FARMERS NATIONAL BANC CORP /OH/
Form 10-K
March 05, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2018

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to

Commission file number 001-35296

Farmers National Banc Corp.

(Exact name of registrant as specified in its charter)

Ohio	34-1371693
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
20 South Broad Street, Canfield, Ohio	44406
(Address of principal executive offices)	(Zip Code)

Registrant’s telephone number, including area code: 330-533-3341

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

Title of each class	Name of each exchange on which registered
Common Shares, no par value	The NASDAQ Stock Market LLC

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

None

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

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

As of June 30, 2018, the estimated aggregate market value of the registrant's common shares, no par value (the only common equity of the registrant), held by non-affiliates of the registrant was approximately $440.9 million based upon the last sales price as of June 30, 2018 reported on NASDAQ. (The exclusion from such amount of the market value of the common shares owned by any person shall not be deemed an admission by the registrant that such person is an affiliate of the registrant).

As of March 1, 2019, the registrant had outstanding 27,790,601 common shares, no par value.

DOCUMENTS INCORPORATED BY REFERENCE

Document	Part of Form 10-K into which Document is Incorporated
Portions of the registrant's definitive proxy statement for the 2019 Annual Meeting of Shareholders	III

FARMERS NATIONAL BANC CORP.

ANNUAL REPORT ON FORM 10-K

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2018

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PART I

Item 1. Business.

General

Farmers National Banc Corp.

Farmers National Banc Corp. (the “Company,” “Farmers,” “we,” “our” or “us”), is a financial holding company and was organized as a one-bank holding company in 1983 under the laws of the State of Ohio and registered under the Bank Holding Company Act of 1956, as amended (the “BHCA”). Amendments to the BHCA in 1999, allowed for a bank holding company to declare itself a financial holding company and thereby engage in financial activities, including securities underwriting and dealing, insurance agency and underwriting activities, and merchant banking activities. The Company made the declaration to become a financial holding company in 2016. For a bank holding company to be eligible to declare itself a financial holding company, all of the depository institution subsidiaries must be well-capitalized and well-managed and have satisfactory or better ratings under the Community Reinvestment Act. The Company operates principally through its wholly-owned subsidiaries, The Farmers National Bank of Canfield (the “Bank” or “Farmers Bank”), Farmers Trust Company (“Farmers Trust”), National Associates, Inc. (“NAI”) and Farmers National Captive, Inc. (“Captive”). Farmers National Insurance, LLC (“Farmers Insurance”) and Farmers of Canfield Investment Co. (“Investments or “Farmers Investments”) are wholly-owned subsidiaries of the Bank. The Company and its subsidiaries operate in the domestic banking, trust, retirement consulting, insurance and financial management industries.

The Company’s principal business consists of owning and supervising its subsidiaries. Although Farmers directs the overall policies of its subsidiaries, including lending practices and financial resources, most day-to-day affairs are managed by their respective officers. Farmers and its subsidiaries had 453 full-time equivalent employees at December 31, 2018.

The Company’s principal executive offices are located at 20 South Broad Street, Canfield, Ohio 44406, and its telephone number is (330) 533-3341. Farmers’ common shares, no par value, are listed on the NASDAQ Capital Market (the “NASDAQ”) under the symbol “FMNB.” Farmers’ business activities are managed and financial performance is primarily aggregated and reported in three lines of business, the Bank segment, the Trust segment and the Retirement Planning/Consulting segment. For a discussion of Farmers’ financial performance for the fiscal year ended December 31, 2018, see the Consolidated Financial Statements and Notes to the Consolidated Financial Statements found in Item 8 of this Annual Report on Form 10-K.

The Farmers National Bank of Canfield

During 2017, the Company acquired all outstanding stock of Monitor Bancorp, Inc. (“Monitor”), the holding company of Monitor Bank. Additional discussion about the acquisition can be found in the Notes to Consolidated Financial Statements in Item 8 of this Annual Report on Form 10-K. The Bank is a full-service national banking association engaged in commercial and retail banking mainly in Mahoning, Trumbull, Columbiana, Wayne, Holmes, Medina and Stark Counties in Ohio and two locations in Beaver County, Pennsylvania. The Bank’s commercial and retail banking services include checking accounts, savings accounts, time deposit accounts, commercial, mortgage and installment loans, home equity loans, home equity lines of credit, night depository, safe deposit boxes, money orders, bank checks, automated teller machines, internet banking, travel cards, “E” Bond transactions, MasterCard and Visa credit cards, brokerage services and other miscellaneous services normally offered by commercial banks.

A discussion of the general development of the Bank's business and information regarding its financial performance throughout 2018, is discussed in "Management Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of this Annual Report on Form 10-K.

The Bank faces significant competition in offering financial services to customers. Ohio has a high density of financial service providers, many of which are significantly larger institutions that have greater financial resources than the Bank, and all of which are competitors to varying degrees. Competition for loans comes principally from savings banks, savings and loan associations, commercial banks, mortgage banking companies, credit unions, insurance companies and other financial service companies. The most direct competition for deposits has historically come from savings and loan associations, savings banks, commercial banks and credit unions. Additional competition for deposits comes from non-depository competitors such as the mutual fund industry, securities and brokerage firms and insurance companies.

Farmers Trust Company

During 2009, the Company acquired the Farmers Trust. Farmers Trust offers a full complement of personal and corporate trust services in the areas of estate settlement, trust administration and employee benefit plans. Farmers Trust operates four offices located in Boardman, Canton, Howland and Wooster, Ohio.

National Associates, Inc.

NAI of Cleveland, Ohio has been a part of the Company since the 2013 acquisition. The acquisition was part of the Company's plan to increase the levels of noninterest income and to complement the existing retirement services that were already being offered through Farmers Trust. NAI operates from its office located in Fairview Park, Ohio

Farmers National Captive, Inc.

Captive was formed during 2016 and is a wholly-owned insurance subsidiary of the Company that provides property and casualty insurance coverage to the Company and its subsidiaries. The Captive pools resources with thirteen similar insurance company subsidiaries of financial institutions to spread a limited amount of risk among themselves and to provide insurance where not currently available or economically feasible in today's insurance market place. The Captive does not account for a material portion of the revenue and, therefore, will not be discussed individually, but as part of the Company.

Farmers National Insurance, LLC

Farmers Insurance was formed during 2009 and offers a variety of insurance products through licensed representatives. During 2016, the Bank completed the acquisition of the Bowers Insurance Agency, Inc. ("Bowers"). The transaction involved both cash and stock. All activity has been merged into Insurance. Farmers Insurance is a subsidiary of Farmers Bank and does not account for a material portion of the revenue and, therefore, will not be discussed individually, but as part of the Bank.

Farmers of Canfield Investment Company

Farmers Investments was formed during 2014, with the primary purpose of investing in municipal securities. Farmers Investments is a subsidiary of Farmers Bank and does not account for a material portion of the revenue and, therefore, will not be discussed individually, but as part of the Bank.

Investor Relations

The Company maintains an Internet site at http://www.farmersbankgroup.com, which contains an Investor Relations section that provides access to the Company's filings with the Securities and Exchange Commission (the "Commission"). Farmers makes available free of charge on or through its website the Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such documents filed or furnished pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act") as soon as reasonably practicable after the Company has filed these documents with the Commission. In addition, the Company's filings with the Commission may be read and copied at the Commission's Public Reference Room at 100 F Street, NE, Washington, DC 20549. Information on the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330. These filings are also available on the Commission's web site at http://www.sec.gov free of charge as soon as reasonably practicable after the Company has filed the above referenced reports.

Supervision and Regulation

Introduction

The Company and its subsidiaries are subject to extensive regulation by federal and state regulatory agencies. The regulation of financial holding companies and their subsidiaries is intended primarily for the protection of consumers, depositors, borrowers, the Deposit Insurance Fund and the banking system as a whole and not for the protection of shareholders. This intensive regulatory environment, among other things, may restrict the Company's ability to diversify into certain areas of financial services, acquire depository institutions in certain markets or pay dividends on its common shares. It also may require the Company to provide financial support to its banking and other subsidiaries, maintain capital balances in excess of those desired by management and pay higher deposit insurance premiums as a result of the deterioration in the financial condition of depository institutions in general.

Significant aspects of the laws and regulations that have, or could have a material impact on Farmers and its subsidiaries are described below. These descriptions are qualified in their entirety by reference to the full text of the applicable statutes, legislation, regulations and policies, as they may be amended or revised by the U.S. Congress or state legislatures and federal or state regulatory agencies, as the case may be. Changes in these statutes, legislation, regulations and policies may have a material adverse effect on the Company and its business, financial condition or results of operations.

Regulatory Agencies

Financial Holding Company. Farmers elected to be a financial holding company. A bank holding company may elect to become a financial holding company if each of its subsidiary banks is well capitalized under the prompt corrective action regulations of the FDIC, is well managed, and has at least a satisfactory rating under the Community Reinvestment Act of 1977 (the "CRA"). Financial holding companies may engage in activities that are financial in nature, including affiliating with securities firms and insurance companies, which are not otherwise permissible for a bank holding company.

As a financial holding company, Farmers is subject to regulation under the BHCA and to inspection, examination and supervision by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"). The Federal Reserve Board has extensive enforcement authority over financial and bank holding companies and may initiate enforcement actions for violations of laws and regulations and unsafe or unsound practices. The Federal Reserve Board may assess civil money penalties, issue cease and desist or removal orders and may require that a bank holding company divest subsidiaries, including subsidiary banks. Farmers is also required to file reports and other information with the Federal Reserve Board regarding its business operations and those of its subsidiaries.

Subsidiary Bank. The Bank is subject to regulation and examination primarily by the Office of the Comptroller of the Currency (the "OCC") and secondarily by the Federal Deposit Insurance Corporation (the "FDIC"). OCC regulations govern permissible activities, capital requirements, dividend limitations, investments, loans and other matters. The OCC has extensive enforcement authority over Farmers Bank and may impose sanctions on Farmers Bank and, under certain circumstances, may place Farmers Bank into receivership.

Farmers Bank is also subject to certain restrictions imposed by the Federal Reserve Act and Federal Reserve Board regulations regarding such matters as the maintenance of reserves against deposits, extensions of credit to Farmers or any of its subsidiaries, investments in the stock or other securities of Farmers or its subsidiaries and the taking of such stock or securities as collateral for loans to any borrower.

Non-Banking Subsidiaries. Farmers' non-banking subsidiaries are also subject to regulation by the Federal Reserve Board and other applicable federal and state agencies. In particular, Farmers Insurance is subject to regulation by the Ohio Department of Insurance, which requires, amongst other things, the education and licensing of agencies and individual agents and imposes business conduct rules.

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Securities and Exchange Commission and The NASDAQ Stock Market LLC. The Company is also under the regulation and supervision of the Commission and certain state securities commissions for matters relating to the offering and sale of its securities. The Company is subject to disclosure and regulatory requirements of the Securities Act of 1933, as amended (the "Securities Act"), and the Exchange Act, and the regulations promulgated thereunder. Farmers common shares are listed on the NASDAQ under the symbol "FMNB" and the Company is subject to the rules for NASDAQ listed companies.

Federal Home Loan Bank. Farmers Bank is a member of the Federal Home Loan Bank of Cincinnati (the "FHLB"), which provides credit to its members in the form of advances. As a member of the FHLB, the Bank must maintain an investment in the capital stock of the FHLB in a specified amount. Upon the origination or renewal of a loan or advance, the FHLB is required by law to obtain and maintain a security interest in certain types of collateral. The FHLB is required to establish standards of community investment or service that its members must maintain for continued access to long-term advances from the FHLB. The standards take into account a member's performance under the CRA and its record of lending to first-time home buyers.

The Federal Deposit Insurance Corporation. The FDIC is an independent federal agency that insures the deposits, up to prescribed statutory limits, of federally-insured banks and savings associations and safeguards the safety and soundness of the financial institution industry. The Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund of the FDIC and subject to deposit insurance assessments to maintain the Deposit Insurance Fund.

The FDIC may terminate insurance coverage upon a finding that an insured depository institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition, or has violated any applicable law, regulation, rule, order or condition enacted or imposed by the institution's regulatory agency.

Dodd-Frank Act - Basel III

In July 2013, the Federal banking regulators approved a final rule to implement the revised capital adequacy standards of the Basel Committee on Banking Supervision, commonly called Basel III, and to address relevant provisions of the Dodd-Frank Act. The final rule strengthens the definition of regulatory capital, increases risk-based capital requirements, makes selected changes to the calculation of risk-weighted assets and adjusts the prompt corrective action thresholds. Community banking organizations, such as the Company and the Bank, became subject to the new rule on January 1, 2015 and certain provisions of the new rule will be phased in over the period of 2015 through 2019.

The final rule:

- Permits banking organizations that had less than $15 billion in total consolidated assets as of December 31, 2009 to include in Tier 1 capital trust preferred securities and cumulative perpetual preferred stock that were issued and included in Tier 1 capital prior to May 19, 2010, subject to a limit of 25% of Tier 1 capital elements, excluding any non-qualifying capital instruments and after all regulatory capital deductions and adjustments have been applied to Tier 1 capital.
- Establishes new qualifying criteria for regulatory capital, including new limitations on the inclusion of deferred tax assets and mortgage servicing rights.
- Requires a minimum ratio of common equity Tier 1 capital to risk-weighted assets of 4.5%.
- Increases the minimum Tier 1 capital to risk-weighted assets ratio requirement from 4% to 6%.
- Retains the minimum total capital to risk-weighted assets ratio requirement of 8%.
- Establishes a minimum leverage ratio requirement of 4%.

- Retains the existing regulatory capital framework for 1-4 family residential mortgage exposures.
- Permits banking organizations that are not subject to the advanced approaches rule, such as the Company and the Bank, to retain, through a one-time election, the existing treatment for most accumulated other comprehensive income, such that unrealized gains and losses on securities available for sale will not affect regulatory capital amounts and ratios.

- Implements a new capital conservation buffer requirement for a banking organization to maintain a common equity capital ratio more than 2.5% above the minimum common equity Tier 1 capital, Tier 1 capital and total risk-based capital ratios in order to avoid limitations on capital distributions, including dividend payments, and certain discretionary bonus payments. The capital conservation buffer requirement will be phased in beginning on January 1, 2016 at 0.625% and will be fully phased in at 2.50% by January 1, 2019. A banking organization with a buffer of less than the required amount would be subject to increasingly stringent limitations on such distributions and payments as the buffer approaches zero. The new rule also generally prohibits a banking organization from making such distributions or payments during any quarter if its eligible retained income is negative and its capital conservation buffer ratio was 2.5% or less at the end of the previous quarter. The eligible retained income of a banking organization is defined as its net income for the four calendar quarters preceding the current calendar quarter, based on the organization's quarterly regulatory reports, net of any distributions and associated tax effects not already reflected in net income.
- Increases capital requirements for past-due loans, high volatility commercial real estate exposures and certain short-term commitments and securitization exposures.
- Expands the recognition of collateral and guarantors in determining risk-weighted assets.
- Removes references to credit ratings consistent with the Dodd Frank Act and establishes due diligence requirements for securitization exposures.

Various legislation affecting financial institutions and the financial industry will likely continue to be introduced in Congress, and such legislation may further change banking statutes and the operating environment of the Company in substantial and unpredictable ways, and could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance depending upon whether any of this potential legislation will be enacted, and if enacted, the effect that it or any implementing regulations, would have on the financial condition or results of operations of the Company or any of its subsidiaries.

Also, such statutes, regulations and policies are continually under review by Congress and state legislatures and federal and state regulatory agencies and are subject to change at any time, particularly in the current economic and regulatory environment. Any such change in statutes, regulations or regulatory policies applicable to the Company could have a material effect on the business of the Company.

Financial Holding Company Regulation

As a financial holding company, Farmers' activities are subject to extensive regulation by the Federal Reserve Board under the BHCA. Generally, in addition to the BHCA limits of banking, managing or controlling banks and other activities that the Federal Reserve Board has determined to be closely related to banking, financial holding company activities may include securities underwriting and dealing, insurance agency and underwriting activities and merchant banking activities. Under Federal Reserve Board policy, a financial holding company is expected to serve as a source of financial and managerial strength to each subsidiary and to commit resources to support those subsidiaries. Under this policy, the Federal Reserve Board may require the company to contribute additional capital to an undercapitalized subsidiary and may disapprove of the payment of dividends to the holding company's shareholders if the Federal Reserve Board believes the payment of such dividends would be an unsafe or unsound practice. The Dodd-Frank Act codified this policy as a statutory requirement.

The BHCA requires prior approval by the Federal Reserve Board for a bank holding company to directly or indirectly acquire more than a 5.0% voting interest in any bank or its parent holding company. Factors taken into consideration in making such a determination include the effect of the acquisition on competition, the public benefits expected to be received from the acquisition, the projected capital ratios and levels on a post-acquisition basis and the acquiring institution's record of addressing the credit needs of the communities it serves.

The BHCA also governs interstate banking and restricts Farmers' nonbanking activities to those determined by the Federal Reserve Board to be financial in nature, or incidental or complementary to such financial activity, without regard to territorial restrictions. Transactions among the Bank and its affiliates are also subject to certain limitations and restrictions of the Federal Reserve Board, as described more fully under the caption "Dividends and Transactions with Affiliates" in this Item 1.

The Gramm-Leach-Bliley Act of 1999 permits a qualifying bank holding company to elect to become a financial holding company and thereby affiliate with securities firms and insurance companies and engage in other activities that are financial in nature and not otherwise permissible for a bank holding company. Farmers elected to become a financial holding company during 2016.

Regulation of Nationally Chartered Banks

As a national banking association, Farmers Bank is subject to regulation under the National Banking Act and is periodically examined by the OCC. OCC regulations govern permissible activities, capital requirements, dividend limitations, investments, loans and other matters. Furthermore, Farmers Bank is subject, as a member bank, to certain rules and regulations of the Federal Reserve Board, many of which restrict activities and prescribe documentation to protect consumers. Under the Bank Merger Act, the prior approval of the OCC is required for a national bank to merge with, or purchase the assets or assume the deposits of, another bank. In reviewing applications to approve merger and other acquisition transactions, the OCC and other bank regulatory authorities may include among their considerations the competitive effect and public benefits of the transactions, the capital position of the combined organization, the applicant’s performance under the CRA and fair housing laws, and the effectiveness of the entities in restricting money laundering activities. In addition, the establishment of branches by Farmers Bank is subject to the prior approval of the OCC. The OCC has the authority to impose sanctions on the Bank and, under certain circumstances, may place Farmers Bank into receivership.

The Bank is also an insured institution as a member of the Deposit Insurance Fund. As a result, it is subject to regulation and deposit insurance assessments by the FDIC.

Dividends and Transactions with Affiliates

The Company is a legal entity separate and distinct from the Bank and its other subsidiaries. The Company’s principal source of funds to pay dividends on its common shares and service its debt is dividends from Farmers Bank and its other subsidiaries. Various federal and state statutory provisions and regulations limit the amount of dividends that Farmers Bank may pay to Farmers without regulatory approval. Farmers Bank generally may not, without prior regulatory approval, pay a dividend in an amount greater than its undivided profits after deducting statutory bad debt in excess of the Bank’s allowance for loan losses. In addition, prior approval of the OCC is required for the payment of a dividend if the total of all dividends declared in a calendar year would exceed the total of Farmers Bank’s net income for the year combined with its retained net income for the two preceding years.

In addition, Farmers and Farmers Bank are subject to other regulatory policies and requirements relating to the payment of dividends, including requirements to maintain adequate capital above regulatory minimums. The federal banking agencies are authorized to determine under certain circumstances that the payment of dividends would be an unsafe or unsound practice and to prohibit payment thereof. The federal banking agencies have stated that paying dividends that deplete a bank’s capital base to an inadequate level would be an unsafe and unsound banking practice and that banking organizations should generally pay dividends only out of current operating earnings. In addition, in the current financial and economic environment, the Federal Reserve Board has indicated that financial holding companies should carefully review their dividend policy and has discouraged payment ratios that are at maximum allowable levels, unless both asset quality and capital are very strong. Thus, the ability of Farmers to pay dividends in the future is currently influenced, and could be further influenced, by bank regulatory policies and capital guidelines.

The Bank is subject to restrictions under federal law that limit the transfer of funds or other items of value to the Company and its nonbanking subsidiaries and affiliates, whether in the form of loans and other extensions of credit, investments and asset purchases or other transactions involving the transfer of value from a subsidiary to an affiliate or for the benefit of an affiliate. These regulations limit the types and amounts of transactions (including loans due and extensions of credit) that may take place and generally require those transactions to be on an arm's-length basis. In general, these regulations require that any "covered transaction" by Farmers Bank with an affiliate must be secured by designated amounts of specified collateral and must be limited, as to any one of Farmers or its non-bank subsidiaries, to 10% of Farmers Bank's capital stock and surplus, and, as to Farmers and all such non-bank subsidiaries in the aggregate, to 20% of Farmers Bank's capital stock and surplus. The Dodd-Frank Act significantly expanded the coverage and scope of the limitations on affiliate transactions within a banking organization including, for example, the requirement that the 10% capital limit on covered transactions apply to financial subsidiaries. “Covered transactions” are defined by statute to include a loan or extension of credit, as well as a purchase of securities issued by an affiliate, a purchase of assets (unless otherwise exempted by the Federal Reserve Board) from the affiliate, certain derivative transactions that create a credit exposure to an affiliate, the acceptance of securities issued by the affiliate as collateral for a loan and the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate.

Capital loans from the Company to the Bank are subordinate in right of payment to deposits and certain other indebtedness of the Bank. In the event of Farmers’ bankruptcy, any commitment by Farmers to a federal bank regulatory agency to maintain the capital of Farmers Bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

The Federal Deposit Insurance Act of 1950, as amended, provides that, in the event of the “liquidation or other resolution” of an insured depository institution such as the Bank, the insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, nondeposit creditors, including the Company, with respect to any extensions of credit they have made to such insured depository institution.

Capital Adequacy

Both Farmers and Farmers Bank are subject to risk-based capital requirements imposed by their respective primary federal banking regulator. The Federal Reserve Bank monitors the capital adequacy of Farmers and the FDIC monitors the capital adequacy of Farmers Bank. The revised risk-based capital requirements applicable to bank holding companies and insured depository institutions, including the Company and the Bank, to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision (“Basel III”) became effective for the Company and the Bank on January 1, 2015. The Basel III Rules require the maintenance of minimum amounts and ratios of common equity tier 1 capital, tier 1 capital and total capital to risk-weighted assets, and of tier 1 capital to adjusted quarterly average assets.

Under the Basel III Rules, common equity tier 1 capital consists of common stock and paid-in capital (net of treasury stock) and retained earnings. Common equity tier 1 capital is reduced by goodwill, certain intangible assets, net of associated deferred tax liabilities, deferred tax assets that arise from tax credit and net operating loss carryforwards, net of any valuation allowance, and certain other items as specified by the Basel III Rules.

Tier 1 capital includes common equity tier 1 capital and certain additional tier 1 items as provided under the Basel III Rules.

Basel III Rules allow for insured depository institutions to make a one-time election not to include most elements of accumulated other comprehensive income in regulatory capital and instead effectively use the existing treatment under the general risk-based capital rules. The Company and the Bank made this opt-out election in the first quarter of 2015 to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of our investment securities portfolio.

The Basel III Rules also changed the risk-weights of assets in an effort to better reflect credit risk and other risk exposures. These include a 150% risk weight (up from 100%) for certain high volatility commercial real estate acquisition, development and construction loans and the unsecured portion of non-residential mortgage loans that are 90 days past due or otherwise on nonaccrual status; a 20% (up from 0%) credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable; a 250% risk weight (up from 100%) for mortgage servicing rights and deferred tax assets that are not deducted from capital; and increased risk weights (from 0% to up to 600%) for equity exposures.

The Basel III Rules limit capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of common equity tier 1 capital, tier 1 capital and total capital to risk-weighted assets in addition to the amount necessary to meet minimum risk-based capital requirements. The capital conservation buffer began being phased in on January 1, 2016. When fully phased in on January 1, 2019, Basel III will require the Bank to maintain: (i) as a newly adopted international standard, a minimum ratio of Common Equity Tier 1 ("CET1") to risk-weighted assets of 4.5%, plus a 2.5% capital conservation buffer (the "CCB") (which is added to the 4.5% CET1 ratio as that buffer is phased in, which will effectively result in a minimum ratio of CET1 to risk-weighted assets of 7.0%); (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of 6.0%, plus the CCB (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% on full implementation); (iii) a minimum ratio of Total (Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0%, plus the CCB (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation); and (iv) as a newly adopted international standard, a minimum leverage ratio of 3.0%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (computed as the average for each quarter of the month-end ratios for the quarter).

Prior to January 1, 2015, federal regulatory agencies required the Company and the Bank to maintain minimum tier 1 and total capital to risk-weighted assets of 4.0% and 8.0%, respectively, and tier 1 capital to average assets (tier 1 leverage ratio) of at least 4.0%. In order to be considered well capitalized under the rules in effect prior to January 1, 2015, the Company had to maintain tier 1 and total capital to risk-weighted assets of 6.0% and 10.0%, respectively, and a leverage ratio of 5.0%. Tier 1 capital consisted of common equity, retained earnings, certain types of preferred stock, qualifying minority interest and trust preferred securities, subject to limitations, and excluded goodwill and various intangible assets.

The Basel III final framework provides for a number of new deductions from and adjustments to CET1, including the deduction of mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities if any one such category exceeds 10.0% of CET1 or if all such categories in the aggregate exceed 15.0% of CET1.

The following is a summary of the other major changes from the current general risk-based capital rule:

- replacement of the external credit ratings approach to standards of creditworthiness with a simplified supervisory formula approach;
- stricter limitations on the extent to which mortgage servicing assets, deferred tax assets and significant investments in unconsolidated financial institutions may be included in common equity tier 1 capital and the risk weight to be assigned to any amounts of such assets not deducted; and
- increased risk weights for past-due loans, certain commercial real estate loans and some equity exposures, and selected other changes in risk weights and credit conversion factors.

Notwithstanding its release of the Basel III framework as a final framework, the Basel Committee is considering further amendments to Basel III, including imposition of additional capital surcharges on globally systemically important financial institutions. In addition to Basel III, the Dodd-Frank Act requires or permits federal banking agencies to adopt regulations affecting capital requirements in a number of respects, including potentially more stringent capital requirements for systemically important financial institutions. Accordingly, the regulations ultimately applicable to the Company may differ substantially from the currently published final Basel III framework. Requirements of higher capital levels or higher levels of liquid assets could adversely impact the Company's net income and return on equity.

Volcker Rule

In December 2013, five federal agencies adopted a final regulation implementing the Volcker Rule provision of the Dodd-Frank Act (the "Volcker Rule"). The Volcker Rule places limits on the trading activity of insured depository institutions and entities affiliated with a depository institution, subject to certain exceptions. The trading activity includes a purchase or sale as principal of a security, derivative, commodity future or option on any such instrument in order to benefit from short-term price movements or to realize short-term profits. The Volcker Rule exempts specified U.S. Government, agency and/or municipal obligations, and it exempts trading conducted in certain capacities, including as a broker or other agent, through a deferred compensation or pension plan, as a fiduciary on behalf of customers, to satisfy a debt previously contracted, repurchase and securities lending agreements and risk-mitigating hedging activities.

The Volcker Rule also prohibits a banking entity from having an ownership interest in, or certain relationships with, a hedge fund or private equity fund, with a number of exceptions.

The Bank does not engage in any of the trading activities or own any of the types of funds prohibited by the Volcker Rule.

Prompt Corrective Action

The federal banking agencies have established a system of prompt corrective action to resolve certain of the problems of undercapitalized institutions. This system is based on five capital level categories for insured depository institutions: "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized."

The federal banking agencies may (or in some cases must) take certain supervisory actions depending upon a bank's capital level. For example, the banking agencies must appoint a receiver or conservator for a bank within 90 days after it becomes "critically undercapitalized" unless the bank's primary regulator determines, with the concurrence of the FDIC, that other action would better achieve regulatory purposes. Banking operations otherwise may be significantly affected depending on a bank's capital category. For example, a bank that is not "well capitalized" generally is prohibited from accepting brokered deposits and offering interest rates on deposits higher than the prevailing rate in its market, and the holding company of any undercapitalized depository institution must guarantee, in part, specific aspects of the bank's capital plan for the plan to be acceptable.

Federal law permits the OCC to order the pro rata assessment of shareholders of a national bank whose capital stock has become impaired, by losses or otherwise, to relieve a deficiency in such national bank's capital stock. This statute also provides for the enforcement of any such pro rata assessment of shareholders of such national bank to cover such impairment of capital stock by sale, to the extent necessary, of the capital stock owned by any assessed shareholder failing to pay the assessment. As the sole shareholder of Farmers Bank, the Company is subject to such provisions.

Deposit Insurance

Substantially all of the deposits of the Bank are insured up to applicable limits by the Deposit Insurance Fund of the FDIC, and Farmers Bank is assessed deposit insurance premiums to maintain the Deposit Insurance Fund. The general insurance limit is $250,000 per separately insured depositor. This insurance is backed by the full faith and credit of the United States Government. Insurance premiums for each insured institution are determined based upon the institution's capital level and supervisory rating provided to the FDIC by the institution's primary federal regulator and other information deemed by the FDIC to be relevant to the risk posed to the Deposit Insurance Fund by the institution. The assessment rate is then applied to the amount of the institution's deposits to determine the institution's insurance premium.

The FDIC assesses a quarterly deposit insurance premiums on each insured institution based on risk characteristics of the institution and may also impose special assessments in emergency situations. The premiums fund the Deposit Insurance Fund ("DIF"). Pursuant to the Dodd-Frank Act, the FDIC has established 2.0% as the designated reserve ratio ("DRR"), which is the amount in the DIF as a percentage of all DIF insured deposits. In March 2016, the FDIC adopted final rules designed to meet the statutory minimum DRR of 1.35% by September 30, 2010, the deadline imposed by the Dodd-Frank Act. The Dodd-Frank Act requires the FDIC to offset the effect on institutions with assets of less than $10 billion of the increase in the statutory minimum DRR to 1.35% from the former statutory minimum of 1.15%. Although the FDIC's new rules reduced assessment rates on all banks, they imposed a surcharge on banks with assets of $10 billion or more to be paid until the DRR reaches 1.35%. The rules also provide assessment credits to banks with assets of less than $1 billion for the portion of their assessments that contribute to the increase of the DRR to 1.35%. The rules further changed the method of determining risk-based assessment rates for established banks with less than $10 billion in assets to better ensure that banks taking on greater risks pay more for deposit insurance than banks that take on less risk.

In addition, all FDIC-insured institutions are required to pay assessments to fund interest payments on bonds issued by the Financing Corporation, which was established by the government to recapitalize a predecessor to the DIF. These assessments will continue until the Financing Corporation bonds mature in 2019.

As insurer, the FDIC is authorized to conduct examinations of and to require reporting by federally-insured institutions. It also may prohibit any federally-insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious threat to the Deposit Insurance Fund. The FDIC also has the authority to take enforcement actions against insured institutions. Insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged or is engaging in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or written agreement entered into with the FDIC. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

Fiscal and Monetary Policies

The Company's business and earnings are affected significantly by the fiscal and monetary policies of the federal government and its agencies. The Company is particularly affected by the policies of the Federal Reserve Board, which regulates the supply of money and credit in the United States in order to influence general economic conditions, primarily through open market operations in U.S. government securities, changes in the discount rate on bank borrowings and changes in the reserve requirements against depository institutions' deposits. These policies and regulations significantly affect the overall growth and distribution of loans, investments and deposits, as well as interest rates charged on loans and paid on deposits.

The monetary policies of the Federal Reserve board have had a significant effect on operations and results of financial institutions in the past and are expected to have significant effects in the future. In view of the changing conditions in the economy, the money markets and activities of monetary and fiscal authorities, Farmers can make no predictions as to future changes in interest rates, credit availability or deposit levels.

Community Reinvestment Act

The CRA requires depository institutions to assist in meeting the credit needs of their market areas consistent with safe and sound banking practice. Under the CRA, each depository institution is required to help meet the credit needs of its market areas by, among other things, providing credit to low and moderate-income individuals and communities. Depository institutions are periodically examined for compliance with the CRA and are assigned ratings. In order for a bank holding company to commence any new activity permitted by the BHCA, or to acquire any company engaged in any new activity permitted by the BHCA, each insured depository institution subsidiary of the bank holding company must have received a rating of at least "satisfactory" in its most recent examination under the CRA. Furthermore, banking regulators take into account CRA ratings when considering approval of a proposed transaction. Farmers received a rating of "satisfactory" in its most recent CRA examination.

Customer Privacy

Farmers Bank is subject to regulations limiting the ability of financial institutions to disclose non-public information about consumers to nonaffiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow customers to prevent disclosure of certain personal information to a nonaffiliated third party. These regulations affect how consumer information is transmitted and conveyed to outside vendors.

Anti-Money Laundering and the USA Patriot Act

The Uniting and Strengthening of America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "USA Patriot Act") and its related regulations require insured depository institutions, broker-dealers and certain other financial institutions to have policies, procedures and controls to detect, prevent, and report money laundering and terrorist financing. The USA Patriot Act and its regulations also provide for information sharing, subject to conditions, between federal law enforcement agencies and financial institutions, as well as among financial institutions, for counter-terrorism purposes. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution. In addition, federal banking agencies are required, when reviewing bank holding company acquisition and bank merger applications, to take into account the effectiveness of the anti-money laundering policies, procedures and controls of the applicants.

Corporate Governance

The Sarbanes-Oxley Act of 2002 effected broad reforms to areas of corporate governance and financial reporting for public companies under the jurisdiction of the Commission. The Company's corporate governance policies include an Audit Committee Charter, a Compensation Committee Charter, Corporate Governance and Nominating Committee Charter and Code of Business Conduct and Ethics. The Board of Directors reviews the Company's corporate governance practices on a continuing basis. These and other corporate governance policies have been provided previously to shareholders and are available, along with other information on Farmers' corporate governance practices, on the Company's website at www.farmersbankgroup.com.

As directed by Section 302(a) of the Sarbanes-Oxley Act, the Company's chief executive officer and chief financial officer are each required to certify that the Company's Quarterly and Annual Reports do not contain any untrue statement of a material fact. The rules have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of the Company's internal controls, they have made certain disclosures about the Company's internal controls to its auditors and the audit committee of the Board of Directors and they have included information in the Company's Quarterly and Annual Reports about their evaluation and whether there have been significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the evaluation.

Executive and Incentive Compensation

In June 2010, the Federal Reserve Board, OCC and FDIC issued joint interagency guidance on incentive compensation policies (the "Joint Guidance") intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. This principles-based guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should: (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks; (ii) be compatible with effective internal controls and risk management; and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors.

Pursuant to the Joint Guidance, the Federal Reserve Board will review as part of a regular, risk-focused examination process, the incentive compensation arrangements of financial institutions such as Farmers. Such reviews will be tailored to each organization based on the scope and complexity of the organization's activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination and deficiencies will be incorporated into the institution's supervisory ratings, which can affect the institution's ability to make acquisitions and take other actions. Enforcement actions may be taken against an institution if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness, and prompt and effective measures are not being taken to correct the deficiencies.

On February 7, 2011, the federal banking agencies initially issued jointly proposed rules on incentive-based compensation arrangements under applicable provisions of the Dodd-Frank Act (the "First Proposed Rules"). The First Proposed Rules generally apply to financial institutions with $1.0 billion or more in assets that maintain incentive-based compensation arrangements for certain covered employees.

In May 2016, the federal bank regulatory agencies issued a second joint notice of proposed rules (the "Second Proposed Joint Rules") likewise designed to prohibit incentive-based compensation arrangements that encourage inappropriate risks at financial institutions. The Second Proposed Joint Rules would also apply to covered financial institutions with total assets of $1 billion or more, but the rules would differ for each of three categories of financial institutions:

- Level 1 – institutions with assets of $250 billion or more;
- Level 2 – institutions with assets of at least $50 billion and less than $250 billion; and
- Level 3 – institutions with assets of at least $1 billion and less than $50 billion.

Farmers would be a Level 3 institution. Some of the requirements would apply only to Level 1 and Level 2 institutions. For all covered institutions, including Level 3 institutions, the proposed rules would:

- prohibit incentive-based compensation arrangements that are "excessive" or "could lead to material financial loss;"
- require incentive based compensation that is consistent with a balance of risk and reward, effective management and control of risk, and effective governance; and
- require board oversight, recordkeeping and disclosure to the appropriate regulatory agency.

Public companies will also be required, once stock exchanges impose additional listing requirements under the Dodd-Frank Act, to implement "clawback" procedures for incentive compensation payments and to disclose the details of the procedures which allow recovery of incentive compensation that was paid on the basis of erroneous financial information necessitating a restatement due to material noncompliance with financial reporting requirements. This clawback policy is intended to apply to compensation paid within a three year look-back window of the restatement and would cover all executives who received incentive awards.

The Dodd-Frank Act also provides shareholders the opportunity to cast a non-binding vote on executive compensation practices, imposes new executive compensation disclosure requirements, and contains additional considerations of the independence of compensation advisors.

Future Legislation

Various and significant legislation affecting financial institutions and the financial industry is from time to time introduced in the U.S. Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to substantially change the financial institution regulatory system. It is likely that the Trump Administration and the U.S. Congress will pursue and potentially implement legislative or regulatory changes affecting financial institutions and the financial industry. In 2018, President Trump signed a bill reforming the Dodd-Frank Act and the Trump Administration has indicated its intent to loosen additional regulations. Such legislation could change the operating environment for Farmers and its subsidiaries in unpredictable ways, it could decrease the costs of doing business, expand permissible activities or affect the competitive balance among financial institutions. With the enactment and the continuing implementation of the Dodd-Frank Act and regulations thereunder, the nature and extent of future legislative and regulatory changes affecting financial institutions remains very unpredictable. Farmers cannot predict the scope and timing of any such future legislation and, if enacted, the effect that it could have on its business, financial condition or results of operations.

Summary

To the extent that the foregoing information describes statutory and regulatory provisions applicable to the Company or its subsidiaries, it is qualified in its entirety by reference to the full text of those provisions or agreements. Also, such statutes, regulations and policies are continually under review by the U.S. Congress and state legislatures as well as federal and state regulatory agencies and are subject to change at any time, particularly in the current economic and regulatory environment. Any such change in applicable statutes, regulations or regulatory policies could have a material effect on Farmers and its business, financial condition or results of operations.

Item 1A. Risk Factors.

The following are certain risk factors that could materially and negatively affect our business, results of operations, cash flows or financial condition. These risk factors should be considered in connection with evaluating the forward-looking statements contained in this Annual Report on Form 10-K because these factors could cause our actual results or financial condition to differ materially from those projected in forward-looking statements. The risks that are discussed below are not the only ones we face. If any of the following risks occur, our business, financial condition or results of operations could be negatively affected. Additional risks that are not presently known or that we presently deem to be immaterial could also have a material, adverse impact on our business, financial condition or results of operations.

Risks Relating to Economic and Market Conditions

Changes in economic, political, and market conditions may adversely affect our industry and our business.

Our success depends in part on national and local economic, political, and market conditions as well as governmental monetary and other financial policies. Conditions such as inflation, recession, unemployment, changes in interest rates, money supply, governmental fiscal policies and other factors beyond our control may adversely affect our asset quality, deposit levels and loan demand and, therefore, our earnings. Because we have a significant amount of real estate loans, additional decreases in real estate values could adversely affect the value of property used as collateral and our ability to sell the collateral upon foreclosure. Adverse changes in the economy may also have a negative effect on the ability of our borrowers to make timely repayments of their loans, which would have an adverse impact on our earnings. If during a period of reduced real estate values we are required to liquidate the collateral securing loans to satisfy the debt or to increase our allowance for loan losses, it could materially reduce our profitability and adversely affect our financial condition. Moreover, the Financial Accounting Standards Board may change its requirements for establishing the loan loss allowance. The majority of our loans are to individuals and businesses in Northeast Ohio. Consequently, further significant declines in the economy in the area could have a material adverse effect on our business, financial condition or results of operations. It is uncertain when the negative credit trends in our market will reverse, and, therefore, future earnings are susceptible to further declining credit conditions in the market in which we operate.

Changes in interest rates could adversely affect our income and financial condition.

Our earnings and cash flow are dependent upon our net interest income. Net interest income is the difference between the interest income generated by our interest-earning assets (consisting primarily of loans and, to a lesser extent, securities) and the interest expense generated by our interest-bearing liabilities (consisting primarily of deposits and wholesale borrowings). Our level of net interest income is primarily a function of the average balance of our interest-earning assets, the average balance of our interest-bearing liabilities and the spread between the yield on such assets and the cost of such liabilities. These factors are influenced by both the pricing and mix of our interest-earning assets and our interest-bearing liabilities which, in turn, are impacted by external factors, such as the local economy, competition for loans and deposits, the monetary policy of the Federal Reserve Board and market interest rates.

Interest rates are beyond our control, and they fluctuate in response to general economic conditions and the policies of various governmental and regulatory agencies, in particular, the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, will influence the origination of loans, the purchase of investments, the generation of deposits and the rates received on loans and investment securities and paid on deposits. While we have taken measures intended to manage the risks of operating in a changing interest rate environment, there can be no assurance that such measures will be effective in avoiding undue interest rate risk. See additional interest rate risk discussion under the Market Risk section found in Item 7A of this Annual Report on Form 10-K.

Defaults by another larger financial institution could adversely affect financial markets generally.

The commercial soundness of many financial institutions may be closely interrelated as a result of credit, trading, clearing or other relationships between institutions. As a result, concerns about, or a default or threatened default by, one institution could lead to significant market-wide liquidity and credit problems, losses or defaults by other institutions. This is sometimes referred to as “systemic risk” and may adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges, with which we and our subsidiaries interact on a daily basis, and therefore could adversely affect our business, financial condition or results of operations.

Risks Related to Our Business

We extend credit to a variety of customers based on internally set standards and judgment. We manage credit risk through a program of underwriting standards, the review of certain credit decisions and an on-going process of assessment of the quality of credit already extended. Our credit standards and on-going process of credit assessment might not protect us from significant credit losses.

We take credit risk by virtue of making loans, extending loan commitments and letters of credit and, to a lesser degree, purchasing non-governmental securities. Our exposure to credit risk is managed through the use of consistent underwriting standards that emphasize "in-market" lending, while avoiding highly leveraged transactions as well as excessive industry and other concentrations. Our credit administration function employs risk management techniques to ensure that loans adhere to corporate policy and problem loans are promptly identified. While these procedures are designed to provide us with the information needed to implement policy adjustments where necessary, and to take proactive corrective actions, there can be no assurance that such measures will be effective in avoiding undue credit risk.

We have significant exposure to risks associated with commercial real estate and residential real estate in our primary markets.

As of December 31, 2018, approximately 65.1% of our loan portfolio consisted of commercial real estate and residential real estate loans, including real estate development, construction and residential and commercial mortgage loans. Consequently, real estate-related credit risks are a significant concern for us. The adverse consequences from real estate-related credit risks tend to be cyclical and are often driven by national economic developments that are not controllable or entirely foreseeable by us or our borrowers. General difficulties in our real estate markets have recently contributed to increases in our non-performing loans, charge-offs and decreases in our income.

Our business depends significantly on general economic conditions in the State of Ohio. Accordingly, the ability of our borrowers to repay their loans, and the value of the collateral securing such loans, may be significantly affected by economic conditions in the regions we serve or by changes in the local real estate markets. A significant decline in general economic conditions caused by inflation, recession, unemployment, acts of terrorism or other factors beyond our control could have an adverse effect on our business, financial condition or results of operations.

Our indirect lending exposes us to increased credit risks.

A portion of our current lending involves the purchase of consumer automobile installment sales contracts from automobile dealers located in Northeastern Ohio. These loans are for the purchase of new or late model used cars. We serve customers over a broad range of creditworthiness, and the required terms and rates are reflective of those risk profiles. While these loans have higher yields than many of our other loans, such loans involve significant risks in addition to normal credit risk. Potential risk elements associated with indirect lending include the limited personal contact with the borrower as a result of indirect lending through dealers, the absence of assured continued employment of the borrower, the varying general creditworthiness of the borrower, changes in the local economy and difficulty in monitoring collateral. While indirect automobile loans are secured, such loans are secured by depreciating assets and characterized by loan to value ratios that could result in us not recovering the full value of an outstanding loan upon default by the borrower. Delinquencies, charge-offs and repossessions of vehicles in this portfolio are always concerns. If general economic conditions worsen, we may experience higher levels of delinquencies, repossessions and charge-offs.

Commercial and industrial loans may expose us to greater financial and credit risk than other loans.

As of December 31, 2018, approximately 17.0% of our loan portfolio consisted of commercial and industrial loans. Commercial and industrial loans generally carry larger loan balances and can involve a greater degree of financial and credit risk than other loans. Any significant failure to pay on time by our customers would hurt our earnings and cause a significant increase in non-performing loans. The increased financial and credit risk associated with these types of loans are a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the size of loan balances, the effects of general economic conditions on income-producing properties and the increased difficulty of evaluating and monitoring these types of loans. In addition, when underwriting a commercial or industrial loan, we may take a security interest in commercial real estate, and, in some instances upon a default by the borrower, we may foreclose on and take title to the property, which may lead to potential financial risks. An increase in non-performing loans could result in a net loss of earnings from these loans, an increase in the provision for loan losses and an increase in loan charge-offs, all of which could have a material adverse effect on our business, financial condition or results of operations.

Our allowance for loan loss may not be adequate to cover actual future losses.

We maintain an allowance for loan losses to cover current, probable incurred loan losses. Every loan we make carries a certain risk of non-repayment, and we make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of loans. Through a periodic review and consideration of the loan portfolio, management determines the amount of the allowance for loan losses by considering general market conditions, credit quality of the loan portfolio, the collateral supporting the loans and performance of customers relative to their financial obligations with us. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates, which may be beyond our control, and these losses may exceed current estimates. We cannot fully predict the amount or timing of losses or whether the loss allowance will be adequate in the future. If our assumptions prove to be incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, which will require additions to the allowance. Excessive loan losses and significant additions to our allowance for loan losses could have a material adverse impact on our business, financial condition or results of operations.

We are subject to certain risks with respect to liquidity.

“Liquidity” refers to our ability to generate sufficient cash flows to support our operations and to fulfill our obligations, including commitments to originate loans, to repay our wholesale borrowings and other liabilities and to satisfy the withdrawal of deposits by our customers. Our primary source of liquidity is our core deposit base, which is raised through our retail branch system. Core deposits – savings and money market accounts, time deposits less than $250 thousand and demand deposits—comprised approximately 93.8% of total deposits at December 31, 2018. Additional available unused wholesale sources of liquidity include advances from the FHLB, issuances through dealers in the capital markets and access to certificates of deposit issued through brokers. Liquidity is further provided by unencumbered, or unpledged, investment securities that totaled $202.4 million at December 31, 2018. An inability to raise funds through deposits, borrowings, the sale or pledging as collateral of loans and other assets could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could negatively affect our access to liquidity sources include a decrease in the level of our business activity due to a market downturn or negative regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as severe disruption of the financial markets or negative news and expectations about the prospects for the financial services industry as a whole, as evidenced by recent turmoil in the domestic and worldwide credit markets.

Our business strategy includes continuing our growth plans. Our business, financial condition or results of operations could be negatively affected if we fail to grow or fail to manage our growth effectively.

We intend to continue pursuing a profitable growth strategy both within our existing markets and in new markets. Our prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in significant growth stages of development. We cannot assure that we will be able to expand our market presence in our existing markets or successfully enter new markets or that any such expansion will not adversely affect our results of operations. Failure to manage our growth effectively could have a material adverse effect on our business, future prospects, financial condition or results of operations and could adversely affect our ability to successfully implement our business strategy. Also, if we grow more slowly than anticipated, our operating results could be materially adversely affected.

We may experience difficulties in integrating acquired businesses, or acquisitions may not perform as expected.

We completed the acquisition of Monitor in 2017 and Bowers in 2016. The successful integration of these acquisitions depends on our ability to manage the operations and personnel of the acquired businesses. Integrating operations is complex and requires significant efforts and expenses. Potential difficulties we may encounter as part of the integration process include the following:

- employees may voluntarily or involuntarily exit the Company because of the acquisitions;
- our management team may have its attention diverted while trying to integrate the acquired companies;
- we may encounter obstacles when incorporating the acquired operations into our operations;
- differences in business backgrounds, corporate cultures and management philosophies;
- potential unknown liabilities and unforeseen increased expenses;
- previously undetected operational or other issues; and
- the acquired operations may not otherwise perform as expected or provide expected results.

Any of these factors could adversely affect each company’s ability to maintain relationships with customers, suppliers, employees and other constituencies or our ability to achieve the anticipated benefits of the acquisition or could reduce each company’s earnings or otherwise adversely affect our business and financial results after the acquisition.

We may fail to realize all of the anticipated benefits of acquisitions, which could reduce our anticipated profitability.

We expect that our acquisitions will result in certain synergies, business opportunities and growth prospects, although we may not fully realize these expectations. Our assumptions underlying estimates of expected cost savings may be inaccurate or general industry and business conditions may deteriorate. In addition, our growth and operating strategies for acquired businesses may be different from the strategies that the acquired companies pursued. If these factors limit our ability to integrate or operate the acquired companies successfully or on a timely basis, our expectations of future results of operations, including certain cost savings and synergies expected to result from acquisitions, may not be met.

We may not be able to attract and retain skilled people.

Our success depends, in large part, on our ability to attract and retain key people. Competition for the best people in most activities in which we engage can be intense, and we may not be able to retain or hire the people we want or need. In order to attract and retain qualified employees, we must compensate them at market levels. If we are unable to continue to attract and retain qualified employees, or do so at rates necessary to maintain our competitive position, our performance, including our competitive position, could suffer, and, in turn, adversely affect our business, financial condition or results of operations.

Strong competition within our markets could reduce our ability to attract and retain business.

We encounter significant competition from banks, savings and loan associations, credit unions, mortgage banks, and other financial service companies in our markets. Some of our competitors offer a broader range of products and services than we can offer as a result of their size and ability to achieve economies of scale. Such competition includes major financial companies whose greater resources may afford them a marketplace advantage by enabling them to maintain more numerous banking locations and support extensive promotional and advertising campaigns. Our ability to maintain our history of strong financial performance and return on investment to shareholders will depend in part on our continued ability to compete successfully in our market. Our financial performance and return on investment to shareholders also depends on our ability to expand the scope of available financial services to our customers. In addition to other banks, competitors include securities dealers, brokers, investment advisors and finance and insurance companies. The increasingly competitive environment is, in part, a result of changes in regulation, changes in technology and product delivery systems and the accelerating pace of consolidation among financial service providers.

Consumers may decide not to use banks to complete their financial transactions.

Technology and other changes are allowing parties to utilize alternative methods to complete financial transactions that historically have involved banks. For example, consumers can now maintain funds in brokerage accounts or mutual funds that would have historically been held as bank deposits. Consumers can also complete transactions such as paying bills and/or transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost deposits as a source of funds could have a material adverse effect on our business, financial condition or results of operations.

We are exposed to operational risk.

Similar to any large organization, we are exposed to many types of operational risk, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, unauthorized transactions by employees or operational errors, including clerical or record-keeping errors or those resulting from faulty or disabled computer or telecommunications systems.

Negative public opinion can result from our actual or alleged conduct in any number of activities, including lending practices, corporate governance and acquisitions and from actions taken by government regulators and community organizations in response to those activities. Negative public opinion can adversely affect our ability to attract and keep customers, and can expose us to litigation and regulatory action.

Given the volume of transactions we process, certain errors may be repeated or compounded before they are discovered and successfully rectified. Our necessary dependence upon automated systems to record and process our transaction volume may further increase the risk that technical system flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. We may also be subject to disruptions of our operating systems arising from events that are wholly or partially beyond our control (for example, computer viruses or electrical or telecommunications outages), which may give rise to disruption of service to customers and to financial loss of liability. We are further exposed to the risk that our external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as we are) and to the risk that our (or our vendors') business continuity and data security systems prove to be inadequate.

Unauthorized disclosure of sensitive or confidential customer information, whether through a data breach of our computer systems by cyber-attack or otherwise, could severely harm our business.

As part of our financial institution business, we collect, process and retain sensitive and confidential client and customer information on behalf of our subsidiaries and other third parties. Despite the security measures we have in place, our facilities and systems, and those of our third-party service providers, may be vulnerable to security breaches, acts of vandalism, computer viruses, misplaced or lost data, programming and/or human errors or other similar events. If information security is breached, information could be lost or misappropriated, resulting in financial loss or costs to us or damages to others. Any security breach involving the misappropriation, loss or other unauthorized disclosure of confidential customer information, whether by us or by our vendors, could severely damage our reputation, expose us to the risks of litigation and liability, or disrupt our operations, and have a material adverse effect on our business, financial condition or results of operations. We have not experienced any material loss relating to a cyber-attack or other information security breach, but there can be no assurance that we will not suffer such attacks or attempted breaches, or incur resulting losses, in the future. Our risks with respect to these threats remains heightened due to the evolving sophistication and frequency of such threats. As cyber-attacks and other attempted information security threats continue to evolve, we may be required to spend significant additional resources in efforts to modify and enhance our protective measures or in investigating or remediating of security breaches or vulnerabilities.

We depend on our subsidiaries for dividends, distributions and other payments.

As a financial holding company, we are a legal entity separate and distinct from our subsidiaries. Our principal source of funds to pay dividends on our common shares is dividends from these subsidiaries. Federal and state statutory provisions and regulations limit the amount of dividends that our banking and other subsidiaries may pay to us without regulatory approval. In the event our subsidiaries become unable to pay dividends to us, we may not be able to pay dividends on our outstanding common shares. Accordingly, our inability to receive dividends from our subsidiaries could also have a material adverse effect on our business, financial condition and results of operations. Further discussion of our ability to pay dividends can be found under the caption "Dividends and Transactions with Affiliates" in Item 1 of this Annual Report on Form 10-K.

We may elect or be compelled to seek additional capital in the future, but that capital may not be available when it is needed.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. Federal banking agencies have proposed extensive changes to their capital requirements; including raising required amounts and eliminating the inclusion of certain instruments from the calculation of capital. The final form of such regulations and their impact on the Company is unknown at this time, but may require us to raise additional capital. In addition, we may elect to raise capital to support our business or to finance acquisitions, if any, or for other anticipated reasons. Our ability to raise additional capital, if needed, will depend on financial performance, conditions in the capital markets, economic conditions and a number of other factors, including the satisfaction or release of preemptive rights in the event of a common share offering, many of which are outside our control. Therefore, there can be no assurance additional capital can be raised when needed or that capital can be raised on acceptable terms. Impairment to our ability to raise capital may have a material adverse effect on our business, financial condition or results of operations.

Risks Related to the Legal and Regulatory Environment

Increases in FDIC insurance premiums may have a material adverse effect on our earnings.

The FDIC maintains the Deposit Insurance Fund to resolve the cost of bank failures. Since late 2008, the FDIC has taken various actions intended to maintain a strong funding position and restore reserve ratios of the Deposit Insurance Fund. Those actions included increasing assessment rates for all insured institutions, requiring riskier institutions to pay a larger share of premiums by factoring in rate adjustments based on secured liabilities and unsecured debt levels, and imposing special assessments. In addition, in 2011 the FDIC approved a final rule that changed the deposit insurance assessment base and assessment rate schedule, adopted a new large-bank pricing assessment scheme and set a target size for the Deposit Insurance Fund. The rule, as mandated by the Dodd-Frank Act, finalized a target size for the Deposit Insurance Fund at 2 percent of insured deposits. The FDIC recently adopted rules revising assessments in a manner that benefits banks with assets of less than $10 billion, although there can be no assurance that such assessments will not change in the future.

We have a limited ability to control the amount of premiums we are required to pay for FDIC insurance. If there are additional financial institution failures or other significant legislative or regulatory changes, the FDIC may be required to increase assessment rates or take actions similar to those taken after 2008. Increases in FDIC insurance assessment rates may materially adversely affect our results of operations and our ability to continue to pay dividends on our common shares at the current rate or at all.

Legislative or regulatory changes or actions, or significant litigation, could adversely impact us or the businesses in which we are engaged.

The financial services industry is extensively regulated. We are subject to extensive state and federal regulation, supervision and legislation that govern almost all aspects of our operations. Laws and regulations may change from time to time and are primarily intended for the protection of consumers, depositors and the Deposit Insurance Fund, and not to benefit our shareholders. The impact of any changes to laws and regulations or other actions by regulatory agencies may negatively impact us or our ability to increase the value of our business. Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of an institution, the classification of assets by an institution and the adequacy of an institution's allowance for loan losses. Additionally, actions by regulatory agencies or significant litigation against us could cause us to devote significant time and resources to defending our business and may lead to penalties that materially affect our shareholders and us.

In addition to laws, regulations and actions directed at the operations of banks, proposals to reform the housing finance market consider winding down Fannie Mae and Freddie Mac, which could negatively affect our sales of loans.

Even a reduction in regulatory restrictions could adversely affect our operations and our shareholders if less restrictive regulation increases competition within the industry generally or within our markets.

Our results of operations, financial condition or liquidity may be adversely impacted by issues arising in foreclosure practices, including delays in the foreclosure process, related to certain industry deficiencies, as well as potential losses in connection with actual or projected repurchases and indemnification payments related to mortgages sold into the secondary market.

Previous announcements of deficiencies in foreclosure documentation by several large seller/servicer financial institutions have raised various concerns relating to mortgage foreclosure practices. The integrity of the foreclosure process is important to our business, as an originator and servicer of residential mortgages. As a result of our continued focus of concentrating our lending efforts in our primary markets in Ohio, as well as servicing loans for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), we do not anticipate suspending any of our foreclosure activities. We previously reviewed our foreclosure procedures and concluded they are generally conservative in nature and do not present the significant documentation deficiencies underlying other industry foreclosure problems. Nevertheless, we could face delays and challenges in the foreclosure process arising from claims relating to industry practices generally, which could adversely affect recoveries and our financial results, whether through increased expenses of litigation and property maintenance, deteriorating values of underlying mortgaged properties or unsuccessful litigation results generally.

In addition, in connection with the origination and sale of residential mortgages into the secondary market, we make certain representations and warranties, which, if breached, may require us to repurchase such loans, substitute other loans or indemnify the purchasers of such loans for actual losses incurred in respect of such loans. Although we believe that our mortgage documentation and procedures have been appropriate and are generally conservative in nature, it is possible that we will receive repurchase requests in the future and we may not be able to reach favorable settlements with respect to such requests. It is therefore possible that we may increase our reserves or may sustain losses associated with such loan repurchases and indemnification payments.

Environmental liability associated with commercial lending could have a material adverse effect on our business, financial condition or results of operations.

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. In addition, we own and operate certain properties that may be subject to similar environmental liability risks.

Environmental laws may require us to incur substantial expenses and may materially reduce the affected property's value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although we have policies and procedures requiring the performance of an environmental site assessment before initiating any foreclosure action on real property, these assessments may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our business, financial condition or results of operations.

Impairment of investment securities, goodwill, other intangible assets, or deferred tax assets could require charges to earnings, which could result in a negative impact on our results of operations.

In assessing the impairment of investment securities, we consider the length of time and extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuers, whether the market decline was affected by macroeconomic conditions and whether we have the intent to sell the debt security or will be required to sell the debt security before its anticipated recovery. Under current accounting standards, goodwill and certain other intangible assets with indeterminate lives are no longer amortized but, instead, are assessed for impairment periodically or when impairment indicators are present. Assessment of goodwill and such other intangible assets could result in circumstances where the applicable intangible asset is deemed to be impaired for accounting purposes. Under such circumstances, the intangible asset's impairment would be reflected as a charge to earnings in the period. Deferred tax assets are only recognized to the extent it is more likely than not they will be realized. Should management determine it is not more likely than not that the deferred tax assets will be realized, a valuation allowance with a change to earnings would be reflected in the period. This was realized as a result of the enactment on December 22, 2017, of H.R.1, known as the "Tax Cuts and Jobs Act" which, among other things, reduced the corporate income tax rate to 21% effective January 1, 2018. As a result of passage of the new tax law, Farmers completed a revaluation of its net deferred tax assets. The Company's deferred tax assets, net of deferred tax liabilities, represent corporate tax benefits anticipated to be realized in the future. The reduction in the federal corporate tax rate, effective January 1, 2018, reduces these benefits. Farmers reduced its net deferred tax assets by approximately $1.8 million in the fourth quarter of 2017, representing an impact on earnings per share of approximately $0.06 per diluted share based fourth quarter weighted average diluted shares outstanding of approximately 27.5 million.

Changes and uncertainty in tax laws, including the recently enacted Tax Cuts and Jobs Act, could adversely affect our performance.

We are subject to extensive federal, state and local taxes, including income, excise, sales/use, payroll, financial institutions tax, withholding and ad valorem taxes. Changes to our taxes could have a material adverse effect on our results of operations and, as described in the above risk discussion and below, the fair value of net deferred tax assets. In addition, our customers are subject to a wide variety of federal, state and local taxes. Changes in taxes paid by our customers may adversely affect their ability to purchase homes or consumer products, which could adversely affect their demand for our loans and deposit products. In addition, such negative effects on our customers could result in defaults on the loans we have made and decrease the value of mortgage-backed securities in which we have invested.

The Tax Cuts and Jobs Act, among other changes, imposes additional limitations on the federal income tax deductions individual taxpayers may take for mortgage loan interest payments and for payments of state and local taxes, including real property taxes. The Tax Cuts and Jobs Act also imposes additional limitations on the deductibility of business interest expense and eliminates other deductions in their entirety, including deductions for certain home equity loan interest payments. Such limits and eliminations may result in customer defaults on loans we have made and decrease the value of mortgage-backed securities in which we have invested.

Anti-takeover provisions could delay or prevent an acquisition or change in control by a third party.

Provisions of the Ohio General Corporation Law, our Amended Articles of Incorporation, and our Amended Code of Regulations, including a staggered board and supermajority voting requirements, could make it more difficult for a third party to acquire control of us or could have the effect of discouraging a third party from attempting to acquire control of us.

We may be a defendant from time to time in the future in a variety of litigation and other actions, which could have a material adverse effect on our business, financial condition or results of operations.

Our subsidiaries and we may be involved from time to time in the future in a variety of litigation arising out of our business. Our insurance may not cover all claims that may be asserted against us, and any claims asserted against us, regardless of merit or eventual outcome, may harm our reputation. Should the ultimate judgments or settlements in any litigation exceed our insurance coverage, they could have a material adverse effect on our business, financial condition or results of operations. In addition, we may not be able to obtain appropriate types or levels of insurance in the future, nor may we be able to obtain adequate replacement policies with acceptable terms, if at all.

Item 1B. Unresolved Staff Comments.

There are no matters of unresolved staff comments from the Commission staff.

Item 2. Properties.

Farmers National Banc Corp.'s Properties

The Company does not own any property. The Company's operations are conducted at Farmers Bank's main office, which is located at 20 and 30 S. Broad St., Canfield, Ohio.

Farmers National Bank Property

The Bank's main office is located at 20 and 30 S. Broad St., Canfield, Ohio. The other locations of Farmers Bank are:

Office Building	40 & 46 S. Broad St., Canfield, Ohio
Austintown Office	22 N. Niles-Canfield Rd., Youngstown, Ohio
Lake Milton Office	17817 Mahoning Avenue, Lake Milton, Ohio
Cornersburg Office	3619 S. Meridian Rd., Youngstown, Ohio
Colonial Plaza Office	401 E. Main St., Canfield, Ohio
Western Reserve Office	102 W. Western Reserve Rd., Youngstown, Ohio
Salem Office	2424 E. State St., Salem, Ohio
Columbiana Office	340 State Rt. 14, Columbiana, Ohio
Damascus Office	29053 State Rt. 62, Damascus, Ohio
Poland Office	106 McKinley Way W., Poland, Ohio
Niles Office	1 S. Main St., Niles, Ohio
Niles Drive Up	170 E. State St., Niles, Ohio
Girard Office	121 N. State St., Girard, Ohio
Eastwood Office	5845 Youngstown-Warren Rd., Niles, Ohio
Niles Operation Center	51 S. Main St., Niles, Ohio
Canton Office	4518 Fulton Dr. NW, Suite 100, Canton, Ohio
McClurg Road Office	42 McClurg Rd., Boardman, Ohio
Howland Office	1625 Niles-Cortland Rd., Warren, Ohio
Fairlawn Office	2820 W. Market St., Suite 120, Akron, Ohio
Wealth Management Bldg.	2 S. Broad St., Canfield, Ohio
Alliance Office	310 W. State St., Alliance, Ohio
Midway Office	7227 E. Lincoln Way, Apple Creek, Ohio
Dalton Office	12 W. Main St., Dalton, Ohio
Calcutta Office	15703 State Rt. 170, Calcutta, Ohio
East Liverpool Office	617 Bradshaw Ave., East Liverpool, Ohio
Kidron Office	4950 Kidron Rd., Kidron, Ohio
Lisbon Office	131 E. Lincoln Way, Lisbon, Ohio
Lodi Office	106 Ainsworth St., Lodi, Ohio
Massillon Office	211 Lincoln Way E., Massillon, Ohio
Mayflower Office	2312 Lincoln Way NW, Massillon, Ohio
Mount Eaton Office	15974 E. Main St., Mount Eaton, Ohio
Orrville Main Office	112 W. Market St., Orrville, Ohio
West High Street Office	1320 W. High St., Orrville, Ohio
Seville Office	4885 Atlantic Dr., Seville, Ohio
Smithville Office	153 E. Main St., Smithville, Ohio
Burbank Road Office	4192 Burbank Rd., Wooster, Ohio
Downtown Wooster Office	305 W. Liberty St., Wooster, Ohio
Midland Office	629 Midland Ave., Midland, Pennsylvania
Beachwood Lending Office	27600 Chagrin Blvd., Suite 300, Woodmere, Ohio
Big Prairie Office	13210 State Route 226, Big Prairie, Ohio
Beaver Lending Office	501 3rd St., Beaver, Pennsylvania

The Bank owns all locations except the Colonial Plaza, Canton, Alliance, East Liverpool, Fairlawn, and Downtown Wooster offices, and the Beaver and Beachwood lending offices, which are leased.

Farmers Trust Company Property

Farmers Trust operates from four locations owned and leased by the Bank:

Boardman Office	42 McClurg Rd., Boardman, Ohio
Howland Office	1625 Niles-Cortland Rd., Warren, Ohio
Canton Office	4518 Fulton Dr. NW, Suite 100, Canton, Ohio
Downtown Wooster Office	305 W. Liberty St., Wooster, Ohio

The Bank owns the Boardman and Howland offices and leases space to Farmers Trust. The Canton and Wooster locations are leased from third parties.

Farmers National Insurance, LLC Property

Farmers Insurance operates from two locations, which are owned by the Bank:

Wealth Management Building	2 S. Broad St., Canfield, Ohio
Bowers Group Building	339 N. High St., Cortland, Ohio

National Associates, Inc. Property

NAI operates from one location, which is leased:

Fairview Park	22720 Fairview Center Dr., Suite 100, Fairview Park, Ohio

Item 3. Legal Proceedings.

In the normal course of business, the Company and its subsidiaries are at times subject to pending and threatened legal actions, some for which the relief or damages sought are substantial. Although Farmers is not able to predict the outcome of such actions, after reviewing pending and threatened actions with counsel, management believes that, based on the information currently available, the outcome of such actions, individually or in the aggregate, would not have a material adverse effect on the results of operations or stockholders’ equity of the Company. However, it is possible that the ultimate resolution of these matters, if unfavorable, may be material to the results of operations in a particular future period as the time and amount of any resolution of such actions and its relationship to the future results of operations are not known.

Item 4. Mine Safety Disclosures

Not applicable.

Part II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuers Purchases of Equity Securities

Market Information regarding the Company's Common Shares.

Farmers' common shares currently trade under the symbol "FMNB" on the Nasdaq Capital Market. Farmers had 27,790,601 common shares outstanding and approximately 3,357 holders of record of common shares at March 1, 2019. The following table sets forth price ranges and dividend information for Farmers' common shares for the calendar quarters indicated. Quotations reflect inter-dealer prices without retail mark-up, mark-down or commission, and may not represent actual transactions. Certain limitations and restrictions on the ability of Farmers to continue to pay quarterly dividends are described under the caption "Capital Resources" in Item 7 of this Part II, and under the caption "Dividends and Transactions with Affiliates" in Item 1 of Part I.

Quarter Ended	March 31, 2018	June 30, 2018	September 30, 2018	December 31, 2018
High	$ 15.90	$ 16.75	$ 16.90	$ 15.48
Low	$ 12.80	$ 13.56	$ 14.95	$ 11.56
Cash dividends paid per share	$ 0.07	$ 0.07	$ 0.08	$ 0.08

Quarter Ended	March 31, 2017	June 30, 2017	September 30, 2017	December 31, 2017
High	$ 14.90	$ 15.25	$ 15.65	$ 15.95
Low	$ 12.13	$ 12.65	$ 12.90	$ 13.35
Cash dividends paid per share	$ 0.05	$ 0.05	$ 0.06	$ 0.06

Purchases of Common Shares by Farmers.

In September 2012, the Company announced that its Board of Directors approved a share repurchase program under which the Company was authorized to repurchase up to 920,000 shares of its common stock in the open market or in privately negotiated transactions, subject to market and other conditions (the "Program"). The Program may be modified, suspended or terminated by the Company at any time. There were no shares repurchased during the course of 2018 and 2017. 19,900 shares of its common stock were repurchased by the Company in 2016.

Item 6. Selected Financial Data.

SELECTED FINANCIAL DATA

(Table Dollar Amounts in Thousands except Per Share Data)

For the Years Ending December 31,	2018	2017	2016	2015	2014
Summary of Earnings					
Total Interest and Dividend Income (including fees on loans)	$91,766	$80,527	$72,498	$53,827	$40,915
Total Interest Expense	13,265	6,881	4,378	4,090	4,579
Net Interest Income	78,501	73,646	68,120	49,737	36,336
Provision for Loan Losses	3,000	3,350	3,870	3,510	1,880
Noninterest Income	25,499	24,051	23,244	18,306	15,303
Noninterest Expense	62,717	61,567	59,452	53,979	38,162
Income Before Income Taxes	38,283	32,780	28,042	10,554	11,597
Income Taxes	5,714	10,069	7,485	2,499	2,632
NET INCOME	$32,569	$22,711	$20,557	$8,055	$8,965
Per Share Data					
Basic Earnings Per Share	$1.18	$0.82	$0.76	$0.36	$0.48
Diluted Earnings Per Share	1.16	0.82	0.76	0.36	0.48
Cash Dividends Paid	0.30	0.22	0.16	0.12	0.12
Book Value at Year-End	9.44	8.79	7.88	7.35	6.71
Tangible Book Value (1)	7.86	7.14	6.21	5.76	6.23
Balances at Year-End					
Total Assets	$2,328,864	$2,159,069	$1,966,113	$1,869,902	$1,136,967
Earning Assets	2,076,969	1,998,245	1,819,455	1,735,843	1,074,434
Total Deposits	1,799,720	1,604,719	1,524,756	1,409,047	915,703
Short-Term Borrowings	244,759	289,565	198,460	225,832	59,136
Long-Term Borrowings	6,033	6,994	15,036	22,153	28,381
Loans Held for Sale	1,237	272	355	1,769	511
Net Loans	1,722,248	1,565,066	1,416,783	1,287,887	656,220
Total Stockholders' Equity	262,320	242,074	213,216	198,047	123,560
Average Balances					
Total Assets	$2,230,380	$2,082,447	$1,924,914	$1,482,527	$1,141,047
Total Stockholders' Equity	247,965	228,963	211,408	162,086	120,352
Significant Ratios					
Return on Average Assets (ROA)	1.46 %	1.09 %	1.07 %	0.54 %	0.79 %
Return on Average Equity (ROE)	13.13	9.92	9.72	4.97	7.45
Average Earning Assets/Average Assets	93.01	92.35	91.49	91.91	93.02
Average Equity/Average Assets	11.12	10.99	10.98	10.93	10.55
Loans/Deposits	96.20	98.30	93.63	92.04	72.50

Allowance for Loan Losses/Total Loans	0.78	0.78	0.76	0.69	1.15
Allowance for Loan Losses/Nonperforming Loans	175.81	160.04	132.83	85.96	89.99
Efficiency Ratio (Tax equivalent basis)(2)	57.93	59.66	61.59	75.26	70.24
Net Interest Margin	3.87	3.99	4.01	3.81	3.59
Dividend Payout Rate	25.53	26.47	21.03	33.32	24.95
Tangible Common Equity Ratio (3)	9.56	9.31	8.75	8.50	10.17

(1) Tangible book value per share is Total Stockholders' Equity minus goodwill and other intangible assets divided by the number of shares outstanding.

(2) The efficiency ratio is calculated by dividing total noninterest expense by net interest income plus noninterest income.

(3) The tangible common equity ratio is calculated by dividing total common stockholders' equity by total assets, after reducing both amounts by intangible assets. The tangible common equity ratio is not required by U.S. GAAP or by applicable bank regulatory requirements, but is a metric used by management to evaluate the adequacy of our capital levels. Since there is no authoritative requirement to calculate the tangible common equity ratio, our tangible common equity ratio is not necessarily comparable to similar capital measures disclosed or used by other companies in the financial services industry. Tangible common equity and tangible assets are non U.S. GAAP financial measures and should be considered in addition to, not as a substitute for or superior to, financial measures determined in accordance with U.S. GAAP. With respect to the calculation of the actual unaudited tangible common equity ratio as of December 31, 2018, reconciliations of tangible common equity to U.S. GAAP total common stockholders' equity and tangible assets to U.S. GAAP total assets are set forth below:

Reconciliation of Common Stockholders' Equity to Tangible Common Equity

December 31,	2018	2017	2016	2015	2014
Stockholders' Equity	$262,320	$242,074	$213,216	$198,047	$123,560
Less Goodwill and other intangibles	43,952	45,369	45,154	42,911	8,813
Tangible Common Equity	$218,368	$196,705	$168,062	$155,136	$114,747

Reconciliation of Total Assets to Tangible Assets

December 31,	2018	2017	2016	2015	2014
Total Assets	$2,328,864	$2,159,069	$1,966,113	$1,869,902	$1,136,967
Less Goodwill and other intangibles	43,952	45,369	45,154	42,911	8,813
Tangible Assets	$2,284,912	$2,113,700	$1,920,959	$1,826,991	$1,128,154

Acquisitions have occurred during the five year periods represented above that makes comparability difficult. The current year impact of enacted federal tax reform makes comparability difficult too. See Note 2 – Business Combinations and Note 17 – Income Taxes for additional details.

Reconciliation of Net Income, Excluding Merger Related Expenses and Deferred Tax Asset Adjustment

December 31,	2018	2017	2016	2015	2014
Net income	$32,569	$22,711	$20,557	$8,055	$8,965
Acquisition related costs - tax equated	(158)	283	412	4,831	0
Deferred tax asset adjustment	0	1,793	0	0	0
Net income - adjusted	32,411	24,787	20,969	12,886	8,965
Average basic shares outstanding	27,675	27,568	27,000	22,678	18,675
EPS excluding acquisition costs and deferred tax asset adjustment	$1.17	$0.90	$0.78	$0.57	$0.48

Reconciliation of Return on Average Assets and Average Equity, Excluding Merger Related Expenses and Deferred Tax Asset Adjustment

December 31,	2018	2017	2016	2015	2014
ROA excluding merger related expenses (4)	1.45 %	1.19 %	1.09%	0.87%	0.79%
ROE excluding merger related expenses (5)	13.07%	10.83%	9.92%	7.95%	7.45%

(4) Net income - adjusted divided by average assets
(5) Net income - adjusted divided by average equity

Average Balance Sheets and Related Yields and Rates

(Table Dollar Amounts in Thousands except Per Share Data)

Years ended December 31,	2018 AVERAGE BALANCE	INTEREST	RATE	2017 AVERAGE BALANCE	INTEREST	RATE	2016 AVERAGE BALANCE	INTEREST	RATE
EARNING ASSETS									
Loans (1) (3) (5)	$1,632,541	$80,192	4.91%	$1,493,550	$70,573	4.73%	$1,344,308	$63,757	4.74%
Taxable securities (2)	202,270	4,928	2.44	213,634	4,899	2.29	240,087	5,058	2.11
Tax-exempt securities (2) (5)	194,302	7,195	3.70	167,824	7,293	4.35	132,550	5,581	4.21
Equity securities (4) (5)	11,382	652	5.73	10,285	537	5.22	9,613	515	5.36
Federal funds sold and other cash	34,006	644	1.89	37,880	394	1.04	34,579	166	0.48
Total earning assets	2,074,501	93,611	4.51	1,923,173	83,696	4.35	1,761,137	75,077	4.26
NONEARNING ASSETS									
Cash and due from banks	33,843			32,696			32,833		
Premises and equipment	21,778			22,953			23,927		
Allowance for Loan Losses	(12,859)			(11,567)			(9,728)		
Unrealized gains on securities	(9,121)			(781)			4,576		
Other assets (1)	122,238			115,973			112,169		
Total Assets	$2,230,380			$2,082,447			$1,924,914		
INTEREST-BEARING LIABILITIES									
Time deposits	$293,725	$4,210	1.43%	$242,650	$2,565	1.06%	$245,384	$1,835	0.75%
Brokered time deposits	68	2	2.35	0	0	0.00	0	0	0.00
Savings deposits	465,283	1,015	0.22	521,099	728	0.14	540,626	685	0.13
Demand deposits	506,099	2,912	0.58	405,062	1,197	0.30	333,712	701	0.21
Short term borrowings	281,063	4,936	1.76	270,949	2,167	0.80	211,713	689	0.33
Long term borrowings	6,491	190	2.93	9,739	224	2.30	19,886	468	2.35
Total Interest-Bearing Liabilities	1,552,729	13,265	0.85	1,449,499	6,881	0.47	1,351,321	4,378	0.32
NONINTEREST-BEARING LIABILITIES AND STOCKHOLDERS' EQUITY									
Demand deposits	415,968			390,230			348,003		
Other Liabilities	13,718			13,755			14,182		

Stockholders' equity	247,965			228,963			211,408		
Total Liabilities and Stockholders' Equity	$2,230,380			$2,082,447			$1,924,914		
Net interest income and interest rate spread		$80,346	3.66%		$76,815	3.88%		$70,699	3.94%
Net interest margin			3.87%			3.99%			4.01%

(1) Non-accrual loans and overdraft deposits are included in other assets.
(2) Includes unamortized discounts and premiums. Average balance and yield are computed using the average historical amortized cost.

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(3) Interest on loans includes fee income of $4.1 million, $3.7 million and $3.9 million for 2018, 2017 and 2016, respectively, and is reduced by amortization of $2.7 million, $2.7 million and $2.5 million for 2018, 2017 and 2016, respectively.
(4) Equity securities include restricted stock, which is included in other assets on the consolidated balance sheets.
(5) For 2018, adjustments of $357 thousand and $1.5 million were made to tax equate income on tax exempt loans and tax exempt securities. For 2017, adjustments of $639 thousand and $2.5 million were made to tax equate income on tax exempt loans and tax exempt securities. For 2016, adjustments of $648 thousand and $1.9 million were made to tax equate income on tax exempt loans and tax exempt securities. These adjustments are based on a marginal federal income tax rate of 21% for 2018 and 35% for 2017 and 2016, less disallowances.

RATE AND VOLUME ANALYSIS

(Table Dollar Amounts in Thousands except Per Share Data)

The following table analyzes by rate and volume the dollar amount of changes in the components of the interest differential:

	2018 change from 2017			2017 change from 2016		
	Net Change	Change Due To Volume	Change Due To Rate	Net Change	Change Due To Volume	Change Due To Rate
Tax Equivalent Interest Income						
Loans	$9,619	$ 6,568	$3,051	$6,816	$ 7,078	$(262)
Taxable securities	29	(4,434)	4,463	(159)	(557)	398
Tax-exempt securities	(98)	1,151	(1,249)	1,712	1,485	227
Equity securities	115	57	58	22	36	(14)
Funds sold and other cash	250	(40)	290	228	16	212
Total interest income	$9,915	$ 3,302	$6,613	$8,619	$ 8,058	$561
Interest Expense						
Time deposits	$1,645	$ 540	$1,105	$730	$ (20)	$750
Brokered time deposits	2	2	0	0	0	0
Savings deposits	287	(78)	365	43	(25)	68
Demand deposits	1,715	299	1,416	496	150	346
Short term borrowings	2,769	81	2,688	1,478	193	1,285
Long term borrowings	(34)	(75)	41	(244)	(239)	(5)
Total interest expense	$6,384	$ 769	$5,615	$2,503	$ 59	$2,444
Increase (decrease) in tax equivalent net interest income	$3,531	$ 2,533	$998	$6,116	$ 7,999	$(1,883)

The amount of change not solely due to rate or volume changes was allocated between the change due to rate and the change due to volume based on the relative size of the rate and volume changes.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following presents a discussion and analysis of Farmers' financial condition and results of operations by its management. The review highlights the principal factors affecting earnings and the significant changes in balance sheet items for the years 2018, 2017 and 2016. Financial information for prior years is presented when appropriate. The objective of this financial review is to enhance the reader's understanding of the accompanying tables and charts, the consolidated financial statements, notes to financial statements and financial statistics appearing elsewhere in this Annual Report on Form 10-K. Where applicable, this discussion also reflects management's insights of known events and trends that have or may reasonably be expected to have a material effect on Farmers' business, financial condition or results of operations.

Cautionary Note Regarding Forward Looking Statements

This Annual Report on Form 10-K contains "forward-looking statements" within the meaning of the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. These forward-looking statements are not statements of historical fact, but rather statements based on Farmers' current expectations, beliefs and assumptions regarding the future of Farmers' business, future plans and strategies, projections, anticipated events and trends, its intended results and future performance, the economy and other future conditions. Forward-looking statements are preceded by terms such as "will," "would," "should," "could," "may," "expect," "estimate," "believe," "anticipate," "intend," or variations of these words, or similar expressions. Forward-looking statements are not a guarantee of future performance, and actual future results could differ materially from those contained in forward-looking information. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict and many of which are outside of our control. Numerous uncertainties, risks, and changes could cause or contribute to Farmers' actual results, performance, and achievements to be materially different from those expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, without limitation, risks and uncertainties detailed from time to time in Farmers' filings with the Securities and Exchange Commission, including without limitation the risk factors disclosed in Item 1A, "Risk Factors" of this Annual Report on Form 10-K.

Readers are cautioned not to put undue reliance on forward-looking statements, which speak only as of the date thereof. The following list, which is not intended to be an all-encompassing list of risks and uncertainties affecting the Company, summarizes several factors that could cause the Company's actual results to differ materially from those anticipated or expected in these forward-looking statements:

- general economic conditions in market areas where Farmers conducts business, which could materially impact credit quality trends;
- business conditions in the banking industry;
- the regulatory environment;
- fluctuations in interest rates;
- demand for loans in the market areas where Farmers conducts business;
- rapidly changing technology and evolving banking industry standards;
- competitive factors, including increased competition with regional and national financial institutions;
- new service and product offerings by competitors and price pressures; and
- other similar items.

Other factors not currently anticipated may also materially and adversely affect Farmers' business, financial condition, results of operations or cash flows. There can be no assurance that future results will meet expectations. Farmers does not undertake, and expressly disclaims, any obligation to update or alter any statements whether as a result of new information, future events or otherwise, except as may be required by applicable law.

Results of Operations

Comparison of Operating Results for the Years Ended December 31, 2018 and 2017.

The Company's net income totaled $32.6 million during 2018, compared to $22.7 million for 2017. On a per share basis, diluted earnings per share were $1.16 as compared to $0.82 diluted earnings per share for 2017. Return on average assets and return on average equity were 1.46% and 13.13%, respectively, for the year ending December 31, 2018, compared to 1.09% and 9.92% for 2017. The return on average tangible equity increased from 13.48% in 2017 to 15.95% in 2018.

On December 22, 2017, H.R.1, known as the "Tax Cuts and Jobs Act," was signed into law. H.R.1, among other things, reduced the corporate income tax rate to 21% effective January 1, 2018. As a result of passage of the new tax law, Farmers' effective tax rate decreased from 30.72% for the year ended December 31, 2017 to 14.92% for the year ended December 31, 2018. It is important to note that also as a result of the new tax law, Farmers determined that its net deferred tax assets needed to be reduced in the fourth quarter of 2017 by approximately $1.8 million, representing an impact on earnings per share of approximately $0.06 per diluted share for that fourth quarter, based on that quarter's weighted average diluted shares outstanding of approximately 28 million.

On August 15, 2017, the Company completed the acquisition of Monitor, the holding company for Monitor Bank. The transaction involved both cash and 465,787 shares of stock totaling $7.5 million. Pursuant to the terms of the merger agreement, common shareholders of Monitor were entitled to elect to receive consideration in cash or in common shares, without par value, of the Farmers National Banc Corp., subject to an overall limitation of 85% of the Monitor common shares being exchanged for Farmers common shares and 15% exchanged for cash. The per share cash consideration of $769.38 is equal to Monitor's March 31 tangible book value multiplied by 1.25. Based on the volume weighted average closing price of Farmers common shares for the 20 trading days ended August 11, 2017 of $14.04, the final stock exchange ratio was 54.80, resulting in an implied value per Monitor common share of $769.38.

Net Interest Income

Net interest income, the principal source of the Company's earnings, represents the difference between interest income on interest-earning assets and interest expense on interest-bearing liabilities. For 2018, taxable equivalent net interest income increased $3.5 million, or 4.6%, from 2017. Interest-earning assets averaged $2.075 billion during 2018, increasing $151.3 million compared to 2017. The Company's interest-bearing liabilities increased 7.1% from $1.449 billion in 2017 to $1.553 billion in 2018.

The Company finances its earning assets with a combination of interest-bearing and interest-free funds. The interest-bearing funds are composed of deposits, short-term borrowings and long-term debt. Interest paid for the use of these funds is the second factor in the net interest income equation. Interest-free funds, such as demand deposits and stockholders' equity, require no interest expense and, therefore, contribute significantly to net interest income.

The profit margin, or spread, on invested funds is a key performance measure. The Company monitors two key performance indicators - net interest spread and net interest margin. The net interest spread represents the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities. The net interest spread in 2018 was 3.66%, decreasing from 3.88% in 2017. The net interest margin represents the overall profit margin – net interest income as a percentage of total interest-earning assets. This performance indicator gives effect to interest earned for all investable funds including the substantial volume of interest-free funds. For 2018, the net interest margin, measured on a fully taxable equivalent basis, decreased to 3.87%, compared to 3.99% in 2017. The net interest margin, excluding the impact of amortization and accretion from acquisitions, decreased 13 basis point to 3.83% for the year ended December 31, 2018. The accretion added $69.5 thousand per month during 2018 and will continue over the next several years.

The decrease in net interest margin is mainly due to pressure on increasing deposit rates as the Federal Reserve Bank continued to raise the federal funds interest rate in 2018. The federal funds interest rate increased 4 times for a total of 100 basis points during the year. Total taxable equivalent interest income was $93.6 million for 2018, which is $9.9 million more than the $83.7 million reported in 2017. In comparing the years ending December 31, 2018 and 2017, yields on earning assets increased 16 basis points while the cost of interest bearing liabilities increased 38 basis points. Average loans increased $139.0 million, or 9.3%, in 2018, and the loan yield increased eighteen basis points to 4.91%. Tax equated income from securities, federal funds and other increased $296 thousand, or 2.3%, in 2018. Farmers saw its yields on these assets decrease slightly from 3.05% in 2017 to 3.04% in 2018 and the average balance of investment securities and federal funds sold also increased from $429.6 million in 2017 to $442.0 million in 2018.

The increase in the federal funds interest rate as mentioned above impacted the cost of short-term borrowings and interest-bearing deposits during 2018. Total interest expense amounted to $13.3 million for 2018, a 92.8% increase from $6.9 million reported in 2017. Interest-bearing deposits increased $96.4 million or 8.2% and increases in interest rates paid on deposits resulted in a $3.6 million or 81.3% increase in interest expense on deposit balances. Other borrowings balances increased only $6.9 million or 2.5%, however the interest expense related to these borrowings increased $2.7 million or 114%. The total cost of interest-bearing deposits and borrowings increased from 0.47% in 2017 to 0.85% in 2018.

Management will continue to evaluate future changes in interest rates and the shape of the treasury yield curve so that assets and liabilities may be priced accordingly to minimize the impact on the net interest margin.

Noninterest Income

Total noninterest income increased by $1.4 million or 6% in 2018. The increase in noninterest income is due to several factors. Trust fee income increased from $6.4 million to $7.1 million, representing an increase of $695 thousand or 10.8%, resulting from growth in new customers and an increase in market value of trust assets. Commissions from the sale of investment products increased $184 thousand or 20% during 2018. Debit card interchange fees increased $262 thousand or 8.5% as customers continue to increase their use of debit cards to make purchases of goods and services. Insurance agency commissions also increased to $2.6 million compared to $2.4 million in 2017 and service charges on deposit accounts increased from $4.1 million in 2017 to $4.3 million in 2018. These increases were offset by a decrease in income from the sale of mortgage loans of $337 thousand and a decrease in retirement plan consulting fees of $173 thousand. The Bank and the Company expect noninterest income to increase during 2019 as management continues to focus on growing the various sources of noninterest income.

Noninterest Expenses

Noninterest expense for 2018 was $62.7 million, compared to $61.6 million in 2017, representing an increase of $1.1 million, or 1.8%. Most of the increase was from salaries and employee benefits, which grew $1.2 million or 3.5%, mainly due to merit increases in salaries and a 1.8% increase the number of full time equivalent employees from 445 to 453. Other operating expenses increased by $309 thousand or 4.2%, and state and local taxes increased by $224 thousand or 13.5%. These increases were offset by a drop in merger related expenses of $1 million. Excluding expenses related to acquisition activities, noninterest expenses measured as a percentage of average assets decreased from 2.93% in 2017 to 2.82% in 2018.

The Company’s tax equivalent efficiency ratio for the twelve-month period ended December 31, 2018 was 57.93%, compared to 59.66% for the same period in 2017. The main factors leading to the improvement in the efficiency ratio was the increase in net interest income and noninterest income, along with the stabilized level of noninterest expenses relative to average assets as explained in the preceding paragraph. The efficiency ratio is calculated as follows: non-interest expense divided by the sum of tax equivalent net interest income plus non-interest income, excluding security gains and losses and intangible amortization. This ratio is a measure of the expense incurred to generate a dollar of revenue. Management will continue to closely monitor and keep the increases in other expenses to a minimum.

Income Taxes

Income tax expense totaled $5.7 million for 2018 and $10.1 million in 2017. Income taxes are computed using the appropriate effective tax rates for each period. The decrease in the current year tax expense is primarily attributable to the previously mentioned reduction in the corporate income tax rate from 35% to 21% as a result of the Tax Cuts and Jobs Act. The income tax expense of $10.1 million in 2017 was also impacted by the $1.8 million adjustment increase to income tax expense as a result of the write-down of the Company's deferred tax asset from 35% to 21%. The effective tax rates are less than the statutory tax rate primarily due to nontaxable interest and dividend income. The effective income tax rate was 14.9% for 2018 and 30.7% for 2017. We anticipate that the effective rate in 2019 will be in the range of 15% to 16%. Refer to Note 16 to the consolidated financial statements for additional information regarding the effective tax rate.

Comparison of Operating Results for the Years Ended December 31, 2017 and 2016.

The Company's net income totaled $22.7 million during 2017, compared to $20.6 million for 2016. On a per share basis, diluted earnings per share were $0.82 as compared to $0.76 diluted earnings per share for 2016. Excluding a $1.8 million adjustment of the net deferred tax asset resulting from the Tax Cut and Jobs Act that became law in December 2017 and $524 thousand in expenses related to acquisition activities, net income for 2017 would have been $24.8 million, or $0.90 per share. Common comparative ratios for results of operations include the return on average assets and return on average stockholders' equity. For 2017, the return on average equity was 9.92%, compared to 9.72% for 2016. The return on average assets was 1.09% for 2017 and 1.07% for 2016. Excluding expenses related to acquisition activities, the return on average assets and return on average stockholders' equity for 2017 would have been 1.19% and 10.83% in 2017, while the return on average tangible equity would have been 13.48%.

Net Interest Income

For 2017, taxable equivalent net interest income increased $6.1 million, or 8.7%, from 2016. Interest-earning assets averaged $1.9 billion during 2017, increasing $162 million compared to 2016. The Company's interest-bearing liabilities increased 7.3% from $1.35 billion in 2016 to $1.45 billion in 2017. The previously mentioned acquisition of Monitor increased interest-earning assets by $38.1 million and interest-bearing liabilities by $17.8 million at the completion date.

Total taxable equivalent interest income was $83.7 million for 2017, which is $8.6 million more than the $75.1 million reported in 2016. In comparing the years ending December 31, 2017 and 2016, yields on earning assets increased 9 basis points while the cost of interest bearing liabilities increased 15 basis points. Average loans increased $149.2 million, or 11.1%, in 2017, and the loan yield decreased one basis point to 4.73%. Tax equated income from securities, federal funds and other increased $1.8 million, or 15.9%, in 2017. Farmers saw its yields on these assets increase slightly from 2.72% in 2016 to 3.05% in 2017. The average balance of investment securities and federal funds sold also increased from $416.8 million in 2016 to $429.6 million in 2017.

Total interest expense amounted to $6.9 million for 2017, a 57.2% increase from $4.4 million reported in 2016. The increase in 2017 is the result of a $49.1 million or 4.4% increase in interest-bearing deposits and a $49.1 million or 21.2% increase in other borrowings. The cost of interest-bearing liabilities increased from 0.32% in 2016 to 0.47% in 2017.

Noninterest Income

Total noninterest income increased by $807 thousand or 3.5% in 2017. The increase in noninterest income is due to several factors. Gains on the sale of mortgage loans increased from $2.8 million to $3.1 million, representing an increase of $300 thousand or 8%. Insurance agency commissions also increased to $2.4 million compared to $1.6 million in 2016 and service charges on deposit accounts increased from $4.0 million in 2016 to $4.1 million in 2017, reflecting the size of the company after previous bank acquisitions. Debit card interchange fees also increased $430 thousand or 16.1%. These increases were offset by a decrease in other operating income of $478 thousand and a decrease in investment commissions of $291 thousand.

Noninterest Expenses

Noninterest expense for 2017 was $61.6 million, compared to $59.5 million in 2016, representing an increase of $2.1 million, or 3.6%. Most of the increase was from salaries and employee benefits, which increased $2.9 million or 8.9%, mainly due to an increase in salaries, as the acquisition of Bowers Insurance Agency, Inc. (Bowers) was completed on June 1, 2016 which resulted in seven months of expense in 2016 compared to a full year in 2017. The Company also experienced an increase in employee health care insurance expense in 2017. The Company's full time equivalent employees ("FTE") increased by 1.0% from December 31, 2016 to December 31, 2017. Other operating expenses decreased by $1.0 million as a result of increased efficiencies gained as the Company grew in 2017. Excluding expenses related to acquisition activities, noninterest expenses measured as a percentage of average assets decreased from 3.06% in 2016 to 2.93% in 2017.

The Company's tax equivalent efficiency ratio for the 12 month period ended December 31, 2017 was 59.66%, compared to 61.59% for the same period in 2016. Excluding expenses related to acquisition activities, the efficiency ratio for the year ended December 31, 2017 improved to 58.79% compared to 60.99% in 2016. The main factors leading to the improvement in the efficiency ratio was the increase in net interest income and noninterest income, along with the stabilized level of noninterest expenses relative to average assets as explained in the preceding paragraph. The efficiency ratio is calculated as follows: non-interest expense divided by the sum of tax equivalent net interest income plus non-interest income, excluding security gains and losses and intangible amortization. This ratio is a measure of the expense incurred to generate a dollar of revenue. Management will continue to closely monitor and keep the increases in other expenses to a minimum.

Income Taxes

Income tax expense totaled $10.1 million for 2017 and $7.5 million in 2016. The increase in the current year tax expense can be mainly attributed to the 16.9% increase in income before taxes. The previously mentioned Tax Cuts and Jobs Act also added $1.8 million to 2017's income tax expense as a result of the write-down of the Company's deferred tax asset from 35% to 21%. The effective tax rates are less than the statutory tax rate primarily due to nontaxable interest and dividend income. The effective income tax rate was 30.7% for 2017 and 26.7% for 2016.

Liquidity

Farmers maintains, in the opinion of management, liquidity sufficient to satisfy depositors' requirements and meet the credit needs of customers. The Company depends on its ability to maintain its market share of deposits as well as acquiring new funds. The Company's ability to attract deposits and borrow funds depends in large measure on its profitability, capitalization and overall financial condition.

Principal sources of liquidity include assets considered relatively liquid, such as short-term investment securities, federal funds sold and cash and due from banks.

Along with its liquid assets, Farmers has additional sources of liquidity available which help to insure that adequate funds are available as needed. These other sources include, but are not limited to, loan repayments, the ability to obtain deposits through the adjustment of interest rates and the purchasing of federal funds and borrowings on approved lines of credit at two major domestic banks. At December 31, 2018, Farmers had not borrowed against these lines of credit. Management feels that its liquidity position is more than adequate and will continue to monitor the position on a monthly basis. The Company also has additional borrowing capacity with the FHLB, as well as access to the Federal Reserve Discount Window, which provides an additional source of funds. The Company views its membership in the FHLB as a solid source of liquidity. As of December 31, 2018, the Bank is eligible to borrow an additional $309 million from the FHLB under various fixed rate and variable rate credit facilities. Advances outstanding from the FHLB at December 31, 2018 amounted to $243.8 million.

Farmers' primary investing activities are originating loans and purchasing securities. During 2018, net cash used by investing activities amounted to $180.5 million, compared to $137.1 million used in 2017. Net increases in loans were $160.2 million in 2018, compared to $132.3 million in 2017. The cash used by lending activities during 2017 can be attributed to the activity in the commercial real estate, commercial and industrial, residential real estate, and agricultural loan portfolios. Purchases of securities available for sale were $70.9 million in 2018, compared to $114.6 million in 2017, and proceeds from maturities and sales of securities available for sale were $53.3 million in 2018, compared to $97.6 million in 2017. Net cash of $16.3 million was received as a result of the acquisition of Monitor in 2017.

Farmers' primary financing activities are obtaining deposits, repurchase agreements and other borrowings. Net cash provided by financing activities amounted to $140.9 million for 2018, compared to $122.4 million in 2017. The majority of this increase can be attributed to the net change in deposits. The increase in deposits was $195 million in 2018 compared to an increase of $45.4 million in 2017. Short-term borrowings decreased $44.8 million in 2018 compared to an increase of $91.1 million in 2018. The decrease in short-term borrowings is mainly a result of the growth in deposit balances, which allowed the Company to pay down short-term Federal Home Loan Bank Advances during the year.

Loan Portfolio

Maturities and Sensitivities of Loans to Interest Rates

The following schedule shows the composition of loans and the percentage of loans in each category at the dates indicated. Balances include unamortized loan origination fees and costs.

Years Ended December 31,	2018		2017		2016		2015		2014	
Commercial Real Estate	$578,181	33.3 %	$512,502	32.5 %	$445,966	31.2 %	$408,534	31.5 %	$222,573	33.5 %
Commercial	244,742	14.1	219,973	13.9	204,359	14.3	199,457	15.4	120,139	18.1
Residential Real Estate	492,133	28.4	468,884	29.7	430,195	30.1	394,582	30.4	183,853	27.7
Consumer	221,795	12.8	212,935	13.5	218,100	15.3	185,077	14.3	137,276	20.7
Agricultural	198,989	11.4	163,087	10.4	129,015	9.1	109,215	8.4	11	0.0
Total Loans	$1,735,840	100.0%	$1,577,381	100.0%	$1,427,635	100.0%	$1,296,865	100.0%	$663,852	100.0%

The following schedule sets forth maturities based on remaining scheduled repayments of principal for commercial and commercial real estate loans listed above as of December 31, 2018:

Types of Loans	1 Year or less	1 to 5 Years	Over 5 Years
Commercial	$58,805	$122,477	$63,460
Commercial Real Estate	$17,490	$133,792	$426,899
Agricultural	$18,369	$28,335	$152,285

The amounts of commercial, commercial real estate and agricultural loans as of December 31, 2018, based on remaining scheduled repayments of principal, are shown in the following table:

Loan Sensitivities	1 Year or less	Total

		Over 1 Year	
Floating or Adjustable Rates of Interest	$ 68,989	$593,881	$662,870
Fixed Rates of Interest	25,675	333,367	359,042
Total Loans	$ 94,664	$927,248	$1,021,912

Total loans were $1.7 billion at year-end 2018, compared to $1.6 billion at year-end 2017. Loans grew 10% organically during the past twelve months. The organic increase in loans is a direct result of Farmers' focus on loan growth utilizing a talented lending and credit team, while adhering to a sound underwriting discipline. Most of the increase in loans has occurred in the commercial real estate, agricultural, residential real estate and commercial loan portfolios. Loans comprised 78.7% of the Bank's average earning assets in 2018, compared to 77.7% in 2017. The Company has also experienced growth in its originated loans portfolio as a result of loans previously acquired from earlier bank mergers being renewed and recorded into the originated book. The product mix in the loan portfolio includes commercial loans comprising 14.1%, residential real estate loans 28.4%, commercial real estate loans 33.3%, consumer loans 12.8% and agricultural loans 11.4% at December 31, 2018, compared with 13.9%, 29.7%, 32.5%, 13.5% and 10.4%, respectively, at December 31, 2017.

Loans contributed 85.7% of total taxable equivalent interest income in 2018 and 84.3% in 2017. Loan yields were 4.91% in 2018, 40 basis points greater than the average rate for total earning assets. Management recognizes that while the loan portfolio holds some of the Bank's' highest yielding assets, it is inherently the most risky portfolio. Accordingly, management attempts to balance credit risk versus return with conservative credit standards. Management has developed and maintains comprehensive underwriting guidelines and a loan review function that monitors credits during and after the approval process. To minimize risks associated with changes in the borrower's future repayment capacity, the Bank generally requires scheduled periodic principal and interest payments on all types of loans and normally requires collateral. Commercial loans at December 31, 2018 increased 11.3% from year-end 2017 with outstanding balances of $244.7 million. The Bank's commercial loans are granted to customers within the immediate trade area of the Bank. The mix is diverse, covering a wide range of borrowers, business types and local municipalities. The Bank monitors and controls concentrations within a particular industry or segment of the economy. These loans are made for purposes such as equipment purchases, capital and leasehold improvements, the purchase of inventory, general working capital and small business lines of credit.

Residential real estate mortgage loans increased 5% to $492.1 million at December 31, 2018, compared to $468.9 million in 2017. Farmers originated both fixed rate and adjustable rate mortgages during 2018. Fixed rate terms are generally limited to fifteen-year terms while adjustable rate products are offered with maturities up to thirty years.

Commercial real estate loans increased from $512.5 million at December 31, 2017 to $578.2 million at December 31, 2018, an increase of $65.7 million or 12.8%. The Company's commercial real estate loan portfolio includes loans for owner occupied and non-owner occupied real estate. These loans are made to finance properties such as office and industrial buildings, hotels and retail shopping centers.

The growth in the commercial and commercial real estate loan portfolios was consistent with the improvements in the local economy. Several new projects announced in the Company's market area, along with relatively decreased levels of unemployment have led small business owners to expand or make additional investments in their operations.

Agricultural loans increased from $163.1 million in 2017 to $199.0 million in 2018, an increase of $35.9 million or 22%. The Company's agricultural loan portfolio contains a diverse mix of dairy, crops, land, poultry and cattle loans.

Summary of Loan Loss Experience

The following is an analysis of the allowance for loan losses for the periods indicated:

Years Ended December 31,	2018	2017	2016	2015	2014
Balance at Beginning of Year	$12,315	$10,852	$8,978	$7,632	$7,568
Charge-Offs:					
Commercial Real Estate	0	(207)	(349)	(536)	(151)
Commercial	(220)	(375)	(245)	(290)	(185)
Residential Real Estate	(318)	(162)	(188)	(320)	(585)
Consumer	(2,318)	(2,542)	(2,019)	(2,058)	(2,213)
Total Charge-Offs	(2,856)	(3,286)	(2,801)	(3,204)	(3,134)
Recoveries on Previous Charge-Offs:					
Commercial Real Estate	126	592	15	130	125
Commercial	190	66	45	9	29
Residential Real Estate	148	100	112	122	77
Consumer	669	641	633	779	1,087
Total Recoveries	1,133	1,399	805	1,040	1,318
Net Charge-Offs	(1,723)	(1,887)	(1,996)	(2,164)	(1,816)
Provision For Loan Losses	3,000	3,350	3,870	3,510	1,880
Balance at End of Year	$13,592	$12,315	$10,852	$8,978	$7,632
Ratio of Net Charge-offs to Average Loans Outstanding	0.10 %	0.13 %	0.15 %	0.22 %	0.28 %
Allowance for Loan Losses/Total Loans	0.78	0.78	0.76	0.69	1.15

Provisions charged to operations amounted to $3 million in 2018, compared to $3.4 million in 2017, a decrease of $350 thousand. This decrease is primarily due to the lower level of net charge-offs as a percentage of loans outstanding in 2018. Net charge-offs for the year ended December 31, 2018 were $1.7 million, $164 thousand or 8.7% less than net charge-offs for the year ended December 31, 2017. The allowance for loan losses to total loans remained at 0.78% at December 31, 2018 and 2017. When the acquired loans from previous mergers are excluded the ratio is 0.92% at December 31, 2018 and 0.97% at December 31, 2017, and compares similarly with the periods prior to 2016 presented in the above table. Additionally, when loans collectively evaluated for impairment, which excludes acquired loans, are compared to the allowance for loan losses for loans collectively evaluated for impairment the ratio is 0.96% for the year ended December 31, 2018, compared to 0.97% for the year ended December 31, 2017. Nonperforming loans to total loans decreased slightly from 0.49% at December 31, 2017 to 0.45% at December 31, 2018. In determining the estimate of the allowance for loan losses, management computes the historical loss percentage based upon the loss history of the past 12 quarters. The Company believes that using a loss history of the previous 12 quarters helps mitigate volatility in the timing of charge-offs and better reflects probable incurred losses.

The provision for loan losses charged to operating expense is based on management's judgment after taking into consideration all factors connected with the collectability of the existing loan portfolio. Management evaluates the loan portfolio in light of economic conditions, changes in the nature and volume of the loan portfolio, industry standards and other relevant factors. Specific factors considered by management in determining the amounts charged to operating expenses include previous charge-off experience, the status of past due interest and principal payments, the quality of financial information supplied by loan customers and the general condition of the industries in the community to which loans have been made.

The allowance for loan losses increased $1.3 million during the year. Aside from the various credit quality metrics discussed above, another reason for the increase in the current year allowance for loan losses was an increase in the size of the loan portfolio. Loan growth in 2018 amounted to 10%.

At December 31, 2018, commercial loans collectively evaluated for impairment totaled $264.2 million with an allowance allocation of $2.1 million compared to commercial loans collectively evaluated for impairment of $225.3 million with an allowance for loan losses of $2.0 million at December 31, 2017. The commercial loan portfolio experienced a provision of $112 thousand, compared to a $446 thousand provision in 2017. Impaired loans are carried at the fair value of the underlying collateral, less estimated disposition costs, if repayment of the loan is expected to be solely dependent on the sale of the collateral. Otherwise, impaired loans are carried at the present value of expected cash flows.

Typically, commercial and commercial real estate loans are identified as impaired when they become ninety days past due, or earlier if management believes it is probable that the Company will not collect all amounts due under the terms of the loan agreement. When Farmers identifies a loan as impaired and concludes that the loan is collateral dependent, Farmers performs an internal collateral valuation as an interim measure. Farmers typically obtains an external appraisal to validate its internal collateral valuation as soon as is practical and adjusts the associated specific loss reserve, if necessary.

The ratio of the allowance for loan losses to non-performing loans at December 31, 2018 improved to 175.81%, compared to 160.04% at December 31, 2017. Increases in nonaccrual loans in the residential real estate loan and agricultural loan portfolios were offset by decreases in the commercial real estate and commercial loan portfolios. The balance in the allowance for loan losses increased in 2018, with the increased loan portfolio size, to $13.6 million compared to $12.3 million in 2017.

Nonperforming Assets December 31,	2018	2017	2016	2015	2014
Nonaccrual loans:					
Commercial Real Estate	$422	$717	$1,410	$3,803	$3,273
Commercial	946	1,192	1,361	1,609	1,645
Residential Real Estate	4,166	4,038	2,636	3,116	2,881
Consumer	495	660	396	457	126
Agricultural	736	56	686	73	83
Total Nonaccrual Loans	$6,765	$6,663	$6,489	$9,058	$8,008
Loans Past Due 90 Days or More	966	1,032	1,681	1,387	473
Total Nonperforming Loans	$7,731	$7,695	$8,170	$10,445	$8,481
Other Real Estate Owned	0	171	482	942	148
Total Nonperforming Assets	$7,731	$7,866	$8,652	$11,387	$8,629
Loans modified in troubled debt restructurings	$5,520	$4,980	$7,007	$9,325	$8,110
TDRs included in Nonaccrual Loans	$2,997	$2,624	$3,113	$4,733	$1,436
Percentage of Nonperforming Loans to Total Loans	0.45 %	0.49 %	0.57 %	0.81 %	1.28 %
Percentage of Nonperforming Assets to Total Assets	0.33 %	0.36 %	0.44 %	0.61 %	0.76 %
Loans Delinquent 30-89 days	8,877	10,191	12,746	9,129	5,426
Percentage of Loans Delinquent 30-89 days to Total Loans	0.51 %	0.65 %	0.89 %	0.70 %	0.82 %

The Company has forgone interest income of approximately $440 thousand from nonaccrual loans as of December 31, 2018 that would have been earned, over the life of the loans, if all loans had performed in accordance with their original terms.

Net charge-offs as a percentage of average loans outstanding decreased from 0.13% for 2017 to 0.10% for 2018 as a result of the larger loan portfolio and improved loan quality. Net charge-offs decreased from $1.9 million in 2017 to $1.7 million in 2018. An increase in gross charge-offs was experienced in the residential real estate loan portfolios of $156 thousand, but that was offset by decreases in the commercial real estate, commercial and industrial and consumer loan portfolios of $207 thousand, $155 thousand and $224 thousand, respectively.

The following table summarizes the Company's allocation of the allowance for loan losses for the past five years:

December 31,	2018			2017			2016			2015			2014		
	Amount	Loans to Total Loans		Amount	Loans to Total Loans		Amount	Loans to Total Loans		Amount	Loans to Total Loans		Amount	Loans to Total Loans	
Commercial Real Estate	$5,036	42.1	%	$4,260	40.0	%	$3,577	37.4	%	$3,127	37.5	%	$2,676	33.5	%
Commercial	2,093	16.8		2,011	16.8		1,874	17.2		1,373	17.8		1,420	18.1	
Residential Real Estate	2,837	28.3		2,521	29.7		2,205	30.1		1,845	30.4		1,689	27.7	
Consumer	2,963	12.8		2,848	13.5		2,766	15.3		2,160	14.3		1,663	20.7	
Unallocated	663	0		675	0		430	0		473	0		184	0	
	$13,592	100.0	%	$12,315	100.0	%	$10,852	100.0	%	$8,978	100.0	%	$7,632	100.0	%

The allowance allocated to each of the four loan categories should not be interpreted as an indication that charge-offs in 2018 occurred in the same proportions or that the allocation indicates future charge-off trends. The allowance allocated to the one-to-four family real estate loan category and the consumer loan category is based upon the Company's allowance methodology for homogeneous loans, and increases and decreases in the balances of those portfolios. In previous years, the indirect installment loan category has represented the largest percentage of loan losses. The consumer loan category represents approximately 12.8% of total loans and in 2018, the gross charge-offs accounted for 81.2% of the losses of the entire loan portfolio. For the commercial loan category, which represents 16.8% of the total loan portfolio, management relies on the Bank's internal loan review procedures and allocates accordingly based on loan classifications. The gross charge-offs in the commercial loan portfolio, was $220 thousand for 2018.

There were no loans other than those identified above, that management has known information about possible credit problems of borrowers and their ability to comply with the loan repayment terms. Management is actively monitoring certain borrowers' financial condition and loans which management wants to more closely monitor due to special circumstances. These loans and their potential loss exposure have been considered in management's analysis of the adequacy of the allowance for loan losses.

Loan Commitments and Lines of Credit

In the normal course of business, the Bank has extended various commitments for credit. Commitments for mortgages, revolving lines of credit and letters of credit generally are extended for a period of one month up to one year. Normally, no fees are charged on any unused portion, but an annual fee of two percent is charged for the issuance of a letter of credit.

As of December 31, 2018, there were no concentrations of loans exceeding 10% of total loans that are not disclosed as a category of loans. As of that date, there were also no other interest-earning assets that are either nonaccrual, past due, restructured or non-performing.

Investment Securities

The investment securities portfolio increased $10.8 million in 2018. This increase is a result of asset growth in 2018 and maintaining the security portfolio at a constant level, as a percentage of total assets. The Company's investment strategy is to maintain a diverse investment security portfolio with a higher concentration in tax-free municipal securities and mortgage-backed securities that are issued by U.S. Government sponsored enterprises. Farmers sold $16.2 million in securities in 2018, resulting in net security gains of $271 thousand. Farmers recognized market appreciation on faster paying mortgage-backed securities and recognized losses on lower rated municipal securities, and reinvested in new mortgage-backed securities and higher rated municipal securities to further diversify the securities portfolio. During 2014, the Company created the Investment subsidiary to hold municipal securities and take advantage of more favorable tax treatment. At December 31, 2018, the Investment entity had a balance of $97.4 million in general market municipal securities.

Farmers' objective in managing the investment portfolio is to preserve and enhance corporate liquidity through investment in primarily short and intermediate term securities which are readily marketable and of the highest credit quality. In general, investment in securities is limited to those funds the Bank feels it has in excess of funds used to satisfy loan demand and operating considerations.

The Volcker Rule places limits on the trading activity of insured depository institutions and entities affiliated with a depository institution, subject to certain exceptions. The Bank does not engage in any of the trading activities or own any of the types of funds regulated by the Volcker Rule.

Mortgage-backed securities are created by the pooling of mortgages and issuance of a security. Mortgage-backed securities typically represent a participation interest in a pool of single-family or multi-family mortgages. Prepayment estimates for mortgage-backed securities are performed at purchase to ensure that prepayment assumptions are reasonable considering the underlying collateral for the mortgage-backed securities at issue and current mortgage interest rates and to determine the yield and estimated maturity of the mortgage-backed security portfolio. Prepayments that are faster than anticipated may shorten the life of the security and may result in faster amortization of any premiums paid and thereby reduce the net yield on such securities. During periods of increasing mortgage interest rates, refinancing generally slows as do the prepayments of the underlying mortgages and the related security. All holdings of mortgage-backed securities were issued by U.S. Government sponsored enterprises.

The following table shows the carrying value of investment securities by type of obligation at the dates indicated:

Type

December 31,	2018	2017
U.S. Treasury securities	$1,447	$4,278
U.S. government sponsored enterprise debt securities	4,562	4,639
Mortgage-backed securities - residential and collateralized mortgage obligations	171,119	177,571
Small Business Administration	11,930	14,212
Obligations of states and political subdivisions	211,944	191,003
Corporate bonds	1,188	1,234
Equity securities	495	394
Other investments measured at net asset value	6,635	5,185
	$409,320	$398,516

A summary of debt securities held at December 31, 2018 classified according to maturity and including weighted average yield for each range of maturities is set forth below:

Type and Maturity Grouping	December 31, 2018		
	Fair Value	Weighted Average Yield (1)	
U.S. Treasury securities			
Maturing within one year	$447	1.63	%
Maturing after one year but within five years	707	2.10	%
Maturing after five years but within ten years	293	2.12	%
Total U.S. Treasury securities	$1,447	1.96	%
U.S. government sponsored enterprise debt securities			
Maturing within one year	$1,241	1.43	%
Maturing after one year but within five years	2,316	2.02	%
Maturing after five years but within ten years	955	2.89	%
Maturing after ten years	50	4.30	%
Total U.S. government sponsored enterprise debt securities	$4,562	2.07	%
Mortgage-backed securities - residential and collateralized mortgage obligations (2)			
Maturing within one year	$21,634	2.48	%
Maturing after one year but within five years	64,268	2.50	%
Maturing after five years but within ten years	50,340	2.62	%
Maturing after ten years	34,877	2.79	%
Total mortgage-backed securities	$171,119	2.59	%
Small Business Administration			
Maturing within one year	$10	3.89	%
Maturing after one year but within five years	5,269	2.37	%
Maturing after five years but within ten years	6,651	1.93	%
Total small business administration	$11,930	2.12	%
Obligations of states and political subdivisions			
Maturing within one year	$3,734	2.78	%
Maturing after one year but within five years	37,750	3.50	%
Maturing after five years but within ten years	145,421	3.94	%
Maturing after ten years	25,039	3.78	%
Total obligations of states and political subdivisions	$211,944	3.82	%
Corporate bonds			
Maturing within one year	$179	3.89	%
Maturing after one year but within five years	908	2.37	%
Maturing after five years but within ten years	101	1.93	%
Total other securities	$1,188	2.12	%

(1) The weighted average yield has been computed by dividing the total contractual interest income adjusted for amortization of premium or accretion of discount over the life of the security by the par value of the securities outstanding. The weighted average yield of tax-exempt obligations of states and political subdivisions has been calculated on a fully taxable equivalent basis. The amounts of adjustments to interest which are based on the new statutory tax rate of 21% as written in the Tax Cuts and Jobs Act were $21 thousand, $259 thousand, $1.2 million and $202 thousand for the four ranges of maturities.

(2) Payments based on contractual maturity.

Premises and Equipment

Premises and equipment had a net decrease of $1.1 million in 2018 as a result of depreciation of $1.5 million. This was offset by new additions of premises and equipment amounting to $450 thousand.

Deposits

Deposits represent the Company's principal source of funds. The deposit base consists of demand deposits, savings, money market accounts and other time deposits, including $25 million in brokered time deposits which were added for the first time in 2018. During the year, the Company's average total deposits increased from $1.559 billion in 2017 to $1.681 billion in 2018, representing an increase of 7.8%. Noninterest demand deposits increased $25.7 million in 2018. Average interest bearing demand deposits increased $101.0 million, which was offset by a decrease in savings deposits of $55.8 million since December 31, 2017. With interest rates increasing during 2018, customers had more incentive to commit funds to term deposit accounts. Average time deposits increased $51.1 million in 2018. The Company's focus is on core deposit growth and Farmers will continue to price deposit rates to remain competitive within the market and to retain customers. At December 31, 2018, core deposits – savings and money market accounts, time deposits less than $250 thousand, demand deposits and interest bearing demand deposits represented approximately 93.8% of total deposits.

Bank Owned Life Insurance

Farmers' owns bank owned life insurance policies on the lives of certain members of management. The purpose of this investment is to help fund the costs of employee benefit plans. The cash surrender value of these policies was $34.8 million at December 31, 2018, compared to $33.9 million at December 31, 2017.

Borrowings

Average short-term borrowings decreased $44.8 million or 15.5% since December 31, 2017 as a result of loan growth outpacing deposit growth in 2018. The decrease was a result of the nearly $70 million of securities sold under repurchase agreements converting to interest bearing checking accounts. This was offset by the $25 million increase in short-term Federal Home Loan Advances ("FHLB"). Average Long-term borrowings decreased $1.0 million as maturing FHLB advances were refinanced with short-term advances to capitalize on the favorable interest rates. See Note 11 and 12 within Item 8 of this Annual report on Form 10-K for additional detail.

Contractual Obligations, Commitments, Contingent Liabilities and Off-Balance Sheet Arrangements

The following table presents, as of December 31, 2018, the Company's significant fixed and determinable contractual obligations by payment date. The payment amounts represent those amounts contractually due to the recipient and do not include any unamortized premiums or discounts or other similar carrying value adjustments. Further discussion of the nature of each obligation is included in the referenced note to the consolidated financial statements.

Commitments
12/31/2018

	Note Ref.	2019	2020	2021	2022	2023	Thereafter
Deposits without maturity		$1,427,260					
Certificates of deposit and brokered time deposits	9	172,193	86,876	63,455	15,934	26,862	7,140
Repurchase agreements	11	4,409					
Short-term borrowed funds	11	350					
Short-term FHLB advances	11	240,000					
Long-term borrowings	12	996	860	792	729	398	2,258

Operating leases	8	453	394	381	250	146	711

There is also a $2 million additional commitment to SBIC investment funds over the next several years. The payments have no predetermined due dates at year end 2018. Note 13 to the consolidated financial statements discusses in greater detail other commitments and contingencies and the various obligations that exists under those agreements. Examples of these commitments and contingencies include commitments to extend credit and standby letters of credit.

At December 31, 2018, the Company did not engage in derivatives or hedging contracts that may expose the Company to liabilities greater than the amounts recorded on the consolidated balance sheet. Management's policy is to not engage in derivatives contracts for speculative trading purposes. The Company does utilize interest-rate swaps as a way of helping manage interest rate risk and not as derivatives for trading purposes. See Note 21 within Item 8 of this Annual report on Form 10-K for additional detail.

Capital Resources

Total Stockholders' Equity increased 8.4% from $242.1 million at December 31, 2017 to $262.3 million in 2018. The increase is due to the net income addition to retained earnings less the amount of dividends paid. During the year, shareholders received a total of $0.30 per share cash dividends paid in the past four quarters, a 36.4% increase compared to the $0.22 cash dividend per share paid in 2017. Book value increased 7.4% from $8.79 per share at December 31, 2017 to $9.44 per share at December 31, 2018. The Company's tangible book value also increased from $7.14 per share at December 31, 2017 to $7.86 per share at December 31, 2018, an increase of 10.1%.

The Bank, as a national chartered bank, is subject to the dividend restrictions set forth by the OCC. The OCC must approve declaration of any dividends in excess of the sum of profits for the current year and retained net profits for the preceding two years (as defined). Farmers and Farmers Bank are required to maintain minimum amounts of capital to total "risk weighted" assets, as defined by the banking regulators. At December 31, 2018, under the new minimum capital requirements associated with the Basel Committee on capital and liquidity regulation (Basel III), Farmers Bank and Farmers are required to have minimum capital ratios. Actual and minimum ratios are detailed in Note 15 of the Consolidated Financial Statements. Farmers Bank and Farmers had capital ratios above the minimum levels at December 31, 2018 and 2017. At year-end 2018 and 2017, the most recent regulatory notifications categorized Farmers Bank as well capitalized under the regulatory framework for prompt corrective action.

During 2013, the Federal banking regulators approved a final rule to implement revised capital adequacy standards of the Basel Committee on Banking Supervision, commonly called Basel III, and to address relevant provisions of the Dodd-Frank Act. The final rule strengthens the definition of regulatory capital, increases risk-based capital requirements, makes selected changes to the calculation of risk-weighted assets, and adjusts the prompt corrective action thresholds. Community banking organizations, such as the Company and the Bank, became subject to the new rule on January 1, 2015 and certain provisions of the new rule will be phased in over the period of 2015 through 2019. The Bank has retained, through a one-time election, the prior treatment for most accumulated other comprehensive income, such that unrealized gains and losses on securities available for sale that did not affect regulatory capital amounts and ratios. As mentioned in the prior paragraph, the Bank falls within the new regulatory capital ratio guidelines.

Critical Accounting Policies

The Company follows financial accounting and reporting policies that are in accordance with generally accepted accounting principles in the United States of America and conform to general practices within the banking industry. Some of these accounting policies are considered to be critical accounting policies. Critical accounting policies are those policies that require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. The Company has identified three accounting policies that are critical accounting policies and an understanding of these policies is necessary to understand the financial statements. These policies relate to determining the adequacy of the allowance for loan losses, if there is any impairment of goodwill and other intangibles, and estimating the fair value of assets acquired and liabilities assumed in connection with any merger activity. Additional information regarding these policies is included in the notes to the consolidated financial statements, including Note 1 (Summary of Significant Accounting Policies), Note 4 (Loans) and Note 2 (Business Combinations), and the section above captioned "Loan

Portfolio." Management believes that the judgments, estimates and assumptions used in the preparation of the consolidated financial statements are appropriate given the factual circumstances at the time.

Farmers maintains an allowance for loan losses. The allowance for loan losses is presented as a reserve against loans on the balance sheets. Loan losses are charged off against the allowance for loan losses, while recoveries of amounts previously charged off are credited to the allowance for loan losses. A provision for loan losses is charged to operations based on management's periodic evaluation of adequacy of the allowance. The provision for credit losses provides for probable losses on loans.

Estimating the amount of the allowance for loan losses requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio represents the largest asset category on the consolidated balance sheets. Management's assessment of the adequacy of the allowance for loan losses considers individually impaired loans, pools of homogeneous loans with similar risk characteristics and other environmental risk factors.

Pools of homogeneous loans with similar risk characteristics are assessed for probable losses. Probable losses are estimated through application of historical loss experience. Historical loss experience data used to establish loss estimates may not precisely correspond to the current portfolio. As a result, the historical loss experience used in the allowance analysis may not be representative of actual unrealized losses inherent in the portfolio.

Management also evaluates the impact of environmental factors which pose additional risks that may not adequately be addressed in the analyses described above. Such environmental factors could include: levels of, and trends in, delinquencies and impaired loans, charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in lending policies and procedures including those for underwriting, collection, charge-off and recovery; experience, ability, and depth of lending management and staff; national and local economic trends and conditions; industry and geographic conditions; concentrations of credit such as, but not limited to, local industries, their employees and suppliers; or any other common risk factor that might affect loss experience across one or more components of the portfolio. The determination of this component of the allowances requires considerable management judgment. To the extent actual outcomes differ from management estimates, additional provision for credit losses could be required that could adversely affect earnings or financial position in future periods. The "Loan Portfolio" section of this financial review includes a discussion of the factors driving changes in the allowance for loan losses during the current period.

Management believes that the accounting for goodwill and other intangible assets also involves a higher degree of judgment than most other significant accounting policies. U.S. GAAP establishes standards for the amortization of acquired intangible assets and the impairment assessment of goodwill. Goodwill arising from business combinations represents the value attributable to unidentifiable intangible assets in the business acquired. The Company's goodwill relates to the value inherent in the banking industry and that value is dependent upon the ability of the Company's subsidiaries to provide quality, cost-effective services in a competitive marketplace. The goodwill value is supported by revenue that is in part driven by the volume of business transacted. A decrease in earnings resulting from a decline in the customer base or the inability to deliver cost-effective services over sustained periods can lead to impairment of goodwill that could adversely impact earnings in future periods. U.S. GAAP requires an annual evaluation of goodwill for impairment, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The fair value of the goodwill is estimated by reviewing the past and projected operating results for the subsidiaries and comparable industry information. At December 31, 2018, on a consolidated basis, Farmers had intangibles of $5.8 million subject to amortization and $38.2 million of goodwill, which was not subject to periodic amortization.

Recent Accounting Pronouncements and Developments

Note 1 to the consolidated financial statements discusses new accounting policies adopted by Farmers during 2018 and the expected impact of accounting policies recently issued or proposed but not yet required to be adopted. To the extent the adoption of new accounting standards materially affects financial condition, results of operations or liquidity, the impacts are discussed in the applicable sections of this financial review and notes to the consolidated financial statements.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

Important considerations in asset/liability management are liquidity, the balance between interest rate sensitive assets and liabilities and the adequacy of capital. Interest rate sensitive assets and liabilities are those which have yields on rates subject to change within a future time period due to maturity of the instrument or changes in market rates. While liquidity management involves meeting the funds flow requirements of the Company, the management of interest rate sensitivity focuses on the structure of these assets and liabilities with respect to maturity and repricing characteristics. Balancing interest rate sensitive assets and liabilities provides a means of tempering fluctuating interest rates and maintaining net interest margins through periods of changing interest rates. The Company monitors interest rate sensitive assets and liabilities to determine the overall interest rate position over various time frames.

The Company considers the primary market exposure to be interest rate risk. Simulation analysis is used to monitor the Company's exposure to changes in interest rates, and the effect of the change to net interest income. The following table shows the effect on net interest income and the net present value of equity in the event of a sudden and sustained 300 basis point increase and 100 basis point decrease in market interest rates. The assumptions and predictions include inputs to compute baseline net interest income, growth rates, expected changes in rates on interest bearing deposit accounts and loans, competition and various other factors that are difficult to accurately predict.

Changes In Interest Rate (basis points)	2018 Result	2017 Result	ALCO Guidelines
Net Interest Income Change			
+300	1.8 %	-1.9 %	15 %
+200	1.6 %	-1.0 %	10 %
+100	0.9 %	-0.5 %	5 %
-100	-3.0 %	-3.3 %	5 %
Net Present Value Of Equity Change			
+300	15.2 %	-7.5 %	20 %
+200	11.8 %	-3.7 %	15 %
+100	8.2 %	0.3 %	10 %
-100	-16.6 %	-7.2 %	10 %

It should be noted that at December 31, 2018, the change in the net present value of equity exceeded policy when the simulation model assumed a sudden decrease in rates of 100 basis points (1%). This is primarily due to the positive impact on the fair value of assets not being as great as the negative impact on the fair value of certain liabilities. Specifically, because core deposits typically bear relatively low interest rates, their fair value would be negatively impacted as the rates could not be adjusted by the full extent of the sudden decrease in rates. Management will continue to monitor the policy exception and may consider changes to the asset/liability position in the future. The remaining results of the simulations indicate that interest rate change results fall within internal limits established by the Company at December 31, 2018 and 2017. A report on interest rate risk is presented to the Board of Directors and the Asset/Liability Committee on a quarterly basis. The Company has no market risk sensitive instruments held for trading purposes, nor does it hold derivative financial instruments, and does not plan to purchase these instruments in the near future.

With the largest amount of interest sensitive assets and liabilities maturing within twelve months, the Company monitors this area most closely. Early withdrawal of deposits, prepayments of loans and loan delinquencies are some of the factors that can impact actual results in comparison to our simulation analysis. In addition, changes in rates on interest sensitive assets and liabilities may not be equal, which could result in a change in net interest margin.

Interest rate sensitivity management provides some degree of protection against net interest income volatility. It is not possible or necessarily desirable to attempt to eliminate this risk completely by matching interest sensitive assets and liabilities. Other factors, such as market demand, interest rate outlook, regulatory restraint and strategic planning also have an effect on the desired balance sheet structure.

Item 8. Financial Statements and Supplementary Financial Data.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Farmers National Banc Corp. (the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(1) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of; our principal executive and principal financial officers and effected by the board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles and includes those policies and procedures that:

Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2018. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in the 2013 Internal Control-Integrated Framework. Based on that assessment, we believe that, as of December 31, 2018, our internal control over financial reporting is effective based on those criteria.

Crowe LLP has audited the effectiveness of the Company's internal control over financial reporting as of December 31, 2018, as stated in their report dated March 5, 2019.

/s/ Kevin J. Helmick	/s/ Carl D. Culp
Kevin J. Helmick	Carl D. Culp
President and Chief Executive Officer	Senior Executive Vice President and Treasurer

Report of Independent Registered Public Accounting Firm

Shareholders and the Board of Directors of

Farmers National Banc Corp.

Canfield, Ohio

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Farmers National Banc Corp. (the "Company") as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2018, and the related notes (collectively referred to as the "financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2018 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework: (2013) issued by COSO.

Basis for Opinions

The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Crowe LLP

Crowe LLP

We have served as the Company’s auditor since 2003.

Cleveland, Ohio

March 5, 2019

CONSOLIDATED BALANCE SHEETS

(Table Dollar Amounts in Thousands except Per Share Data)

December 31,	2018	2017
ASSETS		
Cash and due from banks	$18,042	$17,785
Federal funds sold and other	39,884	39,829
TOTAL CASH AND CASH EQUIVALENTS	57,926	57,614
Securities available for sale	402,190	392,937
Equity securities	7,130	5,579
Loans held for sale	1,237	272
Loans	1,735,840	1,577,381
Less allowance for loan losses	13,592	12,315
NET LOANS	1,722,248	1,565,066
Premises and equipment, net	21,211	22,286
Goodwill	38,201	38,201
Other intangibles	5,751	7,168
Bank owned life insurance	34,758	33,877
Other assets	38,212	36,069
TOTAL ASSETS	$2,328,864	$2,159,069
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	$421,950	$412,346
Interest-bearing	1,352,770	1,192,373
Brokered time deposits	25,000	0
TOTAL DEPOSITS	1,799,720	1,604,719
Short-term borrowings	244,759	289,565
Long-term borrowings	6,033	6,994
Other liabilities	16,032	15,717
TOTAL LIABILITIES	2,066,544	1,916,995
Commitments and contingent liabilities (Note 12)		
Stockholders' equity		
Common Stock - Authorized 50,000,000 shares in 2018 and 35,000,000 in 2017; issued 28,179,598 in 2018 and 2017	186,163	186,903
Retained earnings	83,630	59,208
Accumulated other comprehensive income (loss)	(4,030)	596
Treasury stock, at cost; 387,697 shares in 2018 and 635,550 shares in 2017	(3,443)	(4,633)
TOTAL STOCKHOLDERS' EQUITY	262,320	242,074
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$2,328,864	$2,159,069

See accompanying notes

CONSOLIDATED STATEMENTS OF INCOME

(Table Dollar Amounts in Thousands except Per Share Data)

Years ended December 31,	2018	2017	2016
INTEREST AND DIVIDEND INCOME			
Loans, including fees	$79,835	$69,934	$63,109
Taxable securities	4,928	4,899	5,058
Tax exempt securities	5,707	4,763	3,650
Dividends	652	537	515
Federal funds sold and other interest income	644	394	166
TOTAL INTEREST AND DIVIDEND INCOME	91,766	80,527	72,498
INTEREST EXPENSE			
Deposits	8,139	4,490	3,221
Short-term borrowings	4,936	2,167	689
Long-term borrowings	190	224	468
TOTAL INTEREST EXPENSE	13,265	6,881	4,378
NET INTEREST INCOME	78,501	73,646	68,120
Provision for loan losses	3,000	3,350	3,870
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	75,501	70,296	64,250
NONINTEREST INCOME			
Service charges on deposit accounts	4,254	4,077	4,010
Bank owned life insurance income, including death benefits	881	831	814
Trust fees	7,126	6,431	6,235
Insurance agency commissions	2,621	2,407	1,560
Security gains, including change in fair value for equity securities	271	4	73
Retirement plan consulting fees	1,684	1,857	1,990
Investment commissions	1,103	919	1,210
Net gains on sale of loans	2,729	3,066	2,843
Debit card and EFT fees	3,351	3,089	2,661
Other operating income	1,479	1,370	1,848
TOTAL NONINTEREST INCOME	25,499	24,051	23,244
NONINTEREST EXPENSE			
Salaries and employee benefits	35,976	34,759	31,908
Occupancy and equipment	6,478	6,292	6,615
State and local taxes	1,887	1,663	1,544
Professional fees	2,856	2,891	2,757
Merger related costs	(155)	888	563
Advertising	1,559	1,527	1,462
FDIC insurance	899	869	1,055
Intangible amortization	1,418	1,494	1,461
Core processing charges	3,073	2,880	2,699
Telephone and data	1,061	973	930
Other operating expenses	7,665	6,950	8,458

TOTAL NONINTEREST EXPENSE	62,717	61,186	59,452
INCOME BEFORE INCOME TAXES	38,283	33,161	28,042
INCOME TAXES	5,714	10,450	7,485
NET INCOME	$32,569	$22,711	$20,557
EARNINGS PER SHARE:			
Basic	$1.18	$0.82	$0.76
Diluted	$1.16	$0.82	$0.76

See accompanying notes.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Table Dollar Amounts in Thousands except Per Share Data)

Years ended December 31,	2018	2017	2016
NET INCOME	$32,569	$22,711	$20,557
Other comprehensive income:			
Net unrealized holding gains (losses) on available for sale securities	(5,343)	5,107	(4,270)
Reclassification adjustment for (gains) losses realized in income	(283)	(4)	(73)
Net unrealized holding gains (losses)	(5,626)	5,103	(4,343)
Income tax effect	1,169	(1,786)	1,520
Unrealized holding gains (losses), net of reclassification and tax	(4,457)	3,317	(2,823)
Change in funded status of post-retirement health plan	0	(55)	(156)
Income tax effect	0	19	55
Change in funded status of post-retirement health plan, net of tax	0	(36)	(101)
Other comprehensive income (loss), net of tax	(4,457)	3,281	(2,924)
TOTAL COMPREHENSIVE INCOME	$28,112	$25,992	$17,633

See accompanying notes.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Table Dollar Amounts in Thousands except Per Share Data)

Years ended December 31,	2018	2017	2016
COMMON STOCK			
Balance at beginning of year	$186,903	$178,317	$176,287
Issued 247,853 in 2018 and 18,928 in 2017 treasury shares under the Long Term Incentive Plan	(2,415)	(133)	0
Issued 465,787 shares in 2017 and 123,280 in 2016 as part of business combinations	0	6,358	1,138
Stock compensation expense for unvested shares	1,675	2,361	892
Balance at end of year	186,163	186,903	178,317
RETAINED EARNINGS			
Balance at beginning of year	59,208	42,547	26,316
Cumulative effect adjustment upon adoption of ASU 2016-01	169	0	0
Beginning balance adjusted	59,377	42,547	26,316
Net income	32,569	22,711	20,557
Decrease as a result of shares issued under the Long Term Incentive Plan	0	(5)	0
Increase as a result of a contingent payment as part of a business combination	0	73	0
Reclassification of disproportionate tax effects	0	(106)	0
Dividends declared: $.30 cash dividends per share in 2018, $.22 per share in 2017 and $.16 per share in 2016	(8,316)	(6,012)	(4,326)
Balance at end of year	83,630	59,208	42,547
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)			
Balance at beginning of year	596	(2,791)	133
Cumulative effect adjustment upon adoption of ASU 2016-01	(169)	0	0
Beginning balance adjusted	427	(2,791)	133
Reclassification of disproportionate tax effects	0	106	0
Other comprehensive income (loss)	(4,457)	3,281	(2,924)
Balance at end of year	(4,030)	596	(2,791)
TREASURY STOCK, AT COST			
Balance at beginning of year	(4,633)	(4,857)	(4,689)
Issued 11,669 shares in contingent payments as part of a business combination	0	85	0
Reissued 324,978 and 18,928 shares in 2018 and 2017 under the Long Term Incentive Plan	2,415	139	0
Purchased 19,900 shares in 2016	0	0	(168)
Retained 77,125 shares to cover tax withholdings under the Long Term Incentive Plan	(1,225)	0	0

Balance at end of year	(3,443)	(4,633)	(4,857)
TOTAL STOCKHOLDERS' EQUITY AT END OF YEAR	$262,320	$242,074	$213,216

See accompanying notes.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Table Dollar Amounts in Thousands except Per Share Data)

Years ended December 31,	2018	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$32,569	$22,711	$20,557
Adjustments to reconcile net income to net cash from operating activities:			
Provision for loan losses	3,000	3,350	3,870
Depreciation and amortization	2,991	3,139	3,667
Net amortization of securities	2,798	1,823	2,216
Available for sale security gains	(283)	(4)	(73)
Realized and unrealized gains on equity securities	12	0	0
Loss (gain) on land and building sales, net	0	53	(238)
Stock compensation expense	1,675	2,361	892
Loss on sale of other real estate owned	(16)	20	277
Earnings on bank owned life insurance	(881)	(831)	(814)
Origination of loans held for sale	(79,007)	(56,810)	(64,599)
Proceeds from loans held for sale	80,771	59,959	68,856
Net gains on sale of loans	(2,729)	(3,066)	(2,843)
Net change in other assets and liabilities	(911)	(2,139)	(7,273)
NET CASH FROM OPERATING ACTIVITIES	39,989	30,566	24,495
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from maturities and repayments of securities available for sale	37,012	43,104	59,904
Proceeds from sales of securities available for sale	16,162	54,497	11,493
Purchases of securities available for sale	(69,241)	(114,600)	(52,628)
Proceeds from sale of equity securities	79	0	0
Purchases of equity securities	(1,642)	0	0
Purchases of restricted stock	(1,246)	(842)	(200)
Loan originations and payments, net	(160,204)	(132,597)	(133,248)
Proceeds from sale of other real estate owned	209	643	665
Purchase of bank owned life insurance	0	(3,000)	0
Proceeds from land and building sales	0	439	479
Additions to premises and equipment	(450)	(956)	(788)
Net cash (paid) received in business combinations	0	16,203	(1,073)
NET CASH FROM INVESTING ACTIVITIES	(179,321)	(137,109)	(115,396)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net change in deposits	195,001	45,377	115,709
Net change in short-term borrowings	(44,806)	91,105	(27,372)
Repayments of long-term borrowings	(1,010)	(8,091)	(7,178)
Cash dividends paid	(8,316)	(6,012)	(4,326)

Repurchase of common shares	(1,225)	0	(168)
NET CASH FROM FINANCING ACTIVITIES	139,644	122,379	76,665
NET CHANGE IN CASH AND CASH EQUIVALENTS	312	15,836	(14,236)
Beginning cash and cash equivalents	57,614	41,778	56,014
Ending cash and cash equivalents	$57,926	$57,614	$41,778
Supplemental cash flow information:			
Interest paid	$12,906	$6,754	$4,316
Income taxes paid	$7,300	$8,800	$9,410
Supplemental noncash disclosures:			
Transfer of loans and property to other real estate owned	$22	$279	$482
Issuance of stock for business combinations	$0	$6,358	$1,138
Issuance of stock awards	$2,415	$139	$0
Security purchases not settled	$1,642	$0	$927
Contingent consideration for business combination	$180	$85	$880

See accompanying notes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table Dollar Amounts in Thousands except Per Share Data)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The consolidated financial statements include the accounts of Farmers National Banc Corp. and its wholly-owned subsidiaries, The Farmers National Bank of Canfield (“Bank” or “Farmers Bank”), Farmers Trust Company (“Farmers Trust”), National Associates, Inc. (“NAI”) and Farmers National Captive, Inc. (“Captive”). Captive was formed during 2016 and is a wholly-owned insurance subsidiary of the Company. The consolidated financial statements also include the accounts of the Bank’s subsidiaries; Farmers National Insurance, LLC (“Farmers Insurance”) and Farmers of Canfield Investment Co. (“Farmers Investments”). The Company acquired Monitor Bancorp, Inc. (“Monitor”), the holding company of Monitor Bank in 2017 and consolidated the activity within the Bank. The Bank acquired Bowers Insurance Agency, Inc. (“Bowers”) and consolidated the activity of Bowers with Farmers Insurance during 2016, see Note 2. Together all entities are referred to as “the Company.” All significant intercompany balances and transactions have been eliminated in consolidation.

Nature of Operations: The Company provides full banking services, including wealth management services and mortgage banking activity, through the Bank. As a national bank, the Bank is subject to regulation of the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation. The primary area served by the Bank is the northeastern region of Ohio through thirty nine (39) locations and two-branch location in southwestern Pennsylvania. The Company provides trust services through its Farmers Trust subsidiary, retirement consulting services through its NAI subsidiary and insurance services through the Bank’s Insurance subsidiary. Farmers Trust has a state-chartered bank license to conduct trust business from the Ohio Department of Commerce – Division of Financial Institutions. The primary purpose of Farmers Investments is to invest in municipal securities. Captive provides property and casualty insurance coverage to the Company and its subsidiaries. Captive pools resources with thirteen similar insurance subsidiaries of financial institutions to spread a limited amount of risk among the pool members and to provide insurance where not currently available or economically feasible in today’s insurance market place.

Estimates: The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash Flows: Cash and cash equivalents include cash on hand, deposits with other financial institutions and federal funds sold. Generally, federal funds are purchased and sold for one-day periods. Net cash flows are reported for loan and deposit transactions, short-term borrowings and other assets and liabilities.

Securities: Debt securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax. Equity securities with readily determinable fair values are carried at fair value, with changes in fair value reported in net income. Prior to 2018, equity securities with readily determinable fair values were classified as available for sale, carried at fair value with unrealized holding gains and losses reported in other comprehensive income, net of tax.

On January 1, 2018, the Company adopted the new accounting standard for Financial Instruments, which requires equity investments to be measured at fair value with changes in fair value recognized in net income. The adoption of this guidance resulted in a $169 thousand increase to beginning retained earnings and a $169 thousand decrease to accumulated other comprehensive income.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method. Purchases are recorded on the trade date.

Management evaluates securities for other-than-temporary impairment (OTTI) on at least a quarterly basis, and more frequently when economic or market conditions warrant. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

Loans Held for Sale: Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by outstanding commitments from investors. Net unrealized losses, if any, are charged to earnings.

Mortgage loans held for sale are sold with or without servicing rights released. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs, and an allowance for loan losses. Substantially all loans are secured by specific items of collateral including business assets, consumer assets, and commercial and residential real estate.

Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level yield method without anticipating prepayments. Interest income on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the loan is well secured and in process of collection. Consumer loans are typically charged off no later than 120 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

For all classes of loans, when interest accruals are discontinued, interest accrued but not received for loans placed on non-accrual is reversed against interest income. Interest on such loans is thereafter recorded on a cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Purchased Credit Impaired Loans: The Company purchased loans that have shown evidence of credit deterioration since origination. These loans were recorded at the amount paid, such that there is no carryover of the seller’s allowance for loan losses. The Company estimates the amount and timing of expected cash flows for each loan, and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan. The excess of the loan’s contractual principal and interest over expected cash flows is not recorded.

Over the life of the loan, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded as a provision for loan losses. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Derivatives: Derivative financial instruments are recognized as assets or liabilities at fair value. The Company's derivatives are interest-rate swap agreements, which are used as part of its asset and liability management strategy to help manage its interest rate risk position. The Company does not use derivatives for trading or balance sheet hedging purposes. The derivative transactions are considered instruments with no hedging designation, otherwise known as stand-alone derivatives. Changes in the fair value of the derivatives are reported currently in earnings, as other noninterest income.

Concentration of Credit Risk: There are no significant concentrations of loans to any one industry or customer. However, most of the Company's business activity is with customers located within Northeastern Ohio. Therefore, the Company's exposure to credit risk is significantly affected by changes in the economy of a nine county area. Loans secured by real estate represent 70.5% of the total portfolio and changes related to the real estate markets are monitored by management.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred loan losses, increased by the provision for loan losses and decreased by charge-offs less recoveries. The allowance is based on management's judgment taking into consideration past loss experience, reviews of individual loans, current economic conditions and other factors considered relevant by management at the financial statement date. While management uses the best information available to establish the allowance, future adjustments to the allowance may be necessary, which may be material, if economic conditions differ substantially from the assumptions used in estimating the allowance. If additions to the original estimate of the allowance for loan losses are deemed necessary, they will be reported in earnings in the period in which they become reasonably estimable and probable. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off.

Acquired loans are individually evaluated and for those purchased loans without evidence of credit deterioration, management evaluates each reviewed loan using an internal grading system with a grade assigned to each loan at the date of acquisition. To the extent that any purchased loan is not specifically reviewed, such loan is assumed to have characteristics similar to the characteristics of the acquired portfolio of purchased loans. The grade for each purchased loan without evidence of credit deterioration is reviewed subsequent to the date of acquisition any time a loan is renewed or extended or at any time information becomes available to the Company that provides material insight regarding the loan's performance, the status of the borrower or the quality or value of the underlying collateral. To the extent that current information indicates it is probable that the Company will collect all amounts according to the contractual terms thereof, such loan is not considered impaired and is not individually considered in the determination of the required allowance for loan losses. To the extent that current information indicates it is probable that the Company will not be able to collect all amounts according to the contractual terms thereof, such loan is considered impaired and is considered in the determination of the required level of allowance.

In determining the day one fair values of purchased loans without evidence of credit deterioration at the date of acquisition, management includes (i) no carry-over of any previously recorded allowance for loan losses and (ii) an adjustment of the unpaid principal balance to reflect an appropriate market rate of interest, given the risk profile and grade assigned to each loan. This adjustment is accreted into earnings as a yield adjustment, using the effective yield method, over the remaining life of each loan.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. A loan is considered impaired when, based on the current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Loans, for which the terms have been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed.

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Impairment is measured on a loan by loan basis for commercial and commercial real estate loans over $750 thousand, individually or in the aggregate, by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans are collectively evaluated for impairment and accordingly, they are not separately identified for impairment disclosures. Non-real estate secured consumer loans in bankruptcy where debt has not been reaffirmed are considered troubled debt restructurings and are evaluated individually to ensure that accurate accounting treatment is in place.

The Company considers the guidance on troubled debt restructuring for individual consumer and residential loans when evaluating for impairment disclosure. Troubled debt restructurings are measured at the present value of estimated future cash flow using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced for the most recent twelve quarters. The formula for calculating the allowance for loan losses requires that the historical loss percentage be applied to homogeneous and all risk rated loans. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures and practices; experience, ability and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments have been identified:

Commercial Loans. Commercial credit is extended to commercial customers for use in normal business operations to finance working capital needs, equipment purchases or other projects. The majority of these borrowers are customers doing business within our geographic regions. These loans are generally underwritten individually and secured with the assets of the company and the personal guarantee of the business owners. Commercial loans are made based primarily on the historical and projected cash flow of the borrower and the underlying collateral provided by the borrower.

Commercial Real Estate Loans. Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans. These loans are viewed primarily as cash flow loans and the repayment of these loans is largely dependent on the successful operation of the property. Loan performance may be adversely affected by factors impacting the general economy or conditions specific to the real estate market such as geographic location and property type.

Consumer Loans. Consumer loans are primarily comprised of loans made directly to consumers and indirectly through automobile dealerships. These loans have a specific matrix which consists of several factors including debt to income, type of collateral and loan to collateral value, credit history and relationship with the borrower. Consumer lending uses risk-based pricing in the underwriting process.

Residential Real Estate Loans. Residential mortgage loans represent loans to consumers for the purchase or refinance of a residence. These loans are generally financed up to 15 years and in most cases, are extended to borrowers to finance their primary residence. Real estate market values at the time of origination directly affect the amount of credit extended and, in the event of default, subsequent changes in these values may impact the severity of losses.

Servicing Rights: When mortgage loans are sold and servicing rights are retained, the servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. The Company compares the valuation model inputs and results to published industry data to validate the model results and assumptions.

All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into non interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. Servicing assets are evaluated for impairment based upon the fair value of the assets compared to carrying amount. Any impairment is reported as a valuation allowance, to the extent that fair value is less than the capitalized amount for a grouping. There was no valuation allowance impairment against servicing assets as of December 31, 2018 or 2017.

Servicing fee income is recorded when earned for servicing loans based on a contractual percentage of the outstanding principal or a fixed amount per loan. The amortization of mortgage servicing rights is netted against loan servicing fee income. Servicing fees, late fees and ancillary fees related to loan servicing are not considered significant for financial reporting.

Foreclosed Assets: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. These assets are recorded in other assets on the balance sheets as other real estate owned ("OREO"). OREO totaled $0 at December 31, 2018 and $171 thousand at December 31, 2017. Operating costs after acquisition are expensed.

Premises and Equipment: Land is carried at cost. Premises and equipment are stated at cost, less accumulated depreciation. Buildings and related components are depreciated using the straight-line method with useful lives ranging from 5 to 40 years. Furniture, fixtures and equipment are depreciated using the straight-line method with useful lives ranging from 3 to 10 years.

Restricted Stock: The Bank is a member of the FHLB system. 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. The Bank is also a member of and owns stock in the Federal Reserve Bank. These stocks are carried at cost, classified as restricted securities included in other assets, and periodically evaluated for impairment based on ultimate recovery of par value. Restricted stock totaled $11.7 million at December 31, 2018 and $10.5 million at December 31, 2017. Both cash and stock dividends are reported as income.

Bank Owned Life Insurance: The Company has purchased life insurance policies on certain key officers. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Long-term Assets: Premises and equipment and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Goodwill and Other Intangible Assets: Goodwill resulting from a business combination is generally determined as the excess of the fair value of the consideration transferred over the fair value of the net assets acquired as of the acquisition date. Goodwill acquired in a purchase business combination and determined to have an indefinite useful life is not amortized, but tested for impairment at least annually. The Company has selected September 30 as the date to perform the annual goodwill impairment tests associated with the acquisition of the Farmers Trust, NAI, First National Bank of Orrville, 1st National Community Bank, Bowers and Monitor. Intangible assets with definite useful lives are amortized over their estimated useful lives. Goodwill is the only intangible asset with an indefinite life on the balance sheet. Core deposit intangible assets arising from bank acquisitions are amortized over their estimated useful lives of 7 to 8 years. Non-compete contracts are amortized on a straight line basis, over the term of the agreements. Customer relationship and trade name intangibles are amortized over a range of 13 to 15 years on an accelerated method.

Loan Commitments and Related Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Stock-Based Compensation: Compensation cost is recognized for restricted stock awards issued to employees, based on the fair value of these awards at the date of grant. The market price of the Company's common stock at the grant date is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

Retirement Plans: Employee 401(k) and profit sharing plan expense is the amount of matching and discretionary contributions. Deferred compensation and supplemental retirement plan expense allocates the benefits over years of service.

Earnings per Common Share: Basic earnings per common share is net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share include the dilutive effect of additional potential common shares issuable under stock equity awards. Earnings and dividends per share are restated for all stock splits and stock dividends through the date of issuance of the financial statements.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) consists of unrealized gains and losses on securities available for sale and changes in the funded status of the post-retirement health plan, which are recognized as separate components of equity, net of tax effects.

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are any matters currently that will have a material effect on the financial statements.

Restrictions on Cash: Cash on hand or on deposit with the Federal Reserve Bank ("FRB") was required to meet regulatory reserve and clearing requirements. The Company had deposits with the FRB of $34.2 million at December 31, 2018 and $30.0 million at December 31, 2017.

Equity: Treasury stock is carried at cost.

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank and Farmers Trust to the holding company or by the holding company to shareholders.

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions as more fully disclosed in Note 7. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect these estimates.

Operating Segments: Operations are managed and financial performance is primarily aggregated and reported in three lines of business, the Bank, Farmers Trust and Retirement Consulting segments. The Company discloses segment information in Note 22.

Reclassification: Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or stockholders' equity.

Adoption of New Accounting Standards and Newly Issued, Not Yet Effective Accounting Standards: During February 2018, the FASB issued ASU 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220) Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The amendments in this Update allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. Consequently, the amendments eliminate the stranded tax effects and will improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The standard takes effect for all entities for fiscal years and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption of the amendments in this Update is permitted for public business entities for reporting periods for which financial statements have not yet been issued and for all other entities for reporting periods for which financial statements have not yet been made available for issuance. The Company early adopted this ASU and the result was a reclass of $106 thousand from accumulated other comprehensive income to retained earnings and is reflected in the Consolidated Financial Statements as of December 31, 2017.

During April of 2017, the FASB issued ASU 2017-08, Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. Under current U.S. GAAP, a premium is typically amortized to the maturity date when a callable debt security is purchased at a premium, even if the holder is certain the call will be exercised. As a result, upon the exercise of a call on a callable debt security held at a premium, the unamortized premium is recorded as a loss in earnings. The new standard shortens the amortization period for the premium to the earliest call date to more closely align interest income recorded on bonds held at a premium or a discount with the economics of the underlying instrument. The standard takes effect for public business entities for fiscal years and interim periods within those fiscal years, beginning after December 15, 2018. The Company early adopted this ASU effective January 1, 2018 and there was no material impact on its Consolidated Financial Statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. This ASU eliminates Step 2 from the goodwill impairment test. Instead, under the new guidance, an entity is to perform its annual goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An impairment charge would be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value. The new guidance is effective for annual reporting periods, and interim reporting periods within those annual periods, beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not plan on early adoption of this ASU. The adoption of this guidance is not expected to have an impact on the Company's Consolidated Financial Statements.

In February 2016, FASB issued ASU 2016-02 (Topic 842): Leases. The main objective of ASU 2016-02 is to provide users with useful, transparent and complete information about leasing transactions. ASU 2016-02 requires the rights and obligations associated with leasing arrangements be reflected on the balance sheet to increase transparency and comparability among organizations. Under the updated guidance, lessees will be required to recognize a right-to-use asset and a liability to make a lease payment and disclose key information about leasing arrangements. ASU 2016-02 is effective for public companies for interim and annual reporting periods beginning after December 15, 2018, with early adoption permitted. The Company adopted this ASU on January 1, 2019. As disclosed in footnote 8, certain leases that the Company has in place require the capitalization of $3.6 million on the balance sheet as an asset and a related liability in the same amount with no income statement effect at January 1, 2019.

In January 2016, FASB issued ASU 2016-01: Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The main objective of ASU 2016-01 is to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. ASU 2016-01 addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Some of the amendments in ASU 2016-01 include the following: 1) require 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; 2) simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; 3) require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; and 4) require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value; among others. The amendments of ASU 2016-01 are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company adopted this ASU 2016-01 on January 1, 2018 which resulted in a $169 thousand increase to beginning retained earnings and a $169 thousand decrease to accumulated other comprehensive income on the Consolidated Financial Statements.

In May 2014, FASB issued ASU 2014-09: Revenue from Contracts with Customers (Topic 606). The ASU creates a new topic, Topic 606, to provide guidance on revenue recognition for entities that enter into contracts with customers to transfer goods or services or enter into contracts for the transfer of nonfinancial assets. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised 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. Additional disclosures are required to provide quantitative and qualitative information regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The new guidance is effective for annual reporting periods, and interim reporting periods within those annual periods, beginning after December 15, 2017. The new guidance was adopted as of January 1, 2018. Refer to the Revenue from Contracts with Customers – Note 5 for further discussion on the Company’s accounting for revenue sources within the scope of Accounting Standards Codification (“ASC”) 606.

In June 2016, the Financial Accounting Standards Board (“FASB”) issued ASU 2016-13: Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The ASU requires an organization to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 is effective for public companies for annual periods beginning after December 15, 2019, including interim periods within those fiscal years. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Company continues to accumulate historical credit information, has established an internal committee and has completed the set-up stage of the installation process of new software in preparation of parallel testing in the first quarter of 2019. Adoption of ASU 2016-13 will happen on January 1, 2020. Management has not determined the full impact the new standard will have on the Consolidated Financial Statements.

NOTE 2 – BUSINESS COMBINATIONS

During August of 2017, the Company completed the acquisition of Monitor, the holding company of Monitor Bank. The transaction involved both cash and 465,787 shares of stock totaling $7.5 million. Pursuant to the terms of the merger agreement, common shareholders of Monitor were entitled to elect to receive consideration in cash or in common shares, without par value, of the Company, subject to an overall limitation of 85% of the Monitor common shares being exchanged for the Company’s common shares and 15% exchanged for cash. The per share cash consideration of $769.38 was equal to Monitor’s March 31 tangible book value multiplied by 1.25. Based on the volume weighted average closing price of the Company’s common shares for the 20 trading days ended August 11, 2017 of $14.04, the final stock exchange ratio was 54.80, resulting in an implied value per Monitor common share of $769.38.

Goodwill of $1.0 million, which is recorded on the balance sheet, arising from the acquisition consisted largely of synergies and the cost savings resulting from the combining of the companies. The goodwill was determined not to be deductible for income tax purposes. The fair value of other intangible assets of $673 thousand is related to core deposits.

The following table summarizes the consideration paid for Monitor and the amounts of the assets acquired and liabilities assumed on the closing date of the acquisition.

Consideration	
Cash	$1,154
Stock	6,358
Fair value of total consideration transferred	$7,512
Fair value of assets acquired	
Cash and due from financial institutions	$17,673
Securities available for sale	3,057
Loans, net	19,315
Premises and equipment	192
Core deposit intangible	673
Other assets	272
Total assets acquired	41,182
Fair value of liabilities assumed	
Deposits	34,586
Accrued interest payable and other liabilities	121
Total liabilities	34,707
Net assets acquired	$6,475
Goodwill created	1,037
Total net assets acquired	$7,512

During June of 2016, the Bank completed the acquisition of Bowers, and merged all activity of Bowers with Farmers Insurance, the Bank's wholly-owned insurance agency subsidiary. The Bowers group is engaged in selling insurance, including commercial, farm, home, and auto property/casualty insurance and will help to meet the needs of all the Company's customers. The transaction involved both cash and 123,280 shares of stock totaling $3.2 million, including up to $1.2 million of future payments, contingent upon Bowers meeting performance targets, with an estimated fair value at the acquisition date of $880 thousand. The first of three contingent payments were made during July 2017, totaling $316 thousand, which reduced the earnout payable to $564 thousand. Subsequent to the first payment, management conducted two annual valuations of the contingent consideration and found it necessary to reduce the future payment liability associated with the remaining two payments down to $200 thousand at year end 2017 and $20 thousand at year end 2018. The $364 thousand and $180 thousand were recorded as a reduction to acquisition related costs on the Consolidated Statements of Income as of December 31, 2017 and 2018, respectively. The Company conducts this valuation work annually. The earnout calculation for the second of three contingent payments was completed during June of 2018 and determined that no payment was earned or due. The acquisition is part of the Company's plan to increase the levels of noninterest income and to complement the existing insurance services currently being offered.

Goodwill of $1.8 million, which is recorded on the balance sheet, arising from the acquisition consisted largely of synergies and the cost savings resulting from the combining of the companies. The goodwill was determined not to be deductible for income tax purposes. The original fair value of other intangible assets of $1.6 million was related to client relationships, company name and noncompetition agreements.

The following table summarizes the consideration paid for Bowers and the amounts of the assets acquired and liabilities assumed on the closing date of the acquisition.

Consideration	
Cash	$1,137
Stock	1,138
Contingent consideration	880
Fair value of total consideration transferred	$3,155
Fair value of assets acquired	
Cash	$64
Premises and equipment	290
Other assets	34
Total assets	388
Fair value of liabilities assumed	124
Net assets acquired	$264
Assets and liabilities arising from acquisition	
Identified intangible assets	1,630
Deferred tax liability	(588)
Goodwill created	1,849
Total net assets acquired	$3,155

The following table presents pro forma information as if the above acquisitions that occurred during 2016 and 2017 actually took place at the beginning of 2016. The pro forma information includes adjustments for merger related costs, amortization of intangibles arising from the transaction and the related income tax effects. The pro forma financial information is not necessarily indicative of the results of operations that would have occurred had the transactions been effective on the assumed date.

	2017	2016
Net interest income	$74,409	$69,341
Net income	$22,776	$20,661
Basic and diluted earnings per share	$0.83	$0.77

NOTE 3 – SECURITIES AVAILABLE FOR SALE

The following table summarizes the amortized cost and fair value of the available-for-sale securities portfolio at December 31, 2018 and 2017 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury and U.S. government sponsored entities	$ 6,111	$ 0	$ (102)	$ 6,009
State and political subdivisions	211,762	2,075	(1,893)	211,944
Corporate bonds	1,206	0	(18)	1,188
Mortgage-backed securities - residential	154,130	84	(4,167)	150,047
Collateralized mortgage obligations	21,775	72	(775)	21,072
Small Business Administration	12,292	0	(362)	11,930
Totals	$ 407,276	$ 2,231	$ (7,317)	$ 402,190

2017	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury and U.S. government sponsored entities	$ 8,986	$ 0	$ (69)	$ 8,917
State and political subdivisions	188,032	3,614	(643)	191,003
Corporate bonds	1,238	4	(8)	1,234
	161,635	419	(1,604)	160,450

Mortgage-backed securities - residential				
Collateralized mortgage obligations	17,898	0	(777)	17,121
Small Business Administration	14,608	0	(396)	14,212
Totals	$ 392,397	$ 4,037	$ (3,497)	$ 392,937

The proceeds from sales of available-for-sale securities and the associated gains and losses were as follows:

	2018	2017	2016
Proceeds	$ 16,162	$ 54,497	$ 11,493
Gross gains	408	727	389
Gross losses	(125)	(723)	(316)

The tax provision related to these net realized gains was $59 thousand, $2 thousand and $26 thousand respectively.

The amortized cost and fair value of the debt securities portfolio are shown by expected maturity. Expected maturities may differ from contractual maturities if issuers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

Available for sale	December 31, 2018	
Maturity	Amortized Cost	Fair Value
Within one year	$5,611	$5,601
One to five years	41,647	41,682
Five to ten years	146,439	146,769
Beyond ten years	25,382	25,089
Mortgage-backed securities, collateralized mortgage obligations and Small Business Administration	188,197	183,049
Totals	$407,276	$402,190

Securities with a carrying amount of $194 million at December 31, 2018 and $269 million at December 31, 2017 were pledged to secure public deposits and repurchase agreements. Farmers Trust had securities, with a carrying amount of $100 thousand, at year-end 2018 and 2017, pledged to qualify as a fiduciary in the State of Ohio.

In each year, there were no holdings of any other issuer that exceeded 10% of stockholders' equity, other than the U.S. Government, its agencies and its sponsored entities.

The following table summarizes the investment securities with unrealized losses at December 31, 2018 and 2017 aggregated by major security type and length of time in a continuous unrealized loss position.

2018

	Less than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and U.S. government sponsored entities	$648	$ (2)	$5,065	$ (100)	$5,713	$ (102)
State and political subdivisions	23,569	(201)	64,174	(1,692)	87,743	(1,893)
Corporate bonds	516	(4)	672	(14)	1,188	(18)
Mortgage-backed securities - residential	13,002	(114)	126,200	(4,053)	139,202	(4,167)
Collateralized mortgage obligations	20	(1)	14,003	(774)	14,023	(775)
Small Business Administration	11	0	11,919	(362)	11,930	(362)
Total temporarily impaired	$37,766	$ (322)	$222,033	$ (6,995)	$259,799	$ (7,317)

2017

	Less than 12 Months	12 Months or More	Total

Description of Securities	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and U.S. government sponsored entities	$3,970	$ (34)	$1,912	$ (35)	$5,882	$ (69)
State and political subdivisions	33,188	(220)	25,721	(423)	58,909	(643)
Corporate bonds	397	(3)	383	(5)	780	(8)
Mortgage-backed securities - residential	40,072	(400)	53,760	(1,204)	93,832	(1,604)
Collateralized mortgage obligations	1,701	(22)	15,420	(755)	17,121	(777)
Small Business Administration	0	0	14,182	(396)	14,182	(396)
Total temporarily impaired	$79,328	$ (679)	$111,378	$ (2,818)	$190,706	$ (3,497)

The Company's equity securities include local and regional bank holdings. No other-than-temporary impairments were recognized during 2017 or 2016. If an other-than-temporary impairment were to occur, the amount of the impairment recognized in earnings depends on whether an entity intends to sell the security or it is more likely than not it would be required to sell the security before recovery of its amortized cost basis. The previous amortized cost basis less the impairment recognized in earnings becomes the new amortized cost basis of the investment.

As of December 31, 2018, the Company's security portfolio consisted of 583 securities, 256 of which were in an unrealized loss position. The majority of unrealized losses are related to the Company's holdings in securities issued by state and political subdivisions, mortgage-backed securities - residential, collateralized mortgage obligations and Small Business Administration, as discussed below:

Securities issued by State and Political subdivisions

Unrealized losses on debt securities issued by state and political subdivisions have not been recognized into income. At December 31, 2018 and 2017 all securities issued by state and political subdivisions have investment grade ratings and management does not have the intent and does not expect to be required to sell these securities before their anticipated recovery. The fair value is expected to recover as the securities approach their maturity date.

Mortgage-backed securities - residential

All of the Company's holdings of mortgage-backed securities—residential at year end 2018 and 2017 were issued by U.S. Government sponsored enterprises. Unrealized losses on mortgage-backed securities—residential have not been recognized into income. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company does not have the intent to sell these mortgage-backed securities—residential and it is likely that it will not be required to sell the securities before their anticipated recovery, the Company does not consider these securities to be other-than-temporarily impaired at December 31, 2018 and 2017.

Collateralized mortgage obligations

The Company's portfolio includes collateralized mortgage obligations issued by U.S. Government sponsored enterprises. The decline in fair value is attributable to changes in interest rates and illiquidity, and not credit quality. The Company does not have the intent to sell these collateralized mortgage obligations and it is likely that it will not be required to sell the securities before their anticipated recovery. The Company monitors all securities to ensure adequate credit support and as of December 31, 2018 and 2017, the Company believes there is no other-than-temporary impairment.

Small Business Administration

The Company's holdings of Small Business Administration securities are issued and backed by the full faith and credit of the U.S. Government. Unrealized losses on these Small Business Administration securities have not been recognized into income. The Company does not consider these securities to be other-than-temporarily impaired at December 31, 2018 and 2017 because the decline in fair value is attributable to changes in interest rates and illiquidity, and not credit quality, and the Company does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery.

NOTE 4 – LOANS

Loans at year end were as follows:

	2018	2017
Originated loans:		
Commercial real estate		
Owner occupied	$158,947	$140,321
Non-owner occupied	256,124	199,080
Farmland	110,881	70,534
Other	94,527	89,025
Commercial		
Commercial and industrial	227,031	193,347
Agricultural	37,623	32,587
Residential real estate		
1-4 family residential	307,794	272,421
Home equity lines of credit	82,690	71,507
Consumer		
Indirect	164,509	155,950
Direct	30,277	28,519
Other	11,894	8,876
Total originated loans	$1,482,297	$1,262,167
Acquired loans:		
Commercial real estate		
Owner occupied	$44,872	$53,031
Non-owner occupied	16,920	20,286
Farmland	40,983	47,754
Other	8,091	11,964
Commercial		
Commercial and industrial	18,141	27,094
Agricultural	9,526	12,206
Residential real estate		
1-4 family residential	78,786	96,759
Home equity lines of credit	23,617	28,755
Consumer		
Direct	9,442	14,378
Other	162	128
Total acquired loans	250,540	312,355
Net deferred loan costs	3,003	2,859
Allowance for loan losses	(13,592)	(12,315)
Net loans	$1,722,248	$1,565,066

Purchased credit impaired loans

As part of the NBOH acquisition in 2015 the Company acquired various loans that displayed evidence of deterioration of credit quality since origination and which was probable that all contractually required payments would not be collected. The carrying amounts and contractually required payments of these loans which are included in the loan balances above are summarized in the following tables:

	2018	2017
Commercial real estate		
Owner occupied	$0	$670
Non-owner occupied	292	387
Commercial		
Commercial and industrial	899	1,072
Total outstanding balance	$1,191	$2,129
Carrying amount, net of allowance of $0 in 2018 and 2017	$903	$1,733

Accretable yield, or income expected to be collected, is shown in the table below:

	2018	2017
Beginning balance	$170	$247
New loans purchased	0	0
Accretion of income	(77)	(77)
Ending balance	$93	$170

The key assumptions considered include probability of default and the amount of actual prepayments after the acquisition date. Prepayments affect the estimated life of the loans and could change the amount of interest income and principal expected to be collected. In reforecasting future estimated cash flows, credit loss expectations are adjusted as necessary. There were no adjustments to forecasted cash flows that impacted the allowance for loan losses for the years ended December 31, 2018 and 2017.

The following tables present the activity in the allowance for loan losses by portfolio segment for years ended December 31, 2018, 2017 and 2016:

December 31, 2018	Commercial	Commercial	Residential	Consumer	Unallocated	Total

	Real Estate		Real Estate			
Allowance for loan losses						
Beginning balance	$ 4,260	$ 2,011	$ 2,521	$ 2,848	$ 675	$12,315
Provision for loan losses	650	112	486	1,764	(12)	3,000
Loans charged off	0	(220)	(318)	(2,318)	0	(2,856)
Recoveries	126	190	148	669	0	1,133
Total ending allowance balance	$ 5,036	$ 2,093	$ 2,837	$ 2,963	$ 663	$13,592

December 31, 2017	Commercial Real Estate	Commercial	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses						
Beginning balance	$ 3,577	$ 1,874	$ 2,205	$ 2,766	$ 430	$10,852
Provision for loan losses	298	446	378	1,983	245	3,350
Loans charged off	(207)	(375)	(162)	(2,542)	0	(3,286)
Recoveries	592	66	100	641	0	1,399
Total ending allowance balance	$ 4,260	$ 2,011	$ 2,521	$ 2,848	$ 675	$12,315

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December 31, 2016	Commercial Real Estate	Commercial	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses						
Beginning balance	$ 3,127	$ 1,373	$ 1,845	$ 2,160	$ 473	$ 8,978
Provision for loan losses	784	701	436	1,992	(43)	3,870
Loans charged off	(349)	(245)	(188)	(2,019)	0	(2,801)
Recoveries	15	45	112	633	0	805
Total ending allowance balance	$ 3,577	$ 1,874	$ 2,205	$ 2,766	$ 430	$ 10,852

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment, based on impairment method as of December 31, 2018 and 2017. The recorded investment in loans includes the unpaid principal balance and unamortized loan origination fees and costs, but excludes accrued interest receivable which is not considered to be material:

December 31, 2018	Commercial Real Estate	Commercial	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 6	$ 3	$ 267	$ 0	$ 0	$ 276
Collectively evaluated for impairment	4,981	2,075	2,534	2,960	663	13,213
Acquired loans collectively evaluated for impairment	49	15	36	3	0	103
Acquired with deteriorated credit quality	0	0	0	0	0	0
Total ending allowance balance	$ 5,036	$ 2,093	$ 2,837	$ 2,963	$ 663	$ 13,592
Loans:						
Loans individually evaluated for impairment	$ 790	$ 223	$ 4,627	$ 83	$ 0	$ 5,723
Loans collectively evaluated for impairment	618,729	264,208	385,702	212,130	0	1,480,769
Acquired loans	110,143	26,916	101,804	9,582	0	248,445
Acquired with deteriorated credit	262	641	0	0	0	903

quality						
Total ending loans balance	$ 729,924	$ 291,988	$ 492,133	$ 221,795	$ 0	$ 1,735,840

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December 31, 2017	Commercial Real Estate	Commercial	Residential Real Estate	Consumer	Unallocated	Total
Allowance for loan losses:						
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 0	$ 4	$ 158	$ 0	$ 0	$ 162
Collectively evaluated for impairment	4,214	1,993	2,322	2,844	675	12,048
Acquired loans collectively evaluated for impairment	46	14	41	4	0	105
Acquired with deteriorated credit quality	0	0	0	0	0	0
Total ending allowance balance	$ 4,260	$ 2,011	$ 2,521	$ 2,848	$ 675	$ 12,315
Loans:						
Loans individually evaluated for impairment	$ 658	$ 260	$ 4,559	$ 59	$ 0	$ 5,536
Loans collectively evaluated for impairment	497,168	225,312	339,143	198,370	0	1,259,993
Acquired loans	131,926	38,503	125,182	14,507	0	310,118
Acquired with deteriorated credit quality	948	786	0	0	0	1,734
Total ending loans balance	$ 630,700	$ 264,861	$ 468,884	$ 212,936	$ 0	$ 1,577,381

The following tables present information related to impaired loans by class of loans as of and for years ended December 31, 2018 and 2017. The recorded investment in loans excludes accrued interest receivable due to immateriality.

December 31, 2018	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
With no related allowance recorded:			
Commercial real estate			
Owner occupied	$ 524	$ 494	$ 0
Non-owner occupied	40	38	0
Farmland	0	0	0
Commercial			
Commercial and industrial	191	162	0
Agricultural	0	0	0
Residential real estate			
1-4 family residential	3,451	2,759	0
Home equity lines of credit	379	326	0
Consumer	174	83	0
Subtotal	4,759	3,862	0
With an allowance recorded:			
Commercial real estate			
Owner occupied	0	0	0
Non-owner occupied	0	0	0
Farmland	258	258	6
Commercial			
Commercial and industrial	61	61	3
Agricultural	0	0	0
Residential real estate			
1-4 family residential	1,354	1,343	188
Home equity lines of credit	224	199	79
Consumer	0	0	0
Subtotal	1,897	1,861	276
Total	$ 6,656	$ 5,723	$ 276

December 31, 2017	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
With no related allowance recorded:			
Commercial real estate			
Owner occupied	$ 659	$ 658	$ 0
Non-owner occupied	0	0	0
Farmland	0	0	0
Commercial			
Commercial and industrial	214	192	0
Agricultural	0	0	0
Residential real estate			
1-4 family residential	2,923	2,697	0
Home equity lines of credit	341	319	0
Consumer	145	59	0
Subtotal	4,282	3,925	0
With an allowance recorded:			
Commercial real estate			
Owner occupied	0	0	0
Non-owner occupied	0	0	0
Farmland	0	0	0
Commercial			
Commercial and industrial	68	68	4
Agricultural	0	0	0
Residential real estate			
1-4 family residential	1,409	1,387	84
Home equity lines of credit	159	156	74
Consumer	0	0	0
Subtotal	1,636	1,611	162
Total	$ 5,918	$ 5,536	$ 162

The Following tables present the average recorded investment in impaired loans by class and interest income recognized by loan class for the years ended December 31, 2018, 2017 and 2016.

December 31, 2018	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:		
Commercial real estate		
Owner occupied	$ 490	$ 30
Non-owner occupied	26	2
Farmland	0	0
Commercial		
Commercial and industrial	335	6
Agricultural	0	0
Residential real estate		
1-4 family residential	2,769	186
Home equity lines of credit	309	16
Consumer	72	11
Subtotal	4,001	251
With an allowance recorded:		
Commercial real estate		
Owner occupied	0	0
Non-owner occupied	0	0
Farmland	193	0
Commercial		
Commercial and industrial	68	4
Agricultural	0	0
Residential real estate		
1-4 family residential	1,778	47
Home equity lines of credit	166	7
Consumer	3	0
Subtotal	2,208	58
Total	$ 6,209	$ 309

December 31, 2017	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:		
Commercial real estate		
Owner occupied	$ 767	$ 10
Non-owner occupied	68	2
Farmland	12	0
Commercial		
Commercial and industrial	184	4
Agricultural	10	0
Residential real estate		
1-4 family residential	2,343	138
Home equity lines of credit	299	15
Consumer	74	11
Subtotal	3,757	180
With an allowance recorded:		
Commercial real estate		
Owner occupied	134	6
Non-owner occupied	640	28
Farmland	63	0
Commercial		
Commercial and industrial	71	4
Agricultural	50	0
Residential real estate		
1-4 family residential	837	29
Home equity lines of credit	95	3
Consumer	2	0
Subtotal	1,892	70
Total	$ 5,649	$ 250

December 31, 2016	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:		
Commercial real estate		
Owner occupied	$ 1,601	$ 70
Non-owner occupied	334	5
Farmland	0	0
Commercial		
Commercial and industrial	641	15
Agricultural		
Residential real estate		
1-4 family residential	2,302	145
Home equity lines of credit	221	10
Consumer	97	13
Subtotal	5,196	258
With an allowance recorded:		
Commercial real estate		
Owner occupied	874	29
Non-owner occupied	1,283	67
Farmland	127	0
Commercial		
Commercial and industrial	103	4
Agricultural	73	0
Residential real estate		
1-4 family residential	828	36
Home equity lines of credit	85	4
Consumer	1	0
Subtotal	3,374	140
Total	$ 8,570	$ 398

Cash basis interest income recognized and interest income recognized was materially equal for 2018, 2017 and 2016.

Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. The following table presents the recorded investment in nonaccrual and loans past due 90 days or more still on accrual by class of loans as of December 31, 2018 and 2017:

	2018		2017	
	Nonaccrual	Loans Past Due 90 Days or More Still Accruing	Nonaccrual	Loans Past Due 90 Days or More Still Accruing
Originated loans:				
Commercial real estate				
Owner occupied	$340	$ 0	$501	$ 0
Non-owner occupied	0	0	0	0
Farmland	30	0	45	0
Commercial				
Commercial and industrial	122	0	249	0
Agricultural	158	0	2	0
Residential real estate				
1-4 family residential	2,318	185	2,653	393
Home equity lines of credit	644	31	602	8
Consumer				
Indirect	346	369	457	361
Direct	54	200	63	153
Other	0	2	0	14
Total originated loans	$4,012	$ 787	$4,572	$ 929
Acquired loans:				
Commercial real estate				
Owner occupied	$0	$ 0	$0	$ 0
Non-owner occupied	82	0	216	0
Other	0	0	0	0
Farmland	257	0	0	0
Commercial				
Commercial and industrial	824	0	943	19
Agricultural	291	0	9	0
Residential real estate				
1-4 family residential	1,001	122	613	69
Home equity lines of credit	203	14	170	0
Consumer				
Direct	95	43	140	15
Total acquired loans	$2,753	$ 179	$2,091	$ 103
Total loans	$6,765	$ 966	$6,663	$ 1,032

The following tables present the aging of the recorded investment in past due loans as of December 31, 2018 and 2017 by class of loans:

December 31, 2018	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due and Nonaccrual	Total Past Due	Loans Not Past Due	Total
Originated loans:						
Commercial real estate						
Owner occupied	$82	$0	$ 340	$422	$158,161	$158,583
Non-owner occupied	22	0	0	22	255,458	255,480
Farmland	184	0	30	214	110,547	110,761
Other	0	0	0	0	94,242	94,242
Commercial						
Commercial and industrial	159	0	122	281	226,320	226,601
Agricultural	69	10	158	237	37,484	37,721
Residential real estate						
1-4 family residential	1,964	424	2,503	4,891	302,131	307,022
Home equity lines of credit	64	14	675	753	81,957	82,710
Consumer						
Indirect	1,714	755	715	3,184	166,622	169,806
Direct	714	340	254	1,308	29,183	30,491
Other	33	14	2	49	11,845	11,894
Total originated loans:	$5,005	$1,557	$ 4,799	$11,361	$1,473,950	$1,485,311
Acquired loans:						
Commercial real estate						
Owner occupied	$321	$0	$ 0	$321	$44,618	$44,939
Non-owner occupied	0	0	82	82	16,764	16,846
Farmland	0	102	257	359	40,623	40,982
Other	0	0	0	0	8,091	8,091
Commercial						
Commercial and industrial	94	0	824	918	17,223	18,141
Agricultural	31	5	291	327	9,198	9,525
Residential real estate						
1-4 family residential	750	229	1,123	2,102	76,682	78,784
Home equity lines of credit	208	0	217	425	23,192	23,617
Consumer						
Direct	318	257	138	713	8,729	9,442
Other	0	0	0	0	162	162
Total acquired loans	$1,722	$593	$ 2,932	$5,247	$245,282	$250,529
Total loans	$6,727	$2,150	$ 7,731	$16,608	$1,719,232	$1,735,840

December 31, 2017	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due and Nonaccrual	Total Past Due	Loans Not Past Due	Total
Originated loans:						
Commercial real estate						
Owner occupied	$4	$340	$ 501	$845	$139,081	$139,926
Non-owner occupied	0	0	0	0	198,588	198,588
Farmland	0	0	45	45	70,398	70,443
Other	0	0	0	0	88,703	88,703
Commercial						
Commercial and industrial	292	3	249	544	192,335	192,879
Agricultural	74	0	2	76	32,605	32,681
Residential real estate						
1-4 family residential	2,044	403	3,046	5,493	266,338	271,831
Home equity lines of credit	155	18	610	783	70,754	71,537
Consumer						
Indirect	2,429	829	818	4,076	156,772	160,848
Direct	632	250	216	1,098	27,608	28,706
Other	115	11	14	140	8,736	8,876
Total originated loans:	$5,745	$1,854	$ 5,501	$13,100	$1,251,918	$1,265,018
Acquired loans:						
Commercial real estate						
Owner occupied	0	0	0	0	53,051	53,051
Non-owner occupied	0	0	216	216	20,042	20,258
Farmland	454	0	0	454	47,301	47,755
Other	0	0	0	0	11,976	11,976
Commercial						
Commercial and industrial	327	96	962	1,385	25,709	27,094
Agricultural	87	0	9	96	12,111	12,207
Residential real estate						
1-4 family residential	858	77	682	1,617	95,144	96,761
Home equity lines of credit	161	0	170	331	28,424	28,755
Consumer						
Direct	380	151	155	686	13,692	14,378
Other	0	1	0	1	127	128
Total acquired loans	$2,267	$325	$ 2,194	$4,786	$307,577	$312,363
Total loans	$8,012	$2,179	$ 7,695	$17,886	$1,559,495	$1,577,381

Troubled Debt Restructurings:

Total troubled debt restructurings were $5.5 million and $5.0 million at December 31, 2018 and 2017 respectively. The Company has allocated $72 thousand and $68 thousand of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2018 and 2017, respectively. There were no commitments to lend additional amounts to borrowers with loans that were classified as troubled debt restructurings at December 31, 2018 and 2017.

During the years ending December 31, 2018, 2017 and 2016, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; a permanent increase of the recorded investment in the loan due to a protective advance to pay delinquent real estate taxes or advance new monies; an extension of an interest only period; a deferral of principal payments; a capitalization of interest or a legal concession.

Troubled debt restructuring modifications involved a reduction of the notes stated interest rate in the range of 0.49% to 3.49%. There were also extensions of the maturity dates on these and other troubled debt restructurings in the range of five months to 132 months.

The following tables present loans by class modified as troubled debt restructurings that occurred during the years ending December 31, 2018, 2017 and 2016:

December 31, 2018 Troubled Debt Restructurings:	Number of Loans	Pre- Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment
Originated loans:			
Commercial real estate			
Owner occupied	1	$ 360	$ 360
Commercial			
Commercial and industrial	1	19	19
Residential real estate			
1-4 family residential	7	348	348
Home equity lines of credit	6	91	91
Indirect	23	118	118
Consumer	2	19	19
Total originated loans	40	$ 955	$ 955
Acquired loans:			
Commercial real estate			
Non-owner occupied	1	42	42
Farmland	1	258	258
Commercial			
Commercial and industrial	7	115	115
Residential real estate			
1-4 family residential	7	321	337
Home equity lines of credit	1	32	32
Consumer	2	24	24
Total acquired loans	19	$ 792	$ 808
Total loans	59	$ 1,747	$ 1,763

The troubled debt restructurings described above did not increase the allowance for loan losses or result in any charge offs during the year ended December 31, 2018.

December 31, 2017 Troubled Debt Restructurings:	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Originated loans:			
Residential real estate			
1-4 family residential	15	$ 910	$ 917
Home equity lines of credit	10	234	234
Indirect	29	161	161
Total originated loans	54	$ 1,305	$ 1,312
Acquired loans:			
Commercial			
Commercial and industrial	1	13	13
Residential real estate			
1-4 family residential	3	85	85
Home equity lines of credit	1	57	57
Consumer	2	55	55
Total acquired loans	7	$ 210	$ 210
Total loans	61	$ 1,515	$ 1,522

The troubled debt restructurings described above increased the allowance for loan losses by $75 thousand and resulted in charge offs of $75 thousand during the year ended December 31, 2017.

December 31, 2016 Troubled Debt Restructurings:	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Originated loans:			
Residential real estate			
1-4 family residential	15	$ 436	$ 437
Home equity lines of credit	1	40	40
Indirect	26	182	182
Consumer	2	12	12
Total originated loans	44	$ 670	$ 671
Acquired loans:			

Residential real estate			
1-4 family residential	4	153	153
Home equity lines of credit	1	18	18
Consumer	2	40	40
Total acquired loans	7	$ 211	$ 211
Total loans	51	$ 881	$ 882