**Board of Governors of the Federal Reserve System**

# Annual Report of Holding Companies—FR Y-6

## Report at the close of business as of the end of fiscal year

This Report is required by law: Section 5(c)(1)(A) of the Bank Holding Company Act (12 U.S.C. § 1844(c)(1)(A)); sections 8(a) and 13(a) of the International Banking Act (12 U.S.C. §§ 3106(a) and 3108(a)); sections 11(a)(1), 25, and 25A of the Federal Reserve Act (12 U.S.C. §§ 248(a)(1), 602, and 611a); and sections 113, 165, 312, 618, and 809 of the Dodd-Frank Act (12 U.S.C. §§ 5361, 5365, 5412, 1850a(c)(1), and 5468(b)(1)). Return to the appropriate Federal Reserve Bank the original and the number of copies specified.

This report form is to be filed by all top-tier bank holding companies, top-tier savings and loan holding companies, and U.S. intermediate holding companies organized under U.S. law, and by any foreign banking organization that does not meet the requirements of and is not treated as a qualifying foreign banking organization under Section 211.23 of Regulation K (12 C.F.R. § 211.23). (See page one of the general instructions for more detail of who must file.) The Federal Reserve may not conduct or sponsor, and an organization (or a person) is not required to respond to, an information collection unless it displays a currently valid OMB control number.

NOTE: The *Annual Report of Holding Companies* must be signed by one director of the top-tier holding company. This individual should also be a senior official of the top-tier holding company. In the event that the top-tier holding company does not have an individual who is a senior official and is also a director, the chairman of the board must sign the report. If the holding company is an ESOP/ESOT formed as a corporation or is an LLC, see the General Instructions for the authorized individual who must sign the report.

I, William F. Goettel
Name of the Holding Company Director and Official

President
Title of the Holding Company Director and Official

attest that the *Annual Report of Holding Companies* (including the supporting attachments) for this report date has been prepared in conformance with the instructions issued by the Federal Reserve System and are true and correct to the best of my knowledge and belief.

*With respect to information regarding individuals contained in this report, the Reporter certifies that it has the authority to provide this information to the Federal Reserve. The Reporter also certifies that it has the authority, on behalf of each individual, to consent or object to public release of information regarding that individual. The Federal Reserve may assume, in the absence of a request for confidential treatment submitted in accordance with the Board's "Rules Regarding Availability of Information," 12 C.F.R. Part 261, that the Reporter and individual consent to public release of all details in the report concerning that individual.*

WJGoettel
Signature of Holding Company Director and Official

3/15/19
Date of Signature

**Date of Report** (top-tier holding company's fiscal year-end):
**December 31, 2018**
Month / Day / Year

N/A
Reporter's Legal Entity Identifier (LEI) (20-Character LEI Code)

Reporter's Name, Street, and Mailing Address

Heritage Bancshares, Inc.
Legal Title of Holding Company

11 West Main Street/PO Box 388
(Mailing Address of the Holding Company) Street / P.O. Box

| Mannington | WV | 26582 |
|---|---|---|
| City | State | Zip Code |

Physical Location (if different from mailing address)

Person to whom questions about this report should be directed:

| Jennifer Davis | Secretary/Treasurer |
|---|---|
| Name | Title |

304-986-1700
Area Code / Phone Number / Extension

304-986-1711
Area Code / FAX Number

jenniferd@firstexchangebank.com
E-mail Address

N/A
Address (URL) for the Holding Company's web page

*For holding companies not registered with the SEC–*
Indicate status of Annual Report to Shareholders:

- ☒ is included with the FR Y-6 report
- ☐ will be sent under separate cover
- ☐ is not prepared

Is confidential treatment requested for any portion of this report submission? .................................. 0=No 1=Yes **0**

In accordance with the General Instructions for this report (check only one),

1. a letter justifying this request is being provided along with the report ........................................ ☐
2. a letter justifying this request has been provided separately ... ☐

NOTE: Information for which confidential treatment is being requested must be provided separately and labeled as "confidential."

**For Federal Reserve Bank Use Only**

RSSD ID ____________
C.I. ____________

Public reporting burden for this information collection is estimated to vary from 1.3 to 101 hours per response, with an average of 5.50 hours per response, including time to gather and maintain data in the required form and to review instructions and complete the information collection. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551, and to the Office of Management and Budget, Paperwork Reduction Project (7100-0297), Washington, DC 20503.

**Results:** A list of branches for your depository institution: FIRST EXCHANGE BANK (ID_RSSD: 170332).
This depository institution is held by HERITAGE BANCSHARES, INC. (2257116) of MANNINGTON, WV.
The data are as of 12/31/2018. Data reflects information that was received and processed through 01/06/2019.

**Reconciliation and Verification Steps**
1. In the **Data Action** column of each branch row, enter one or more of the actions specified below
2. If required, enter the date in the **Effective Date** column

**Actions**
**OK:** If the branch information is correct, enter 'OK' in the **Data Action** column.
**Change:** If the branch information is incorrect or incomplete, revise the data, enter 'Change' in the **Data Action** column and the date when this information first became valid in the **Effective Date** column.
**Close:** If a branch listed was sold or closed, enter 'Close' in the **Data Action** column and the sale or closure date in the **Effective Date** column.
**Delete:** If a branch listed was never owned by this depository institution, enter 'Delete' in the **Data Action** column.
**Add:** If a reportable branch is missing, insert a row, add the branch data, and enter 'Add' in the **Data Action** column and the opening or acquisition date in the **Effective Date** column.

If printing this list, you may need to adjust your page setup in MS Excel. Try using landscape orientation, page scaling, and/or legal sized paper.

**Submission Procedure**
When you are finished, send a saved copy to your FRB contact. See the detailed instructions on this site for more information.
If you are e-mailing this to your FRB contact, put your institution name, city and state in the subject line of the e-mail.

Note:
To satisfy the **FR Y-10 reporting requirements**, you must also submit FR Y-10 Domestic Branch Schedules for each branch with a **Data Action** of Change, Close, Delete, or Add.
The FR Y-10 report may be submitted in a hardcopy format or via the FR Y-10 Online application - https://y10online.federalreserve.gov.

* FDIC UNINUM, Office Number, and ID_RSSD columns are for reference only. Verification of these values is not required.

| Data Action | Effective Date | Branch Service Type | Branch ID_RSSD* | Popular Name | Street Address | City | State | Zip Code | County | Country | FDIC UNINUM* | Office Number* | Head Office | Head Office ID_RSSD* | Comments |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| OK | | Full Service (Head Office) | 170332 | FIRST EXCHANGE BANK | 11 WEST MAIN STREET | MANNINGTON | WV | 26582 | MARION | UNITED STATES | 8227 | 0 | FIRST EXCHANGE BANK | 170332 | |
| OK | | Full Service | 3116715 | BARRACKVILLE BRANCH | 211 PIKE STREET | BARRACKVILLE | WV | 26559 | MARION | UNITED STATES | 363496 | 4 | FIRST EXCHANGE BANK | 170332 | |
| OK | | Full Service | 2529868 | FAIRMONT BRANCH | 216 FAIRMONT AVE | FAIRMONT | WV | 26554 | MARION | UNITED STATES | 228749 | 1 | FIRST EXCHANGE BANK | 170332 | |
| OK | | Full Service | 2945794 | FAIRVIEW BRANCH | 309 MAIN STREET | FAIRVIEW | WV | 26570 | MARION | UNITED STATES | 228751 | 3 | FIRST EXCHANGE BANK | 170332 | |
| OK | | Full Service | 2635938 | HUNDRED BRANCH | ROUTE 250 | HUNDRED | WV | 26575 | WETZEL | UNITED STATES | 228750 | 2 | FIRST EXCHANGE BANK | 170332 | |
| OK | | Full Service | 3281453 | UNIVERSITY AVENUE BRANCH | 3081 UNIVERSITY AVE | MORGANTOWN | WV | 26505 | MONONGALIA | UNITED STATES | 419234 | 6 | FIRST EXCHANGE BANK | 170332 | |

**BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**

**ANNUAL REPORT OF BANK HOLDING COMPANIES-FR Y-6**
**31-Dec-18**

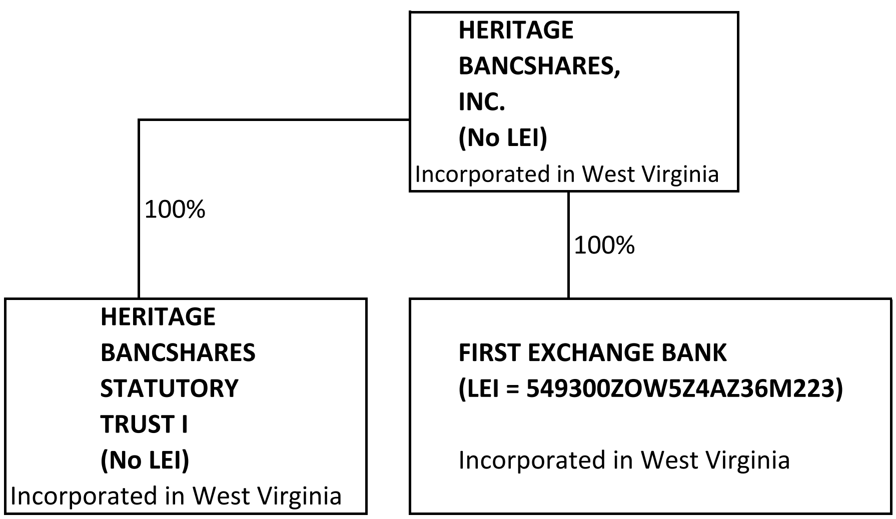
**REPORTING COMPANY**
HERITAGE BANCSHARES, INC
11 W. MAIN STREET
MANNINGTON, WV 26582

**REPORT ITEM 1 ANNUAL REPORT TO SHAREHOLDERS**

The BHC is not required to prepare or file form 10K with the SEC.

The BHC does prepare an annual report for its shareholders. Three copies of the annual report will be mailed when they become available.

**REPORT ITEM 2a ORGANIZATION CHART**




**REPORT ITEM 2 LEGAL NAME AND ADDRESS**

HERITAGE BANCSHARES STATUTORY TRUST 1
11 WEST MAIN STREET
MANNINGTON, WV 26582

FIRST EXCHANGE BANK
11 WEST MAIN STREET
MANNINGTON, WV 26582

**REPORT ITEM 2**

A. Companies reportable on the FR Y -10, and thus reportable on the FR Y - 6: All companies reported on the FR Y 10 and FR Y 6.

B. Additional companies reportable on the FR Y - 6: All companies reported on the FR Y 6.

C. Companies not reportable on the FR Y -6 Organizational Chart: All companies reported on the FR Y 6 Organizational Chart.

**REPORT ITEM 3 (1) SECURITIES HOLDERS**

FOLLOWING IS A LIST OF SHAREHOLDERS WHO DIRECTLY OR INDIRECTLY
OWN 5% OF THE COMMON STOCK OF THE COMPANY AS OF: 12/31/2018

| NAME | | # OWNED | % OWNED |
|---|---|---|---|
| BOYERS, JAMES | FAIRMONT, WV<br>US CITIZEN | 163,829 | 15.45% |
| Goettel, William | FAIRMONT, WV<br>US CITIZEN | 56,600 | 5.34% |
| PITROLO, JOSEPHINE | FAIRMONT, WV<br>US CITIZEN | 120,750 | 11.39% |
| FIRST EXCHANGE BANK<br>EMPLOYEES 401(K) PLAN<br>TRUSTEES - JENNIFER DAVIS & WILLIAM F. GOETTEL | MANNINGTON, WV<br>U.S. ENTITY | 76,690 | 7.23% |

* THE COMPANY HAS ONE CLASS OF VOTING SECURITIES AND THE COMPANY
HAS NOT ISSUED ANY OPTIONS, WARRANTS OR OTHER SECURITIES OR
RIGHTS THAT HAVE VOTING PRIVILEGES.

**REPORT ITEM 3 (2) SECURITIES HOLDERS**

NO SHAREHOLDERS TO REPORT AS REQUIRED BY THIS ITEM.

REPORT ITEM 4: DIRECTORS AND OFFICERS

1. NAME AND ADDRESS

DR. F. DAVID BONASSO
FAIRMONT, WV

2. PRINCIPAL OCCUPATION, IF OTHER THAN WITH THE HOLDING COMPANY ORGANIZATION.

Dentist

3. TITLE OR POSITION WITH:

A. The Bank Holding Company

Director

B. All direct & indirect subsidiaries of the bank holding company:

Director - First Exchange Bank

C. Any other business company in which the person is a director, trustee, partner, or executive officer:

BGP, LLC, Partner
Youth Academy, LLC, Partner
DBGH, LLC, Partner
Yale Academy, Partner
Yore Academy, Partner
Crosswinds Properties, Partner

4. PERCENTAGE OF EACH CLASS OF VOTING SECURITIES OWNED, CONTROLLED OR HELD WITH POWER TO VOTE IN:

A. The Bank Holding Company:

0.75%

B. Direct & indirect subsidiaries of the bank holding company:

N/A

C. Any other business company, if 25 percent or more of its outstanding voting securities or proportionate interest in a partnership are held (% ownership follows in ( ) ):

BGP, LLC, Partner (100%)
Youth Academy, LLC, Partner (50%)
DBGH, LLC, Partner (50%)
Yale Academy, Partner (50%)
Yore Academy, Partner (50%)
Crosswinds Properties, Partner (50%)

REPORT ITEM 4: DIRECTORS AND OFFICERS

1. NAME AND ADDRESS

JAMES A. BOYERS
FAIRMONT, WV

2. PRINCIPAL OCCUPATION, IF OTHER THAN WITH THE HOLDING COMPANY ORGANIZATION.

Businessman

3. TITLE OR POSITION WITH:

A. The Bank Holding Company

Director

B. All direct & indirect subsidiaries of the bank holding company:

Director - First Exchange Bank

C. Any other business company in which the person is a director, trustee, partner, or executive officer:

Paradise Valley Farm, LLC-Owner
BP Investments, Partner
Boyers Enterprises, LLC, Partner
Inn Group of Fairmont, LLC
Endeavors Unlimited, LLC

4. PERCENTAGE OF EACH CLASS OF VOTING SECURITIES OWNED, CONTROLLED OR HELD WITH POWER TO VOTE IN:

A. The Bank Holding Company:

15.45%

B. Direct & indirect subsidiaries of the bank holding company:

N/A

C. Any other business company, if 25 percent or more of its outstanding voting securities or proportionate interest in a partnership are held (% ownership follows in ( ) ):

Paradise Valley Farm, Owner, (100%)
BP Investments, Partner, (50%)
Boyers Enterprises, LLC, Partner (51%)
Endeavors Unlimited, LLC (60%)

REPORT ITEM 4:  DIRECTORS AND OFFICERS

1. NAME AND ADDRESS

WILLIAM F. GOETTEL
FAIRMONT, WV

2. PRINCIPAL OCCUPATION, IF OTHER THAN WITH THE HOLDING COMPANY ORGANIZATION.

Chief Executive Officer, President - First Exchange Bank

3. TITLE OR POSITION WITH:

A. The Bank Holding Company

President / Director

B. All direct & indirect subsidiaries of the bank holding company:

President & Chief Executive Officer - First Exchange Bank
Director – First Exchange Bank

C. Any other business company in which the person is a director, trustee, partner, or executive officer:

None

4. PERCENTAGE OF EACH CLASS OF VOTING SECURITIES OWNED, CONTROLLED OR HELD WITH POWER TO VOTE IN:

A. The Bank Holding Company:

5.34%

B. Direct & indirect subsidiaries of the bank holding company:

N/A

C. Any other business company, if 25 percent or more of its outstanding voting securities or proportionate interest in a partnership are held (% ownership follows in ( ) ):

None

REPORT ITEM 4: DIRECTORS AND OFFICERS

1. NAME AND ADDRESS

R. WILLIAM KENT
GREAT FALLS, VA

2. PRINCIPAL OCCUPATION, IF OTHER THAN WITH THE HOLDING COMPANY ORGANIZATION.

Businessman

3. TITLE OR POSITION WITH:

A. The Bank Holding Company

Director

B. All direct & indirect subsidiaries of the bank holding company:

Director - First Exchange Bank

C. Any other business company in which the person is a director, trustee, partner, or executive officer:

None

4. PERCENTAGE OF EACH CLASS OF VOTING SECURITIES OWNED, CONTROLLED OR HELD WITH POWER TO VOTE IN:

A. The Bank Holding Company:

0.91%

B. Direct & indirect subsidiaries of the bank holding company:

N/A

C. Any other business company, if 25 percent or more of its outstanding voting securities or proportionate interest in a partnership are held (% ownership follows in ( ) ):

None

REPORT ITEM 4: DIRECTORS AND OFFICERS

1. NAME AND ADDRESS

   DAVID W. MYERS
   FAIRMONT, WV

2. PRINCIPAL OCCUPATION, IF OTHER THAN WITH THE HOLDING COMPANY ORGANIZATION.

   Businessman

3. TITLE OR POSITION WITH:

   A. The Bank Holding Company

      Director

   B. All direct & indirect subsidiaries of the bank holding company:

      Director - First Exchange Bank

   C. Any other business company in which the person is a director, trustee, partner, or executive officer:

      None

4. PERCENTAGE OF EACH CLASS OF VOTING SECURITIES OWNED, CONTROLLED OR HELD WITH POWER TO VOTE IN:

   A. The Bank Holding Company:

      1.17%

   B. Direct & indirect subsidiaries of the bank holding company:

      N/A

   C. Any other business company, if 25 percent or more of its outstanding voting securities or proportionate interest in a partnership are held (% ownership follows in ( ) ):

      N/A

REPORT ITEM 4: DIRECTORS AND OFFICERS

1. NAME AND ADDRESS

   JENNIFER DAVIS
   MORGANTOWN, WV

2. PRINCIPAL OCCUPATION, IF OTHER THAN WITH THE HOLDING COMPANY ORGANIZATION.

   Vice President & Chief Financial Officer - First Exchange Bank

3. TITLE OR POSITION WITH:

   A. The Bank Holding Company

   Secretary/Treasurer

   B. All direct & indirect subsidiaries of the bank holding company:

   Vice President & Chief Financial Officer - First Exchange Bank

   C. Any other business company in which the person is a director, trustee, partner, or executive officer:

   None

4. PERCENTAGE OF EACH CLASS OF VOTING SECURITIES OWNED, CONTROLLED OR HELD WITH POWER TO VOTE IN:

   A. The Bank Holding Company:

   0.47%

   B. Direct & indirect subsidiaries of the bank holding company:

   N/A

   C. Any other business company, if 25 percent or more of its outstanding voting securities or proportionate interest in a partnership are held (% ownership follows in ( ) ):

REPORT ITEM 4: DIRECTORS AND OFFICERS

1. NAME AND ADDRESS

WILLIAM J. YOHO
MANNINGTON, WV

2. PRINCIPAL OCCUPATION, IF OTHER THAN WITH THE HOLDING COMPANY ORGANIZATION.

Realtor/ Real Estate Appraiser

3. TITLE OR POSITION WITH:

A. The Bank Holding Company

Director

B. All direct & indirect subsidiaries of the bank holding company:

Director - First Exchange Bank

C. Any other business company in which the person is a director, trustee, partner, or executive officer:

Springston & Company, Inc. - President and Real Estate Broker
William J. Yoho, GRI Appraiser - WV Certified General Real Estate Appraiser (Sole Proprieter)
Bucman, LLC - Partner

4. PERCENTAGE OF EACH CLASS OF VOTING SECURITIES OWNED, CONTROLLED OR HELD WITH POWER TO VOTE IN:

A. The Bank Holding Company:

3.14%

B. Direct & indirect subsidiaries of the bank holding company:

N/A

C. Any other business company, if 25 percent or more of its outstanding voting securities or proportionate interest in a partnership are held (% ownership follows in ( ) ):

Springston & Company, Inc. (33.33%)
Bucman, LLC (50%)
William J. Yoho, GRI Appraiser (100%)

REPORT ITEM 4: DIRECTORS AND OFFICERS

1. NAME AND ADDRESS

KAREN YOKUM
FAIRMONT, WV

2. PRINCIPAL OCCUPATION, IF OTHER THAN WITH THE HOLDING COMPANY ORGANIZATION.

Attorney

3. TITLE OR POSITION WITH:

A. The Bank Holding Company

Director

B. All direct & indirect subsidiaries of the bank holding company:

Director - First Exchange Bank

C. Any other business company in which the person is a director, trustee, partner, or executive officer:

Tharp, Liotta & Yokum (Partner)

4. PERCENTAGE OF EACH CLASS OF VOTING SECURITIES OWNED, CONTROLLED OR HELD WITH POWER TO VOTE IN:

A. The Bank Holding Company:

0.30%

B. Direct & indirect subsidiaries of the bank holding company:

N/A

D. Any other business company, if 25 percent or more of its outstanding voting securities or proportionate interest in a partnership are held (% ownership follows in ( ) ):

None

REPORT ITEM 4: DIRECTORS AND OFFICERS

1. NAME AND ADDRESS

   KEVIN D. WILFONG
   FAIRMONT, WV

2. PRINCIPAL OCCUPATION, IF OTHER THAN WITH THE HOLDING COMPANY ORGANIZATION.

   Businessman

3. TITLE OR POSITION WITH:

   A. The Bank Holding Company

      Director

   B. All direct & indirect subsidiaries of the bank holding company:

      Director - First Exchange Bank

   C. Any other business company in which the person is a director, trustee, partner, or executive officer:

      Middletown Properties - President

4. PERCENTAGE OF EACH CLASS OF VOTING SECURITIES OWNED, CONTROLLED OR HELD WITH POWER TO VOTE IN:

   A. The Bank Holding Company:

      0.19%

   B. Direct & indirect subsidiaries of the bank holding company:

      N/A

   C. Any other business company, if 25 percent or more of its outstanding voting securities or proportionate interest in a partnership are held (% ownership follows in ( ) ):

      Middletown Properties (100%)

REPORT ITEM 4: DIRECTORS AND OFFICERS

1. NAME AND ADDRESS

ADAM BOYERS
FAIRMONT, WV

2. PRINCIPAL OCCUPATION, IF OTHER THAN WITH THE HOLDING COMPANY ORGANIZATION.

Businessman

3. TITLE OR POSITION WITH:

A. The Bank Holding Company

Director

B. All direct & indirect subsidiaries of the bank holding company:

Director - First Exchange Bank

C. Any other business company in which the person is a director, trustee, partner, or executive officer:

Boyers Equipment (dba Middletown Tractor), President
Boyers Enterprises, LLC, Partner
Inn Group of Fairmont, LLC, Partner
Endeavors Unlimited, LLC, Partner
AC Holdings, LLC, Partner

4. PERCENTAGE OF EACH CLASS OF VOTING SECURITIES OWNED, CONTROLLED OR HELD WITH POWER TO VOTE IN:

A. The Bank Holding Company:

0.30%

B. Direct & indirect subsidiaries of the bank holding company:

N/A

C. Any other business company, if 25 percent or more of its outstanding voting securities or proportionate interest in a partnership are held (% ownership follows in ( ) ):

Boyers Equipment (dba Middletown Tractor), President, (100%)
Boyers Enterprises, LLC, Partner (49%)
AC Holdings, LLC, Partner (100%)

REPORT ITEM 4: DIRECTORS AND OFFICERS

1. NAME AND ADDRESS

   PRESHA E. NEIDERMEYER
   MORGANTOWN, WV

2. PRINCIPAL OCCUPATION, IF OTHER THAN WITH THE HOLDING COMPANY ORGANIZATION.

   Professor

3. TITLE OR POSITION WITH:

   A. The Bank Holding Company

      Director

   B. All direct & indirect subsidiaries of the bank holding company:

      Director - First Exchange Bank

   C. Any other business company in which the person is a director, trustee, partner, or executive officer:

      N/A

4. PERCENTAGE OF EACH CLASS OF VOTING SECURITIES OWNED, CONTROLLED OR HELD WITH POWER TO VOTE IN:

   A. The Bank Holding Company:

      0.21%

   B. Direct & indirect subsidiaries of the bank holding company:

      N/A

   C. Any other business company, if 25 percent or more of its outstanding voting securities or proportionate interest in a partnership are held (% ownership follows in ( ) ):

      None

REPORT ITEM 4:  PRINCIPAL SECURITIES HOLDER

1. NAME AND ADDRESS

   JOSEPHINE J PITROLO
   FAIRMONT, WV

2. PRINCIPAL OCCUPATION, IF OTHER THAN WITH THE HOLDING COMPANY ORGANIZATION.

   Retired

3. TITLE OR POSITION WITH:

   A. The Bank Holding Company

      N/A

   B. All direct & indirect subsidiaries of the bank holding company:

      N/A

C. Any other business company in which the person is a director, trustee, partner, or executive officer:

   Bond Finance Company – Vice President

4. PERCENTAGE OF EACH CLASS OF VOTING SECURITIES OWNED, CONTROLLED OR HELD WITH POWER TO VOTE IN:

   A. The Bank Holding Company:

      11.39%

   B. Direct & indirect subsidiaries of the bank holding company:

      N/A

   C. Any other business company, if 25 percent or more of its outstanding voting securities or proportionate interest in a partnership are held (% ownership follows in (  ) ):

      Bond Finance Company (100%)

REPORT ITEM 4:  PRINCIPAL SECURITIES HOLDER

1. NAME AND ADDRESS

FIRST EXCHANGE BANK EMPLOYEES 401(K) PLAN
TRUSTEES – JENNIFER DAVIS & WILLIAM F. GOETTEL
MANNINGTON, WV

2. PRINCIPAL OCCUPATION, IF OTHER THAN WITH THE HOLDING COMPANY ORGANIZATION.

N/A

3. TITLE OR POSITION WITH:

A. The Bank Holding Company

N/A

B. All direct & indirect subsidiaries of the bank holding company:

N/A

C. Any other business company in which the person is a director, trustee, partner, or executive officer:

N/A

4. PERCENTAGE OF EACH CLASS OF VOTING SECURITIES OWNED, CONTROLLED OR HELD WITH POWER TO VOTE IN:

A. The Bank Holding Company:

7.23%

B. Direct & indirect subsidiaries of the bank holding company:

N/A

C. Any other business company, if 25 percent or more of its outstanding voting securities or proportionate interest in a partnership are held (% ownership follows in (  ) ):

N/A

# HERITAGE
BANCSHARES, INC.

Dear Fellow Shareholder:

On behalf of the Board of Directors and employees of your Company, we are pleased to provide you with our 2018 annual report. A disciplined adherence to our strategic objectives produced stellar financial results for the year, while we also experienced continued exceptional growth in the core elements of our balance sheet. This has enabled us to reward our shareholders with a cash distribution of $2.22 per share in 2018.

The company's long-term goal has been to expand the bank's market share and to develop into the premier regional bank of North Central West Virginia and beyond. Recently, the company has released innovative products and services, emphasized employee training and development, and began our expansion into the South Fairmont-White Hall market. The company is committed to continue meeting the banking needs of North Central West Virginia and beyond by providing an outstanding customer service experience, exceptional products and services, and an emphasis on community involvement.

Construction on the company's new location in South Fairmont-White Hall is currently in progress with scheduled completion for late summer to early fall of 2019. The state-of-the-art facility will include a retail branch, an operations center, and our corporate headquarters. A modern lobby with concierge service, dual-height drive-thru kiosks, safe deposit boxes with hand scanners, and a Smart ATM are some of the exciting features of the new location, which will be our foundation as we become North Central West Virginia's premier regional bank. The new building will be located on the corner of Nasa Boulevard and U.S. Route 250, which provides excellent visibility from Interstate 79 and U.S. Route 250. ***Please refer to the following page for the architectural rendering of our new location.***

We strive for total customer satisfaction while giving back to the community. The company and its employees have contributed to multiple causes during 2018, including monetary donations to Bonnies' Bus in support of Breast Cancer Awareness Month and Fairmont State Foundation for the "Every Gift Matters" scholarship campaign. Chairs, appliances, and other items were also donated to the Mannington Park Board and the Mannington District Fair in our continued support of the 2017 flood relief. Additionally, the company has supported various parades and festivals hosted by the communities that we serve. We are grateful to be part of a community bank that is focused on building better communities.

As regulatory and interest rate environments evolve, we are well-positioned to adapt to new opportunities and challenges. Our strong capital base, experienced leadership team and dedication to unparalleled customer care will continue to fuel positive momentum in 2019 and beyond. Lastly, we thank our loyal customers, our talented staff, and our Board of Directors for their efforts this past year.

Sincerely,

W F Goettel

William F. Goettel, CPA

President

11 West Main Street Post Office Box 388 Mannington, WV 26582 Telephone 304-986-1700

first Exchange Bank

# South Fairmont Office/Corporate Headquarters

## *Coming Fall 2019*


## *Special Features:*

- Smart ATM
- Concierge Service
- Dual Height Drive-Thru Lanes
- Free-Standing Pedestal Kiosks
- Biometric Hand Reader to Safety Deposit Boxes
- Customer Accessible Coin Counter

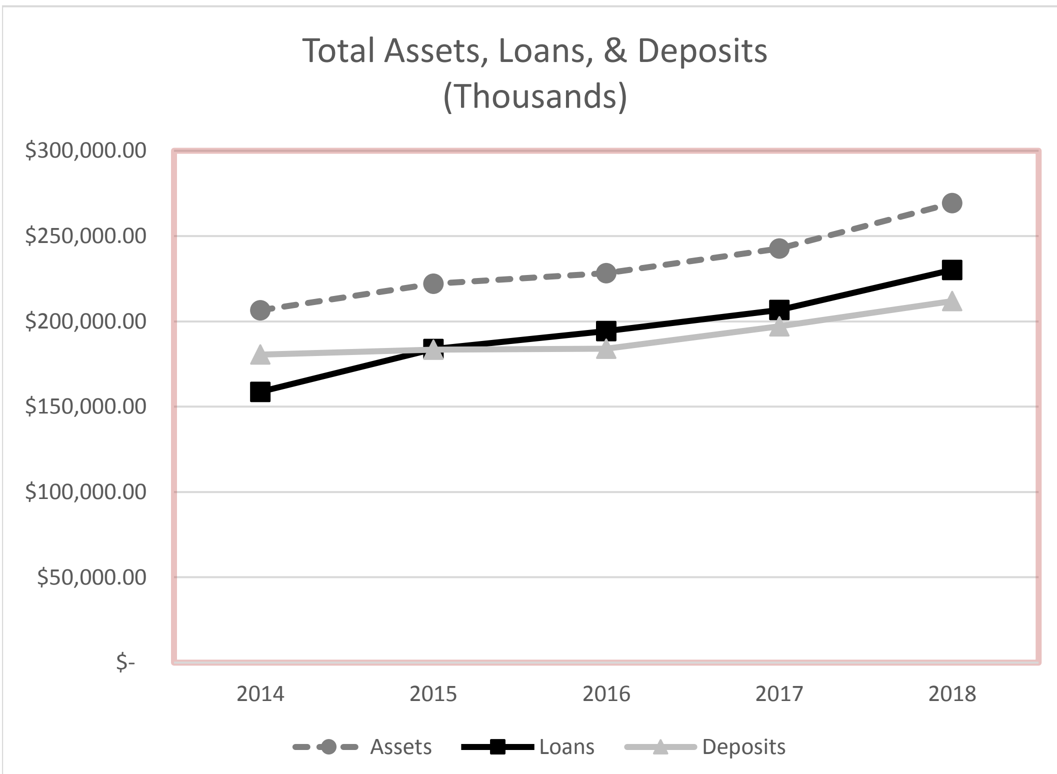
# Five Year Performance Summary

(unaudited)

| $ (thousands, except ratios) | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|
| **Income and expense:** | | | | | |
| Interest income | $ 11,349 | $ 10,213 | $ 9,755 | $ 9,087 | $ 8,355 |
| Interest expense | 1,804 | 1,292 | 1,198 | 1,258 | 1,621 |
| Provision for loan losses | 1,291 | 560 | 201 | -93 | 500 |
| Noninterest income | 1,938 | 1,486 | 1,492 | 1,034 | 1,400 |
| Noninterest expense | 7,265 | 6,530 | 6,281 | 6,013 | 5,807 |
| Net income | 2,927 | 3,317 | 3,567 | 2,943 | 1,827 |
| **Per common share data:** | | | | | |
| Net income | $ 2.76 | $ 3.13 | $ 3.36 | $ 2.78 | $ 1.72 |
| Book value | 15.95 | 15.64 | 14.97 | 13.86 | 12.38 |
| Total Distributions | 2.22 | 2.36 | 2.16 | 1.11 | 0.60 |
| **Balance sheet:** | | | | | |
| Loans outstanding, net | $ 230,172 | $ 206,614 | $ 194,251 | $ 183,767 | $ 158,762 |
| Deposits | 211,865 | 197,175 | 183,990 | 183,374 | 180,535 |
| Total Equity | 16,907 | 16,582 | 15,872 | 14,692 | 13,120 |
| Total Assets | 269,262 | 242,787 | 228,204 | 222,107 | 206,541 |
| Annual Growth - Total Assets | 10.90 % | 6.39 % | 2.75 % | 7.54 % | 0.98 % |
| **Operating Ratios:** | | | | | |
| Return on average assets | 1.16 % | 1.41 % | 1.59 % | 1.39 % | 0.90 % |
| Net interest margin (1) | 3.95 | 4.01 | 4.01 | 3.87 | 3.63 |
| **Equity Ratio:** | | | | | |
| Return on average shareholder's equity | 17.08 % | 20.10 % | 22.99 % | 21.19 % | 14.99 % |
| Equity to assets | 6.28 | 6.83 | 6.96 | 6.62 | 6.35 |

Visit our website at www.firstexchangebank.com

(1) As a percent of average earning assets


Total Assets, Loans, & Deposits
(Thousands)
$300,000.00
$250,000.00
$200,000.00
$150,000.00
$100,000.00
$50,000.00
$-
2014
2015
2016
2017
2018
Assets
Loans
Deposits

HERITAGE BANCSHARES, INC. (AN S CORPORATION) AND SUBSIDIARY
AUDITED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2018

SNODGRASS
CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

# INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Shareholders
Heritage Bancshares, Inc. (an S Corporation) and Subsidiary
Mannington, West Virginia

**Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of Heritage Bancshares, Inc. (an S Corporation) and its Subsidiary, which comprise the consolidated balance sheet as of December 31, 2018 and 2017; the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended; and the related notes to the consolidated financial statements.

**Management's Responsibility for the Financial Statements**

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

**Auditor's Responsibility**

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

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

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

**Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Heritage Bancshares, Inc. (an S Corporation) and Subsidiary as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

S. R. Snodgrass, P.C.

Cranberry Township, Pennsylvania
February 22, 2019

S.R. Snodgrass, P.C. • 2009 Mackenzie Way, Suite 340 • Cranberry Township, Pennsylvania 16066 • Phone: 724-934-0344 • Fax: 724-934-0345

HERITAGE BANCSHARES, INC. (AN S CORPORATION) AND SUBSIDIARY
HERITAGE BANCSHARES, INC.
CONSOLIDATED BALANCE SHEET

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 5,183,752 | $ 4,348,744 |
| Federal funds sold | 11,388 | 169,814 |
| Total cash and cash equivalents | 5,195,140 | 4,518,558 |
| Certificates of deposit | 100,000 | 100,000 |
| Investment securities available for sale | 20,584,999 | 19,657,519 |
| Loans | 233,269,591 | 209,281,270 |
| Less allowance for loan losses | (3,097,667) | (2,667,733) |
| Net loans | 230,171,924 | 206,613,537 |
| Bank premises and equipment, net | 4,219,768 | 3,669,046 |
| Bank-owned life insurance | 5,781,280 | 5,628,541 |
| Federal Home Loan Bank stock | 1,525,500 | 1,053,200 |
| Accrued interest receivable | 722,902 | 646,340 |
| Other assets | 960,868 | 899,842 |
| TOTAL ASSETS | $ 269,262,381 | $ 242,786,583 |
| LIABILITIES | | |
| Deposits: | | |
| Noninterest-bearing demand | $ 39,581,892 | $ 43,277,057 |
| Interest-bearing demand | 172,282,793 | 153,898,200 |
| Total deposits | 211,864,685 | 197,175,257 |
| Short-term borrowings | 31,610,600 | 16,926,181 |
| Subordinated debentures owed to unconsolidated subsidiary trust | 5,671,000 | 5,671,000 |
| Long-term borrowings | 1,553,336 | 4,902,724 |
| Other liabilities | 1,655,668 | 1,529,157 |
| TOTAL LIABILITIES | 252,355,289 | 226,204,319 |
| SHAREHOLDERS' EQUITY | | |
| Common stock, par value $.50 per share; authorized 5,600,000 shares, issued 1,383,575 shares, 1,060,042 shares outstanding | 691,788 | 691,788 |
| Capital surplus | 2,426,852 | 2,426,852 |
| Retained earnings | 17,442,415 | 16,868,634 |
| Treasury stock, at cost, 323,533 shares | (3,305,110) | (3,305,110) |
| Accumulated other comprehensive loss | (348,853) | (99,900) |
| TOTAL SHAREHOLDERS' EQUITY | 16,907,092 | 16,582,264 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | $ 269,262,381 | $ 242,786,583 |

See accompanying notes to the consolidated financial statements.

HERITAGE BANCSHARES, INC. (AN S CORPORATION) AND SUBSIDIARY
HERITAGE BANCSHARES, INC.
CONSOLIDATED STATEMENT OF INCOME

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| INTEREST INCOME | | | |
| Interest and fees on loans: | | | |
| Taxable | $ 10,680,485 | $ 9,633,285 | $ 9,169,233 |
| Tax-exempt | 81,109 | 91,660 | 93,471 |
| Interest and dividends on securities: | | | |
| Taxable | 576,301 | 476,566 | 479,521 |
| Interest on federal funds sold | 9,918 | 6,464 | 2,909 |
| Interest on certificates of deposit | 1,882 | 4,723 | 9,442 |
| Total interest income | 11,349,695 | 10,212,698 | 9,754,576 |
| INTEREST EXPENSE | | | |
| Interest expense on deposits | 1,097,036 | 841,265 | 908,924 |
| Other interest | 707,170 | 451,227 | 288,491 |
| Total interest expense | 1,804,206 | 1,292,492 | 1,197,415 |
| NET INTEREST INCOME | 9,545,489 | 8,920,206 | 8,557,161 |
| Provision for loan losses | 1,291,000 | 559,500 | 201,000 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 8,254,489 | 8,360,706 | 8,356,161 |
| OTHER OPERATING INCOME | | | |
| Service fees | 1,126,761 | 1,095,604 | 1,117,616 |
| Insurance commissions | 6,885 | 10,358 | 22,572 |
| Earnings on bank-owned life insurance | 152,739 | 155,335 | 115,588 |
| Gain (loss) on sale of other real estate owned | 20,119 | (14,751) | (101,738) |
| Other | 631,338 | 239,003 | 337,782 |
| Total other operating income | 1,937,842 | 1,485,549 | 1,491,820 |
| OTHER OPERATING EXPENSES | | | |
| Salaries and employee benefits | 3,305,742 | 3,068,869 | 2,936,790 |
| Net occupancy expense | 262,381 | 230,236 | 223,455 |
| Equipment rentals, depreciation, and maintenance | 784,102 | 776,091 | 711,361 |
| Professional fees | 278,296 | 192,493 | 227,989 |
| Computer expense | 1,058,276 | 925,956 | 731,118 |
| FDIC assessment | 154,488 | 112,190 | 134,922 |
| Other | 1,421,972 | 1,223,738 | 1,315,467 |
| Total other operating expenses | 7,265,257 | 6,529,573 | 6,281,102 |
| NET INCOME | $ 2,927,074 | $ 3,316,682 | $ 3,566,879 |
| EARNINGS PER SHARE | $ 2.76 | $ 3.13 | $ 3.36 |
| AVERAGE SHARES OUTSTANDING | 1,060,042 | 1,060,042 | 1,060,042 |

See accompanying notes to the consolidated financial statements.

HERITAGE BANCSHARES, INC. (AN S CORPORATION) AND SUBSIDIARY
HERITAGE BANCSHARES, INC.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

| | Year Ended December 31, 2018 | 2017 | 2016 |
|---|---|---|---|
| Net income | $ 2,927,074 | $ 3,316,682 | $ 3,566,879 |
| Other comprehensive loss: | | | |
| Increase in unrealized losses on available-for-sale securities | (248,953) | (105,064) | (97,319) |
| Other comprehensive loss | (248,953) | (105,064) | (97,319) |
| Comprehensive income | $ 2,678,121 | $ 3,211,618 | $ 3,469,560 |

See accompanying notes to the consolidated financial statements.

HERITAGE BANCSHARES, INC. (AN S CORPORATION) AND SUBSIDIARY
HERITAGE BANCSHARES, INC.
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

| | Common Stock | Capital Surplus | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive (Loss) income | Total |
|---|---|---|---|---|---|---|
| Balance, December 31, 2015 | $ 691,788 | $ 2,426,852 | $ 14,776,464 | $ (3,305,110) | $ 102,483 | $ 14,962,477 |
| Net income | - | - | 3,566,879 | - | - | 3,566,879 |
| Dividends declared ($2.16 per share) | - | - | (2,289,691) | - | - | (2,289,691) |
| Change in net unrealized gain (loss) on securities | - | - | - | - | (97,319) | (97,319) |
| Balance, December 31, 2016 | 691,788 | 2,426,852 | 16,053,652 | (3,305,110) | 5,164 | 15,872,346 |
| Net income | - | - | 3,316,682 | - | - | 3,316,682 |
| Dividends declared ($2.36 per share) | - | - | (2,501,700) | - | - | (2,501,700) |
| Change in net unrealized gain (loss) on securities | - | - | - | - | (105,064) | (105,064) |
| Balance, December 31, 2017 | 691,788 | 2,426,852 | 16,868,634 | (3,305,110) | (99,900) | 16,582,264 |
| Net income | - | - | 2,927,074 | - | - | 2,927,074 |
| Dividends declared ($2.22 per share) | - | - | (2,353,293) | - | - | (2,353,293) |
| Change in net unrealized gain (loss) on securities | - | - | - | - | (248,953) | (248,953) |
| Balance, December 31, 2018 | $ 691,788 | $ 2,426,852 | $ 17,442,415 | $ (3,305,110) | $ (348,853) | $ 16,907,092 |

See accompanying notes to the consolidated financial statements.

HERITAGE BANCSHARES, INC. (AN S CORPORATION) AND SUBSIDIARY
HERITAGE BANCSHARES, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

| | Year Ended December 31, 2018 | 2017 | 2016 |
|---|---|---|---|
| OPERATING ACTIVITIES | | | |
| Net income | $ 2,927,074 | $ 3,316,682 | $ 3,566,879 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation | 348,689 | 361,521 | 330,902 |
| Provision for loan losses | 1,291,000 | 559,500 | 201,000 |
| Loss on disposal of fixed assets | 1,052 | 3,337 | 322 |
| (Gain) loss on sale of other real estate owned | (20,119) | 14,751 | 101,738 |
| Increase in accrued interest receivable | (76,562) | (90,387) | (51,227) |
| Amortization of security premiums and accretion of discounts, net | 136,129 | 134,734 | 164,825 |
| Earnings on bank-owned life insurance | (152,739) | (155,335) | (115,588) |
| (Increase) decrease in other assets | (110,478) | (94,963) | 159,486 |
| Increase (decrease) in other liabilities | 190,115 | (8,567) | 76,221 |
| Net cash provided by operating activities | 4,534,161 | 4,041,273 | 4,434,558 |
| INVESTING ACTIVITIES | | | |
| Proceeds from certificates of deposits, net | - | 500,000 | 498,000 |
| Proceeds from maturities and calls of securities available for sale | 2,000,001 | - | - |
| Principal payments received on securities available for sale | 3,892,181 | 3,865,405 | 4,023,276 |
| Purchases of securities available for sale | (7,204,744) | (5,247,617) | - |
| Loans made to customers, net | (24,965,541) | (13,247,673) | (10,784,913) |
| Purchases of bank premises and equipment | (900,463) | (345,968) | (1,449,856) |
| Purchase of bank-owned life insurance | - | (1,200,000) | - |
| Proceeds from sale of other real estate owned | 185,725 | 182,642 | 480,192 |
| Purchase of FHLB stock | (1,977,200) | (1,502,300) | (1,298,100) |
| Redemption of FHLB stock | 1,504,900 | 1,430,000 | 1,261,000 |
| Net cash used for investing activities | (27,465,141) | (15,565,511) | (7,270,401) |
| FINANCING ACTIVITIES | | | |
| Net increase of demand deposits, NOW accounts and savings accounts | 3,990,150 | 11,714,003 | 5,194,605 |
| Increase (decrease) in time deposits | 10,699,278 | 1,470,786 | (4,577,862) |
| Dividends paid | (2,416,897) | (2,628,904) | (1,971,678) |
| Net proceeds from short-term borrowings | 14,684,419 | 1,131,099 | 6,261,482 |
| Proceeds form long-term borrowings | - | 3,000,000 | - |
| Principal payments on long-term borrowings | (3,349,388) | (3,307,186) | (2,355,625) |
| Net cash provided by financing activities | 23,607,562 | 11,379,798 | 2,550,922 |
| Increase (decrease) in cash and cash equivalents | 676,582 | (144,440) | (284,921) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | 4,518,558 | 4,662,998 | 4,947,919 |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | $ 5,195,140 | $ 4,518,558 | $ 4,662,998 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | | |
| Cash payments for: | | | |
| Interest on deposits and borrowings | $ 1,767,735 | $ 1,285,104 | $ 1,226,484 |
| SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCIAL ACTIVITIES | | | |
| Other real estate and repossessed assets acquired in settlement of loans | $ 116,155 | $ 325,500 | $ 100,000 |
| Dividends declared but unpaid | $ 593,623 | $ 657,227 | $ 784,431 |

See accompanying notes to the consolidated financial statements.

HERITAGE BANCSHARES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

# 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of business: Heritage Bancshares, Inc. (an S Corporation) (the "Company") is a bank holding company. The subsidiary, First Exchange Bank (the "Bank"), is a commercial bank with locations in Marion County, Wetzel County, and Monongalia County, West Virginia. The Bank provides retail and commercial loan and deposit services to individuals and small businesses in Marion, Wetzel, Monongalia, and the surrounding counties of West Virginia. The Bank is the sole member of First Heritage Insurance Services, LLC, a company incorporated during 2000. First Heritage Insurance Services, LLC had no significant operations during 2018, 2017, and 2016.

Basis of financial statement presentation: The accounting and reporting policies of Heritage Bancshares, Inc. (an S Corporation) and its wholly owned subsidiary conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry.

Principles of consolidation: The accompanying consolidated financial statements include the accounts of Heritage Bancshares, Inc. (an S Corporation) and it's wholly owned subsidiary, First Exchange Bank, which is also the parent of First Heritage Insurance Services, LLC. All significant intercompany accounts and transactions have been eliminated in consolidation.

Variable interest entities: In accordance with ASC Topic 810, business enterprises that represent the primary beneficiary of another entity by retaining a controlling interest in that entity's assets, liabilities, and results of operations must consolidate the entity in its financial statements. The Company has determined that the provisions of ASC Topic 810 require deconsolidation of subsidiary trusts which issued guaranteed preferred beneficial interests in subordinated debentures (trust preferred securities). Heritage Bancshares Statutory Trust I, issued in 2005, has not been consolidated in the Consolidated Balance Sheet. The trust preferred securities continue to qualify as Tier 1 capital for regulatory purposes. The banking regulatory agencies have not issued any guidance that would change the regulatory capital treatment for the trust preferred securities based on the adoption of ASC Topic 810. See Note 8 of the Notes to Consolidated Financial Statements for a discussion of the subordinated debentures.

Accounting estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. For the year ended December 31, 2018, we evaluated subsequent events through February 22, 2019.

Presentation of cash flows: For purposes of reporting cash flows, cash and due from banks includes cash on hand and noninterest-bearing balances due from banks (including cash items in process of clearing) and federal funds sold. Cash flows from demand deposits, NOW accounts, savings accounts, and interest-bearing deposits, and short-term borrowings are reported net since their original maturities are less than three months. Cash flows from loans and certificates of deposits and other time deposits are reported net.

Securities: Securities are classified as held to maturity, available for sale, or trading at the time of purchase of each security and are re-evaluated at each reporting date.

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The appropriate classification is determined as follows:

Securities held to maturity: Debt securities for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted for amortization of premiums and accretion of discounts that are recognized using the interest method.

Securities available for sale: Securities not classified as held to maturity or as trading are classified as available for sale. Securities classified as available for sale are those securities the Bank intends to hold for an indefinite period of time, but not necessarily to maturity. Available for sale securities are reported at estimated fair value net of unrealized gains or losses, which are adjusted for applicable income taxes, and reported as a separate component of shareholders' equity.

Trading securities: There are no securities classified as trading in the accompanying consolidated financial statements.

Realized gains and losses on sales of securities are recognized on the specific identification method. Amortization of premiums and accretion of discounts are computed using methods that approximate the interest method.

Loans and allowance for loan losses: Loans are stated at the amount of unpaid principal, reduced by an allowance for loan losses. For all loans, interest is accrued daily on the outstanding balances.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. The allowance is increased by provisions charged to operating expense and reduced by net charge-offs. The Bank makes continuous credit reviews of the loan portfolio and considers current economic conditions, historical loan loss experience, review of specific problem loans, and other factors in determining the adequacy of the allowance for loan losses. Loans are charged against the allowance for loan losses when management believes collectability to be unlikely. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in conditions.

A loan is impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due in accordance with the contractual terms of the specific loan agreement. Impaired loans, other than certain large groups of smaller-balance, homogeneous loans that are collectively evaluated for impairment, are required to be reported at the present value of expected future cash flows discounted using the loan's original effective interest rate or, alternatively, at the loan's observable market price, or at the fair value of the loan's collateral if the loan is collateral dependent. The method selected to measure impairment is made on a loan-by-loan basis, unless foreclosure is deemed to be probable, in which case the fair value of the collateral method is used.

Loans are placed on nonaccrual status when management believes that the borrower's financial condition, after giving consideration to economic and business conditions and collection efforts, is such that collection of interest is doubtful. Interest is accrued daily on impaired loans unless the loan is placed on nonaccrual status. Impaired loans are placed on nonaccrual status when the payments of principal and interest are in default for a period of 90 days, unless the loan is both well-secured and in the process of collection. Interest on nonaccrual loans is recognized primarily using the cost-recovery method. Loans may be returned to accrual status when repayment is reasonably assured and there has been demonstrated performance under the terms of the loan or if applicable, the terms of the restructured loans.

Certain loan fees and direct loan costs are recognized as income or expense when incurred, whereas, ASC Topic 310 requires that such fees and costs be deferred and amortized as adjustments of the related loan's yield over the contractual life of the loan. The Bank's method of recognition of loan fees and direct loan costs produces results that are not materially different from those that would have been recognized had ASC Topic 310 been adopted.

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Bank premises and equipment: Land is carried at cost. Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed primarily by the straight-line method over the estimated useful lives of the assets. Repairs and maintenance expenditures are charged to operating expenses as incurred. Major improvements and additions to premises and equipment are capitalized.

Other real estate owned: Other real estate owned consists primarily of real estate held for resale, which was acquired through foreclosure on loans secured by such real estate. At the time of acquisition, these properties are recorded at the lower of cost or estimated fair value with any write-down being charged to the allowance for loan losses. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are recorded to loss on foreclosed real estate as incurred. Other real estate owned, which is included in other assets in the accompanying Consolidated Balance Sheet, was not significant at December 31, 2018 and 2017.

Foreclosed assets acquired in settlement of loans carried at fair value less estimated costs to sell are included in the other assets on the Consolidated Balance Sheet. As of December 31, 2018 and 2017, a total of $117,655 and $167,107, respectively, of residential real estate foreclosed assets were included in other assets. As of December 31, 2017, the Company has not initiated formal foreclosure procedures on any consumer residential mortgages. As of December 31, 2018, the Company has initiated formal foreclosure procedures on $74,000 of consumer residential mortgages. The Company did not have any consumer residential mortgages for which foreclosing proceedings had been initiated at December 31, 2017.

Federal Home Loan Bank stock: The Bank is a member of the Federal Home Loan Bank (FHLB) system federal funds program. FHLB members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is an equity security, which is included in other assets in the accompanying consolidated financial statements. Such securities are carried at cost since they may only be sold back to the respective issuer or another member at par value. These securities are classified as restricted securities and are periodically evaluated for impairment based on the ultimate recovery of par value. Both cash and stock dividends are reported as income.

Employee benefits: The Bank has a contributory pension plan that covers substantially all employees. Pension costs are approved by the Board of Directors and charged to expense.

Income taxes: The Company elected S Corporation status effective January 1, 2009. As an S Corporation, the earnings and losses after that date will be included in the personal income tax returns of the shareholders and taxed depending on their personal tax strategies. Accordingly, the Company will not incur additional income tax obligations, and financial statements will not include a provision for income taxes.

The Company recognizes and measures its unrecognized tax benefits in accordance with FASB ASC 740, *Income Taxes*. Under the guidance, the Company assesses the likelihood, based on their technical merit, that tax positions will be sustained upon examination based on the facts, circumstances, and information available at the end of each period. The measurement of unrecognized tax benefits is adjusted when new information is available, or when an event occurs that requires change. There is currently no liability for uncertain tax positions and no known unrecognized tax benefits. The Company recognizes, when applicable, interest and penalties related to on the unrecognized tax benefits in other expenses on the Consolidated Statement of Income. The Company's federal and state income tax returns for taxable years ending prior to 2015 are closed for purposes of examination by the Internal Revenue Service and state taxing authorities.

Earnings per share: Basic earnings per common share are computed based upon the weighted-average shares outstanding. The weighted-average shares outstanding were 1,060,042 for 2018, 2017, and 2016. During the years ended December 31, 2018, 2017, and 2016, the Company did not have any potentially dilutive securities.

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Reclassifications: Certain amounts in the consolidated financial statements such reclassification had no effect on net income or shareholders' equity, as previously presented, have been reclassified to conform to current-year classifications.

Cash surrender value of life insurance: The Company owns insurance on the lives of a certain group of key employees. The policies were purchased to help offset the increase in the costs of various fringe benefit plans including healthcare. The cash surrender value of these policies is included as an asset on the Consolidated Balance Sheet, and any increases in the cash surrender value are recorded as noninterest income on the Consolidated Statements of Income. In the event of the death of an insured individual under these policies, the Company would receive a death benefit, which would be recorded as noninterest income.

Comprehensive income: The Company is required to present comprehensive income and its components in a full set of general-purpose financial statements for all periods presented. Other comprehensive income (loss) comprises unrealized holding gains and losses on the available-for-sale securities portfolio.

Transfers of financial assets: Transfers of financial assets, including loan and loan participation sales, are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Bank; (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets; and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Adoption of accounting standard: The Company has early adopted FASB ASU 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." For entities other than public business entities, the update eliminates the requirement under Topic 825, "Financial Instruments," to disclose the fair values of financial assets and financial liabilities measured in the financial statements at amortized cost. Further, this update excludes receivables and payables due in one year or less, deposit liabilities with no defined or contractual maturities and nonmarketable equity securities accounted for under the practicability election from this disclosure requirement.

Significant authoritative guidance: In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This Update applies to all entities that hold financial assets or owe financial liabilities and is intended to provide more useful information on the recognition, measurement, presentation, and disclosure of financial instruments. Among other things, this Update (a) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (b) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (c) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (d) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (e) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (f) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (g) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For all other entities, including not-for-profit entities and employee benefit plans within the scope of Topics 960 through 965 on plan accounting, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Significant authoritative guidance (Continued)

within fiscal years beginning after December 15, 2019. All entities that are not public business entities may adopt the amendments in this Update earlier as of the fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. This Update is not expected to have a significant impact on the Company's financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (a new revenue recognition standard). The Update's core principle is that a company will recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, this Update specifies the accounting for certain costs to obtain or fulfill a contract with a customer and expands disclosure requirements for revenue recognition.

In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606). The amendments in this Update defer the effective date of ASU 2014-09 for all entities by one year. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. All other entities should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. The Company is evaluating the effect of adopting this new accounting Update.

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

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments*, which changes the impairment model for most financial assets. This Update is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The underlying premise of the Update is that financial assets measured at amortized cost should be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The allowance for credit losses should reflect management's current estimate of credit losses that are expected to occur over the remaining life of a financial asset. The income statement will be effected for the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2019, and early adoption is permitted for annual and interim periods beginning after December 15, 2018. With certain exceptions, transition to the new requirements will be through a cumulative effect adjustment to opening retained earnings as of the beginning of the first reporting period in which the guidance is adopted.

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Significant authoritative guidance (Continued)

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

## 2. INVESTMENT SECURITIES AVAILABLE FOR SALE

The amortized cost, unrealized gains, unrealized losses, and fair values of investment securities are as follows:

| | 2018 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| U.S. government agencies and corporations | $ 999,344 | $ - | $ (2,514) | $ 996,830 |
| Mortgage-backed securities - U.S. government agencies and corporations | 19,904,835 | 41,234 | (357,900) | 19,588,169 |
| Total available for sale | $ 20,904,179 | $ 41,234 | $ (360,414) | $ 20,584,999 |

| | 2017 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| U.S. government agencies and corporations | $ 2,992,988 | $ 493 | $ - | $ 2,993,481 |
| Mortgage-backed securities - U.S. government agencies and corporations | 16,734,758 | 77,538 | (148,258) | 16,664,038 |
| Total available for sale | $ 19,727,746 | $ 78,031 | $ (148,258) | $ 19,657,519 |

Impairment is evaluated considering numerous factors and their relative significance varies case to case. Factors considered include the length of time and extent to which the market value has been less than cost; the financial condition and near-term prospects of the issuer; and the ability and intent to retain the security until recovery.

The Company has 65 securities in an unrealized loss position at December 31, 2018. The unrealized losses are due to overall increases in market interest rates and not underlying credit concerns of the issuers. The Company has the ability and intent to hold such investments until maturity or market price recovery. Accordingly, the Company has concluded that none of the securities in its investment portfolio are other-than-temporarily impaired at December 31, 2018 and 2017.

## 2. INVESTMENT SECURITIES AVAILABLE FOR SALE (Continued)

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

| | 2018 | | | | | |
|---|---|---|---|---|---|---|
| | Less than Twelve Months | | Twelve Months or Greater | | Total | |
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| U.S. government agencies and corporations | $ 996,830 | $ (2,514) | $ - | $ - | $ 996,830 | $ (2,514) |
| Mortgage-backed securities - U.S. government agencies and corporations | 5,116,832 | (50,188) | 11,133,864 | (307,712) | 16,250,696 | (357,900) |
| Total | $ 6,113,662 | $ (52,702) | $ 11,133,864 | $ (307,712) | $ 17,247,526 | $ (360,414) |

| | 2017 | | | | | |
|---|---|---|---|---|---|---|
| | Less than Twelve Months | | Twelve Months or Greater | | Total | |
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| U.S. government agencies and corporations | $ 240,246 | $ (5,010) | $ - | $ - | $ 240,246 | $ (5,010) |
| Mortgage-backed securities - U.S. government agencies and corporations | $ 6,221,654 | $ (58,257) | $ 5,986,934 | $ (84,991) | $ 12,208,588 | $ (143,248) |
| Total | $ 6,461,900 | $ (63,267) | $ 5,986,934 | $ (84,991) | $ 12,448,834 | $ (148,258) |

Mortgage-backed obligations of U.S. government agencies and corporations are included in securities at December 31, 2018 and 2017, respectively. These obligations, having contractual remaining lives to maturities ranging from less than a year to 30 years, are reflected in the following maturity distribution schedules. Accordingly, discounts are accreted and premiums are amortized over the anticipated average life to maturity of the specific obligation. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

## 2. INVESTMENT SECURITIES AVAILABLE FOR SALE (Continued)

| | Amortized Cost | Fair Value |
|---|---|---|
| Due in one year or less | $ 999,381 | $ 996,867 |
| Due after one year through five years | 417,261 | 410,906 |
| Due after five years through ten years | 5,659,126 | 5,534,739 |
| Due after ten years | 13,828,411 | 13,642,487 |
| Total | $ 20,904,179 | $ 20,584,999 |

Securities carried at $590,125 and $685,243 at December 31, 2018 and 2017, respectively, with estimated fair values of $591,308 and $686,608, respectively, were pledged to secure public deposits and for other purposes required or permitted by law.

The following table discloses proceeds from investment securities available for sale and gross gains and losses for the years ended December 31:

| | Proceeds From | | | Gross Realized | |
|---|---|---|---|---|---|
| For the Years Ended December 31, | Sales | Calls and Maturities | Principal Payments | Gains | Losses |
| 2018 | | | | | |
| Available for sale | $ - | $ 2,000,001 | $ 3,892,181 | $ - | $ - |
| 2017 | | | | | |
| Available for sale | $ - | $ - | $ 3,865,405 | $ | $ |
| 2016 | | | | | |
| Available for sale | $ - | $ | $ 4,023,276 | $ - | $ - |

## 3. LOANS

Major classifications of loans are summarized as follows:

| | 2018 | 2017 |
|---|---|---|
| Commercial, financial, and agricultural - secured by real estate | $ 83,232,526 | $ 70,272,580 |
| Commercial, financial, and agricultural - other | 22,020,511 | 20,946,211 |
| Consumer real estate | 118,375,994 | 108,921,775 |
| Consumer loans | 9,640,560 | 9,140,704 |
| | 233,269,591 | 209,281,270 |
| Less: Allowance for loan losses | 3,097,667 | 2,667,733 |
| Net loans | $ 230,171,924 | $ 206,613,537 |

## 3. LOANS (Continued)

Included in the balance of net loans are nonaccrual loans amounting to $5,797,766 and $4,539,178 at December 31, 2018 and 2017, respectively. If interest on nonaccrual loans had been accrued, such income would have approximated $277,380, $208,107, and $214,203 for the years ended December 31, 2018, 2017, and 2016, respectively.

The following table presents the nonaccrual loans included in the net balance of loans at December 31, 2018 and 2017:

| | 2018 | 2017 |
|---|---|---|
| Commercial, financial, and agricultural - secured by real estate | $ 2,921,590 | $ 1,338,032 |
| Commercial, financial, and agricultural - other | 49,068 | 17,500 |
| Consumer real estate | 2,784,425 | 3,031,780 |
| Consumer loans | | |
| Auto | 28,250 | 94,027 |
| Other | 14,433 | 57,839 |
| Net loans | $ 5,797,766 | $ 4,539,178 |

## 4. ALLOWANCE FOR LOAN LOSSES

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Company has segmented certain loans in the portfolio by product type. Loans are segmented into the following pools: residential; commercial real estate loans; commercial non-real estate loans; and consumer loans. Historical loss percentages for each risk category are calculated and used as the basis for calculating allowance allocations. These historical loss percentages are calculated over a three-year period for all portfolio segments. Certain qualitative factors are then added to the historical allocation percentage to get the adjusted factor to be applied to nonclassified loans.

The qualitative factors are reviewed each quarter and adjusted based upon relevant changes within the portfolio. During 2018, the commercial real estate, residential, and consumer allowance for loan losses increase resulted from the increased loan growth over the period and an increase in the level of charge offs at the Bank. The commercial non-real estate allowance for loan losses remained relatively the same as a result of the moderate loan growth and little charge off activity. During 2017, the commercial non- real estate allowance for loan losses increase was directly a result of the increased volume for loan growth for the year. The increase in the allowance for loan loss for commercial real estate was a result of an increased volume of loan growth and the decrease in credit quality. The consumer allowance for loan losses decrease resulted from the decrease in the overall approval accompanied by increase in credit quality. The residential allowance for loan losses increased due to a decrease in credit quality accompanied with increases in the impaired loans for the loan type and an increase in delinquencies.

## 4. ALLOWANCE FOR LOAN LOSSES (Continued)

Changes in the allowance for loan losses for the years ended 2018, 2017, and 2016 by loan portfolio segment are as follows:

| | 2018 | | | | |
|---|---|---|---|---|---|
| | Commercial Non-Real Estate | Commercial Real Estate | Consumer | Residential | Total |
| Allowance for loan losses: | | | | | |
| Beginning balance | $ 488,709 | $ 1,000,431 | $ 286,231 | $ 892,362 | $ 2,667,733 |
| Charge-offs | 10,058 | 167,176 | 162,615 | 620,387 | 960,236 |
| Recoveries | 11,600 | 18,725 | 58,558 | 10,287 | 99,170 |
| (Credit) provision | (2,312) | 222,573 | 156,013 | 914,726 | 1,291,000 |
| Ending balance | $ 487,939 | $ 1,074,553 | $ 338,187 | $ 1,196,988 | $ 3,097,667 |

| | 2017 | | | | |
|---|---|---|---|---|---|
| | Commercial Non-Real Estate | Commercial Real Estate | Consumer | Residential | Total |
| Allowance for loan losses: | | | | | |
| Beginning balance | $ 432,710 | $ 839,870 | $ 477,331 | $ 709,404 | $ 2,459,315 |
| Charge-offs | - | 232,862 | 292,711 | 108,268 | 633,841 |
| Recoveries | - | 205,554 | 77,175 | 30 | 282,759 |
| Provision | 55,999 | 187,869 | 24,436 | 291,196 | 559,500 |
| Ending balance | $ 488,709 | $ 1,000,431 | $ 286,231 | $ 892,362 | $ 2,667,733 |

| | 2016 | | | | |
|---|---|---|---|---|---|
| | Commercial Non-Real Estate | Commercial Real Estate | Consumer | Residential | Total |
| Allowance for loan losses: | | | | | |
| Beginning balance | $ 430,112 | $ 709,782 | $ 449,879 | $ 729,428 | $ 2,319,201 |
| Charge-offs | - | - | 166,765 | 91,168 | 257,933 |
| Recoveries | 2,598 | 130,088 | 64,261 | 100 | 197,047 |
| Provision | - | - | 129,956 | 71,044 | 201,000 |
| Ending balance | $ 432,710 | $ 839,870 | $ 477,331 | $ 709,404 | $ 2,459,315 |

## 4. ALLOWANCE FOR LOAN LOSSES (Continued)

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the Consolidated Balance Sheet date. The Company considers the allowance for loan losses of $3,097,667 and $2,667,733 adequate to cover loan losses inherent in the loan portfolio, at December 31, 2018 and 2017, respectively. The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31:

| | 2018 | | | | |
|---|---|---|---|---|---|
| | Commercial Non-Real Estate | Commercial Real Estate | Consumer | Residential | Total |
| **Allowance for loan losses:** | | | | | |
| Individually evaluated for impairment | $ 19,672 | $ 535,791 | $ - | $ 393,959 | $ 949,422 |
| Collectively evaluated for impairment | 468,267 | 538,762 | 338,187 | 803,029 | 2,148,245 |
| Total | $ 487,939 | $ 1,074,553 | $ 338,187 | $ 1,196,988 | $ 3,097,667 |
| **Loans:** | | | | | |
| Individually evaluated for impairment | $ 97,317 | $ 4,923,921 | $ 17,371 | $ 2,731,149 | $ 7,769,758 |
| Collectively evaluated for impairment | 21,923,194 | 78,308,605 | 9,623,189 | 115,644,845 | 225,499,833 |
| Total | $ 22,020,511 | $ 83,232,526 | $ 9,640,560 | $ 118,375,994 | $ 233,269,591 |

| | 2017 | | | | |
|---|---|---|---|---|---|
| | Commercial Non-Real Estate | Commercial Real Estate | Consumer | Residential | Total |
| **Allowance for loan losses:** | | | | | |
| Individually evaluated for impairment | $ 26,749 | $ 49,777 | $ 3,690 | $ 50,058 | $ 130,274 |
| Collectively evaluated for impairment | 461,960 | 950,654 | 282,541 | 842,304 | 2,537,459 |
| Total | $ 488,709 | $ 1,000,431 | $ 286,231 | $ 892,362 | $ 2,667,733 |
| **Loans:** | | | | | |
| Individually evaluated for impairment | $ 146,362 | $ 4,843,316 | $ 21,590 | $ 2,040,950 | $ 7,052,218 |
| Collectively evaluated for impairment | 20,799,849 | 65,429,264 | 9,119,114 | 106,880,825 | 202,229,052 |
| Total | $ 20,946,211 | $ 70,272,580 | $ 9,140,704 | $ 108,921,775 | $ 209,281,270 |

## 4. ALLOWANCE FOR LOAN LOSSES (Continued)

### Credit Quality Information

Loans are categorized 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, and current economic trends, among other factors.

**GRADE 1 (Superior)**
Loans in this category are considered to be of the highest quality. The customer's financial performance provides substantial asset protection. Cash flow is continually very high relative to all demand. Earnings are always very strong, stable, or increasing even through economic swings. Leverage, including operating leverage, is very low relative to the borrower's industry and is stable or decreasing. Overall asset quality is very strong.

**GRADE 2 (Excellent)**
Loans in this category are considered to be of excellent quality. The borrower is very liquid. Overall, leverage is relatively low and is stable or declining. Cash flow is more than sufficient to meet total demands. Earnings are very strong and stable, but the rate of growth may differ from year to year.

**GRADE 3 (Very Good)**
Loans graded 3 are of very good quality. These borrowers have a history of successful performance, but may be susceptible to economic changes. Asset quality is very good. The balance sheet shows good liquidity, and overall leverage is normal for the industry in which the borrower operates and is stable. Cash flow levels may fluctuate, but are sufficient to meet demands.

**GRADE 4 (Good)**
Loans in this category, like risk grade 3, are loans of good quality with risk levels within the Bank's range of acceptability. The borrower's business may be cyclical, or its customer base may be concentrated. Servicing requirements are higher than those for risk grade 3 loans.

**GRADE 5 (Fair)**
Loans in this grade are considered to have higher than normal credit risk and servicing needs. Accordingly, a higher than market return is expected. Asset quality is marginally acceptable. Overall leverage may fluctuate, but is not highly volatile, and is frequently at the upper end of the range of what is considered normal for the industry. Cash flow may be marginal, but continues to support operating needs. Cash flow is not considered to be highly volatile. The borrower's profitability trend is favorable and the outlook for continued improvement is good. Companies or borrowers in this category would have limited access to other financing sources (to a few banks and/or asset base lenders) and usually at a premium price. Full guaranties on loans to closely held businesses in this risk grade are always required. Collateral is required on all loans, and advances up to the maximum loan to value per policy are often needed.

**GRADE 6 (Management Attention)**
Loans in this category are considered to have high credit risk and servicing needs. Loans should be in this category, not because they are problem credits, but because they pose a relatively high risk and the Bank needs to follow their performance more closely than other credits with better risk ratings. The borrowers' ability to repay from the primary repayment sources is marginally adequate, and is not clearly sufficient to ensure continued performance as contracted. Loans to borrowers in this category are currently performing as contracted and secondary repayment sources are clearly sufficient to protect against the risk of principal or income loss. It is also reasonable to expect that the circumstances causing repayment capacity to be uncertain will be resolved within six to nine months. Access to alternative financing sources exist, though may be limited to institutions specializing in high-risk financing. Borrowers in this category may have a long-term satisfactory repayment history (i.e., more than 12 consecutive months with no 30+ days past-due status) but financial information is dated, or there is a delay in receiving financials. Borrowers in this category may be operating in an industry that is highly susceptible to downturns in the national or local economies.

## 4. ALLOWANCE FOR LOAN LOSSES (Continued)

**Credit Quality Information (Continued)**

**GRADE 7 (Special Mention)**
Customer's financial condition and position are often unstable. Industry conditions are often troubled or in the process of rapid change. The borrower's ability to repay from primary sources is currently adequate but threatened by potential weakness, which is not checked or corrected, resulting in the Bank being inadequately protected against the risk of principal or income loss at some future date. The borrower is highly susceptible to current economic or market conditions that may adversely affect its ability to repay. The cash flow of these borrowers is currently adequately or slightly inadequate and may not improve in the near future.

Borrowers in this category are experiencing adverse operating trends or operating with unusually high financial leverage, thereby increasing the risk of untimely payment, but not to the extent that liquidation of the loan is jeopardized. This category may include borrowers that have filed bankruptcy and are successfully operating under a plan of reorganization that is provided to the Bank with adequate repayment of debt.

**GRADE 8 (Substandard)**
The Bank is inadequately protected by the current net worth and paying capacity of the customer. Loans in this category are characterized by high debt to worth, negative cash flow, and negative debt service capacity. There is a history of consecutive operating losses and negative cash flow for the business. Customers who have filed bankruptcy and are in the status of initial filing/up to acceptance of reorganization plan are considered Substandard. Collateral securing the debt may be real estate, accounts receivable, inventory, and equipment that have questionable value. Loans in this category may be placed on nonaccrual until such a time as the borrower's financial condition improves. Some loss of principal or income is possible; however, the total amount of such loss should not exceed 25 percent of the outstanding loan balance.

**GRADE 9 (Doubtful)**
Loans classified in this category are considered partially uncollectible and of such little value that their continuation as bankable assets may not be warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but the estimate principal loss of a loan in this classification will exceed 25 percent of the outstanding loan balance. Any time a credit is placed in this category, it should also assume nonaccrual status. The collateral values securing loans in this category are not sufficient to completely cover the loss, but until certain pending factors, such as liquidation procedures, merger acquisition, capital injection, or additional collateral is completed, determination of total loss is unknown.

**GRADE 10 (Loss)**
Loans classified in this category are considered uncollectible and the possibility of recovery is unlikely.

The following tables present the recorded investment in commercial and commercial real estate loans, which are generally evaluated based upon the internal risk ratings defined above as of December 31, 2018 and 2017. Loans classified as Pass below include loans rated as Management Attention or better.

| | 2018 | | |
|---|---|---|---|
| | | Commercial Real Estate | |
| | Commercial | Construction | Other |
| Pass | $ 21,971,483 | $ 5,832,612 | $ 74,902,094 |
| Special Mention | - | - | - |
| Substandard | 49,068 | - | 2,497,820 |
| Doubtful | - | - | - |
| Loss | - | - | - |
| Total | $ 22,020,511 | $ 5,832,612 | $ 77,399,914 |

## 4. ALLOWANCE FOR LOAN LOSSES (Continued)

**Credit Quality Information (Continued)**

| | 2017 | | |
|---|---|---|---|
| | | Commercial Real Estate | |
| | Commercial | Construction | Other |
| Pass | $ 20,928,661 | $ 5,856,494 | $ 61,594,141 |
| Special Mention | - | - | 1,327,387 |
| Substandard | 17,550 | - | 1,494,558 |
| Doubtful | - | - | - |
| Loss | - | - | - |
| Total | $ 20,946,211 | $ 5,856,494 | $ 64,416,086 |

The following tables present performing and nonperforming residential real estate and consumer loans based on payment activity for the years ended December 31, 2018 and 2017. Payment activity is reviewed by management on a monthly basis to determine how loans are performing. Loans are considered to be nonperforming when they become 90 days past due or are placed on nonaccrual status.

| | 2018 | |
|---|---|---|
| | Performing | Nonperforming |
| Consumer | | |
| Auto | $ 3,844,570 | $ 64,506 |
| Other | 5,672,842 | 58,642 |
| Residential | 115,508,215 | 2,867,779 |
| Total | $ 125,025,627 | $ 2,990,927 |

| | 2017 | |
|---|---|---|
| | Performing | Nonperforming |
| Consumer | | |
| Auto | $ 3,412,165 | $ 94,027 |
| Other | 5,576,673 | 57,839 |
| Residential | 105,889,995 | 3,031,780 |
| Total | $ 114,878,833 | $ 3,183,646 |

Loans to related parties: The Bank has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, principal officers, their immediate families, and affiliated companies in which they are principal stockholders (commonly referred to as related parties), all of which have been, in the opinion of management, on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others.

## 4. ALLOWANCE FOR LOAN LOSSES (Continued)

### Credit Quality Information (Continued)

The following represents the activity with respect to related-party loans aggregating $60,000 or more to directors and officers and their related business interests during the years ended December 31, 2018 and 2017. Other changes represent additions to and changes in director's status.

| | 2018 | 2017 |
|---|---|---|
| Balance, beginning | $ 5,795,612 | $ 6,213,211 |
| Additions | 504,452 | 1,585,751 |
| Amount collected | (158,783) | (1,926,844) |
| Other | (1,129,958) | (76,506) |
| Balance, ending | $ 5,011,323 | $ 5,795,612 |

Concentrations of credit risk: The Bank grants installment, commercial, and residential loans primarily to customers in Marion, Wetzel, Monongalia, and the surrounding West Virginia counties. Although the Bank strives to maintain a diversified loan portfolio, exposure to credit losses can be adversely impacted by downturns in local economic and employment conditions.

The Bank accepts chattel paper without recourse from various approved businesses, primarily automobile dealerships, within its lending area. The Bank has sole discretion whether to purchase such paper on a case-by-case basis, which is evaluated substantially under the Bank's normal credit underwriting standards and is generally secured by a first lien on the property purchased by the borrower. At December 31, 2018 and 2017, such loans approximated $3,455,980 and $3,446,480, respectively.

The following are tables that include an aging analysis of the recorded investment of past-due loans at December 31, 2018 and 2017:

| | 2018 | | | | | | |
|---|---|---|---|---|---|---|---|
| | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or Greater | Total Past Due | Current | Total Loans | Recorded Investment 90 Days or More and Accruing |
| Commercial - | | | | | | | |
| Non-real estate | $ - | $ - | $ - | $ - | $ 22,020,511 | $ 22,020,511 | $ - |
| Commercial - | | | | | | | |
| Real estate | | | | | | | |
| Construction | 37,938 | 51,874 | - | 89,812 | 5,742,800 | 5,832,612 | - |
| Other | 238,741 | 597,772 | 163,055 | 999,568 | 76,400,346 | 77,399,914 | - |
| Consumer | | | | | | | |
| Auto | 134,310 | - | 36,256 | 170,566 | 3,738,510 | 3,909,076 | 36,256 |
| Other | 98,755 | 55,946 | 44,209 | 198,910 | 5,532,574 | 5,731,484 | 44,209 |
| Consumer real estate | 1,275,914 | 561,111 | 1,496,177 | 3,333,202 | 115,042,792 | 118,375,994 | 83,354 |
| Total | $ 1,785,658 | $ 1,266,703 | $ 1,739,697 | $ 4,792,058 | $ 228,477,533 | $ 233,269,591 | $ 163,819 |

## 4. ALLOWANCE FOR LOAN LOSSES (Continued)

**Credit Quality Information (Continued)**

| | 2017 | | | | | | |
|---|---|---|---|---|---|---|---|
| | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or Greater | Total Past Due | Current | Total Loans | Recorded Investment 90 Days or More and Accruing |
| Commercial - Non-real estate | $ - | $ - | $ - | $ - | $ 20,946,211 | $ 20,946,211 | $ - |
| Commercial - Real estate | | | | | | | |
| Construction | - | 26,185 | - | 26,185 | 5,830,309 | 5,856,494 | - |
| Other | - | - | 41,204 | 41,204 | 64,374,882 | 64,416,086 | - |
| Consumer | | | | | | | |
| Auto | 194,539 | - | 41,386 | 235,925 | 3,270,267 | 3,506,192 | - |
| Other | 118,848 | 36,826 | 13,979 | 169,653 | 5,464,859 | 5,634,512 | - |
| Consumer real estate | 1,130,752 | 130,585 | 2,428,619 | 3,689,956 | 105,231,819 | 108,921,775 | - |
| Total | $ 1,444,139 | $ 193,596 | $ 2,525,188 | $ 4,162,923 | $ 205,118,347 | $ 209,281,270 | $ - |

**Impaired Loans**

Management evaluates commercial loans, commercial real estate loans, construction real estate loans, and other loans rated Substandard, Doubtful, or Loss for impairment. The Company will deem a loan to be impaired when, based on current circumstances and events, it is probable that the Bank will be unable to collect all amounts due, including principal and interest, according to the original contractual terms of the loan. These loans are analyzed to determine whether it is probable that all amounts will not be collected according to the contractual terms of the loan agreement. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees, or costs and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance.

## 4. ALLOWANCE FOR LOAN LOSSES (Continued)

### Impaired Loans (Continued)

The following tables include the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount by loan portfolio segment, if applicable, as of and for the years ended December 31, 2018 and 2017:

| | 2018 | | | | |
|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| With a related allowance recorded: | | | | | |
| Commercial | $ 30,672 | $ 30,672 | $ 19,672 | $ 32,803 | $ 1,515 |
| Commercial real estate | | | | | |
| Construction | - | - | - | - | - |
| Other | 1,414,887 | 1,677,880 | 535,791 | 1,356,486 | 51,063 |
| Consumer | | | | | |
| Auto | - | - | - | 14,591 | - |
| Other | - | - | - | - | - |
| Consumer real estate | 1,090,394 | 1,690,394 | 393,959 | 321,442 | - |
| Total | 2,535,953 | 3,398,946 | 949,422 | 1,725,322 | 52,578 |
| With no related allowance recorded: | | | | | |
| Commercial | 66,645 | 66,645 | - | 71,618 | 3,510 |
| Commercial real estate | | | | | |
| Construction | 203 | 203 | - | 623 | 94 |
| Other | 4,599,225 | 5,354,555 | - | 5,599,767 | 128,474 |
| Consumer | | | | | |
| Auto | 17,371 | 17,371 | - | 17,371 | 1,514 |
| Other | - | - | - | - | - |
| Consumer real estate | 1,640,755 | 1,880,073 | - | 1,636,465 | 76,555 |
| Total | 6,324,199 | 7,318,847 | - | 7,325,844 | 210,147 |
| Total impaired loans: | | | | | |
| Commercial | 97,317 | 97,317 | 19,672 | 104,421 | 5,025 |
| Commercial real estate | | | | | |
| Construction | 203 | 203 | - | 623 | 94 |
| Other | 6,014,112 | 7,032,435 | 535,791 | 6,956,253 | 179,537 |
| Consumer | | | | | |
| Auto | 17,371 | 17,371 | - | 31,962 | 1,514 |
| Other | - | - | - | - | - |
| Consumer real estate | 2,731,149 | 3,570,467 | 393,959 | 1,957,907 | 76,555 |
| Total | $ 8,860,152 | $ 10,717,793 | $ 949,422 | $ 9,051,166 | $ 262,725 |

## 4. ALLOWANCE FOR LOAN LOSSES (Continued)

**Impaired Loans (Continued)**

| | 2017 | | | | |
|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
| With a related allowance recorded: | | | | | |
| Commercial | $ 63,319 | $ 63,319 | $ 26,749 | $ 66,771 | $ 3,288 |
| Commercial real estate | | | | | |
| Construction | - | - | - | - | - |
| Other | 301,346 | 433,213 | 49,777 | 347,122 | 21,468 |
| Consumer | | | | | |
| Auto | 21,590 | 21,590 | 3,690 | 21,590 | 746 |
| Other | - | - | - | - | - |
| Consumer real estate | 99,938 | 271,850 | 50,058 | 102,313 | - |
| Total | 486,193 | 789,972 | 130,274 | 537,796 | 25,502 |
| With no related allowance recorded: | | | | | |
| Commercial | 83,043 | 83,043 | - | 128,755 | 4,795 |
| Commercial real estate | | | | | |
| Construction | - | - | - | - | - |
| Other | 4,541,970 | 4,654,751 | - | 3,320,670 | 156,954 |
| Consumer | | | | | |
| Auto | - | - | - | - | - |
| Other | - | - | - | - | - |
| Consumer real estate | 1,941,012 | 1,943,363 | - | 1,961,940 | 77,751 |
| Total | 6,566,025 | 6,681,157 | - | 5,411,365 | 239,500 |
| Total impaired loans: | | | | | |
| Commercial | 146,362 | 146,362 | 26,749 | 195,526 | 8,083 |
| Commercial real estate | | | | | |
| Construction | - | - | - | - | - |
| Other | 4,843,316 | 5,087,964 | 49,777 | 3,667,792 | 178,422 |
| Consumer | | | | | |
| Auto | 21,590 | 21,590 | 3,690 | 21,590 | 746 |
| Other | - | - | - | - | - |
| Consumer real estate | 2,040,950 | 2,215,213 | 50,058 | 2,064,253 | 77,751 |
| Total | $ 7,052,218 | $ 7,471,129 | $ 130,274 | $ 5,949,161 | $ 265,002 |

**Impaired Loans (Continued)**

Included in impaired loans are troubled debt restructurings of $4,719,372 and $5,412,435 at December 31, 2018 and 2017, respectively. The specific allowance for loan loss reserve for loans modified as troubled debt restructurings was $316,453 and $80,497 as of December 31, 2018, and December 31, 2017, respectively.

The allowance for loan losses is maintained at a level considered adequate to provide for the estimate of probable credit losses inherent in the loan portfolio. The allowance is increased by provisions charged to operating expense and reduced by net charge-offs. Loans are charges against the allowance for loan losses when it is believed that collectability is unlikely. Future adjustments may be necessary if there are significant changes in conditions.

The allowance is comprised of three distinct reserve components: (1) specific reserves related to loans individually evaluated, (2) quantitative reserves related to loans collectively evaluated, and (3) qualitative reserves related to loans collectively evaluated. A summary of the methodology with respect to each of these components in order to evaluate the overall adequacy of the allowance for loan losses is as follows:

**Specific Reserve for Loans Individually Evaluated**
Generally, for purposes of evaluating impairment, commercial loans with a remaining balance of $150,000 or greater and rated as Substandard (8), Doubtful (9), or Loss (10) will be reviewed for impairment. Business loans that meet the definition of a troubled debt restructuring (TDR) will also be classified as an impaired loan, and an ASC 310 (ASC 310 or FAS 114) analysis will be completed. Management reserves the right to classify additional loans as impaired. Generally, the entire credit relationship of commercial loans identified above will be included and considered for impairment, even though the additional loans may remain rated as Special Mention (7) or better. Such loan relationships are identified primarily through the analysis of internal loan evaluations, watch-list and past due loan reports, and loans adversely classified by regulatory authorities. Each loan so identified is then individually evaluated to determine whether it is impaired – such that, based on current information and events, it is probable that the Bank will be unable to collect all amounts due in accordance with the contractual terms of the underlying loan agreement. Substantially all of the Bank's impaired loans are, and historically have been, collateral dependent, meaning repayment of the loan is expected to be provided solely from the sale of the loan's underlying collateral. For such loans, impairment is measured based on the fair value of the loan's collateral, which is generally determined utilizing appraisals that are one year old or less. A specific reserve is established in an amount equal to the excess, if any, of the recorded investment in each impaired loan over the fair value of its underlying collateral, less estimated costs to sell.

**Quantitative Reserve for Loans Collectively Evaluated**
Quantitative reserves relative to each loan pool are calculated by applying the three-year average net loan charge-off rate to the aggregate recorded investment in loans.

**Qualitative Reserve for Loans Collectively Evaluated**
The Bank considers it necessary to reserve for additional factors for each of the above loan pools for potential risk factors that could result in actual losses. Such qualitative risk factors considered are: (1) Changes in national and local economic and business conditions and developments, including the condition of various market segments; (2) Changes in the nature and volume of the portfolio; (3) Changes in the experience, ability, and depth of lending management and staff; (4) Changes in the trend of the volume and severity of past-due and classified loans; and trends in the volume of nonaccrual loans, TDRs, and other loan modifications; (5) Changes in the levels and trends in charge-offs and recoveries; (6) Changes in the quality of the institution's loan review system and the degree of oversight by the institution's Board of Directors; and the experience, ability, and depth of lending management and other relevant staff; (7) The existence and effect of any concentrations of credit, and changes in the level of such concentrations; (8) The effect of external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the institutions current portfolio; (9) Change in lending policies and procedures, including underwriting standards and collection, charge-off, and recovery trends; (10) Other analytical procedures that identify divergent trends.

## 4. ALLOWANCE FOR LOAN LOSSES (Continued)

**Troubled Debt Restructuring (TDR)**

The following tables present by class the TDRs that were restructured during the 12 months ended December 31, 2018 and 2017. Generally, the modifications were extensions of term, modifying the payment terms from principal and interest to interest only for an extended period, or reduction in interest rate. All TDRs are evaluated individually for allowance for loan loss purposes:

| | 2018 | | |
|---|---|---|---|
| | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Commercial | - | $ - | $ - |
| Commercial real estate | | | |
| Construction | - | - | - |
| Other | 4 | 317,075 | 317,075 |
| Consumer | | | |
| Auto | - | - | - |
| Other | - | - | - |
| Residential | | | |
| Prime | - | - | - |
| Subprime | - | - | - |
| Total | 4 | $ 317,075 | $ 317,075 |

| | 2017 | | |
|---|---|---|---|
| | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Commercial | - | $ - | $ - |
| Commercial real estate | | | |
| Construction | - | - | - |
| Other | 3 | 1,557,918 | 1,557,918 |
| Consumer | | | |
| Auto | 1 | 22,167 | 22,167 |
| Other | - | - | - |
| Residential | | | |
| Prime | 3 | 280,094 | 280,094 |
| Subprime | - | - | - |
| Total | 7 | $ 1,860,179 | $ 1,860,179 |

## 4. ALLOWANCE FOR LOAN LOSSES (Continued)

**Troubled Debt Restructuring (TDR) (Continued)**

The following tables show TDRs that were granted in the previous 12 months and subsequently defaulted for the years ended December 31:

| | 2018 | |
|---|---|---|
| | Number of Contracts | Recorded Investments |
| Commercial | - | $ - |
| Commercial real estate | | |
| Construction | - | - |
| Other | 3 | 292,499 |
| Consumer | | |
| Auto | - | - |
| Other | - | - |
| Residential | | |
| Prime | - | - |
| Subprime | - | - |
| Total | 3 | $ 292,499 |

| | 2017 | |
|---|---|---|
| | Number of Contracts | Recorded Investments |
| Commercial | - | $ - |
| Commercial real estate | | |
| Construction | - | - |
| Other | 1 | 169,429 |
| Consumer | | |
| Auto | - | - |
| Other | - | - |
| Residential | | |
| Prime | 2 | 276,916 |
| Subprime | - | - |
| Total | 3 | $ 446,345 |

## 5. BANK PREMISES AND EQUIPMENT

Major classifications of Bank premises and equipment are summarized as follows:

| | 2018 | 2017 |
|---|---|---|
| Land | $ 1,901,130 | $ 1,866,351 |
| Buildings and improvements | 3,455,835 | 3,425,744 |
| Furniture and equipment | 2,662,556 | 2,735,766 |
| Construction in progress | 740,149 | - |
| | 8,759,670 | 8,027,861 |
| Less accumulated depreciation | 4,539,902 | 4,358,815 |
| Bank premises and equipment, net | $ 4,219,768 | $ 3,669,046 |

Depreciation charged to operations was $348,689 in 2018, $361,521 in 2017, and $330,902 in 2016.

## 6. DEPOSITS

The following is a summary of interest-bearing deposits by type as of December 31, 2018 and 2017:

| | 2018 | 2017 |
|---|---|---|
| NOW and MMDA accounts | $ 56,448,153 | $ 50,977,294 |
| Savings accounts | 40,446,922 | 38,232,466 |
| Certificates of deposit | 69,314,394 | 58,620,786 |
| Individual retirement accounts | 6,073,324 | 6,067,654 |
| Total | $ 172,282,793 | $ 153,898,200 |

Time certificates of deposit in denominations of $100,000 or more totaled $36,083,092 and $25,717,307 at December 31, 2018 and 2017, respectively. Interest paid on such time certificates totaled $386,828, $271,591, and $314,581 for the years ended December 31, 2018, 2017, and 2016, respectively.

The following is a summary of the maturity distribution of certificates of deposit in amounts of $100,000 or more as of December 31, 2018 and 2017:

| | 2018 | 2017 |
|---|---|---|
| Three months or less | $ 2,986,740 | $ 755,938 |
| Three through six months | 8,346,452 | 431,777 |
| Six through twelve months | 6,313,170 | 1,639,122 |
| Over twelve months | 18,436,730 | 22,890,470 |
| Total | $ 36,083,092 | $ 25,717,307 |

Additionally, time certificates of deposit in denominations of $250,000 or more totaled $5,852,364 and $2,606,229 at December 31, 2018 and 2017, respectively.

## 6. DEPOSITS (Continued)

A summary of the maturities on time deposits, which includes certificates of deposit and certain individual retirement accounts, for each of the next five years and thereafter follows:

| Years Ending December 31, | | Amount |
|---|---|---|
| 2019 | $ | 36,794,824 |
| 2020 | | 21,100,471 |
| 2021 | | 7,398,983 |
| 2022 | | 5,398,842 |
| 2023 | | 4,235,220 |
| Thereafter | | 459,378 |
| Total | $ | 75,387,718 |

## 7. BORROWINGS

**Federal Home Loan Bank Advances**

The Bank is a member of the Federal Home Loan Bank (FHLB) of Pittsburgh. As a member, the Bank obtained an Open Repo Plus Commitment from the FHLB to finance loan growth and/or meet liquidity needs. The maximum credit available under this agreement is equal to 50 percent of the maximum borrowing capacity available, calculated as a percentage of collateral pledged to the FHLB. Any borrowing bears interest at the interest rate posted by the FHLB on the day of the borrowing and is subject to change daily. The interest rate at December 31, 2018 and 2017, was 2.62 percent and 1.54 percent, respectively. This line of credit is secured by a blanket lien on all unpledged and unencumbered assets of the Bank. The balance outstanding on this line of credit at December 31, 2018 and 2017, was $31,610,600 and $16,404,900, respectively.

The Company has obtained a line of credit from a financial institution in the amount of $2,000,000. The interest rate on this line of credit is equal to the Wall Street Journal Prime with a floor of 3.50 percent. This line of credit is secured by a first lien assignment and security interest in First Exchange Bank's common stock equal to a loan/value of no less than 70 percent and no less than 25 percent of all outstanding shares. There was no outstanding balance on this line of credit at December 31, 2018, and a balance of $521,281 at December 31, 2017.

A summary of short-term borrowings as of December 31, 2018, 2017, and 2016, follows:

| | 2018 | |
|---|---|---|
| | FHLB Borrowings | Line of Credit |
| Outstanding at year-end | $ 31,610,600 | $ - |
| Average amount outstanding | 20,732,544 | 67,124 |
| Maximum amount outstanding at any month-end | 31,610,600 | 521,281 |
| Weighted-average interest rate | 2.62 % | 5.50 % |

| | 2017 | |
|---|---|---|
| | FHLB Borrowings | Line of Credit |
| Outstanding at year-end | $ 16,404,900 | $ 521,281 |
| Average amount outstanding | 16,873,977 | 836,624 |
| Maximum amount outstanding at any month-end | 23,221,200 | 1,071,281 |
| Weighted-average interest rate | 1.54 % | 4.50 % |

## 7. BORROWINGS (Continued)

**Federal Home Loan Bank Advances (Continued)**

| | 2016 | |
|---|---|---|
| | FHLB Borrowings | Line of Credit |
| Outstanding at year-end | $ 14,523,801 | $ 1,271,281 |
| Average amount outstanding | 10,556,265 | 1,273,141 |
| Maximum amount outstanding at any month-end | 17,096,700 | 1,275,000 |
| Weighted-average interest rate | 0.60 % | 3.50 % |

## 8. LONG-TERM BORROWINGS

Subordinated debentures: On November 10, 2005, the Company formed Heritage Bancshares Statutory Trust I. The Trust is a 100 percent owned subsidiary of the Company and exists for the purpose of (1) issuing trust-preferred capital securities (Capital Securities) and (2) using the proceeds from the sale of the Capital Securities to acquire subordinated debentures issued by the Company. The debentures are the sole assets of the trust and the Company's payments under the debentures are the sole source of revenue of the trust. Five thousand-five hundred Capital Securities ($1,000 liquidation value per Capital Security) were issued in the aggregate liquidation amount of $5,500,000 and 171 common securities were also issued in the aggregate amount of $171,000.

The Company has irrevocably and unconditionally guaranteed with respect to the Capital Securities and to the extent not paid by the Trust, accrued and unpaid distributions on the Capital Securities and the redemption price payable to the holders of the Capital Securities. The Company has the option to defer payment of the distributions for an extended period up to five years, so long as the Company is not in default of the terms of the debentures.

The Capital Securities term is 30 years; however, the Capital Securities and debentures are redeemable, in whole or in part, at any distribution payment date on or after the distribution payment date of December 2011, at the redemption price. In addition, the debentures may be redeemed at a special redemption price, in whole but not in part, at any distribution payment date, upon the occurrence of and continuation of a special event within 120 days following the occurrence of such special event at the special redemption price, upon not less than 30 nor more than 60 days notice to holders of such debentures so long as such special event is continuing. Interest is payable quarterly during the 30-year term. Interest will be equal to the three-month LIBOR plus 1.50 percent. The interest rate at December 31, 2018 and 2017 was 4.29 percent and 3.19 percent, respectively.

FHLB long-term borrowings: As a member of the FHLB, the Bank obtained borrowings from the FHLB under various lending programs to finance loan growth and/or meet liquidity needs as necessary. All such borrowings are secured by a lien on all unpledged and unencumbered assets of the Bank.

## 8. LONG-TERM BORROWINGS (Continued)

A summary of the Company's FHLB borrowings at December 31, 2018 and 2017, follows:

| | 2018 | 2017 |
|---|---|---|
| Note payable, dated September 2015, to FHLB at 1.27 percent. Interest due monthly. The borrowing matures September 2019. | $ 191,377 | $ 443,736 |
| Note payable, dated September 2015, to FHLB at 1.45 percent. Interest due monthly. The borrowing matures September 2020. | 537,417 | 838,443 |
| Note payable, dated October 2015, to FHLB at 1.06 percent. Interest due monthly. The borrowing matures October 2018. | - | 1,545,350 |
| Note payable, dated March 2017, to FHLB at 1.54 percent. Interest due monthly. The borrowing matures March 2019. | 190,034 | 942,902 |
| Note payable, dated March 2017, to FHLB at 1.74 percent. Interest due monthly. The borrowing matures March 2020. | 634,508 | 1,132,293 |
| | 1,553,336 | 4,902,724 |
| Less current portion of long-term borrowings | 1,193,337 | 1,545,350 |
| | $ 359,999 | $ 3,357,374 |

A summary of the maturities of FHLB borrowings over the next two years follows:

| Years Ending December 31, | Amount |
|---|---|
| 2019 | $ 1,193,337 |
| 2020 | 359,999 |
| Total | $ 1,553,336 |

## 9. LEASES

The Company leases land, building, and equipment under various noncancelable operating lease agreements. These noncancelable operating leases are subject to renewal options under various terms. Rent expense under noncancelable operating leases approximated $102,203, $97,760, and $89,000 for the years ended December 31, 2018, 2017, and 2016, respectively.

Future minimum payment under noncancelable operating leases with initial or remaining terms of one year or more consisted of the following at December 31, 2018:

| Years Ending December 31, | Amount |
|---|---|
| 2019 | $ 102,203 |
| 2020 | 102,203 |
| 2021 | 102,203 |
| 2022 | 42,585 |
| Total | $ 349,194 |

## 10. COMMITMENTS AND CONTINGENT LIABILITIES

### Financial Instruments with Off-Balance Sheet Risk

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the accompanying consolidated balance sheets. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

| Financial Instruments Whose Contract Amounts Represent Credit Risk | Contract Amount 2018 | Contract Amount 2017 |
|---|---|---|
| Commitments to extend credit | $ 9,321,955 | $ 6,870,414 |
| Unused open business lines of credit | 4,384,705 | 4,243,622 |
| Unused open home equity and personal lines of credit | 5,507,753 | 4,472,442 |
| Standy letters of credit and financial guarantees | 30,000 | 65,000 |
| Remaining commitments on constrution loans | 4,372,807 | 2,698,177 |
| Overdraft protection commitments | 2,115,142 | 2,083,145 |
| Total | $ 25,732,362 | $ 20,432,800 |

The Bank implemented an overdraft privilege product to qualified individual transaction account holders providing automatic payment of overdrafts up to a specified amount based on the type of account, charging the standard overdraft fee.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

### Contingent Liabilities

Due to the nature of the Bank's business, which involves the collection of loans and the enforcement and validity of liens, security interests and mortgages, the Bank is plaintiff in various routine legal proceedings, the outcome of which is not expected to have a material effect on the Company's financial position.

### Employment Contracts

The Company and its subsidiary have employment contracts with certain executive officers. Under the terms of these agreements, each officer has the option to terminate employment in the event of a merger or the acquisition of the Company or the Bank by another financial institution or company, and receive cash payments, plus health benefits, for periods specified in the agreements. The aggregate estimated commitment under these agreements approximated $806,480 at December 31, 2018.

## 11 EMPLOYEE BENEFITS

The Bank maintains a voluntary retirement savings plan. Participation in the plan is available upon attaining the age of 20½ years and completion of six months service. Participants are permitted to contribute up to the maximum dollar amount allowed by the Internal Revenue Service, which is $18,500 for 2018. The Bank matches contributions made by the participants on a dollar-for-dollar basis, up to a maximum of 5 percent of the employee's compensation. In addition, the Bank may elect to make additional contributions, as prescribed by the Plan, not to exceed certain limitations by the Internal Revenue Service regulations.

## 11 EMPLOYEE BENEFITS (Continued)

The participants' contributions are fully vested upon payment while the employer portions are subject to certain vesting requirements if an employee terminates prior to normal retirement age. Employer contributions are fully vested after six years. Plan participants are entitled to receive Plan benefits upon termination of employment, death, disability or retirement at an age not earlier than 59½ with ten years of service, with age 65 being normal retirement age. For the years ended December 31, 2018, 2017, and 2016, the Bank charged to operations $88,973, $89,589, and $99,806, respectively, for matching contributions.

**Phantom Stock Plan**

The Bank has an Executive Phantom Stock Appreciation Plan and a Director Phantom Stock Appreciation Plan (Director Plan and Executive Plan) that provide for the issuance of phantom stock awards to directors and an executive of the Bank. A committee authorized by the Bank's Board of Directors has authority to administer the Director Plan and Executive Plan subject to the approval of the Bank's Board of Directors. For each of the years ended December 31, 2018, 2017, and 2016, the Bank charged $74,581, $45,823, and $93,935, to operations for the phantom stock plan and awarded 2,366, 2,143, and 2,641, shares, respectively.

**Executive Plans**

The value of each phantom share award will be, at the date of the grant award, equal to a percentage of the executive's base salary divided by the appraised value of the common stock of Heritage Bancshares of January 1 of the award year, providing pre-established goals, as established by the Board of Directors, have been met. The executive shall vest in the account balance in equal annual increments.

Upon retirement, voluntary termination and involuntary termination without cause, the executive is subject to a one-year non-compete clause in consideration for phantom share awards.

**Director Plan**

The value of each phantom share award will be, at the date of the grant award, (a) 100 percent of the Annual Incentive Compensation Award divided by the appraised value of the Common Stock of Heritage Bancshares of January 1 of the award year, (b) amount of the Annual Income Compensation Award shall be equal to 25 percent of the annual director's fees, including the retainer paid to the director, providing pre-established goals, as established by the Board of Directors, have been met. The director is immediately vested in the plan. In the event of death, disability or separation of service, the director will receive his or her net book value in a lump sum payment.

## 12. REGULATORY MATTERS

The primary source of funds for the dividends paid by Heritage Bancshares, Inc., is dividends received from its subsidiary bank. Dividends paid by the Bank are subject to restrictions by banking regulations. The most restrictive provision requires approval by the regulatory agency if dividends declared in any year exceed the year's net income, as defined, plus the net retained profits of the two preceding years.

Heritage Bancshares, Inc. and Subsidiary are also subject to various regulatory capital requirements administered by regulatory authorities. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and Bank must meet specific capital guidelines that involve quantitative measures of the assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices.

Quantitative measures established by regulation to ensure capital adequacy require a bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined) and common equity

## 12. REGULATORY MATTERS (Continued)

Tier 1 capital (as defined) to risk-weighted assets. Management believes, as of December 31, 2018, that the Company and Bank meet all capital adequacy requirements to which they are subject.

The most recent notification from the Company's primary regulatory agency categorized the Company as well capitalized under the regulatory framework for prompt corrective action. To be categorized as such, the Company and Bank must maintain minimum total risk-based, Tier 1 risk- based, common equity Tier 1 and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the institution's category.

The Company and Bank's actual capital ratios are presented in the following table (in thousands) and show the Company and Bank met all regulatory capital requirements.

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of December 31, 2018 | | | | | | |
| Common equity Tier 1 capital (to risk-weighted assets): | | | | | | |
| Heritage Bancshares | $ 22,229 | 10.97 % | $ 9,117 | 4.50 % | $ 13,169 | 6.50 % |
| First Exchange Bank | 22,883 | 11.29 | 9,117 | 4.50 | 13,169 | 6.50 |
| Total capital (to risk-weighted assets) | | | | | | |
| Heritage Bancshares | $ 24,773 | 12.23 % | $ 16,208 | 8.00 % | $ 20,261 | 10.00 % |
| First Exchange Bank | 25,426 | 12.55 | 16,208 | 8.00 | 20,261 | 10.00 |
| Tier 1 capital (to risk-weighted assets) | | | | | | |
| Heritage Bancshares | $ 22,229 | 10.97 % | $ 8,104 | 4.00 % | $ 12,156 | 6.00 % |
| First Exchange Bank | 22,883 | 11.29 | 8,104 | 4.00 | 12,156 | 6.00 |
| Tier 1 capital (to average assets) | | | | | | |
| Heritage Bancshares | $ 22,229 | 8.67 % | $ 10,255 | 4.00 % | $ 15,382 | 6.00 % |
| First Exchange Bank | 22,883 | 9.09 | 10,067 | 4.00 | 15,100 | 6.00 |

## 12. REGULATORY MATTERS (Continued)

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of December 31, 2017 | | | | | | |
| Common equity Tier 1 capital (to risk-weighted assets): | | | | | | |
| Heritage Bancshares | $ 22,353 | 12.50 % | $ 8,050 | 4.50 % | $ 11,628 | 6.50 % |
| First Exchange Bank | 23,325 | 13.04 | 8,048 | 4.50 | 11,625 | 6.50 |
| Total capital (to risk-weighted assets) | | | | | | |
| Heritage Bancshares | $ 24,594 | 13.75 % | $ 14,311 | 8.00 % | $ 17,889 | 10.00 % |
| First Exchange Bank | 25,566 | 14.29 | 14,308 | 8.00 | 17,885 | 10.00 |
| Tier 1 capital (to risk-weighted assets) | | | | | | |
| Heritage Bancshares | $ 22,353 | 12.50 % | $ 7,156 | 4.00 % | $ 10,734 | 6.00 % |
| First Exchange Bank | 23,325 | 13.04 | 7,154 | 4.00 | 10,731 | 6.00 |
| Tier 1 capital (to average assets) | | | | | | |
| Heritage Bancshares | $ 22,353 | 9.20 % | $ 9,714 | 4.00 % | $ 14,571 | 5.00 % |
| First Exchange Bank | 23,325 | 9.61 | 9,712 | 4.00 | 14,568 | 5.00 |

## 13. FAIR VALUE MEASUREMENTS

The following disclosures show the hierarchal disclosure framework associated with the level of pricing observations utilized in measuring assets and liabilities at fair value. The three broad levels of pricing observations are as follows:

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

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

Level III: Valuations are derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires the use of observable market data, when available.

## 13. FAIR VALUE MEASUREMENTS (Continued)

The following tables present the assets reported on a recurring basis on the Consolidated Balance Sheet at their fair value as of December 31, 2018 and 2017, by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

| | December 31, 2018 | | | |
|---|---|---|---|---|
| | Level I | Level II | Level III | Total |
| Assets measured on a recurring basis: | | | | |
| U.S. government agencies and corporations | $ - | $ 996,830 | $ - | $ 996,830 |
| Mortgage-backed securities - U.S. government agencies and corporations | - | 19,588,169 | - | 19,588,169 |
| Total | $ - | $ 20,584,999 | $ - | $ 20,584,999 |

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | Level I | Level II | Level III | Total |
| Assets measured on a recurring basis: | | | | |
| U.S. government agencies and corporations | $ - | $ 2,993,481 | $ - | $ 2,993,481 |
| Mortgage-backed securities - U.S. government agencies and corporations | - | 16,664,038 | - | 16,664,038 |
| Total | $ - | $ 19,657,519 | $ - | $ 19,657,519 |

The following tables present the assets measured on a nonrecurring basis on the Consolidated Balance Sheet at December 31, 2018 and 2017, by level within the fair value hierarchy. Impaired loans that are collateral-dependent are written down to fair value through the establishment of specific reserves. Techniques used to value the collateral that secure the impaired loans include quoted market prices for identical assets classified as Level I inputs and observable inputs, employed by certified appraisers, for similar assets classified as Level II inputs. In cases where valuation techniques included inputs that are unobservable and are based on estimates and assumptions developed by management based on the best information available under each circumstance, the asset valuation is classified as Level III inputs.

Certain assets such as other real estate owned (OREO) acquired through foreclosure are initially recorded at fair value of the property at the transfer date less estimated selling costs. At or near the time of foreclosure, real estate appraisals are obtained on the properties acquired through foreclosure. The real estate is then valued and subsequently carried at the lesser of the appraised value or the loan balance, including interest receivable at the time of foreclosure, less an estimate of costs to sell the property. Appraised values are typically determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company using observable market data or on a recent sales offer (Level II). However, if the acquired property is a house or building in the process of construction or if an appraisal of the real estate property is over two years old, then the fair value is considered Level III. The estimate of costs to sell the property is based on historical transactions of similar holdings.

## 13. FAIR VALUE MEASUREMENTS (Continued)

| | December 31, 2018 | | | |
|---|---|---|---|---|
| | Level I | Level II | Level III | Total |
| Assets measured on nonrecurring basis: | | | | |
| Other real estate owned | $ - | $ - | $ 117,655 | $ 117,655 |
| Impaired loans: | | | | |
| Commercial | - | - | 1,003,765 | 1,003,765 |
| Total | $ - | $ - | $ 1,121,420 | $ 1,121,420 |

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | Level I | Level II | Level III | Total |
| Assets measured on nonrecurring basis: | | | | |
| Other real estate owned | $ - | $ - | $ 167,107 | $ 167,107 |
| Impaired loans: | | | | |
| Residential | - | | 17,900 | 17,900 |
| Total | $ - | $ - | $ 185,007 | $ 185,007 |

The following table presents additional qualitative information about assets measured on a nonrecurring basis and how the Corporation has utilized Level III inputs to determine fair value:

| | **Fair Value Estimate** | **Valuation Techniques** | **Unobservable Input** | **Range** |
|---|---|---|---|---|
| | | **2018** | | |
| Impaired loans: | | | | |
| Commercial | $ 1,003,765 | Appraisal of collateral | Selling costs | 7% - 43% discount |
| Consumer real estate | 696,435 | Appraisal of collateral | Selling costs | 7% discount |
| Other real estate owned | 117,655 | | Management adjustments for liquidation expenses | 9% - 33% discount |
| | | **2017** | | |
| Impaired loans: | | | | |
| Consumer real estate | $ 17,900 | Appraisal of collateral | Selling costs | 6% discount |
| Other real estate owned | 167,107 | | Management adjustments for liquidation expenses | 1% discount |

## 14. ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table presents the changes in accumulated other comprehensive income (loss), net of tax, for the years ended December 31, 2018 and 2017:

| | | Net Unrealized Gains (Losses) on Investment Securities |
|---|---|---|
| Accumulated other comprehensive income, January 1, 2017 | $ | 5,164 |
| Unrealized holding losses on available-for-sale securities before reclassification | | (105,064) |
| Amount reclassified for investment securities gains included in net income | | - |
| Accumulated other comprehensive loss, December 31, 2017 | | (99,900) |
| Unrealized holding losses on available-for-sale securities before reclassification | | (248,953) |
| Amount reclassified for investment securities gains included in net income | | - |
| Accumulated other comprehensive loss, December 31, 2018 | $ | (348,853) |

There were no amounts reclassified from accumulated other comprehensive income (loss) during either period ended December 31.

## 15. CONDENSED FINANCIAL STATEMENTS

The investment of the Company in its wholly owned subsidiary is presented on the equity method of accounting. Information relative to the Company's Consolidated Balance Sheet at December 31, 2018 and 2017, and the related Consolidated Statements of Income and Cash Flows for the years ended December 31, 2018, 2017, and 2016, are presented below:

CONDENSED BALANCE SHEET

| | 2018 | 2017 |
|---|---|---|
| ASSETS | | |
| Cash | $ 518,405 | $ 89,878 |
| Investment in bank subsidiary, eliminated | 22,534,070 | 23,225,327 |
| TOTAL ASSETS | $ 23,052,475 | $ 23,315,205 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Interest payable | $ 11,760 | $ 14,194 |
| Short-term borrowings | - | 521,281 |
| Long-term borrowings | 5,500,000 | 5,500,000 |
| Other liabilities | 633,623 | 697,466 |
| TOTAL LIABILITIES | 6,145,383 | 6,732,941 |
| TOTAL SHAREHOLDERS' EQUITY | 16,907,092 | 16,582,264 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | $ 23,052,475 | $ 23,315,205 |

## 15. CONDENSED FINANCIAL STATEMENTS (Continued)

### CONDENSED STATEMENT OF INCOME

| | Year Ended December 31, 2018 | 2017 | 2016 |
|---|---|---|---|
| Dividends from subsidiary bank | $ 3,645,000 | $ 3,715,000 | $ 1,510,000 |
| Interest expense | 215,334 | 186,095 | 151,635 |
| Expenses - operating | 60,288 | 40,115 | 50,131 |
| Income before undistributed income | 3,369,378 | 3,488,790 | 1,308,234 |
| (Deficit) equity in undistributed income | (442,304) | (172,108) | 2,258,645 |
| NET INCOME | $ 2,927,074 | $ 3,316,682 | $ 3,566,879 |

### CONDENSED STATEMENT OF CASH FLOWS

| | Year Ended December 31, 2018 | 2017 | 2016 |
|---|---|---|---|
| OPERATING ACTIVITIES | | | |
| Net income | $ 2,927,074 | $ 3,316,682 | $ 3,566,879 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Equity in undistributed net income of subsidiary | 442,304 | 172,108 | (2,258,645) |
| (Decrease) increase in other liabilities | (2,673) | (21,647) | 16,966 |
| Net cash provided by operating activities | 3,366,705 | 3,467,143 | 1,325,200 |
| FINANCING ACTIVITIES | | | |
| Repayment of short-term borrowings | (521,281) | (750,000) | (3,719) |
| Cash dividends paid | (2,416,897) | (2,628,904) | (1,971,678) |
| Net cash used for financing activities | (2,938,178) | (3,378,904) | (1,975,397) |
| Change in cash and cash equivalents | 428,527 | 88,239 | (650,197) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 89,878 | 1,639 | 651,836 |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | $ 518,405 | $ 89,878 | $ 1,639 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW | | | |
| Dividends declared but unpaid | $ 593,623 | $ 657,227 | $ 784,431 |

## 15. CONDENSED FINANCIAL STATEMENTS (Continued)

Heritage Bancshares, Inc. accounts for its investments in its bank subsidiary by the equity method. During the years ended December 31, 2018 and 2017, changes were as follows:

| | |
|---|---|
| Number of shares owned – First Exchange Bank | 56,000 |
| Percent of shares owned – First Exchange Bank | 100 percent |

| | |
|---|---|
| Balance at December 31, 2015 | 21,341,175 |
| Add (deduct): | |
| Equity in net income | 2,258,645 |
| Change in net unrealized gain (loss) on securities | (97,319) |
| Balance at December 31, 2016 | 23,502,501 |
| Add (deduct): | |
| Equity in net income | (172,108) |
| Change in net unrealized gain (loss) on securities | (105,066) |
| Balance at December 31, 2017 | 23,225,327 |
| Add (deduct): | |
| Equity in net income | (442,304) |
| Change in net unrealized gain (loss) on securities | (248,953) |
| Balance at December 31, 2018 | $ 22,534,070 |

# DIRECTORS

Directors of Heritage Bancshares, Inc. and First Exchange Bank

| | |
|---|---|
| Dr. F. David Bonasso ............................ | Dentist, Businessman |
| J. Adam Boyers ................................... | Businessman - President, Middletown Tractor Sales |
| James A. Boyers ................................... | Pharmacist - CVS, Owner - Paradise Valley Farm<br>Member - Boyers' Enterprises, Endeavors Unlimited<br>Chairman - Heritage Bancshares, Inc.<br>Chairman - First Exchange Bank |
| William F. Goettel ................................ | President/Chief Executive Officer - First Exchange Bank<br>President - Heritage Bancshares, Inc. |
| R. William Kent ................................... | Executive Vice President, Capital Markets, CBRE, Inc. |
| David W. Myers ................................... | Retired Businessman/Contractor |
| Dr. Presha E. Neidermeyer................... | Professor of Accounting, West Virginia University |
| William J. Yoho ................................... | Realtor, President, Springston & Co., Inc.<br>Real Estate Appraiser<br>Vice Chairman - Heritage Bancshares, Inc.<br>Vice Chairman - First Exchange Bank |
| Karen M. Yokum.................................. | Attorney & Partner - Tharp, Liotta & Yokum |
| Kevin Wilfong...................................... | President - Middletown Properties, Real Estate Developer/<br>Property Management |

# first Exchange Bank

**Main Office, Mannington**
11 West Main Street, P.O. Box 388
Mannington, WV  26582
Phone (304) 986-1700 Fax (304) 986-1711

**Fairmont Office**
216 Fairmont Avenue
Fairmont, WV  26554
Phone (304) 367-1700 Fax (304) 367-1779

**Hundred Office**
Route 250, P.O. Box 780
Hundred, WV  26575
Phone (304) 775-1700 Fax (304) 775-1702

**Fairview Office**
309 Main Street
Fairview, WV  26570
Phone (304) 449-1700 Fax (304) 449-1967

**Barrackville Office**
211 Pike Street
Barrackville, WV 26559
Phone (304) 333-2217 Fax (304) 333-2220

**Suncrest Office**
3081 University Avenue
Morgantown, WV 26505
Phone (304) 225-2600 Fax (304) 225-2605

**South Fairmont Office/Corporate Headquarters**
Construction in Progress
Corner of Nasa Blvd and US Route 250
Fairmont, WV 26554