,823)			(8,655)		
Non-interest earning assets	76,303			78,769		
Total assets	$ 1,093,924			$ 1,012,862		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Interest-bearing liabilities:						
Certificates of deposit and other time deposits	$ 482,181	$ 7,035	1.95%	$ 433,933	$ 4,041	1.25%
NOW and money market deposits	260,902	1,579	0.81	246,271	1,040	0.56
Savings accounts	33,829	43	0.17	35,221	42	0.16
FHLB advances	36,502	668	2.45	43,035	605	1.88
Junior subordinated debentures	21,000	772	4.92	22,057	733	4.44
Subordinated capital note	4,359	190	5.83	—	—	—
Senior debt	8,718	271	4.16	10,000	292	3.90
Total interest-bearing liabilities	847,491	10,558	1.67%	790,517	6,753	1.14%
Non-interest-bearing liabilities:						
Non-interest-bearing deposits	143,577			133,756		
Other liabilities	4,472			5,406		
Total liabilities	995,540			929,679		
Stockholders' equity	98,384			83,183		
Total liabilities and stockholders' equity	$ 1,093,924			$ 1,012,862		
Net interest income		$ 26,489			$ 24,967	
Net interest spread			3.16%			3.37%
Net interest margin			3.46%			3.55%

(1) Includes loan fees in both interest income and the calculation of yield on loans.

(2) Calculations include non-accruing loans averaging $2.3 million and $4.0 million, respectively, in average loan amounts outstanding.

(3) Taxable equivalent yields are calculated assuming a federal income tax rate of 21%.

Rate/Volume Analysis

The table below sets forth certain information regarding changes in interest income and interest expense for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (1) changes in rate (changes in rate multiplied by old volume); (2) changes in volume (changes in volume multiplied by old rate); and (3) changes in rate-volume (change in rate multiplied by change in volume). Changes in rate-volume are proportionately allocated between rate and volume variance.

	Three Months Ended September 30, 2019 vs. 2018			Nine Months Ended September 30, 2019 vs. 2018		
	Increase (decrease) due to change in			Increase (decrease) due to change in		
	Rate	Volume	Net Change	Rate	Volume	Net Change
	(in thousands)					
Interest-earning assets:						
Loan receivables	$ 454	$ 678	$ 1,132	$ 2,002	$ 1,965	$ 3,967
Securities	115	174	289	533	785	1,318
FHLB stock	(25)	(9)	(34)	(19)	(20)	(39)
Federal funds sold and other	8	(30)	(22)	89	(8)	81
Total increase (decrease) in interest income	552	813	1,365	2,605	2,722	5,327
Interest-bearing liabilities:						
Certificates of deposit and other time deposits	704	196	900	2,503	491	2,994
NOW and money market accounts	64	9	73	474	65	539
Savings accounts	2	—	2	3	(2)	1
FHLB advances	16	(117)	(101)	164	(101)	63
Junior subordinated debentures	4	—	4	75	(36)	39
Subordinated capital note	—	190	190	—	190	190
Senior debt	22	(43)	(21)	18	(39)	(21)
Total increase (decrease) in interest expense	812	235	1,047	3,237	568	3,805
Increase (decrease) in net interest income	$ (260)	$ 578	$ 318	$ (632)	$ 2,154	$ 1,522

Non-Interest Income – The following table presents the major categories of non-interest income for the three and nine months ended September 30, 2019 and 2018:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2019	2018	2019	2018
	(dollars in thousands)			
Service charges on deposit accounts	$ 633	$ 608	$ 1,700	$ 1,767
Bank card interchange fees	623	411	1,727	1,258
Income from bank owned life insurance	97	100	314	337
Net gain (loss) on sales and calls of securities	—	—	(5)	(6)
Other	181	390	528	751
Total non-interest income	$ 1,534	$ 1,509	$ 4,264	$ 4,107

Non-interest income for the third quarter of 2019 increased by $25,000, or 1.7%, compared with the third quarter of 2018. The increase in non-interest income for the third quarter of 2019 compared to the third quarter of 2018 was primarily driven by an increase in bank card interchange fees of $212,000 partially offset by a decrease in other non-interest income primarily related to a $150,000 one-time gain on the sale of the Bank's secondary market residential mortgage servicing rights portfolio during the third quarter of 2018. For the nine months ended September 30, 2019, non-interest income increased by $157,000, or 3.8% to $4.3 million compared with $4.1 million for the same period of 2018. The increase in non-interest income between the nine-month comparative periods was primarily due to an increase in bank card interchange fees of $469,000 partially offset by a decrease in other non-interest income primarily related to the $150,000 one-time gain on the sale of the secondary market residential servicing rights portfolio.

Non-interest Expense – The following table presents the major categories of non-interest expense for the three and nine months ended September 30, 2019 and 2018:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2019	2018	2019	2018
	(dollars in thousands)			
Salary and employee benefits	$ 4,202	$ 3,893	$ 12,032	$ 11,566
Occupancy and equipment	880	896	2,632	2,671
Professional fees	254	186	598	613
Marketing expense	251	259	690	867
FDIC insurance	—	118	211	439
Data processing expense	315	281	943	912
State franchise and deposit tax	315	282	945	846
Deposit account related expenses	300	213	891	653
Other real estate owned expense	25	271	333	590
Litigation and loan collection expense	32	61	112	162
Other	877	770	2,569	2,485
Total non-interest expense	$ 7,451	$ 7,230	$ 21,956	$ 21,804

Non-interest expense for the third quarter ended September 30, 2019 increased $221,000, or 3.1%, compared with the third quarter of 2018. This increase was primarily due to an increase of $309,000 in salaries and employee benefits. For the nine months ended September 30, 2019, non-interest expense increased $152,000, or 0.7% to $22.0 million compared with $21.8 million for the first nine months of 2018. The increase in non-interest expense for the nine months ended September 30, 2019 was primarily attributable to increases of $466,000 in salary and employee benefits, as the Bank added sales talent and customer facing associates during the second and third quarters of 2019, and $238,000 in deposit account related expense partially offset by decreases in OREO expenses of $257,000, and FDIC insurance expense of $228,000.

Income Tax Expense – Effective tax rates differ from the federal statutory rate of 21% applied to income before income taxes due to the following:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2019	2018	2019	2018
	(dollars in thousands)			
Federal statutory rate times financial statement income	$ 591	$ 639	$ 1,847	$ 1,632
Effect of:				
Tax-exempt income	(15)	(20)	(52)	(60)
Establish state deferred tax asset	(33)	—	(1,583)	—
Non-taxable life insurance income	(20)	(13)	(66)	(63)
Restricted stock vesting	—	—	(128)	(116)
Other, net	8	(2)	25	23
Total	$ 531	$ 604	$ 43	$ 1,416

Net income before taxes and income tax expense was $2.8 million and $531,000, respectively for the three months ended September 30, 2019, compared with $3.0 million and income tax expense of $604,000, respectively, for the three months ended September 30, 2018.

Net income before taxes and income tax expense was $8.8 million and $43,000, respectively for the nine months ended September 30, 2019, compared with $7.8 million and income tax expense of $1.4 million, respectively, for the nine months ended September 30, 2018. Income tax expense for the first nine months of 2019 benefitted $1.6 million from the establishment of a state net deferred tax asset related to the 2019 tax law enactments discussed above. The new laws eliminate the Kentucky bank franchise tax, which is assessed at a rate of 1.1% of average capital, and implements a state income tax for the Bank at a statutory rate of 5%. The new Kentucky income tax will go into effect on January 1, 2021.

Analysis of Financial Condition

Total assets increased $62.5 million, or 5.8%, to $1.13 billion at September 30, 2019, from $1.07 billion at December 31, 2018. This increase was primarily attributable to an increase in net loans of $38.3 million, as well as an increase in cash and cash equivalents of $22.6 million.

Loans Receivable – Loans receivable increased $38.3 million, or 5.0%, during the nine months ended September 30, 2019 to $803.6 million as loan growth outpaced paydowns. Our commercial and commercial real estate portfolios increased by an aggregate of $13.2 million, or 2.8% during the first nine months of 2019 and comprised 59.7% of the loan portfolio at September 30, 2019. Within the commercial real estate portfolio, construction loans decreased $20.5 million as several commercial construction projects were completed and sold or migrated to permanent financing. Residential real estate and consumer portfolios increased by an aggregate of $13.5 million, or 5.1% during the first nine months of 2019 and comprised 34.6% of the loan portfolio at September 30, 2019.

Loan Portfolio Composition – The following table presents a summary of the loan portfolio at the dates indicated, net of deferred loan fees, by type. There are no foreign loans in our portfolio and other than the categories noted, there is no concentration of loans in any industry exceeding 10% of total loans.

	As of September 30, 2019		As of December 31, 2018	
	Amount	Percent	Amount	Percent
	(dollars in thousands)			
Commercial	$ 135,981	16.92%	$ 129,368	16.91%
Commercial Real Estate				
Construction	66,351	8.26	86,867	11.35
Farmland	82,593	10.28	77,937	10.18
Nonfarm nonresidential	194,660	24.22	172,177	22.50
Residential Real Estate				
Multi-family	59,385	7.39	49,757	6.50
1-4 Family	166,412	20.71	175,761	22.97
Consumer	52,347	6.51	39,104	5.11
Agriculture	45,357	5.64	33,737	4.41
Other	483	0.07	536	0.07
Total loans	$ 803,569	100.00%	$ 765,244	100.00%

Loan Portfolio by Risk Category – The following table presents a summary of the loan portfolio at the dates indicated, by risk category.

	September 30, 2019		December 31, 2018	
	Loans	% to Total	Loans	% to Total
	(dollars in thousands)			
Pass	$ 754,050	93.8%	$ 745,604	97.4%
Watch	37,537	4.7	13,164	1.8
Special Mention	—	—	113	—
Substandard	11,982	1.5	6,363	0.8
Doubtful	—	—	—	—
Total	$ 803,569	100.0%	$ 765,244	100.00%

Loans receivable increased $38.3 million, or 5.0%, during the nine months ended September 30, 2019. Since December 31, 2018, the pass category increased approximately $8.4 million, the watch category increased approximately $24.4 million, and the substandard category increased approximately $5.6 million. The increase in the watch category primarily related to $11.3 million in commercial loans and $8.2 million in agricultural loans migrating to watch during the nine months ended September 30, 2019, and was considered during the evaluation of qualitative trends in the portfolio when establishing the general component of the allowance for loan losses. The $5.6 million increase in loans classified as substandard was primarily driven by $9.7 million in loans moved to substandard, offset by $1.3 million in loans upgraded from substandard, $2.3 million in payments, and $540,000 in charge-offs during the first nine months of 2019.

Loan Delinquency – The following table presents a summary of loan delinquencies at the dates indicated.

	September 30, 2019	December 31, 2018
	(in thousands)	
Past Due Loans:		
30-59 Days	$ 979	$ 1,593
60-89 Days	557	331
90 Days and Over	—	—
Total Loans Past Due 30-90+ Days	1,536	1,924
Nonaccrual Loans	2,389	1,991
Total Past Due and Nonaccrual Loans	$ 3,925	$ 3,915

During the nine months ended September 30, 2019, nonaccrual loans increased by $398,000 to $2.4 million and loans past due 30-59 days decreased from $1.6 million at December 31, 2018 to $979,000 at September 30, 2019. Loans past due 60-89 days increased from $331,000 at December 31, 2018 to $557,000 at September 30, 2019. This represents a $388,000 decrease from December 31, 2018 to September 30, 2019 in loans past due 30-89 days. This trend in delinquency levels is considered during the evaluation of qualitative trends in the portfolio when establishing the general component of the allowance for loan losses.

Troubled Debt Restructuring - A troubled debt restructuring (TDR) occurs when the Bank has agreed to a loan modification in the form of a concession to a borrower who is experiencing financial difficulty. The Bank’s TDRs may involve a reduction in interest rate, a deferral of principal for a stated period of time, or an interest only period. All TDRs are considered impaired, and the Bank has allocated reserves for these loans to reflect the present value of the concessionary terms granted to the borrower. If the loan is considered collateral dependent, it is reported net of allocated reserves, at the fair value of the collateral less cost to sell.

At September 30, 2019 and December 31, 2018, the Bank had one restructured loan totaling $188,000 and two restructured loans totaling $910,000, respectively, with borrowers who experienced deterioration in financial condition. In general, these loans were granted interest rate reductions to provide cash flow relief to borrowers experiencing cash flow difficulties. The Bank had no restructured loans that had been granted principal payment deferrals until maturity at September 30, 2019 or December 31, 2018. There were no concessions made to forgive principal relative to these loans, although partial charge-offs have been recorded for certain restructured loans. At September 30, 2019, this loan is secured by commercial real estate. All TDRs were performing according to their modified terms at September 30, 2019 and December 31, 2018.

There were no modifications granted during 2019 or 2018 that resulted in loans being identified as TDRs. See “Note 3 – Loans,” to the financial statements for additional disclosure related to troubled debt restructuring.

Non-Performing Assets – Non-performing assets consist of certain restructured loans for which interest rate or other terms have been renegotiated, loans past due 90 days or more still on accrual, loans on which interest is no longer accrued, real estate acquired through foreclosure and repossessed assets. The following table sets forth information with respect to non-performing assets as of September 30, 2019 and December 31, 2018.

	September 30, 2019	December 31, 2018
	(dollars in thousands)	
Loans on nonaccrual status	$ 2,389	$ 1,991
Troubled debt restructurings on accrual	188	910
Past due 90 days or more still on accrual	—	—
Total non-performing loans	2,577	2,901
Real estate acquired through foreclosure	3,225	3,485
Other repossessed assets	—	—
Total non-performing assets	$ 5,802	$ 6,386
Non-performing loans to total loans	0.32%	0.38%
Non-performing assets to total assets	0.51%	0.60%
Allowance for non-performing loans	$ 28	$ 83
Allowance for non-performing loans to non-performing loans	1.09%	8.65%

Nonperforming loans at September 30, 2019, were $2.6 million, or 0.32% of total loans, compared with $2.9 million, or 0.38% of total loans at December 31, 2018, and $3.6 million, or 0.48% of total loans at September 30, 2018.

Allowance for Loan Losses – The allowance for loan losses is based on management's continuing review and evaluation of individual loans, loss experience, current economic conditions, risk characteristics of various categories of loans and such other factors that, in management's judgment, require current recognition in estimating loan losses.

Management has established loan grading procedures that result in specific allowance allocations for any estimated inherent risk of loss. For loans not individually evaluated, a general allowance allocation is computed using factors developed over time based on actual loss experience. The specific and general allocations plus consideration of qualitative factors represent management's estimate of probable losses contained in the loan portfolio at the evaluation date. Although the allowance for loan losses is comprised of specific and general allocations, the entire allowance is available to absorb any credit losses.

An analysis of changes in the allowance for loan losses and selected ratios for the three and nine month periods ended September 30, 2019 and 2018, and for the year ended December 31, 2018 follows:

	Three Months Ended September 30,		Nine Months Ended September 30,		December 31,
	2019	**2018**	**2019**	**2018**	**2018**
			(in thousands)		
Balance at beginning of period	$ 8,832	$ 8,580	$ 8,880	$ 8,202	$ 8,202
Loans charged-off:					
Real estate	105	78	237	364	450
Commercial	10	50	10	50	50
Consumer	184	15	398	49	95
Agriculture	—	—	4	12	13
Other	—	—	—	8	8
Total charge-offs	299	143	649	483	616
Recoveries					
Real estate	352	526	499	1,076	1,437
Commercial	6	10	101	255	261
Consumer	9	9	69	59	69
Agriculture	3	2	3	13	15
Other	1	—	1	12	12
Total recoveries	371	547	673	1,415	1,794
Net charge-offs (recoveries)	(72)	(404)	(24)	(932)	(1,178)
Provision (negative provision) for loan losses	—	(350)	—	(500)	(500)
Balance at end of period	$ 8,904	$ 8,634	$ 8,904	$ 8,634	$ 8,880
Allowance for loan losses to period-end loans	1.11%	1.14%	1.11%	1.14%	1.16%
Net charge-offs (recoveries) to average loans	(0.04)%	(0.21)%	0.00%	(0.17)%	(0.16)%
Allowance for loan losses to non-performing loans	345.52%	239.70%	345.52%	239.70%	306.10%

The allowance for loan losses is a reserve established through charges to earnings in the form of a provision for loan losses. The allowance for loan losses is comprised of general reserves and specific reserves. The loan loss reserve, as a percentage of total loans at September 30, 2019, decreased to 1.11% from 1.16% at December 31, 2018 and from 1.14% at September 30, 2018. New loans continue to be underwritten with lower loss expectations. Historical loss experience, risk grade classification metrics, charge-off levels, and past due trends remain at historically strong levels and were generally stable between periods. The allowance for loan losses to non-performing loans was 345.52% at September 30, 2019, compared with 306.10% at December 31, 2018, and 239.70% at September 30, 2018. Net loan recoveries in the first nine months of 2019 totaled $24,000 compared to net recoveries of $932,000 in the first nine months of 2018.

The majority of nonperforming loans are secured by real estate collateral, and the underlying collateral coverage for nonperforming loans supports the likelihood of collection of principal. Management has assessed these loans for collectability and considered, among other things, the borrower's ability to repay, the value of the underlying collateral, and other market conditions to ensure the allowance for loan losses is adequate to absorb probable incurred losses. The allowance for loan losses to non-performing loans and TDRs on accrual was 345.52% at September 30, 2019 compared with 306.10% at December 31, 2018, and 239.70% at September 30, 2018. The increase in this ratio from December 31, 2018 to September 30, 2019 was primarily attributable to trends in non-performing loans during the period.

Based on prior charge-offs, the current recorded investment in loans individually evaluated for impairment in the commercial real estate and residential real estate segments of the portfolio are significantly below the unpaid principal balance for those loans. The recorded investment net of the allocated allowance was 52.35% and 65.85% of the unpaid principal balance in the commercial real estate and residential real estate segments of the portfolio, respectively, at September 30, 2019.

Provision for Loan Losses – Based upon historically strong trends in asset quality and management's assessment of risk in the loan portfolio, no provision for loan losses was recorded for the third quarter or the first nine months of 2019. A negative provision for loan losses of $350,000 and $500,000 was recorded for the third quarter and the first nine months of 2018, respectively. The pass category increased approximately $8.4 million, the watch category increased approximately $24.4 million, and the substandard category increased approximately $5.6 million. Net loan recoveries were $24,000 for the nine months ended September 30, 2019, compared with net recoveries of $932,000 for the nine months ended September 30, 2018. Management considers the size and volume of our portfolio as well as the credit quality of the loan portfolio based upon risk category classification when determining the loan loss provision for each period and the allowance for loan losses at period end.

Foreclosed Properties – Foreclosed properties at September 30, 2019 were $3.2 million compared with $3.8 million at September 30, 2018 and $3.5 million at December 31, 2018. See Note 4 – "Other Real Estate Owned," to the financial statements. Management values foreclosed properties at fair value less estimated costs to sell when acquired and expects to liquidate these properties to recover the investment in the due course of business.

OREO is recorded at fair market value less estimated cost to sell at time of acquisition. Any write-down of the property at the time of acquisition is charged to the allowance for loan losses. When foreclosed properties are acquired, management obtains a new appraisal or has staff from the Bank's special assets group evaluate the latest in-file appraisal in connection with the transfer to OREO. Management typically obtains updated appraisals within five quarters of the anniversary date of ownership unless a sale is imminent. Subsequent reductions in fair value are recorded as non-interest expense when a new appraisal indicates a decline in value or in cases where a listing price is lowered below the appraisal amount.

Write-downs and operating expenses for OREO totaled $333,000 for the nine months ended September 30, 2019, compared to net gain (loss) on sales, write-downs, and operating expenses of $590,000 for the nine months ending September 30, 2018. During the nine months ended September 30, 2019, fair value write-downs of $260,000 were recorded due to changing marketing strategies compared with write-downs of $585,000 for the nine months ended September 30, 2018.

Liabilities – Total liabilities at September 30, 2019 were $1.0 billion compared with $977.6 million at December 31, 2018, an increase of $50.2 million, or 5.1%. This increase was primarily attributable to an increase in deposits of $29.2 million and the issuance of the $17.0 million subordinated capital note.

Deposits are the Bank's primary source of funds. The following table sets forth the average daily balances and weighted average rates paid for our deposits for the periods indicated:

	For the Nine Months Ended September 30, 2019		For the Year Ended December 31, 2018	
	Average Balance	Average Rate	Average Balance	Average Rate
	(dollars in thousands)			
Demand	$ 143,577		$ 136,947	
Interest checking	97,462	0.28%	90,583	0.13%
Money market	163,440	1.12	158,832	0.90
Savings	33,829	0.17	34,866	0.16
Certificates of deposit	482,181	1.95	439,597	1.35
Total deposits	$ 920,489	1.26%	$ 860,825	0.88%

The following table sets forth the average daily balances and weighted average rates paid for our certificates of deposit for the periods indicated:

	For the Nine Months Ended September 30, 2019		For the Year Ended December 31, 2018	
	Average Balance	Average Rate	Average Balance	Average Rate
	(dollars in thousands)			
Less than $250,000	$ 453,421	1.94%	$ 410,942	1.34%
$250,000 or more	28,760	2.14%	28,655	1.51%
Total deposits	$ 482,181	1.95%	$ 439,597	1.35%

The following table shows at September 30, 2019 the amount of our time deposits of $250,000 or more by time remaining until maturity (in thousands):

Maturity Period	
Three months or less	$ 4,163
Three months through six months	11,714
Six months through twelve months	7,922
Over twelve months	3,778
Total	$ 27,577

Liquidity

Liquidity risk arises from the possibility the Company may not be able to satisfy current or future financial commitments, or may become unduly reliant on alternative funding sources. The objective of liquidity risk management is to ensure that we meet the cash flow requirements of depositors and borrowers, as well as operating cash needs, taking into account all on- and off-balance sheet funding demands. Liquidity risk management also involves ensuring that cash flow needs are met at a reasonable cost. Management maintains an investment and funds management policy, which identifies the primary sources of liquidity, establishes procedures for monitoring and measuring liquidity, and establishes minimum liquidity requirements in compliance with regulatory guidance. The Asset Liability Committee regularly monitors and reviews our liquidity position.

Funds are available to the Bank from a number of sources, including the sale of securities in the available for sale investment portfolio, principal pay-downs on loans and mortgage-backed securities, customer deposit inflows, and other wholesale funding.

The Bank also borrows from the FHLB to supplement funding requirements. At September 30, 2019, the Bank had an unused borrowing capacity with the FHLB of $30.7 million. Advances are collateralized by first mortgage residential loans and borrowing capacity is based on the underlying book value of eligible pledged loans.

The Bank also has available on an unsecured basis federal funds borrowing lines from a correspondent bank totaling $5.0 million. Management believes the sources of liquidity are adequate to meet expected cash needs for the foreseeable future. The Bank has also in the past utilized brokered and wholesale deposits to supplement its funding strategy. At September 30, 2019, the Bank had no brokered deposits.

The Company uses cash on hand to service senior debt, subordinated debt, and to provide for operating cash flow needs. The Company also may issue common equity, preferred equity and debt to support cash flow needs and liquidity requirements. At September 30, 2019, cash on hand totaled $5.2 million, of which, $146,000 is held in escrow by the Company's senior debt holder to service interest payments.

Capital

Stockholders' equity increased $12.2 million to $104.3 million at September 30, 2019, compared with $92.1 million at December 31, 2018 primarily due to current year net income of $8.8 million and other comprehensive income for the first nine months of 2019 of $3.4 million.

The following table shows the ratios of Tier 1 capital, common equity Tier 1 capital, and total capital to risk-adjusted assets and the leverage ratios (excluding the capital conservation buffer) for the Bank at the dates indicated:

	Regulatory Minimums	Well-Capitalized Minimums	September 30, 2019	December 31, 2018
Tier 1 Capital	6.0%	8.0%	13.87%	11.83%
Common equity Tier 1 capital	4.5	6.5	13.87	11.83
Total risk-based capital	8.0	10.0	14.89	12.88
Tier 1 leverage ratio	4.0	5.0	11.25	9.60

The Company's capital ratios were positively impacted by the $17.0 million of subordinated notes issued during the third quarter, as the subordinated notes meet the requirements to qualify as Tier 2 capital. The Bank's capital ratios also benefitted as the Company contributed $10.0 million of the proceeds to the Bank as Common Equity Tier 1 Capital.

Failure to meet minimum capital requirements could result in discretionary actions by regulators that, if taken, could have a materially adverse effect on our financial condition.

Each of the federal bank regulatory agencies has established risk-based capital requirements for banking organizations. The Basel III regulatory capital reforms became effective for the Company and Bank on January 1, 2015, and include new minimum risk-based capital and leverage ratios. These rules refine the definition of what constitutes "capital" for purposes of calculating those ratios, including the definitions of Tier 1 capital and Tier 2 capital. The final rules allow banks and their holding companies with less than $250 billion in assets a one-time opportunity to opt-out of a requirement to include unrealized gains and losses in accumulated other comprehensive income in their capital calculation. The Company and the Bank opted out of this requirement. The rules also establish a "capital conservation buffer" of 2.5%, to be phased in over three years, above the regulatory minimum risk-based capital ratios. With the capital conservation buffer as fully phased in effective January 1, 2019, the minimum ratios are a common equity Tier 1 risk-based capital ratio of 7.0%, a Tier 1 risk-based capital ratio of 8.5%, and a total capital to total risk-weighted assets ("total risk-based capital ratio") of 10.5%. The capital conservation buffer for 2019 is 2.50% and was 1.875% for 2018. An institution is subject to limitations on paying dividends, engaging in share repurchases and paying discretionary bonuses if capital levels fall below minimum levels plus the buffer amounts. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Given an instantaneous 100 basis point increase in interest rates, the base net interest income would decrease by an estimated 0.7% at September 30, 2019, compared with an increase of 2.0% at December 31, 2018. Given a 200 basis point increase in interest rates, base net interest income would decrease by an estimated 1.8% at September 30, 2019, compared with an increase of 3.9% at December 31, 2018.

The following table indicates the estimated impact on net interest income under various interest rate scenarios for the twelve months following September 30, 2019, as calculated using the static shock model approach:

	Change in Future Net Interest Income	
	Dollar Change	Percentage Change
	(dollars in thousands)	
+ 200 basis points	$ (636)	(1.82)%
+ 100 basis points	(252)	(0.72)
- 100 basis points	(279)	(0.80)
- 200 basis points	(530)	(1.52)

Item 4. Controls and Procedures

As of the end of the quarterly period covered by this report, an evaluation was carried out under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934 ("Exchange Act")). Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were, to the best of their knowledge, effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms as of such date.

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

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

In the normal course of business, the Company and its subsidiaries have been named, from time to time, as defendants in various legal actions. Certain of the actual or threatened legal actions may include claims for substantial compensatory and/or punitive damages or claims for indeterminate amount of damages. Litigation is subject to inherent uncertainties and unfavorable outcomes could occur.

The Company contests liability and/or the amount of damages as appropriate in each pending matter. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases where claimants seek substantial or indeterminate damages or where investigations and proceedings are in the early stages, the Company cannot predict with certainty the loss or range of loss, if any, related to such matters, how or if such matters will be resolved, when they will ultimately be resolved, or what the eventual settlement, or other relief, if any, might be. Subject to the foregoing, the Company believes, based on current knowledge and after consultation with counsel, that the outcome of such pending matters will not have a material adverse effect on the consolidated financial condition of the Company, although the outcome of such matters could be material to the Company's operating results and cash flows for a particular future period, depending on, among other things, the level of the Company's revenues or income for such period. The Company will accrue for a loss contingency if (1) it is probable that a future event will occur and confirm the loss and (2) the amount of the loss can be reasonably estimated.

The Company is not currently involved in any material litigation.

Item 1A. Risk Factors

Refer to the detailed cautionary statements and discussion of risks that affect the Company and its business in "Item 1A – Risk Factors" of the Annual Report on Form 10-K, for the year ended December 31, 2018. There have been no material changes from the risk factors previously discussed in those reports.

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

Not applicable.

Item 3. Default Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable

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Item 6. Exhibits

(a) Exhibits

The following exhibits are filed or furnished as part of this report:

Exhibit Number	Description of Exhibit
2.1*	Branch Purchase and Assumption Agreement between Republic Bank & Trust Company and Limestone Bank, Inc. dated July 24, 2019. Exhibit 2.1 to Form 8-K filed July 25, 2019 is incorporated by reference.
3.1	Articles of Incorporation of the Company, restated to reflect amendments. Filed as Exhibit 3.1 to the Quarterly Report on Form 10-Q filed August 2, 2019 and incorporated by reference.
3.2	Amended and Restated Bylaws of Limestone Bancorp, Inc. dated June 18, 2018. Exhibit 3.2 to Form 8-K filed June 6, 2018 is hereby incorporated by reference.
4.1	Tax Benefits Preservation Plan, dated as of June 25, 2015, between the Company and American Stock Transfer Company, as Rights Agent. Exhibit 3.1 to Form 8-K filed June 29, 2015 is incorporated by reference.
4.2	Amendment No. 1 to the Tax Benefits Preservation Plan, dated August 4, 2015. Exhibit 4.2 to the Quarterly Report on Form 10-Q filed August 5, 2015 is incorporated by reference.
4.3*	Amendment No. 2 to the Tax Benefits Preservation Plan dated May 23, 2018. Exhibit 4 to the Form 8-K filed May 23, 2018 is incorporated by reference.
4.4	Indenture, dated July 23, 2019, by and between Limestone Bancorp, Inc. and Wilmington Trust National Association, as trustee. Exhibit 4.1 to Form 8-K filed July 25, 2019 is incorporated by reference.
4.5	Form of 5.75% Fixed-to-Floating Subordinated Notes due 2029 of Limestone Bancorp, Inc. Exhibit 4.2 to Form 8-K filed July 25, 2019 is incorporated by reference.
10.1	Form of Subordinated Note Purchase Agreement, dated July 23, 2019, by and among Limestone Bancorp, Inc. and the Purchasers. Exhibit 10.1 to Form 8-K filed July 25, 2019 is incorporated by reference.
31.1	Certification of Principal Executive Officer, pursuant to Rule 13a - 14(a)
31.2	Certification of Principal Financial Officer, pursuant to Rule 13a - 14(a).
32.1	Certification of Principal Executive Officer, pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Principal Financial Officer, pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following financial statements from the Company's Quarterly Report on Form 10Q for the quarter ended September 30, 2019, formatted in XBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income (Loss), (iv) Consolidated Statement of Changes in Stockholders' Equity, (v) Consolidated Statements of Cash Flows, (vi) Notes to Consolidated Financial Statements.
*	Schedules and similar attachments to the Purchase and Assumption Agreement have been omitted pursuant to Item 601(a)(5) of Regulation S-K. A copy of any omitted schedule or similar attachment will be furnished to the Securities and Exchange Commission upon request.

The Company has other long-term debt agreements that meet the exclusion set forth in Section 601 (b)(4)(iii)(A) of Regulation S-K. The Company hereby agrees to furnish a copy of such agreements to the Securities and Exchange Commission upon request.

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SIGNATURES

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

LIMESTONE BANCORP, INC.
(Registrant)

November 1, 2019

By: /s/ John T. Taylor
John T. Taylor
Chief Executive Officer

November 1, 2019

By: /s/ Phillip W. Barnhouse
Phillip W. Barnhouse
Chief Financial Officer

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Section 2: EX-31.1 (EXHIBIT 31.1)

Exhibit 31.1

Limestone Bancorp, Inc.

Rule 13a-14(a) Certification

of Chief Executive Officer

I, John T. Taylor, Chief Executive Officer of Limestone Bancorp, Inc. (the "Company"), certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of the Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 1, 2019

/s/ John T. Taylor
John T. Taylor
Chief Executive Officer

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Section 3: EX-31.2 (EXHIBIT 31.2)

Exhibit 31.2

Limestone Bancorp, Inc.

Rule 13a-14(a) Certification

of Chief Financial Officer

I, Phillip W. Barnhouse, Chief Financial Officer of Limestone Bancorp, Inc. (the "Company"), certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of the Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 1, 2019

/s/ Phillip W. Barnhouse
Phillip W. Barnhouse
Chief Financial Officer

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Section 4: EX-32.1 (EXHIBIT 32.1)

Exhibit 32.1

SECTION 906 CERTIFICATION

In connection with the Quarterly Report on Form 10-Q of Limestone Bancorp, Inc. (the "Company") for the quarterly period ended September 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John T. Taylor, Chief Executive Officer of the Company, do hereby certify, in accordance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

LIMESTONE BANCORP, INC.

Dated: November 1, 2019

By: /s/ John T. Taylor
John T. Taylor
Chief Executive Officer

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Section 5: EX-32.2 (EXHIBIT 32.2)

Exhibit 32.2

SECTION 906 CERTIFICATION

In connection with the Quarterly Report on Form 10-Q of Limestone Bancorp, Inc. (the "Company") for the quarterly period ended September 30, 2019, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Phillip W. Barnhouse, Chief Financial Officer of the Company, do hereby certify, in accordance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

LIMESTONE BANCORP, INC.

Dated: November 1, 2019

By: /s/ Phillip W. Barnhouse
Phillip W. Barnhouse
Chief Financial Officer

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