

NBT BANCORP INC  
Form 10-Q  
August 09, 2018

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549  
FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 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 0-14703

NBT BANCORP INC.

(Exact Name of Registrant as Specified in its Charter)

DELAWARE 16-1268674  
(State of Incorporation) (I.R.S. Employer Identification No.)

52 SOUTH BROAD STREET, NORWICH, NEW YORK 13815  
(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Code: (607) 337-2265

None

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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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 July 31, 2018, there were 43,653,799 shares outstanding of the Registrant's common stock, \$0.01 par value per share.

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NBT BANCORP INC.

FORM 10-Q - Quarter Ended June 30, 2018

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## Item 1 – FINANCIAL STATEMENTS

NBT Bancorp Inc. and Subsidiaries  
Consolidated Balance Sheets (unaudited)

|  | June 30,<br>2018 | December 31,<br>2017 |
|--|------------------|----------------------|
| (In thousands, except share and per share data)  |                  |                      |
| Assets   |                  |                      |
| Cash and due from banks  | \$149,723        | \$ 156,852           |
| Short-term interest bearing accounts   | 2,760            | 2,812                |
| Equity securities, at fair value   | 24,293           | -                    |
| Securities available for sale, at fair value   | 1,192,939        | 1,255,925            |
| Securities held to maturity (fair value \$532,979 and \$481,871, respectively)   | 544,163          | 484,073              |
| Trading securities   | -                | 11,467               |
| Federal Reserve and Federal Home Loan Bank stock   | 54,223           | 46,706               |
| Loans  | 6,859,063        | 6,584,773            |
| Less allowance for loan losses   | 72,450           | 69,500               |
| Net loans  | \$6,786,613      | \$ 6,515,273         |
| Premises and equipment, net  | 78,578           | 81,305               |
| Goodwill   | 274,769          | 268,043              |
| Intangible assets, net   | 17,630           | 13,420               |
| Bank owned life insurance  | 174,952          | 172,388              |
| Other assets   | 166,495          | 128,548              |
| Total assets   | \$9,467,138      | \$ 9,136,812         |
| Liabilities  |                  |                      |
| Demand (noninterest bearing)   | \$2,343,948      | \$ 2,286,892         |
| Savings, NOW and money market  | 4,136,449        | 4,076,978            |
| Time   | 864,052          | 806,766              |
| Total deposits   | \$7,344,449      | \$ 7,170,636         |
| Short-term borrowings  | 853,997          | 719,123              |
| Long-term debt   | 73,778           | 88,869               |
| Junior subordinated debt   | 101,196          | 101,196              |
| Other liabilities  | 114,789          | 98,811               |
| Total liabilities  | \$8,488,209      | \$ 8,178,635         |
| Stockholders' equity   |                  |                      |
| Preferred stock, \$0.01 par value. Authorized 2,500,000 shares at June 30, 2018 and December 31, 2017  | \$-              | \$ -                 |
| Common stock, \$0.01 par value. Authorized 100,000,000 shares at June 30, 2018 and December 31, 2017; issued 49,651,493 at June 30, 2018 and December 31, 2017 | 497              | 497                  |
| Additional paid-in-capital   | 574,741          | 574,209              |
| Retained earnings  | 585,044          | 543,713              |
| Accumulated other comprehensive loss   | (44,756 )        | (22,077 )            |
| Common stock in treasury, at cost, 6,004,294 and 6,108,684 shares at June 30, 2018 and December 31, 2017, respectively   | (136,597 )       | (138,165 )           |
| Total stockholders' equity   | \$978,929        | \$ 958,177           |
| Total liabilities and stockholders' equity   | \$9,467,138      | \$ 9,136,812         |

See accompanying notes to unaudited interim consolidated financial statements.



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## NBT Bancorp Inc. and Subsidiaries

## Consolidated Statements of Income (unaudited)

|   | Three months ended June 30, |           | Six months ended June 30, |            |
|---|-----------------------------|-----------|---------------------------|------------|
|   | 2018                        | 2017      | 2018                      | 2017       |
| (In thousands, except per share data)               |                             |           |                           |            |
| Interest, fee and dividend income                   |                             |           |                           |            |
| Interest and fees on loans                          | \$ 74,172                   | \$ 65,286 | \$ 144,615                | \$ 129,313 |
| Securities available for sale                       | 7,003                       | 7,218     | 13,929                    | 14,227     |
| Securities held to maturity                         | 2,811                       | 2,736     | 5,436                     | 5,517      |
| Other   | 781                         | 654       | 1,547                     | 1,273      |
| Total interest, fee and dividend income             | \$ 84,767                   | \$ 75,894 | \$ 165,527                | \$ 150,330 |
| Interest expense                                    |                             |           |                           |            |
| Deposits  | \$ 5,079                    | \$ 3,536  | \$ 9,010                  | \$ 7,010   |
| Short-term borrowings                               | 2,455                       | 1,366     | 4,421                     | 2,505      |
| Long-term debt                                      | 452                         | 599       | 928                       | 1,205      |
| Junior subordinated debt                            | 1,040                       | 772       | 1,941                     | 1,498      |
| Total interest expense                              | \$ 9,026                    | \$ 6,273  | \$ 16,300                 | \$ 12,218  |
| Net interest income                                 | \$ 75,741                   | \$ 69,621 | \$ 149,227                | \$ 138,112 |
| Provision for loan losses                           | 8,778                       | 7,567     | 16,274                    | 14,946     |
| Net interest income after provision for loan losses | \$ 66,963                   | \$ 62,054 | \$ 132,953                | \$ 123,166 |
| Noninterest income                                  |                             |           |                           |            |
| Insurance and other financial services revenue      | \$ 5,826                    | \$ 5,621  | \$ 12,330                 | \$ 12,391  |
| Service charges on deposit accounts                 | 4,246                       | 4,161     | 8,218                     | 8,138      |
| ATM and debit card fees                             | 5,816                       | 5,518     | 11,089                    | 10,468     |
| Retirement plan administration fees                 | 7,296                       | 5,437     | 12,635                    | 9,609      |
| Trust   | 5,265                       | 5,161     | 10,143                    | 9,693      |
| Bank owned life insurance                           | 1,217                       | 1,218     | 2,564                     | 2,629      |
| Net securities gains                                | 91                          | 2         | 163                       | 2          |
| Other   | 4,401                       | 3,186     | 8,293                     | 6,124      |
| Total noninterest income                            | \$ 34,158                   | \$ 30,304 | \$ 65,435                 | \$ 59,054  |
| Noninterest expense                                 |                             |           |                           |            |
| Salaries and employee benefits                      | \$ 37,726                   | \$ 33,503 | \$ 74,293                 | \$ 67,736  |
| Occupancy   | 5,535                       | 5,184     | 11,654                    | 11,354     |
| Data processing and communications                  | 4,508                       | 4,229     | 8,787                     | 8,427      |
| Professional fees and outside services              | 3,336                       | 3,609     | 6,828                     | 6,641      |
| Equipment   | 4,151                       | 3,793     | 8,189                     | 7,491      |
| Office supplies and postage                         | 1,504                       | 1,640     | 3,077                     | 3,248      |
| FDIC expenses                                       | 1,092                       | 1,136     | 2,293                     | 2,314      |
| Advertising   | 700                         | 656       | 1,037                     | 1,046      |
| Amortization of intangible assets                   | 1,096                       | 1,039     | 2,010                     | 2,006      |
| Loan collection and other real estate owned, net    | 908                         | 664       | 2,245                     | 1,943      |
| Other   | 4,332                       | 4,868     | 8,747                     | 9,397      |
| Total noninterest expense                           | \$ 64,888                   | \$ 60,321 | \$ 129,160                | \$ 121,603 |
| Income before income tax expense                    | \$ 36,233                   | \$ 32,037 | \$ 69,228                 | \$ 60,617  |
| Income tax expense                                  | 8,112                       | 10,678    | 15,121                    | 18,979     |
| Net income  | \$ 28,121                   | \$ 21,359 | \$ 54,107                 | \$ 41,638  |
| Earnings per share                                  |                             |           |                           |            |
| Basic   | \$ 0.64                     | \$ 0.49   | \$ 1.24                   | \$ 0.96    |
| Diluted   | \$ 0.64                     | \$ 0.49   | \$ 1.23                   | \$ 0.95    |

See accompanying notes to unaudited interim consolidated financial statements.

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## NBT Bancorp Inc. and Subsidiaries

## Consolidated Statements of Comprehensive Income (unaudited)

|   | Three months ended June 30, |            | Six months ended June 30, |            |   |
|---|-----------------------------|------------|---------------------------|------------|---|
|   | 2018                        | 2017       | 2018                      | 2017       |   |
| (In thousands)  |                             |            |                           |            |   |
| Net income  | \$ 28,121                   | \$ 21,359  | \$ 54,107                 | \$ 41,638  |   |
| Other comprehensive (loss) income, net of tax:  |                             |            |                           |            |   |
| Securities available for sale:  |                             |            |                           |            |   |
| Unrealized net holding (losses) gains arising during the period, gross  | \$ (5,353                   | ) \$ 2,528 | \$ (20,807                | ) \$ 3,364 |   |
| Tax effect  | 1,338                       | (966       | ) 5,202                   | (1,305     | ) |
| Unrealized net holding (losses) gains arising during the period, net  | \$ (4,015                   | ) \$ 1,562 | \$ (15,605                | ) \$ 2,059 |   |
| Reclassification adjustment for net (gains) in net income, gross  | \$ -                        | \$ (2      | ) \$ -                    | \$ (2      | ) |
| Tax effect  | -                           | 1          | -                         | 1          | ) |
| Reclassification adjustment for net (gains) in net income, net  | \$ -                        | \$ (1      | ) \$ -                    | \$ (1      | ) |
| Amortization of unrealized net gains for the reclassification of available for sale securities to held to maturity, gross | \$ 177                      | \$ 225     | \$ 365                    | \$ 463     |   |
| Tax effect  | (44                         | ) (86      | ) (91                     | ) (177     | ) |
| Amortization of unrealized net gains for the reclassification of available for sale securities to held to maturity, net   | \$ 133                      | \$ 139     | \$ 274                    | \$ 286     |   |
| Reclassification adjustment for an impairment write-down of equity security, gross  | \$ -                        | \$ -       | \$ -                      | \$ 1,312   |   |
| Tax effect  | -                           | -          | -                         | (501       | ) |
| Reclassification adjustment for an impairment write-down of equity security, net  | \$ -                        | \$ -       | \$ -                      | \$ 811     |   |
| Total securities available for sale, net  | \$ (3,882                   | ) \$ 1,700 | \$ (15,331                | ) \$ 3,155 |   |
| Cash flow hedges:   |                             |            |                           |            |   |
| Unrealized gains (losses) on derivatives (cash flow hedges), gross  | \$ 424                      | \$ (411    | ) \$ 1,472                | \$ (162    | ) |
| Tax effect  | (106                        | ) 157      | (368                      | ) 62       | ) |
| Unrealized gains (losses) on derivatives (cash flow hedges), net  | \$ 318                      | \$ (254    | ) \$ 1,104                | \$ (100    | ) |
| Reclassification of net unrealized (gains) losses on cash flow hedges to interest (income) expense, gross                 | \$ (540                     | ) \$ (23   | ) \$ (899                 | ) \$ 59    |   |
| Tax effect  | 135                         | 9          | 225                       | (23        | ) |
| Reclassification of net unrealized (gains) losses on cash flow hedges to interest (income) expense, net                   | \$ (405                     | ) \$ (14   | ) \$ (674                 | ) \$ 36    |   |
| Total cash flow hedges, net   | \$ (87                      | ) \$ (268  | ) \$ 430                  | \$ (64     | ) |



Pension and other benefits:

|   |           |   |           |            |           |          |      |   |
|---|-----------|---|-----------|------------|-----------|----------|------|---|
| Pension and other benefits:                                   |           |   |           |            |           |          |      |   |
| Amortization of prior service cost and actuarial gains, gross | \$ 295    |   | \$ 435    | \$ 590     | \$ 870    |          |      |   |
| Tax effect  | (74       | ) | (166      | )          | (148      | )        | (332 | ) |
| Amortization of prior service cost and actuarial gains, net   | \$ 221    |   | \$ 269    | \$ 442     | \$ 538    |          |      |   |
|   |           |   |           |            |           |          |      |   |
| Total pension and other benefits, net                         | \$ 221    |   | \$ 269    | \$ 442     | \$ 538    |          |      |   |
|   |           |   |           |            |           |          |      |   |
| Total other comprehensive (loss) income                       | \$ (3,748 | ) | \$ 1,701  | \$ (14,459 | )         | \$ 3,629 |      |   |
| Comprehensive income  | \$ 24,373 |   | \$ 23,060 | \$ 39,648  | \$ 45,267 |          |      |   |

See accompanying notes to unaudited interim consolidated financial statements.

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NBT Bancorp Inc. and Subsidiaries

Consolidated Statements of Stockholders' Equity (unaudited)

|  | Common<br>Stock | Additional<br>Paid-in-<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>(Loss) Income | Common<br>Stock in<br>Treasury | Total     |
|--|-----------------|-----------------------------------|----------------------|--|--------------------------------|-----------|
| (In thousands, except share and per share data)                  |                 |                                   |                      |  |                                |           |
| Balance at December 31, 2016                                     | \$ 497          | \$575,078                         | \$501,761            | \$ (21,520 )   | \$(142,500)                    | \$913,316 |
| Net income   | -               | -                                 | 41,638               | -  | -                              | 41,638    |
| Cash dividends - \$0.46 per share                                | -               | -                                 | (20,044 )            | -  | -                              | (20,044 ) |
| Net issuance of 252,312 shares to employee and other stock plans | -               | (4,702 )                          | -                    | -  | 3,886                          | (816 )    |
| Stock-based compensation   | -               | 2,733                             | (95 )                | -  | -                              | 2,638     |
| Other comprehensive income                                       | -               | -                                 | -                    | 3,629  | -                              | 3,629     |
| Balance at June 30, 2017   | \$ 497          | \$573,109                         | \$523,260            | \$ (17,891 )   | \$(138,614)                    | \$940,361 |
| Balance at December 31, 2017                                     | \$ 497          | \$574,209                         | \$543,713            | \$ (22,077 )   | \$(138,165)                    | \$958,177 |
| Net income   | -               | -                                 | 54,107               | -  | -                              | 54,107    |
| Cumulative effect adjustment for ASU 2016-01 implementation      | -               | -                                 | 2,618                | (2,645 )   | -                              | (27 )     |
| Cumulative effect adjustment for ASU 2018-02 implementation      | -               | -                                 | 5,575                | (5,575 )   | -                              | -         |
| Cash dividends - \$0.48 per share                                | -               | -                                 | (20,969 )            | -  | -                              | (20,969 ) |
| Net issuance of 104,390 shares to employee and other stock plans | -               | (2,422 )                          | -                    | -  | 1,568                          | (854 )    |
| Stock-based compensation   | -               | 2,954                             | -                    | -  | -                              | 2,954     |
| Other comprehensive (loss)                                       | -               | -                                 | -                    | (14,459 )  | -                              | (14,459 ) |
| Balance at June 30, 2018   | \$ 497          | \$574,741                         | \$585,044            | \$ (44,756 )   | \$(136,597)                    | \$978,929 |

See accompanying notes to unaudited interim consolidated financial statements.

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## NBT Bancorp Inc. and Subsidiaries

## Consolidated Statements of Cash Flows (unaudited)

|  | Six months ended June 30, |               |
|--|---------------------------|---------------|
|  | 2018                      | 2017          |
| (In thousands)   |                           |               |
| Operating activities   |                           |               |
| Net income   | \$ 54,107                 | \$ 41,638     |
| Adjustments to reconcile net income to net cash provided by operating activities |                           |               |
| Provision for loan losses  | 16,274                    | 14,946        |
| Depreciation and amortization of premises and equipment                          | 4,644                     | 4,488         |
| Net amortization on securities   | 2,133                     | 2,430         |
| Amortization of intangible assets  | 2,010                     | 2,006         |
| Excess tax (benefit) on stock-based compensation                                 | (447 )                    | (1,526 )      |
| Stock-based compensation expense   | 2,954                     | 2,638         |
| Bank owned life insurance income   | (2,564 )                  | (2,629 )      |
| Trading security purchases   | -                         | (1,293 )      |
| Net unrealized losses on trading securities                                      | -                         | 145           |
| Proceeds from sales of loans held for sale                                       | 49,572                    | 60,650        |
| Originations and purchases of loans held for sale                                | (49,243 )                 | (62,163 )     |
| Net gains on sales of loans held for sale  | (87 )                     | (223 )        |
| Net security (gains)   | (163 )                    | (2 )          |
| Net (gain) on sales and write-down of other real estate owned                    | (190 )                    | (704 )        |
| Impairment write-down of equity security   | -                         | 1,312         |
| Net (increase) in other assets   | (32,687 )                 | (209 )        |
| Net increase in other liabilities  | 10,862                    | 4,405         |
| Net cash provided by operating activities  | \$ 57,175                 | \$ 65,909     |
| Investing activities   |                           |               |
| Net cash used in acquisitions  | \$ (7,884 )               | \$ (4,000 )   |
| Securities available for sale:   |                           |               |
| Proceeds from maturities, calls and principal paydowns                           | 124,873                   | 136,898       |
| Purchases  | (98,502 )                 | (162,723 )    |
| Securities held to maturity:   |                           |               |
| Proceeds from maturities, calls and principal paydowns                           | 45,332                    | 52,883        |
| Proceeds from sales  | -                         | 764           |
| Purchases  | (105,531 )                | (41,334 )     |
| Equity securities:   |                           |               |
| Proceeds from sales  | 2,623                     | -             |
| Other:   |                           |               |
| Net increase in loans  | (288,768 )                | (186,546 )    |
| Proceeds from Federal Home Loan Bank stock redemption                            | 123,642                   | 112,841       |
| Purchases of Federal Reserve and Federal Home Loan Bank stock                    | (131,159 )                | (118,848 )    |
| Purchases of premises and equipment, net   | (2,037 )                  | (2,604 )      |
| Proceeds from the sales of other real estate owned                               | 1,282                     | 6,420         |
| Net cash (used in) investing activities  | \$ (336,129 )             | \$ (206,249 ) |
| Financing activities   |                           |               |
| Net increase in deposits   | \$ 173,813                | \$ 41,596     |
| Net increase in short-term borrowings  | 134,874                   | 149,482       |
| Proceeds from issuance of long-term debt   | 25,000                    | -             |
| Repayments of long-term debt   | (40,091 )                 | (15,129 )     |

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|  |             |            |
|--|-------------|------------|
| Proceeds from the issuance of shares to employee and other stock plans | 881         | 2,007      |
| Cash paid by employer for tax-withholdings on stock issuance           | (1,735 )    | (2,823 )   |
| Cash dividends   | (20,969 )   | (20,044 )  |
| Net cash provided by financing activities                              | \$ 271,773  | \$ 155,089 |
| Net (decrease) increase in cash and cash equivalents                   | \$ (7,181 ) | \$ 14,749  |
| Cash and cash equivalents at beginning of period                       | 159,664     | 149,181    |
| Cash and cash equivalents at end of period                             | \$ 152,483  | \$ 163,930 |

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|  | Six months ended June 30, |           |
|--|---------------------------|-----------|
|  | 2018                      | 2017      |
| Supplemental disclosure of cash flow information |                           |           |
| Cash paid during the period for:                 |                           |           |
| Interest expense                                 | \$ 15,672                 | \$ 12,404 |
| Income taxes paid, net of refund                 | 22,890                    | 12,886    |
| Noncash investing activities:                    |                           |           |
| Loans transferred to other real estate owned     | \$ 912                    | \$ 4,882  |
| Acquisitions:                                    |                           |           |
| Fair value of assets acquired                    | \$ 6,274                  | \$ 3,096  |

See accompanying notes to unaudited interim consolidated financial statements.

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NBT Bancorp Inc. and Subsidiaries

Notes to Unaudited Interim Consolidated Financial Statements

June 30, 2018

1. Description of Business

NBT Bancorp Inc. (the “Registrant” or the “Company”) is a registered financial holding company incorporated in the state of Delaware in 1986, with its principal headquarters located in Norwich, New York. The principal assets of the Registrant consist of all of the outstanding shares of common stock of its subsidiaries, including: NBT Bank, National Association (the “Bank”), NBT Financial Services, Inc. (“NBT Financial”), NBT Holdings, Inc. (“NBT Holdings”), Hathaway Agency, Inc. and CNBF Capital Trust I, NBT Statutory Trust I, NBT Statutory Trust II, Alliance Financial Capital Trust I and Alliance Financial Capital Trust II (collectively, the “Trusts”). The Company’s principal sources of revenue are the management fees and dividends it receives from the Bank, NBT Financial and NBT Holdings.

The Company’s business, primarily conducted through the Bank but also through its other subsidiaries, consists of providing commercial banking, retail banking and wealth management services primarily to customers in its market area, which includes central and upstate New York, northeastern Pennsylvania, southern New Hampshire, western Massachusetts, Vermont and the southern coastal area of Maine. The Company has been, and intends to continue to be, a community-oriented financial institution offering a variety of financial services. The Company’s business philosophy is to operate as a community bank with local decision-making providing a broad array of banking and financial services to retail, commercial and municipal customers.

2. Basis of Presentation

The accompanying unaudited interim consolidated financial statements include the accounts of the Registrant and its wholly owned subsidiaries, the Bank, NBT Financial and NBT Holdings. Collectively, the Registrant and its subsidiaries are referred to herein as “the Company.” The interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods in accordance with generally accepted accounting principles in the United States of America (“GAAP”). These unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our 2017 Annual Report on Form 10-K. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year or any other interim period. All intercompany transactions have been eliminated in consolidation. Amounts in the prior period financial statements are reclassified whenever necessary to conform to current period presentation. The Company has evaluated subsequent events for potential recognition and/or disclosure and there were none identified.

3. Securities

The amortized cost, estimated fair value and unrealized gains (losses) of available for sale (“AFS”) securities are as follows:

| (In thousands)                       | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Estimated<br>Fair Value |
|--------------------------------------|-------------------|---------------------|----------------------|-------------------------|
| June 30, 2018                        |                   |                     |                      |                         |
| Federal agency                       | \$ 119,964        | \$ -                | \$ 1,394             | \$ 118,570              |
| State & municipal                    | 36,676            | 28                  | 302                  | 36,402                  |
| Mortgage-backed:                     |                   |                     |                      |                         |
| Government-sponsored enterprises     | 503,303           | 307                 | 13,579               | 490,031                 |
| U.S. government agency securities    | 30,232            | 225                 | 843                  | 29,614                  |
| Collateralized mortgage obligations: |                   |                     |                      |                         |

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|                                      |             |          |           |             |
|--------------------------------------|-------------|----------|-----------|-------------|
| Government-sponsored enterprises     | 486,029     | 234      | 17,702    | 468,561     |
| U.S. government agency securities    | 51,309      | 132      | 1,680     | 49,761      |
| Total AFS securities                 | \$1,227,513 | \$ 926   | \$ 35,500 | \$1,192,939 |
| December 31, 2017                    |             |          |           |             |
| Federal agency                       | \$109,862   | \$ -     | \$ 963    | \$108,899   |
| State & municipal                    | 42,171      | 62       | 277       | 41,956      |
| Mortgage-backed:                     |             |          |           |             |
| Government-sponsored enterprises     | 530,392     | 1,406    | 3,345     | 528,453     |
| U.S. government agency securities    | 26,363      | 334      | 223       | 26,474      |
| Collateralized mortgage obligations: |             |          |           |             |
| Government-sponsored enterprises     | 496,033     | 254      | 10,114    | 486,173     |
| U.S. government agency securities    | 50,721      | 165      | 1,065     | 49,821      |
| Equity securities                    | 10,623      | 3,672    | 146       | 14,149      |
| Total AFS securities                 | \$1,266,165 | \$ 5,893 | \$ 16,133 | \$1,255,925 |

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The amortized cost, estimated fair value and unrealized gains (losses) of held to maturity ("HTM") securities are as follows:

| (In thousands)                       | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Estimated<br>Fair Value |
|--------------------------------------|-------------------|---------------------|----------------------|-------------------------|
| June 30, 2018                        |                   |                     |                      |                         |
| Mortgage-backed:                     |                   |                     |                      |                         |
| Government-sponsored enterprises     | \$ 90,696         | \$ -                | \$ 3,244             | \$ 87,452               |
| U.S. government agency securities    | 376               | 43                  | -                    | 419                     |
| Collateralized mortgage obligations: |                   |                     |                      |                         |
| Government-sponsored enterprises     | 229,353           | 92                  | 5,989                | 223,456                 |
| U.S. government agency securities    | 9,788             | 1                   | -                    | 9,789                   |
| State & municipal                    | 213,950           | 265                 | 2,352                | 211,863                 |
| Total HTM securities                 | \$ 544,163        | \$ 401              | \$ 11,585            | \$ 532,979              |
| December 31, 2017                    |                   |                     |                      |                         |
| Mortgage-backed:                     |                   |                     |                      |                         |
| Government-sponsored enterprises     | \$ 96,357         | \$ 85               | \$ 810               | \$ 95,632               |
| U.S. government agency securities    | 418               | 57                  | -                    | 475                     |
| Collateralized mortgage obligations: |                   |                     |                      |                         |
| Government-sponsored enterprises     | 186,327           | 224                 | 2,577                | 183,974                 |
| State & municipal                    | 200,971           | 1,439               | 620                  | 201,790                 |
| Total HTM securities                 | \$ 484,073        | \$ 1,805            | \$ 4,007             | \$ 481,871              |

AFS and HTM securities with amortized costs totaling \$1.6 billion at June 30, 2018 and \$1.5 billion at December 31, 2017 were pledged to secure public deposits and for other purposes required or permitted by law. At June 30, 2018 and December 31, 2017, AFS and HTM securities with an amortized cost of \$226.2 million and \$256.2 million, respectively, were pledged as collateral for securities sold under repurchase agreements.

The following table sets forth information with regard to investment securities with unrealized losses segregated according to the length of time the securities had been in a continuous unrealized loss position:

| (In thousands)                          | Less than 12 months |                   |                     | 12 months or longer |                   |                     | Total       |                   |                     |
|---|---------------------|-------------------|---------------------|---------------------|-------------------|---------------------|-------------|-------------------|---------------------|
|   | Fair Value          | Unrealized Losses | Number of Positions | Fair Value          | Unrealized Losses | Number of Positions | Fair Value  | Unrealized Losses | Number of Positions |
| As of June 30, 2018                     |                     |                   |                     |                     |                   |                     |             |                   |                     |
| AFS securities:                         |                     |                   |                     |                     |                   |                     |             |                   |                     |
| Federal agency                          | \$39,457            | \$(526 )          | 4                   | \$79,113            | \$(868 )          | 6                   | \$118,570   | \$(1,394 )        | 10                  |
| State & municipal                       | 23,273              | (232 )            | 37                  | 5,479               | (70 )             | 8                   | 28,752      | (302 )            | 45                  |
| Mortgage-backed                         | 432,173             | (11,590 )         | 93                  | 60,657              | (2,832 )          | 26                  | 492,830     | (14,422 )         | 119                 |
| Collateralized mortgage obligations     | 233,086             | (6,076 )          | 40                  | 260,766             | (13,306 )         | 46                  | 493,852     | (19,382 )         | 86                  |
| Total securities with unrealized losses | \$727,989           | \$(18,424 )       | 174                 | \$406,015           | \$(17,076 )       | 86                  | \$1,134,004 | \$(35,500 )       | 260                 |
| HTM securities:                         |                     |                   |                     |                     |                   |                     |             |                   |                     |
| Mortgage-backed                         | \$56,920            | \$(1,686 )        | 4                   | \$30,532            | \$(1,558 )        | 2                   | \$87,452    | \$(3,244 )        | 6                   |
| Collateralized mortgage obligations     | 149,776             | (3,693 )          | 24                  | 33,586              | (2,296 )          | 6                   | 183,362     | (5,989 )          | 30                  |
| State & municipal                       | 73,496              | (1,310 )          | 110                 | 15,665              | (1,042 )          | 25                  | 89,161      | (2,352 )          | 135                 |



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|  |           |            |     |          |            |    |           |             |     |
|--|-----------|------------|-----|----------|------------|----|-----------|-------------|-----|
| Total securities with<br>unrealized losses | \$280,192 | \$(6,689 ) | 138 | \$79,783 | \$(4,896 ) | 33 | \$359,975 | \$(11,585 ) | 171 |
|--|-----------|------------|-----|----------|------------|----|-----------|-------------|-----|

As of December 31,  
2017

AFS securities:

|   |           |            |     |           |             |    |             |             |     |
|---|-----------|------------|-----|-----------|-------------|----|-------------|-------------|-----|
| Federal agency  | \$64,653  | \$(242 )   | 5   | \$44,246  | \$(721 )    | 4  | \$108,899   | \$(963 )    | 9   |
| State & municipal   | 23,566    | (200 )     | 39  | 5,994     | (77 )       | 8  | 29,560      | (277 )      | 47  |
| Mortgage-backed<br>Collateralized<br>mortgage obligations | 317,630   | (2,381 )   | 55  | 58,316    | (1,187 )    | 24 | 375,946     | (3,568 )    | 79  |
| Equity securities   | 227,917   | (2,658 )   | 35  | 275,303   | (8,521 )    | 42 | 503,220     | (11,179 )   | 77  |
| Total securities with<br>unrealized losses                | -         | -          | -   | 2,959     | (146 )      | 1  | 2,959       | (146 )      | 1   |
|   | \$633,766 | \$(5,481 ) | 134 | \$386,818 | \$(10,652 ) | 79 | \$1,020,584 | \$(16,133 ) | 213 |

HTM securities:

|   |           |            |    |          |            |    |           |            |    |
|---|-----------|------------|----|----------|------------|----|-----------|------------|----|
| Mortgage-backed<br>Collateralized<br>mortgage obligations | \$15,477  | \$(140 )   | 2  | \$33,703 | \$(670 )   | 2  | \$49,180  | \$(810 )   | 4  |
| State & municipal   | 118,476   | (1,064 )   | 17 | 37,614   | (1,513 )   | 6  | 156,090   | (2,577 )   | 23 |
| Total securities with<br>unrealized losses                | 22,387    | (132 )     | 40 | 15,720   | (488 )     | 24 | 38,107    | (620 )     | 64 |
|   | \$156,340 | \$(1,336 ) | 59 | \$87,037 | \$(2,671 ) | 32 | \$243,377 | \$(4,007 ) | 91 |

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Declines in the fair value of HTM securities below their amortized cost, less any current period credit loss, that are deemed to be other-than-temporary are reflected in earnings as realized losses or in other comprehensive income ("OCI"). This classification is dependent upon whether the Company intends to sell the security, or whether it is more likely than not that, the Company will be required to sell the security before recovery. The other-than-temporary impairment ("OTTI") shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the OTTI shall be separated into (i) the amount representing the credit loss and (ii) the amount related to all other factors. The amount of the total OTTI related to the credit loss shall be recognized in earnings. The amount of the total OTTI related to other factors shall be recognized in OCI, net of applicable taxes.

In estimating OTTI losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer and (iii) the historical and implied volatility of the fair value of the security.

Management has the intent to hold the securities classified as HTM until they mature, at which time it is believed the Company will receive full value for the securities. The unrealized losses on HTM debt securities are due to increases in market interest rates over yields at the time the underlying securities were purchased. When necessary, the Company has performed a discounted cash flow analysis to determine whether it will receive the contractual principal and interest on certain securities. The fair value is expected to recover as the bond approaches its maturity date or repricing date or if market yields for such investments declines.

Management also has the intent to hold and will not be required to sell, the debt securities classified as AFS for a period sufficient for a recovery of cost, which may be until maturity. The unrealized losses on AFS debt securities are due to increases in market interest rates over the yields available at the time the underlying securities were purchased. When necessary, the Company has performed a discounted cash flow analysis to determine whether it will receive the contractual principal and interest on certain securities. For AFS debt securities, OTTI losses are recognized in earnings if the Company intends to sell the security. In other cases the Company considers the relevant factors noted above, as well as the Company's intent and ability to retain its investment for a period of time sufficient to allow for any anticipated recovery in market value and whether evidence exists to support a realizable value equal to or greater than the cost basis. Any impairment loss on an equity security is equal to the full difference between the cost basis and the fair value of the security.

As of June 30, 2018 and December 31, 2017, management believes the impairments detailed in the table above are temporary. There were no OTTI losses realized in the Company's unaudited interim consolidated statements of income for the three and six months ended June 30, 2018 or in the three months ended June 30, 2017. For the six months ended June 30, 2017, a \$1.3 million impairment loss on an equity investment was realized in the Company's unaudited interim consolidated statements of income.

The following tables set forth information with regard to gains and losses on equity securities at:

| (In thousands)                                       | Three months ended<br>June 30, 2018 | Six months ended<br>June 30, 2018 |
|--|-------------------------------------|-----------------------------------|
| Net gains and losses recognized on equity securities | \$ 91                               | \$ 163                            |
| Less: Net gains and losses recognized during         | -                                   | 44                                |

the period on  
equity securities  
sold during the  
period  
Unrealized gains  
and losses  
recognized on  
equity securities  
still held

|    |    |    |     |
|----|----|----|-----|
| \$ | 91 | \$ | 119 |
|----|----|----|-----|

As of June 30, 2018, the carrying value of equity securities without readily determinable fair values was \$4.2 million. The Company performed a qualitative assessment to determine whether the investments were impaired and identified no areas of concern as of June 30, 2018. There were no impairments, downward or upward adjustments recognized for equity securities without readily determinable fair values during the three and six months ended June 30, 2018.

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The following tables set forth information with regard to contractual maturities of debt securities at June 30, 2018:

| (In thousands)            | Amortized<br>Cost | Estimated<br>Fair Value |
|---------------------------|-------------------|-------------------------|
| AFS debt securities:      |                   |                         |
| Within one year           | \$79,927          | \$79,698                |
| From one to five years    | 78,012            | 76,566                  |
| From five to ten years    | 186,454           | 182,532                 |
| After ten years           | 883,120           | 854,143                 |
| Total AFS debt securities | \$1,227,513       | \$1,192,939             |
| HTM debt securities:      |                   |                         |
| Within one year           | \$51,786          | \$51,786                |
| From one to five years    | 50,159            | 50,281                  |
| From five to ten years    | 201,007           | 196,191                 |
| After ten years           | 241,211           | 234,721                 |
| Total HTM debt securities | \$544,163         | \$532,979               |

Maturities of mortgage-backed, collateralized mortgage obligations and asset-backed securities are stated based on their estimated average lives. Actual maturities may differ from estimated average lives or contractual maturities because, in certain cases, borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

Except for U.S. Government securities, there were no holdings, when taken in the aggregate, of any single issuer that exceeded 10% of consolidated stockholders' equity at June 30, 2018 and December 31, 2017.

#### 4. Allowance for Loan Losses and Credit Quality of Loans

##### Allowance for Loan Losses

The allowance for loan losses is maintained at a level estimated by management to provide adequately for probable incurred losses inherent in the current loan portfolio. The appropriateness of the allowance for loan losses is continuously monitored. It is assessed for appropriateness using a methodology designed to ensure the level of the allowance reasonably reflects the loan portfolio's risk profile. It is evaluated to ensure that it is sufficient to absorb all reasonably estimable credit losses inherent in the current loan portfolio.

To develop and document a systematic methodology for determining the allowance for loan losses, the Company has divided the loan portfolio into three segments, each with different risk characteristics and methodologies for assessing risk. Those segments are further segregated between our loans accounted for under the amortized cost method (referred to as "originated" loans) and loans acquired in a business combination (referred to as "acquired" loans). Each portfolio segment is broken down into class segments where appropriate. Class segments contain unique measurement attributes, risk characteristics and methods for monitoring and assessing risk that are necessary to develop the allowance for loan losses. Unique characteristics such as borrower type, loan type, collateral type and risk characteristics define each class segment.

During the first quarter of 2018, the Company adjusted the class segments within the portfolios to better align risk characteristics and reflect the monitoring and assessment of risks as the portfolios continue to evolve. Agricultural Non-Real Estate and Agricultural Real Estate were consolidated with Commercial and Commercial Real Estate, respectively. Agricultural loans are a type of commercial loan with some specific underwriting guidelines; however, as of March 31, 2018, the portfolio had decreased to less than 3% of the Commercial portfolio and separation was no longer warranted. The Indirect class segment was further separated into Dealer Finance and Specialty Lending class

segments. The growth in our Specialty Lending portfolio to 21% of Consumer Loans as of March 31, 2018 warranted evaluation of this class separately due to different risk characteristics from the Dealer Finance class segment. The Direct and Home Equity class segments were consolidated into Direct to reflect common management, similar underwriting and in-market focus. The change to the class segments in the allowance methodology did not have a significant impact on the allowance for loan losses. The following table illustrates the portfolio and class segments for the loan portfolio in 2018 compared to 2017:

| Portfolio               | Class - 2018                                  | Class - 2017             |
|-------------------------|---|--------------------------|
| Commercial Loans        | Commercial and Industrial                     | Commercial               |
|                         | Commercial Real Estate                        | Commercial Real Estate   |
|                         | Business Banking                              | Agricultural             |
|                         |   | Agricultural Real Estate |
| Consumer Loans          | Dealer Finance<br>Specialty Lending<br>Direct | Business Banking         |
|                         |   | Indirect                 |
|                         |   | Home Equity              |
|                         |   | Direct                   |
| Residential Real Estate |   |                          |

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### Commercial Loans

The Company offers a variety of commercial loan products including commercial (non-real estate), commercial real estate, agricultural, agricultural real estate and business banking loans. The Company's underwriting analysis for commercial loans typically includes credit verification, independent appraisals, a review of the borrower's financial condition and a detailed analysis of the borrower's underlying cash flows.

**Commercial and Industrial ("C&I")** – The Company offers a variety of loan options to meet the specific needs of our C&I customers including term loans, time notes and lines of credit. Such loans are made available to businesses for working capital needs such as inventory and receivables, business expansion, equipment purchases, livestock purchases and finance seasonal crop expenses. Generally, a collateral lien is placed on equipment or other assets owned by the borrower. These loans typically carry a higher risk than commercial real estate loans due to the nature of the underlying collateral, which can be business assets such as equipment, accounts receivable and perishable agricultural products, which are generally less liquid than real estate and exposed to industry price volatility. To reduce these risks, management also attempts to obtain personal guarantees of the borrowers or obtain government loan guarantees to provide further support. In 2018, the Commercial and Agricultural class segments were combined to create the C&I class segment.

**Commercial Real Estate ("CRE")** – The Company offers CRE loans to finance real estate purchases, refinancings, expansions and improvements to commercial and agricultural properties. CRE loans are made to finance the purchases and improvements of real property, which generally consists of real estate with completed structures. These CRE loans are secured by liens on the real estate, which may include both owner occupied and non-owner-occupied properties, such as apartments, commercial structures, health care facilities and other facilities. These loans are typically less risky than commercial loans, since they are secured by real estate. The Company's underwriting analysis includes credit verification, independent appraisals, a review of the borrower's financial condition and a detailed analysis of the borrower's underlying cash flows. These loans are typically originated in amounts of no more than 80% of the appraised value of the property and no more than 75% of the appraised value of the agricultural property. Government loan guarantees may be obtained to provide further support for agricultural property. In 2018, the Commercial Real Estate and Agricultural Real Estate class segments were combined to create the CRE segment.

**Business Banking** – The Company offers a variety of loan options to meet the specific needs of our Business Banking customers including term loans, Business Banking mortgages and lines of credit. Such loans are generally less than \$750 thousand and are made available to businesses for working capital such as inventory and receivables, business expansion, equipment purchases and agricultural needs. Generally, a collateral lien is placed on assets owned by the borrower and can include real estate, equipment, inventory, receivables or other business assets. These loans carry a higher risk than C&I and CRE loans due to the smaller size of the borrower and lower levels of capital. To reduce these risks, the Company obtains personal guarantees of the owners for a majority of the loans.

### Consumer Loans

The Company offers a variety of consumer loan products including Dealer Finance, Specialty Lending and Direct loans.

**Dealer Finance** – The Company maintains relationships with many dealers primarily in the communities that we serve. Through these relationships, the Company primarily finances the purchases of automobiles and recreational vehicles (such as campers, boats, etc.) indirectly through dealer relationships. Approximately 70% of the Dealer Finance relationships represent automobile financing. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from three to six years, based upon the nature of the collateral and the size of the loan. The majority of Dealer Finance consumer loans are underwritten on a secured basis using the underlying collateral being financed. In 2018, the Indirect class segment was further separated into Dealer Finance and Specialty

Lending class segments (see above and below).

Specialty Lending – The Company offers unsecured consumer loans across a national footprint originated through our relationships with national technology-driven consumer lending companies to finance such things as dental and medical procedures, K-12 tuition, solar energy installations and other consumer purpose loans. Advances of credit through this specialty lending business line are subject to the Company's underwriting standards including criteria such as FICO score and debt to income thresholds. In 2018, the Indirect class segment has been further separated into Dealer Finance (see above) and Specialty Lending class segments.

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Direct – The Company offers a variety of consumer installment loans to finance vehicle purchases, mobile home purchases and personal expenditures. In addition to installment loans, the Company also offers personal lines of credit, overdraft protection, home equity lines of credit and second mortgage loans (loans secured by a lien position on one-to-four family residential real estate) to finance home improvements, debt consolidation, education and other uses. Most of the consumer installment loans carry a fixed rate of interest with principal repayment terms typically ranging from one to ten years, based upon the nature of the collateral and the size of the loan. For home equity loans, consumers are able to borrow up to 85% of the equity in their homes. These loans carry a higher risk than first mortgage residential loans as they are in a second position with respect to collateral. Consumer installment loans are often secured with collateral consisting of a perfected lien on the asset being purchased or a perfected lien on a consumer's deposit account. A minimal amount of consumer installment loans are unsecured, which carry a higher risk of loss. Risk is reduced through underwriting criteria, which include credit verification, appraisals, a review of the borrower's financial condition and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate. In 2018, the Home Equity segment was consolidated into the Direct class segment.

## Residential Real Estate

Residential real estate loans consist primarily of loans secured by a first or second mortgage on primary residences. We originate adjustable-rate and fixed-rate, one-to-four-family residential real estate loans for the construction, purchase or refinancing of a mortgage. These loans are collateralized by owner-occupied properties located in the Company's market area. When market conditions are favorable, for longer term, fixed-rate residential real estate mortgages without escrow, the Company retains the servicing, but sells the right to receive principal and interest to Freddie Mac. This practice allows the Company to manage interest rate risk, liquidity risk and credit risk. Loans on one-to-four-family residential real estate are generally originated in amounts of no more than 85% of the purchase price or appraised value (whichever is lower) or have private mortgage insurance. Mortgage title insurance and hazard insurance are normally required. Construction loans have a unique risk, because they are secured by an incomplete dwelling. This risk is reduced through periodic site inspections, including one at each loan draw period.

## Allowance for Loan Loss Calculation

For purposes of evaluating the adequacy of the allowance, the Company considers a number of significant factors that affect the collectability of the portfolio. For individually impaired loans, these include estimates of impairment, if any, which reflect the facts and circumstances that affect the likelihood of repayment of such loans as of the evaluation date. For homogeneous pools of loans, estimates of the Company's exposure to credit loss reflect a current assessment of a number of factors, which could affect collectability. These factors include: past loss experience, size, trend, composition and nature of loans; changes in lending policies and procedures, including underwriting standards and collection, charge-offs and recoveries; trends experienced in nonperforming and delinquent loans; current economic conditions in the Company's market; portfolio concentrations that may affect loss experienced across one or more components of the portfolio; the effect of external factors such as competition, legal and regulatory requirements; and the experience, ability and depth of lending management and staff. In addition, various regulatory agencies, as an integral component of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to make loan grade changes as well as recognize additions to the allowance based on their examinations.

After a thorough consideration of the factors discussed above, any required additions or reductions to the allowance for loan losses are made periodically by charges or credits to the provision for loan losses. These charges are necessary to maintain the allowance at a level that management believes is reflective of overall level of incurred loss in the portfolio. While management uses available information to recognize losses on loans, additions and reductions of the allowance may fluctuate from one reporting period to another. These fluctuations are reflective of changes in risk associated with portfolio content or changes in management's assessment of any or all of the determining factors discussed above.



The following tables illustrate the changes in the allowance for loan losses by our portfolio segments:

| (In thousands)                     | Commercial<br>Loans | Consumer<br>Loans | Residential<br>Real Estate | Total    |
|------------------------------------|---------------------|-------------------|----------------------------|----------|
| Balance as of March 31, 2018       | \$ 28,190           | \$ 36,973         | \$ 5,037                   | \$70,200 |
| Charge-offs                        | (907 )              | (7,442 )          | (208 )                     | (8,557 ) |
| Recoveries                         | 183                 | 1,700             | 146                        | 2,029    |
| Provision                          | 3,593               | 5,248             | (63 )                      | 8,778    |
| Ending Balance as of June 30, 2018 | \$ 31,059           | \$ 36,479         | \$ 4,912                   | \$72,450 |
| Balance as of March 31, 2017       | \$ 24,727           | \$ 34,769         | \$ 6,204                   | \$65,700 |
| Charge-offs                        | (1,123 )            | (6,261 )          | (698 )                     | (8,082 ) |
| Recoveries                         | 206                 | 1,199             | 10                         | 1,415    |
| Provision                          | 618                 | 5,816             | 1,133                      | 7,567    |
| Ending Balance as of June 30, 2017 | \$ 24,428           | \$ 35,523         | \$ 6,649                   | \$66,600 |

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| (In thousands)                     | Commercial<br>Loans | Consumer<br>Loans | Residential<br>Real Estate | Total    |
|------------------------------------|---------------------|-------------------|----------------------------|----------|
| Balance as of December 31, 2017    | \$ 27,606           | \$ 36,830         | \$ 5,064                   | \$69,500 |
| Charge-offs                        | (1,712 )            | (15,129 )         | (390 )                     | (17,231) |
| Recoveries                         | 370                 | 3,344             | 193                        | 3,907    |
| Provision                          | 4,795               | 11,434            | 45                         | 16,274   |
| Ending Balance as of June 30, 2018 | \$ 31,059           | \$ 36,479         | \$ 4,912                   | \$72,450 |
| Balance as of December 31, 2016    | \$ 25,444           | \$ 33,375         | \$ 6,381                   | \$65,200 |
| Charge-offs                        | (2,417 )            | (12,763 )         | (1,296 )                   | (16,476) |
| Recoveries                         | 653                 | 2,234             | 43                         | 2,930    |
| Provision                          | 748                 | 12,677            | 1,521                      | 14,946   |
| Ending Balance as of June 30, 2017 | \$ 24,428           | \$ 35,523         | \$ 6,649                   | \$66,600 |

For acquired loans, to the extent that we experience deterioration in borrower credit quality resulting in a decrease in our expected cash flows subsequent to the acquisition of the loans, an allowance for loan losses is established based on our estimate of incurred losses at the balance sheet date. There was no allowance for loan losses for the acquired loan portfolio as of June 30, 2018 and December 31, 2017. Net charge-offs of acquired loans totaled approximately \$0.1 million and \$0.3 million during the three months ended June 30, 2018 and 2017, respectively and approximately \$0.2 million and \$0.7 million during the six months ended June 30, 2018 and 2017, respectively and are included in the table above.

The following tables illustrate the allowance for loan losses and the recorded investment by portfolio segments:

| (In thousands)   | Commercial<br>Loans | Consumer<br>Loans | Residential<br>Real Estate | Total       |
|--|---------------------|-------------------|----------------------------|-------------|
| As of June 30, 2018  |                     |                   |                            |             |
| Allowance for loan losses  | \$31,059            | \$36,479          | \$4,912                    | \$72,450    |
| Allowance for loans individually evaluated for impairment                | 25                  | -                 | -                          | 25          |
| Allowance for loans collectively evaluated for impairment                | \$31,034            | \$36,479          | \$4,912                    | \$72,425    |
| Ending balance of loans  | \$3,190,556         | \$2,317,746       | \$1,350,761                | \$6,859,063 |
| Ending balance of originated loans individually evaluated for impairment | 5,132               | 8,006             | 6,591                      | 19,729      |
| Ending balance of acquired loans collectively evaluated for impairment   | 162,216             | 36,865            | 158,908                    | 357,989     |
| Ending balance of originated loans collectively evaluated for impairment | \$3,023,208         | \$2,272,875       | \$1,185,262                | \$6,481,345 |
| As of December 31, 2017  |                     |                   |                            |             |
| Allowance for loan losses  | \$27,606            | \$36,830          | \$5,064                    | \$69,500    |
| Allowance for loans individually evaluated for impairment                | 57                  | -                 | -                          | 57          |
| Allowance for loans collectively evaluated for impairment                | \$27,549            | \$36,830          | \$5,064                    | \$69,443    |
| Ending balance of loans  | \$3,028,269         | \$2,234,809       | \$1,321,695                | \$6,584,773 |
| Ending balance of originated loans individually evaluated for impairment | 5,876               | 8,432             | 6,830                      | 21,138      |
| Ending balance of acquired loans collectively evaluated for impairment   | 187,313             | 43,906            | 170,472                    | 401,691     |
| Ending balance of originated loans collectively evaluated for impairment | \$2,835,080         | \$2,182,471       | \$1,144,393                | \$6,161,944 |

## Credit Quality of Loans

For all loan classes within the Company's loan portfolio, loans are placed on nonaccrual status when timely collection of principal and/or interest in accordance with contractual terms is in doubt. Loans are transferred to nonaccrual status generally when principal or interest payments become ninety days delinquent, unless the loan is well-secured and in the process of collection or sooner when management concludes circumstances indicate that borrowers may be unable to meet contractual principal or interest payments. When a loan is transferred to a nonaccrual status, all interest previously accrued in the current period but not collected is reversed against interest income in that period. Interest accrued in a prior period and not collected is charged-off against the allowance for loan losses.

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If ultimate repayment of a nonaccrual loan is expected, any payments received are applied in accordance with contractual terms. If ultimate repayment of principal is not expected, any payment received on a nonaccrual loan is applied to principal until ultimate repayment becomes expected. For all loan classes within the Company's loan portfolio, nonaccrual loans are returned to accrual status when they become current as to principal and interest and demonstrate a period of performance under the contractual terms and, in the opinion of management, are fully collectible as to principal and interest. For loans in all portfolios, the principal amount is charged off in full or in part as soon as management determines, based on available facts, that the collection of principal in full or in part is improbable. For commercial loans, management considers specific facts and circumstances relative to individual credits in making such a determination. For consumer and residential loan classes, management uses specific guidance and thresholds from the Federal Financial Institutions Examination Council's Uniform Retail Credit Classification and Account Management Policy.

The following tables set forth information with regard to past due and nonperforming loans by loan class:

|                         | 31-60 Days<br>Past Due<br>Accruing | 61-90 Days<br>Past Due<br>Accruing | Greater<br>Than 90<br>Days Past<br>Due<br>Accruing | Total Past<br>Due<br>Accruing | Nonaccrual | Current      | Recorded<br>Total Loans |
|-------------------------|------------------------------------|------------------------------------|--|-------------------------------|------------|--------------|-------------------------|
| (In thousands)          |                                    |                                    |  |                               |            |              |                         |
| As of June 30, 2018     |                                    |                                    |  |                               |            |              |                         |
| <u>Originated</u>       |                                    |                                    |  |                               |            |              |                         |
| Commercial Loans:       |                                    |                                    |  |                               |            |              |                         |
| C&I                     | \$ 1,395                           | \$ 394                             | \$ -   | \$ 1,789                      | \$ 1,041   | \$ 833,557   | \$ 836,387              |
| CRE                     | 1,846                              | -                                  | -  | 1,846                         | 4,085      | 1,704,773    | 1,710,704               |
| Business Banking        | 1,089                              | 540                                | -  | 1,629                         | 6,047      | 473,573      | 481,249                 |
| Total Commercial Loans  | \$ 4,330                           | \$ 934                             | \$ -   | \$ 5,264                      | \$ 11,173  | \$ 3,011,903 | \$ 3,028,340            |
| Consumer Loans:         |                                    |                                    |  |                               |            |              |                         |
| Dealer Finance          | \$ 11,909                          | \$ 1,956                           | \$ 745   | \$ 14,610                     | \$ 1,972   | \$ 1,235,983 | \$ 1,252,565            |
| Specialty Lending       | 2,960                              | 1,921                              | 1,106  | 5,987                         | -          | 501,631      | 507,618                 |
| Direct                  | 2,488                              | 653                                | 322  | 3,463                         | 2,716      | 514,519      | 520,698                 |
| Total Consumer Loans    | \$ 17,357                          | \$ 4,530                           | \$ 2,173   | \$ 24,060                     | \$ 4,688   | \$ 2,252,133 | \$ 2,280,881            |
| Residential Real Estate | \$ 2,477                           | \$ 746                             | \$ 36  | \$ 3,259                      | \$ 5,600   | \$ 1,182,994 | \$ 1,191,853            |
| Total Originated Loans  | \$ 24,164                          | \$ 6,210                           | \$ 2,209   | \$ 32,583                     | \$ 21,461  | \$ 6,447,030 | \$ 6,501,074            |
| <u>Acquired</u>         |                                    |                                    |  |                               |            |              |                         |
| Commercial Loans:       |                                    |                                    |  |                               |            |              |                         |
| C&I                     | \$ -                               | \$ -                               | \$ -   | \$ -                          | \$ -       | \$ 34,054    | \$ 34,054               |
| CRE                     | -                                  | -                                  | -  | -                             | 2          | 90,049       | 90,051                  |
| Business Banking        | 442                                | 80                                 | -  | 522                           | 603        | 36,986       | 38,111                  |
| Total Commercial Loans  | \$ 442                             | \$ 80                              | \$ -   | \$ 522                        | \$ 605     | \$ 161,089   | \$ 162,216              |
| Consumer Loans:         |                                    |                                    |  |                               |            |              |                         |
| Dealer Finance          | \$ 5                               | \$ -                               | \$ -   | \$ 5                          | \$ 14      | \$ 259       | \$ 278                  |
| Direct                  | 227                                | 44                                 | -  | 271                           | 314        | 36,002       | 36,587                  |
| Total Consumer Loans    | \$ 232                             | \$ 44                              | \$ -   | \$ 276                        | \$ 328     | \$ 36,261    | \$ 36,865               |
| Residential Real Estate | \$ 972                             | \$ -                               | \$ -   | \$ 972                        | \$ 1,612   | \$ 156,324   | \$ 158,908              |
| Total Acquired Loans    | \$ 1,646                           | \$ 124                             | \$ -   | \$ 1,770                      | \$ 2,545   | \$ 353,674   | \$ 357,989              |
| Total Loans             | \$ 25,810                          | \$ 6,334                           | \$ 2,209   | \$ 34,353                     | \$ 24,006  | \$ 6,800,704 | \$ 6,859,063            |



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|                          | 31-60 Days<br>Past Due<br>Accruing | 61-90 Days<br>Past Due<br>Accruing | Greater<br>Than 90<br>Days Past<br>Due<br>Accruing | Total Past<br>Due<br>Accruing | Nonaccrual | Current     | Recorded<br>Total Loans |
|--------------------------|------------------------------------|------------------------------------|--|-------------------------------|------------|-------------|-------------------------|
| (In thousands)           |                                    |                                    |  |                               |            |             |                         |
| As of December 31, 2017  |                                    |                                    |  |                               |            |             |                         |
| <u>Originated</u>        |                                    |                                    |  |                               |            |             |                         |
| Commercial Loans:        |                                    |                                    |  |                               |            |             |                         |
| Commercial               | \$ -                               | \$ -                               | \$ -   | \$ -                          | \$ 202     | \$753,577   | \$753,779               |
| Commercial Real Estate   | 161                                | 138                                | -  | 299                           | 3,178      | 1,533,065   | 1,536,542               |
| Agricultural             | 117                                | -                                  | -  | 117                           | 1,043      | 34,386      | 35,546                  |
| Agricultural Real Estate | 493                                | -                                  | -  | 493                           | 2,736      | 30,905      | 34,134                  |
| Business Banking         | 1,907                              | 597                                | -  | 2,504                         | 5,304      | 473,147     | 480,955                 |
| Total Commercial Loans   | \$ 2,678                           | \$ 735                             | \$ -   | \$ 3,413                      | \$ 12,463  | \$2,825,080 | \$2,840,956             |
| Consumer Loans:          |                                    |                                    |  |                               |            |             |                         |
| Indirect                 | \$ 18,747                          | \$ 4,033                           | \$ 3,492   | \$ 26,272                     | \$ 2,115   | \$1,642,664 | \$1,671,051             |
| Home Equity              | 2,887                              | 854                                | 341  | 4,082                         | 2,736      | 448,081     | 454,899                 |
| Direct                   | 341                                | 108                                | 70   | 519                           | 35         | 64,399      | 64,953                  |
| Total Consumer Loans     | \$ 21,975                          | \$ 4,995                           | \$ 3,903   | \$ 30,873                     | \$ 4,886   | \$2,155,144 | \$2,190,903             |
| Residential Real Estate  | \$ 3,730                           | \$ 667                             | \$ 1,262   | \$ 5,659                      | \$ 5,987   | \$1,139,577 | \$1,151,223             |
| Total Originated Loans   | \$ 28,383                          | \$ 6,397                           | \$ 5,165   | \$ 39,945                     | \$ 23,336  | \$6,119,801 | \$6,183,082             |
| <u>Acquired</u>          |                                    |                                    |  |                               |            |             |                         |
| Commercial Loans:        |                                    |                                    |  |                               |            |             |                         |
| Commercial               | \$ -                               | \$ -                               | \$ -   | \$ -                          | \$ -       | \$39,575    | \$39,575                |
| Commercial Real Estate   | -                                  | -                                  | -  | -                             | 2          | 106,632     | 106,634                 |
| Business Banking         | 354                                | -                                  | -  | 354                           | 669        | 40,081      | 41,104                  |
| Total Commercial Loans   | \$ 354                             | \$ -                               | \$ -   | \$ 354                        | \$ 671     | \$186,288   | \$187,313               |
| Consumer Loans:          |                                    |                                    |  |                               |            |             |                         |
| Indirect                 | \$ 38                              | \$ -                               | \$ 1   | \$ 39                         | \$ 22      | \$1,157     | \$1,218                 |
| Home Equity              | 254                                | 34                                 | 103  | 391                           | 225        | 39,256      | 39,872                  |
| Direct                   | 6                                  | 1                                  | 1  | 8                             | 23         | 2,785       | 2,816                   |
| Total Consumer Loans     | \$ 298                             | \$ 35                              | \$ 105   | \$ 438                        | \$ 270     | \$43,198    | \$43,906                |
| Residential Real Estate  | \$ 627                             | \$ 226                             | \$ 140   | \$ 993                        | \$ 1,431   | \$168,048   | \$170,472               |
| Total Acquired Loans     | \$ 1,279                           | \$ 261                             | \$ 245   | \$ 1,785                      | \$ 2,372   | \$397,534   | \$401,691               |
| Total Loans              | \$ 29,662                          | \$ 6,658                           | \$ 5,410   | \$ 41,730                     | \$ 25,708  | \$6,517,335 | \$6,584,773             |

There were no material commitments to extend further credit to borrowers with nonperforming loans as of June 30, 2018 and December 31, 2017.

Impaired Loans

The methodology used to establish the allowance for loan losses on impaired loans incorporates specific allocations on loans analyzed individually. Classified loans, including all trouble debt restructured loans ("TDRs") and nonaccrual commercial loans that are graded Substandard, Doubtful or Loss, with outstanding balances of \$750 thousand or more are evaluated for impairment through the Company's quarterly status review process. The Company considers commercial loans less than \$750 thousand to be homogeneous loans. In determining that we will be unable to collect all principal and/or interest payments due in accordance with the contractual terms of the loan agreements, we consider factors such as payment history and changes in the financial condition of individual borrowers, local

economic conditions, historical loss experience and the conditions of the various markets in which the collateral may be liquidated. For loans that are identified as impaired, impairment is measured by one of three methods: 1) the fair value of collateral less cost to sell, 2) present value of expected future cash flows or 3) the loan's observable market price. These impaired loans are reviewed on a quarterly basis for changes in the level of impairment. Impaired amounts are charged off immediately if such amounts are determined by management to be uncollectable. Any change to the previously recognized impairment loss is recognized as a component of the provision for loan losses.

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The following table provides information on loans specifically evaluated for impairment:

|                                     | June 30, 2018                            |                                |                      | December 31, 2017                        |                                |                      |
|-------------------------------------|--|--------------------------------|----------------------|--|--------------------------------|----------------------|
|                                     | Recorded Unpaid<br>Investment<br>Balance | Unpaid<br>Principal<br>Balance | Related<br>Allowance | Recorded Unpaid<br>Investment<br>Balance | Unpaid<br>Principal<br>Balance | Related<br>Allowance |
| (In thousands)                      | (Book)                                   | (Legal)                        |                      | (Book)                                   | (Legal)                        |                      |
| <u>Originated</u>                   |  |                                |                      |  |                                |                      |
| With no related allowance recorded: |  |                                |                      |  |                                |                      |
| Commercial Loans:                   |  |                                |                      |  |                                |                      |
| C&I                                 | \$412                                    | \$681                          |                      | \$-                                      | \$-                            |                      |
| CRE                                 | 3,665                                    | 5,585                          |                      | -  | -                              |                      |
| Commercial                          | -  | -                              |                      | -  | 251                            |                      |
| Commercial Real Estate              | -  | -                              |                      | 2,211                                    | 3,979                          |                      |
| Agricultural                        | -  | -                              |                      | 452                                      | 465                            |                      |
| Agricultural Real Estate            | -  | -                              |                      | 2,250                                    | 2,423                          |                      |
| Business Banking                    | 1,030                                    | 2,104                          |                      | 860                                      | 1,730                          |                      |
| Total Commercial Loans              | \$5,107                                  | \$8,370                        |                      | \$5,773                                  | \$8,848                        |                      |
| Consumer Loans:                     |  |                                |                      |  |                                |                      |
| Dealer Finance                      | \$149                                    | \$189                          |                      | \$-                                      | \$-                            |                      |
| Direct                              | 7,857                                    | 9,836                          |                      | -  | -                              |                      |
| Indirect                            | -  | -                              |                      | 131                                      | 143                            |                      |
| Home Equity                         | -  | -                              |                      | 8,027                                    | 9,966                          |                      |
| Direct                              | -  | -                              |                      | 274                                      | 274                            |                      |
| Total Consumer Loans                | \$8,006                                  | \$10,025                       |                      | \$8,432                                  | \$10,383                       |                      |
| Residential Real Estate             | \$6,591                                  | \$8,836                        |                      | \$6,830                                  | \$8,780                        |                      |
| Total                               | \$19,704                                 | \$27,231                       |                      | \$21,035                                 | \$28,011                       |                      |
| With an allowance recorded:         |  |                                |                      |  |                                |                      |
| Commercial Loans:                   |  |                                |                      |  |                                |                      |
| C&I                                 | \$25                                     | \$25                           | \$ 25                | \$-                                      | \$-                            | \$ -                 |
| Commercial Real Estate              | -  | -                              | -                    | 76                                       | 82                             | 30                   |
| Agricultural                        | -  | -                              | -                    | 27                                       | 27                             | 27                   |
| Total Commercial Loans              | \$25                                     | \$25                           | \$ 25                | \$103                                    | \$109                          | \$ 57                |
| Total Loans                         | \$19,729                                 | \$27,256                       | \$ 25                | \$21,138                                 | \$28,120                       | \$ 57                |

There were no acquired impaired loans specifically evaluated for impairment as of June 30, 2018 or December 31, 2017.

The following tables summarize the average recorded investments on loans specifically evaluated for impairment and the interest income recognized:

|                | For the three months ended          |                                     |
|----------------|-------------------------------------|-------------------------------------|
|                | June 30, 2018                       | June 30, 2017                       |
|                | Average Interest<br>Recorded Income | Average Interest<br>Recorded Income |
| (In thousands) | Investment<br>Recognized            | Investment<br>Recognized            |

Originated

Commercial Loans:



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|                          |          |        |          |        |
|--------------------------|----------|--------|----------|--------|
| C&I                      | \$447    | \$ 1   | \$-      | \$ -   |
| CRE                      | 3,882    | 32     | -        | -      |
| Commercial               | -        | -      | 3,931    | -      |
| Commercial Real Estate   | -        | -      | 3,243    | 1      |
| Agricultural             | -        | -      | 157      | 1      |
| Agricultural Real Estate | -        | -      | 1,549    | 10     |
| Business Banking         | 1,044    | 3      | 890      | 3      |
| Total Commercial Loans   | \$5,373  | \$ 36  | \$9,770  | \$ 15  |
| Consumer Loans:          |          |        |          |        |
| Dealer Finance           | \$194    | \$ 1   | \$-      | \$ -   |
| Direct                   | 7,952    | 106    | -        | -      |
| Indirect                 | -        | -      | 25       | 1      |
| Home Equity              | -        | -      | 8,205    | 110    |
| Direct                   | -        | -      | 120      | -      |
| Total Consumer Loans     | \$8,146  | \$ 107 | \$8,350  | \$ 111 |
| Residential Real Estate  | \$6,738  | \$ 71  | \$6,388  | \$ 68  |
| Total Originated Loans   | \$20,257 | \$ 214 | \$24,508 | \$ 194 |
|                          |          |        |          |        |
| Total Loans              | \$20,257 | \$ 214 | \$24,508 | \$ 194 |

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|                          | For the six months ended |            |               |            |
|--------------------------|--------------------------|------------|---------------|------------|
|                          | June 30, 2018            |            | June 30, 2017 |            |
|                          | Average                  | Interest   | Average       | Interest   |
| (In thousands)           | Recorded                 | Income     | Recorded      | Income     |
| <u>Originated</u>        | Investmen                | Recognized | Investmen     | Recognized |
| Commercial Loans:        |                          |            |               |            |
| C&I                      | \$457                    | \$ 1       | \$-           | \$ -       |
| CRE                      | 4,154                    | 64         | -             | -          |
| Commercial               | -                        | -          | 3,419         | -          |
| Commercial Real Estate   | -                        | -          | 4,584         | 45         |
| Agricultural             | -                        | -          | 165           | 1          |
| Agricultural Real Estate | -                        | -          | 1,564         | 21         |
| Business Banking         | 988                      | 8          | 788           | 5          |
| Total Commercial Loans   | \$5,599                  | \$ 73      | \$10,520      | \$ 72      |
| Consumer Loans:          |                          |            |               |            |
| Dealer Finance           | \$188                    | \$ 4       | \$-           | \$ -       |
| Direct                   | 8,066                    | 215        | -             | -          |
| Indirect                 | -                        | -          | 16            | 1          |
| Home Equity              | -                        | -          | 8,310         | 220        |
| Direct                   | -                        | -          | 120           | -          |
| Total Consumer Loans     | \$8,254                  | \$ 219     | \$8,446       | \$ 221     |
| Residential Real Estate  | \$6,815                  | \$ 144     | \$6,308       | \$ 129     |
| Total Originated Loans   | \$20,668                 | \$ 436     | \$25,274      | \$ 422     |

Acquired

|                        |          |        |          |        |
|------------------------|----------|--------|----------|--------|
| Commercial Loans:      |          |        |          |        |
| Commercial Real Estate | \$-      | \$ -   | \$172    | \$ -   |
| Total Commercial Loans | \$-      | \$ -   | \$172    | \$ -   |
| Total Acquired Loans   | \$-      | \$ -   | \$172    | \$ -   |
| Total Loans            | \$20,668 | \$ 436 | \$25,446 | \$ 422 |

## Credit Quality Indicators

The Company has developed an internal loan grading system to evaluate and quantify the Company's loan portfolio with respect to quality and risk. The system focuses on, among other things, financial strength of borrowers, experience and depth of borrower's management, primary and secondary sources of repayment, payment history, nature of the business and outlook on particular industries. The internal grading system enables the Company to monitor the quality of the entire loan portfolio on a consistent basis and provide management with an early warning system, enabling recognition and response to problem loans and potential problem loans.

## Commercial Grading System

For commercial and agricultural loans, the Company uses a grading system that relies on quantifiable and measurable characteristics when available. This would include comparison of financial strength to available industry averages, comparison of transaction factors (loan terms and conditions) to loan policy and comparison of credit history to stated repayment terms and industry averages. Some grading factors are necessarily more subjective such as economic and industry factors, regulatory environment and management. Commercial loans are graded Doubtful, Substandard, Special Mention and Pass.

### Doubtful

A Doubtful loan has a high probability of total or substantial loss, but because of specific pending events that may strengthen the asset, its classification as a loss is deferred. Doubtful borrowers are usually in default, lack adequate liquidity or capital and lack the resources necessary to remain an operating entity. Pending events can include mergers, acquisitions, liquidations, capital injections, the perfection of liens on additional collateral, the valuation of collateral and refinancing. Generally, pending events should be resolved within a relatively short period and the ratings will be adjusted based on the new information. Nonaccrual treatment is required for Doubtful assets because of the high probability of loss.

### Substandard

Substandard loans have a high probability of payment default or they have other well-defined weaknesses. They require more intensive supervision by bank management. Substandard loans are generally characterized by current or expected unprofitable operations, inadequate debt service coverage, inadequate liquidity or marginal capitalization. Repayment may depend on collateral or other credit risk mitigants. For some Substandard loans, the likelihood of full collection of interest and principal may be in doubt and those loans should be placed on nonaccrual. Although Substandard assets in the aggregate will have a distinct potential for loss, an individual asset's loss potential does not have to be distinct for the asset to be rated Substandard.

### Special Mention

Special Mention loans have potential weaknesses that may, if not checked or corrected, weaken the asset or inadequately protect the Company's position at some future date. These loans pose elevated risk, but their weakness does not yet justify a Substandard classification. Borrowers may be experiencing adverse operating trends (i.e., declining revenues or margins) or may be struggling with an ill-proportioned balance sheet (i.e., increasing inventory without an increase in sales, high leverage, tight liquidity). Adverse economic or market conditions, such as interest rate increases or the entry of a new competitor, may also support a Special Mention rating. Although a Special Mention loan has a higher probability of default than a Pass asset, its default is not imminent.

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Pass

Loans graded as Pass encompass all loans not graded as Doubtful, Substandard or Special Mention. Pass loans are in compliance with loan covenants and payments are generally made as agreed. Pass loans range from superior quality to fair quality.

Business Banking Grading System

Business banking loans are graded as either Classified or Non-classified:

Classified

Classified loans are inadequately protected by the current worth and paying capacity of the obligor or, if applicable, the collateral pledged. These loans have a well-defined weakness or weaknesses, which jeopardize the liquidation of the debt or in some cases make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Classified loans have a high probability of payment default or a high probability of total or substantial loss. These loans require more intensive supervision by management and are generally characterized by current or expected unprofitable operations, inadequate debt service coverage, inadequate liquidity or marginal capitalization. Repayment may depend on collateral or other credit risk mitigants. When the likelihood of full collection of interest and principal may be in doubt, Classified loans are considered to have a nonaccrual status. In some cases, Classified loans are considered uncollectable and of such little value that their continuance as assets is not warranted.

Non-classified

Loans graded as Non-classified encompass all loans not graded as Classified. Non-classified loans are in compliance with loan covenants and payments are generally made as agreed.

Consumer and Residential Real Estate Grading System

Consumer and Residential Real Estate loans are graded as either Nonperforming or Performing.

Nonperforming

Nonperforming loans are loans that are 1) over 90 days past due and interest is still accruing or 2) on nonaccrual status.

Performing

All loans not meeting any of these criteria are considered Performing.

The following tables illustrate the Company's credit quality by loan class:

(In thousands)

As of June 30, 2018

Originated

Commercial Credit Exposure

| By Internally Assigned Grade: | C&I        | CRE          | Total        |
|-------------------------------|------------|--------------|--------------|
| Pass                          | \$ 773,097 | \$ 1,658,780 | \$ 2,431,877 |
| Special Mention               | 46,153     | 14,720       | 60,873       |

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|             |           |             |             |
|-------------|-----------|-------------|-------------|
| Substandard | 16,737    | 37,204      | 53,941      |
| Doubtful    | 400       | -           | 400         |
| Total       | \$836,387 | \$1,710,704 | \$2,547,091 |

|                                  |           |           |
|----------------------------------|-----------|-----------|
| Business Banking Credit Exposure | Business  |           |
| By Internally Assigned Grade:    | Banking   | Total     |
| Non-classified                   | \$469,660 | \$469,660 |
| Classified                       | 11,589    | 11,589    |
| Total                            | \$481,249 | \$481,249 |

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| Consumer Credit Exposure | Dealer      | Specialty |           |             |
|--------------------------|-------------|-----------|-----------|-------------|
| By Payment Activity:     | Finance     | Lending   | Direct    | Total       |
| Performing               | \$1,249,848 | \$506,512 | \$517,660 | \$2,274,020 |
| Nonperforming            | 2,717       | 1,106     | 3,038     | 6,861       |
| Total                    | \$1,252,565 | \$507,618 | \$520,698 | \$2,280,881 |

| Residential Real Estate Credit Exposure | Residential |             |
|---|-------------|-------------|
| By Payment Activity:                    | Real Estate | Total       |
| Performing                              | \$1,186,217 | \$1,186,217 |
| Nonperforming                           | 5,636       | 5,636       |
| Total                                   | \$1,191,853 | \$1,191,853 |

Acquired

| Commercial Credit Exposure    |          |          |           |
|-------------------------------|----------|----------|-----------|
| By Internally Assigned Grade: | C&I      | CRE      | Total     |
| Pass                          | \$28,989 | \$88,818 | \$117,807 |
| Special Mention               | 5,019    | 564      | 5,583     |
| Substandard                   | 46       | 669      | 715       |
| Total                         | \$34,054 | \$90,051 | \$124,105 |

| Business Banking Credit Exposure | Business |          |
|----------------------------------|----------|----------|
| By Internally Assigned Grade:    | Banking  | Total    |
| Non-classified                   | \$35,691 | \$35,691 |
| Classified                       | 2,420    | 2,420    |
| Total                            | \$38,111 | \$38,111 |

| Consumer Credit Exposure | Dealer  |          |          |
|--------------------------|---------|----------|----------|
| By Payment Activity:     | Finance | Direct   | Total    |
| Performing               | \$ 264  | \$36,273 | \$36,537 |
| Nonperforming            | 14      | 314      | 328      |
| Total                    | \$ 278  | \$36,587 | \$36,865 |

| Residential Real Estate Credit Exposure | Residential |           |
|---|-------------|-----------|
| By Payment Activity:                    | Real Estate | Total     |
| Performing                              | \$ 157,296  | \$157,296 |
| Nonperforming                           | 1,612       | 1,612     |
| Total                                   | \$ 158,908  | \$158,908 |

(In thousands)

As of December 31, 2017

Originated

| Commercial Credit Exposure    | Commercial | Agricultural |              |
|-------------------------------|------------|--------------|--------------|
| By Internally Assigned Grade: | Commercial | Real Estate  | Agricultural |
| Pass                          | \$708,567  | \$1,481,926  | \$ 31,142    |
| Special Mention               | 30,337     | 28,264       | 2,294        |
| Substandard                   | 14,875     | 26,352       | 2,110        |
| Total                         | \$753,779  | \$1,536,542  | \$ 35,546    |

| Business Banking Credit Exposure | Business  |           |
|----------------------------------|-----------|-----------|
| By Internally Assigned Grade:    | Banking   | Total     |
| Non-classified                   | \$468,898 | \$468,898 |

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|            |           |           |
|------------|-----------|-----------|
| Classified | 12,057    | 12,057    |
| Total      | \$480,955 | \$480,955 |

Consumer Credit Exposure

| By Payment Activity: | Indirect    | Home Equity | Direct   | Total       |
|----------------------|-------------|-------------|----------|-------------|
| Performing           | \$1,665,444 | \$ 451,822  | \$64,848 | \$2,182,114 |
| Nonperforming        | 5,607       | 3,077       | 105      | 8,789       |
| Total                | \$1,671,051 | \$ 454,899  | \$64,953 | \$2,190,903 |

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|   |             |             |
|---|-------------|-------------|
| Residential Real Estate Credit Exposure | Residential |             |
| By Payment Activity:                    | Real Estate | Total       |
| Performing                              | \$1,143,974 | \$1,143,974 |
| Nonperforming                           | 7,249       | 7,249       |
| Total                                   | \$1,151,223 | \$1,151,223 |

Acquired

|                               |            |             |           |
|-------------------------------|------------|-------------|-----------|
| Commercial Credit Exposure    | Commercial |             |           |
| By Internally Assigned Grade: | Commercial | Real Estate | Total     |
| Pass                          | \$ 37,825  | \$ 103,248  | \$141,073 |
| Special Mention               | 425        | 498         | 923       |
| Substandard                   | 1,325      | 2,888       | 4,213     |
| Total                         | \$ 39,575  | \$ 106,634  | \$146,209 |

|                                  |          |          |
|----------------------------------|----------|----------|
| Business Banking Credit Exposure | Business |          |
| By Internally Assigned Grade:    | Banking  | Total    |
| Non-classified                   | \$38,236 | \$38,236 |
| Classified                       | 2,868    | 2,868    |
| Total                            | \$41,104 | \$41,104 |

## Consumer Credit Exposure

|                      |          |             |         |          |
|----------------------|----------|-------------|---------|----------|
| By Payment Activity: | Indirect | Home Equity | Direct  | Total    |
| Performing           | \$ 1,195 | \$ 39,544   | \$2,792 | \$43,531 |
| Nonperforming        | 23       | 328         | 24      | 375      |
| Total                | \$ 1,218 | \$ 39,872   | \$2,816 | \$43,906 |

|   |             |           |
|---|-------------|-----------|
| Residential Real Estate Credit Exposure | Residential |           |
| By Payment Activity:                    | Real Estate | Total     |
| Performing                              | \$ 168,901  | \$168,901 |
| Nonperforming                           | 1,571       | 1,571     |
| Total                                   | \$ 170,472  | \$170,472 |

## Troubled Debt Restructured Loans

When the Company modifies a loan in a trouble debt restructuring, such modifications include one or a combination of the following: an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; temporary reduction in the interest rate or change in scheduled payment amount. Residential and consumer TDRs occurring during 2018 and 2017 were due to the reduction in the interest rate or extension of the term. Commercial TDRs during 2018 and 2017 were both a reduction of the interest rate and change in terms.

When the Company modifies a loan in a troubled debt restructuring, management measures for impairment, if any, based on the present value of the expected future cash flows, discounted at the contractual interest rate of the original loan agreement, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases, management uses the current fair value of the collateral, less selling costs. If management determines that the value of the modified loan is less than the recorded investment in the loan an impairment charge would be recognized.

The following tables illustrate the recorded investment and number of modifications for modified loans, including the recorded investment in the loans prior to a modification and the recorded investment in the loans after restructuring:



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|                                    | Three months ended June 30, 2018 |   |          |  |
|------------------------------------|----------------------------------|---|----------|--|
|                                    | Number<br>of<br>Contracts        | Pre-Modification<br>Outstanding<br>Investment | Recorded | Post-Modification<br>Outstanding<br>Recorded<br>Investment |
| (Dollars in thousands)             |                                  |   |          |  |
| Commercial Loans:                  |                                  |   |          |  |
| Business Banking                   | 1                                | \$ 6  |          | \$ 5   |
| Total Commercial Loans             | 1                                | \$ 6  |          | \$ 5   |
| Consumer Loans:                    |                                  |   |          |  |
| Dealer Finance                     | 1                                | \$ 13   |          | \$ 13  |
| Total Consumer Loans               | 1                                | \$ 13   |          | \$ 13  |
| Total Troubled Debt Restructurings | 2                                | \$ 19   |          | \$ 18  |

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| (Dollars in thousands)             | Three months ended June 30, 2017 |  |   |
|------------------------------------|----------------------------------|--|---|
|                                    | Number of Contracts              | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Commercial Loans:                  |                                  |  |   |
| Commercial                         | 1                                | \$ 3,300   | \$ 3,239  |
| Business Banking                   | 1                                | 337  | 333   |
| Total Commercial Loans             | 2                                | \$ 3,637   | \$ 3,572  |
| Consumer Loans:                    |                                  |  |   |
| Indirect                           | 3                                | \$ 32  | \$ 31   |
| Home Equity                        | 1                                | 78   | 78  |
| Direct                             | 1                                | 120  | 120   |
| Total Consumer Loans               | 5                                | \$ 230   | \$ 229  |
| Residential Real Estate            | 4                                | \$ 346   | \$ 346  |
| Total Troubled Debt Restructurings | 11                               | \$ 4,213   | \$ 4,147  |

| (Dollars in thousands)             | Six months ended June 30, 2018 |  |   |
|------------------------------------|--------------------------------|--|---|
|                                    | Number of Contracts            | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Commercial Loans:                  |                                |  |   |
| Business Banking                   | 3                              | \$ 369   | \$ 371  |
| Total Commercial Loans             | 3                              | \$ 369   | \$ 371  |
| Consumer Loans:                    |                                |  |   |
| Dealer Finance                     | 7                              | \$ 95  | \$ 94   |
| Direct                             | 2                              | 41   | 41  |
| Total Consumer Loans               | 9                              | \$ 136   | \$ 135  |
| Residential Real Estate            | 5                              | \$ 323   | \$ 323  |
| Total Troubled Debt Restructurings | 17                             | \$ 828   | \$ 829  |

| (Dollars in thousands)             | Six months ended June 30, 2017 |  |   |
|------------------------------------|--------------------------------|--|---|
|                                    | Number of Contracts            | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Commercial Loans:                  |                                |  |   |
| Commercial                         | 1                              | \$ 3,300   | \$ 3,239  |
| Business Banking                   | 1                              | 337  | 333   |
| Total Commercial Loans             | 2                              | \$ 3,637   | \$ 3,572  |
| Consumer Loans:                    |                                |  |   |
| Indirect                           | 3                              | \$ 32  | \$ 31   |
| Home Equity                        | 4                              | 185  | 192   |
| Direct                             | 1                              | 120  | 120   |
| Total Consumer Loans               | 8                              | \$ 337   | \$ 343  |
| Residential Real Estate            | 6                              | \$ 548   | \$ 554  |
| Total Troubled Debt Restructurings | 16                             | \$ 4,522   | \$ 4,469  |

The following tables illustrate the recorded investment and number of modifications for TDRs where a concession has been made and subsequently defaulted during the period:

Three months ended June      Three months ended June

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|                                    | 30, 2018  |            | 30, 2017  |            |
|------------------------------------|-----------|------------|-----------|------------|
|                                    | Number    | Recorded   | Number    | Recorded   |
| (Dollars in thousands)             | of        | Investment | of        | Investment |
|                                    | Contracts |            | Contracts |            |
| Commercial Loans:                  |           |            |           |            |
| Business Banking                   | 1         | \$ 58      | 1         | \$ 329     |
| Total Commercial Loans             | 1         | \$ 58      | 1         | \$ 329     |
| Consumer Loans:                    |           |            |           |            |
| Indirect                           | -         | \$ -       | 1         | \$ 14      |
| Home Equity                        | -         | -          | 13        | 589        |
| Direct                             | 13        | 495        | -         | -          |
| Total Consumer Loans               | 13        | \$ 495     | 14        | \$ 603     |
| Residential Real Estate            | 7         | \$ 599     | 4         | \$ 251     |
| Total Troubled Debt Restructurings | 21        | \$ 1,152   | 19        | \$ 1,183   |

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| (Dollars in thousands)             | Six months ended June 30,<br>2018 |                        | Six months ended June 30,<br>2017 |                        |
|------------------------------------|-----------------------------------|------------------------|-----------------------------------|------------------------|
|                                    | Number<br>of<br>Contracts         | Recorded<br>Investment | Number<br>of<br>Contracts         | Recorded<br>Investment |
| Commercial Loans:                  |                                   |                        |                                   |                        |
| Commercial                         | -                                 | \$ -                   | 1                                 | \$ 145                 |
| Business Banking                   | 2                                 | 258                    | 1                                 | 329                    |
| Total Commercial Loans             | 2                                 | \$ 258                 | 2                                 | \$ 474                 |
| Consumer Loans:                    |                                   |                        |                                   |                        |
| Indirect                           | -                                 | \$ -                   | 2                                 | \$ 19                  |
| Home Equity                        | -                                 | -                      | 22                                | 1,101                  |
| Direct                             | 25                                | 1,260                  | -                                 | -                      |
| Total Consumer Loans               | 25                                | \$ 1,260               | 24                                | \$ 1,120               |
| Residential Real Estate            | 13                                | \$ 907                 | 8                                 | \$ 419                 |
| Total Troubled Debt Restructurings | 40                                | \$ 2,425               | 34                                | \$ 2,013               |

## 5. Defined Benefit Post-Retirement Plans

The Company has a qualified, noncontributory, defined benefit pension plan (“the Plan”) covering substantially all of its employees at June 30, 2018. Benefits paid from the plan are based on age, years of service, compensation, social security benefits and are determined in accordance with defined formulas. The Company’s policy is to fund the Plan in accordance with Employee Retirement Income Security Act of 1974 standards. Assets of the Plan are invested in publicly traded stocks and mutual funds.

In addition to the Plan, the Company also provides supplemental employee retirement plans to certain current and former executives. The Company also assumed supplemental retirement plans for certain current and former executives of Alliance Financial Corporation (“Alliance”) when the Company acquired Alliance.

These supplemental employee retirement plans and the Plan are collectively referred to herein as “Pension Benefits.”

In addition, the Company provides certain health care benefits for retired employees. Benefits are accrued over the employees’ active service period. Only employees that were employed by the Company on or before January 1, 2000 are eligible to receive post-retirement health care benefits. In addition, the Company assumed post-retirement medical life insurance benefits for certain Alliance employees, retirees and their spouses, if applicable, in the Alliance acquisition. These post-retirement benefits are referred to herein as “Other Benefits.”

The Company made no voluntary contributions to the pension and other benefits plans in 2017 and did not do so during the three and six months ended June 30, 2018.

The components of expense for Pension Benefits and Other Benefits are set forth below:

| (In thousands)                             | Pension Benefits                    |          | Other Benefits                      |      |
|--|-------------------------------------|----------|-------------------------------------|------|
|  | Three months ended June 30,<br>2018 | 2017     | Three months ended June 30,<br>2018 | 2017 |
| Components of net periodic (benefit) cost: |                                     |          |                                     |      |
| Service cost                               | \$ 420                              | \$ 402   | \$ 3                                | \$ 3 |
| Interest cost                              | 920                                 | 1,042    | 82                                  | 86   |
| Expected return on plan assets             | (2,123 )                            | (1,985 ) | -                                   | -    |
| Net amortization                           | 251                                 | 415      | 44                                  | 20   |

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|  |                           |           |                           |        |
|--|---------------------------|-----------|---------------------------|--------|
| Total net periodic (benefit) cost          | \$ (532 )                 | \$ (126 ) | \$ 129                    | \$ 109 |
|  | Pension Benefits          |           | Other Benefits            |        |
|  | Six months ended June 30, |           | Six months ended June 30, |        |
| (In thousands)                             | 2018                      | 2017      | 2018                      | 2017   |
| Components of net periodic (benefit) cost: |                           |           |                           |        |
| Service cost                               | \$ 840                    | \$ 801    | \$ 6                      | \$ 6   |
| Interest cost                              | 1,840                     | 2,084     | 164                       | 172    |
| Expected return on plan assets             | (4,246 )                  | (3,970 )  | -                         | -      |
| Net amortization                           | 502                       | 830       | 88                        | 40     |
| Total net periodic (benefit) cost          | \$ (1,064 )               | \$ (255 ) | \$ 258                    | \$ 218 |

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The service cost component of the net periodic (benefit) cost is included in Salaries and Employee Benefits and the interest cost, expected return on plan assets and net amortization components are including in Other Noninterest Expense on the unaudited interim consolidated statements of income.

## 6. Earnings Per Share

Basic earnings per share ("EPS") excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity (such as the Company's dilutive stock options and restricted stock units).

The following is a reconciliation of basic and diluted EPS for the periods presented in the unaudited interim consolidated statements of income:

| (In thousands, except per share data)       | Three Months Ended June 30, |           |
|---|-----------------------------|-----------|
|   | 2018                        | 2017      |
| Basic EPS:                                  |                             |           |
| Weighted average common shares outstanding  | 43,699                      | 43,579    |
| Net income available to common stockholders | \$ 28,121                   | \$ 21,359 |
| Basic EPS                                   | \$ 0.64                     | \$ 0.49   |

|  |           |           |
|--|-----------|-----------|
| Diluted EPS:   |           |           |
| Weighted average common shares outstanding                   | 43,699    | 43,579    |
| Dilutive effect of common stock options and restricted stock | 318       | 322       |
| Weighted average common shares and common share equivalents  | 44,017    | 43,901    |
| Net income available to common stockholders                  | \$ 28,121 | \$ 21,359 |
| Diluted EPS  | \$ 0.64   | \$ 0.49   |

| (In thousands, except per share data)       | Six Months Ended June 30, |           |
|---|---------------------------|-----------|
|   | 2018                      | 2017      |
| Basic EPS:                                  |                           |           |
| Weighted average common shares outstanding  | 43,681                    | 43,546    |
| Net income available to common stockholders | \$ 54,107                 | \$ 41,638 |
| Basic EPS                                   | \$ 1.24                   | \$ 0.96   |

|  |           |           |
|--|-----------|-----------|
| Diluted EPS:   |           |           |
| Weighted average common shares outstanding                   | 43,681    | 43,546    |
| Dilutive effect of common stock options and restricted stock | 311       | 340       |
| Weighted average common shares and common share equivalents  | 43,992    | 43,886    |
| Net income available to common stockholders                  | \$ 54,107 | \$ 41,638 |
| Diluted EPS  | \$ 1.23   | \$ 0.95   |

There were 1,500 and 3,250 stock options for the quarters ended June 30, 2018 and June 30, 2017, respectively that were not considered in the calculation of diluted EPS since the stock options' exercise price was greater than the average market price during these periods.

There were 1,500 and 1,144 stock options for the six months ended June 30, 2018 and June 30, 2017, respectively, that were not considered in the calculation of diluted EPS since the stock options' exercise price was greater than the average market price during these periods.



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## 7.Reclassification Adjustments Out of Other Comprehensive Income (Loss)

The following table summarizes the reclassification adjustments out of accumulated other comprehensive income (loss) ("AOCI"):

| Detail About AOCI Components  | Amount Reclassified From<br>AOCI<br>Three months ended |                  | Affected Line Item in<br>the<br>Consolidated Statement<br>of<br>Comprehensive Income<br>(Loss) |
|---|--|------------------|--|
| (In thousands)  | June 30,<br>2018                                       | June 30,<br>2017 |  |
| AFS securities:   |  |                  |  |
| (Gains) on AFS securities   | \$ -   | \$ (2            | ) Net securities gains   |
| Amortization of unrealized gains related to securities transfer                             | 177  | 225              | Interest income  |
| Tax effect  | \$ (44   | ) \$ (85         | ) Income tax (expense)   |
| Net of tax  | \$ 133   | \$ 138           | ) benefit  |
| Cash flow hedges:   |  |                  |  |
| Net unrealized (gains) losses on cash flow hedges reclassified to interest (income) expense | \$ (540  | ) \$ (23         | ) Interest expense   |
| Tax effect  | \$ 135   | \$ 9             | Income tax (expense)   |
| Net of tax  | \$ (405  | ) \$ (14         | ) benefit  |
| Pension and other benefits:   |  |                  |  |
| Amortization of net losses  | \$ 273   | \$ 425           | Other noninterest expense  |
| Amortization of prior service costs   | 22   | 10               | Other noninterest expense  |
| Tax effect  | \$ (74   | ) \$ (166        | ) Income tax (expense)   |
| Net of tax  | \$ 221   | \$ 269           | ) benefit  |
| Total reclassifications during the period, net of tax                                       | \$ (51   | ) \$ 393         |  |

| Detail About AOCI Components | Amount Reclassified From<br>AOCI<br>Six months ended |               | Affected Line item in<br>the<br>Consolidated Statement<br>of<br>Comprehensive Income<br>(Loss) |
|------------------------------|--|---------------|--|
| (In thousands)               | June 30,<br>2018                                     | June 30, 2017 |  |
| AFS securities:              |  |               |  |



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|   |         |           |                           |
|---|---------|-----------|---------------------------|
| (Gains) on AFS securities   | \$ -    | \$ (2     | ) Net securities gains    |
| Amortization of unrealized gains related to securities transfer                             | 365     | 463       | Interest income           |
| Impairment write-down of equity security  | -       | 1,312     | Other noninterest income  |
| Tax effect  | \$ (91  | ) \$ (677 | ) Income tax (expense)    |
| Net of tax  | \$ 274  | \$ 1,096  | ) benefit                 |
| Cash flow hedges:   |         |           |                           |
| Net unrealized (gains) losses on cash flow hedges reclassified to interest (income) expense | \$ (899 | ) \$ 59   | Interest expense          |
| Tax effect  | \$ 225  | \$ (23    | ) Income tax (expense)    |
| Net of tax  | \$ (674 | ) \$ 36   | ) benefit                 |
| Pension and other benefits:   |         |           |                           |
| Amortization of net losses  | \$ 546  | \$ 850    | Other noninterest expense |
| Amortization of prior service costs   | 44      | 20        | Other noninterest expense |
| Tax effect  | \$ (148 | ) \$ (332 | ) Income tax (expense)    |
| Net of tax  | \$ 442  | \$ 538    | ) benefit                 |
| Total reclassifications during the period, net of tax                                       | \$ 42   | \$ 1,670  |                           |

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8. Fair Value Measurements and Fair Value of Financial Instruments

GAAP states that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Fair value measurements are not adjusted for transaction costs. A fair value hierarchy exists within GAAP that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 - Quoted prices for similar assets or liabilities in active markets, quoted prices in markets that are not active or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability;

Level 3 - Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The types of instruments valued based on quoted market prices in active markets include most U.S. government and agency securities, many other sovereign government obligations, liquid mortgage products, active listed equities and most money market securities. Such instruments are generally classified within Level 1 or Level 2 of the fair value hierarchy. The Company does not adjust the quoted prices for such instruments.

The types of instruments valued based on quoted prices in markets that are not active, broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency include most investment-grade and high-yield corporate bonds, less liquid mortgage products, less liquid agency securities, less liquid listed equities, state, municipal and provincial obligations and certain physical commodities. Such instruments are generally classified within Level 2 of the fair value hierarchy. Certain common equity securities are reported at fair value utilizing Level 1 inputs (exchange quoted prices). Other investment securities are reported at fair value utilizing Level 1 and Level 2 inputs. The prices for Level 2 instruments are obtained through an independent pricing service or dealer market participants with whom the Company has historically transacted both purchases and sales of investment securities. Prices obtained from these sources include prices derived from market quotations and matrix pricing. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Management reviews the methodologies used in pricing the securities by its third party providers.

Level 3 is for positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate will be used. Management's best estimate consists of both internal and external support on certain Level 3 investments. Subsequent to inception, management only changes Level 3 inputs and assumptions when corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalizations and other transactions across the capital structure, offerings in the equity or debt markets and changes in financial ratios or cash flows.

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For the three and six months ended June 30, 2018, the Company made no transfers of assets from Level 1 to Level 2. For the three months ended June 30, 2018, the Company made no transfers of assets from Level 2 to Level 1. For the six months ended June 30, 2018, the Company made a \$4.0 million transfer from Level 2 to Level 1. For the year ended December 31, 2017, the Company made no transfer of assets between the levels of the fair value hierarchy.

The following tables set forth the Company's financial assets and liabilities measured on a recurring basis that were accounted for at fair value. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

| (In thousands)                      | Level 1  | Level 2     | Level 3 | June 30, 2018 |
|-------------------------------------|----------|-------------|---------|---------------|
| Assets:                             |          |             |         |               |
| AFS securities:                     |          |             |         |               |
| Federal agency                      | \$-      | \$118,570   | \$ -    | \$ 118,570    |
| State & municipal                   | -        | 36,402      | -       | 36,402        |
| Mortgage-backed                     | -        | 519,645     | -       | 519,645       |
| Collateralized mortgage obligations | -        | 518,322     | -       | 518,322       |
| Total AFS securities                | \$-      | \$1,192,939 | \$ -    | \$ 1,192,939  |
| Equity securities                   | 20,109   | 4,184       | -       | 24,293        |
| Derivatives                         | -        | 22,568      | -       | 22,568        |
| Total                               | \$20,109 | \$1,219,691 | \$ -    | \$ 1,239,800  |
| Liabilities:                        |          |             |         |               |
| Derivatives                         | \$-      | \$18,463    | \$ -    | \$ 18,463     |
| Total                               | \$-      | \$18,463    | \$ -    | \$ 18,463     |

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| (In thousands)                      | Level 1  | Level 2     | Level 3 | December 31,<br>2017 |
|-------------------------------------|----------|-------------|---------|----------------------|
| <b>Assets:</b>                      |          |             |         |                      |
| AFS securities:                     |          |             |         |                      |
| Federal agency                      | \$-      | \$108,899   | \$ -    | \$ 108,899           |
| State & municipal                   | -        | 41,956      | -       | 41,956               |
| Mortgage-backed                     | -        | 554,927     | -       | 554,927              |
| Collateralized mortgage obligations | -        | 535,994     | -       | 535,994              |
| Other securities                    | 5,845    | 8,304       | -       | 14,149               |
| Total AFS securities                | \$5,845  | \$1,250,080 | \$ -    | \$ 1,255,925         |
| Trading securities                  | 11,467   | -           | -       | 11,467               |
| Derivatives                         | -        | 3,732       | -       | 3,732                |
| Total                               | \$17,312 | \$1,253,812 | \$ -    | \$ 1,271,124         |
| <b>Liabilities:</b>                 |          |             |         |                      |
| Derivatives                         | \$-      | \$324       | \$ -    | \$ 324               |
| Total                               | \$-      | \$324       | \$ -    | \$ 324               |

GAAP requires disclosure of assets and liabilities measured and recorded at fair value on a non-recurring basis such as goodwill, loans held for sale, other real estate owned, collateral-dependent impaired loans, mortgage servicing rights and HTM securities. The only non-recurring fair value measurements recorded during the three and six month periods ended June 30, 2018 and December 31, 2017 were related to impaired loans, write-down of other real estate owned and impairments of goodwill and intangible assets. The Company uses the fair value of underlying collateral, less costs to sell, to estimate the specific reserves for collateral dependent impaired loans. The appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses ranging from 10% to 35%. Based on the valuation techniques used, the fair value measurements for collateral dependent impaired loans are classified as Level 3.

As of June 30, 2018 and December 31, 2017, the Company had collateral dependent loans with a carrying value of \$25 thousand and \$0.1 million, respectively, which had specific reserves including in the allowance for loan losses of \$25 thousand and \$0.1 million, respectively.

**Interest Rate Swaps**

The Company enters into interest rate swaps to facilitate customer transactions and meet their financing needs. These swaps are considered derivatives, but are not designated in hedging relationships. These instruments have interest rate and credit risk associated with them. To mitigate the interest rate risk, the Company enters into offsetting interest rate swaps with counterparties. The counterparty swaps are also considered derivatives and are also not designated in hedging relationships. Interest rate swaps are recorded within other assets or other liabilities on the unaudited interim consolidated balance sheet at their estimated fair value. Changes to the fair value of assets and liabilities arising from these derivatives are included, net, in other operating income in the unaudited interim consolidated statement of income. At June 30, 2018 the notional amount of these customer derivative agreements and the offsetting derivative counterparty positions each totaled \$625.7 million and the fair values included in other assets and other liabilities on the unaudited interim consolidated balance sheet applicable to these agreements amounted to \$18.5 million. At December 31, 2017, the notional amount of these customer derivative agreements and the offsetting derivative counterparty positions each totaled \$481.2 million and the fair values included in other assets and other liabilities on the unaudited interim consolidated balance sheet applicable to these agreements amounted to \$0.2 million.

The Company has entered into interest rate swaps to modify the interest rate characteristics of certain short-term FHLB advances from variable rate to fixed rate in order to reduce the impact of changes in future cash flows due to

market interest rate changes. These agreements are designated as cash flow hedges. The notional amount of these interest rate derivative agreements total \$225.0 million at June 30, 2018 and \$250.0 million at December 31, 2017. Fair values included in other assets on the unaudited interim consolidated balance sheet applicable to these agreements amounted to \$4.1 million at June 30, 2018 and \$3.5 million at December 31, 2017.

For derivatives designated and that qualify as cash flow hedges of interest rate risk, the gain or loss on the derivative is recorded in AOCI and subsequently reclassified into interest expense in the same period during which the hedge transaction affects earnings. Amounts reported in AOCI related to derivatives will be reclassified to interest expense as interest payments are made on the Company's short-term rate borrowings. The change in net unrealized gains (losses) on cash flow hedges reflects a reclassification of \$0.5 million and \$0.1 million of net unrealized gains from AOCI to interest expense during the three months ended June 30, 2018 and 2017, respectively. The change in net unrealized gains (losses) on cash flow hedges reflects a reclassification of \$0.9 million of net unrealized gains and \$0.1 million of net unrealized (losses) from AOCI to interest expense during the six months ended June 30, 2018 and 2017, respectively. During the next twelve months, the Company estimates that an additional \$3.0 million will be reclassified from AOCI as a reduction to interest expense.

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The following table sets forth information with regard to estimated fair values of financial instruments. This table excludes financial instruments for which the carrying amount approximates fair value. Financial instruments for which the fair value approximates carrying value include cash and cash equivalents, AFS securities, equity securities, trading securities, accrued interest receivable, non-maturity deposits, short-term borrowings, accrued interest payable and interest rate swaps.

|                          |                      | June 30, 2018   |                      | December 31, 2017 |                      |
|--------------------------|----------------------|-----------------|----------------------|-------------------|----------------------|
| (In thousands)           | Fair Value Hierarchy | Carrying Amount | Estimated Fair Value | Carrying Amount   | Estimated Fair Value |
| Financial assets:        |                      |                 |                      |                   |                      |
| HTM securities           | 2                    | \$544,163       | \$532,979            | \$484,073         | \$481,871            |
| Net loans                | 3                    | 6,786,613       | 6,811,553            | 6,515,273         | 6,651,931            |
| Financial liabilities:   |                      |                 |                      |                   |                      |
| Time deposits            | 2                    | \$864,052       | \$856,646            | \$806,766         | \$801,294            |
| Long-term debt           | 2                    | 73,778          | 72,379               | 88,869            | 88,346               |
| Junior subordinated debt | 2                    | 101,196         | 101,248              | 101,196           | 104,593              |

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. For example, the Company has a substantial trust and investment management operation that contributes net fee income annually. The trust and investment management operation is not considered a financial instrument and its value has not been incorporated into the fair value estimates. Other significant assets and liabilities include the benefits resulting from the low-cost funding of deposit liabilities as compared to the cost of borrowing funds in the market and premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimate of fair value.

**HTM Securities**

The fair value of the Company's investment HTM securities is primarily measured using information from a third party pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things.

**Net Loans**

The fair value of the Company's loans was estimated by discounting the expected future cash flows using the current interest rates at which similar loans would be made for the same remaining maturities, in accordance with the exit price notion as defined by Financial Accounting Standards Board ("FASB") Accounting Standard Codification ("ASC") 820, Fair Value Measurement ("ASC 820"). Loans were first segregated by type and then further segmented into fixed and variable rate and loan quality categories. Expected future cash flows were projected based on contractual cash flows, adjusted for estimated prepayments and as a result of the adoption of Accounting Standard

Update ("ASU") 2016-01, *Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities*, which also included credit risk, illiquidity risk and other market factors to calculate the exit price fair value in accordance with ASC 820. Upon adoption, ASU 2016-01, did not materially change the estimated fair value of loans.

#### Time Deposits

The fair value of time deposits was estimated using a discounted cash flow approach that applies prevailing market interest rates for similar maturity instruments. The fair values of the Company's time deposit liabilities do not take into consideration the value of the Company's long-term relationships with depositors, which may have significant value.

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### Long-Term Debt

The fair value of long-term debt was estimated using a discounted cash flow approach that applies prevailing market interest rates for similar maturity instruments.

### Junior Subordinated Debt

The fair value of junior subordinated debt has been estimated using a discounted cash flow analysis.

## 9. Commitments and Contingencies

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, unused lines of credit, standby letters of credit and certain agricultural real estate loans sold to investors with recourse, with the sold portion having a government guarantee that is assignable back to the Company upon repurchase of the loan in the event of default. The Company's exposure to credit loss in the event of nonperformance by the other party to the commitments to extend credit, unused lines of credit, standby letters of credit and loans sold with recourse is represented by the contractual amounts of those investments. The credit risk associated with commitments to extend credit and standby and commercial letters of credit is essentially the same as that involved with extending loans to customers and is subject to normal credit policies. Commitments to extend credit and unused lines of credit totaled \$1.7 billion at June 30, 2018 and \$1.6 billion at December 31, 2017.

Since many loan commitments, standby letters of credit, guarantees and indemnification contracts expire without being funded in whole or in part, the contract amounts are not necessarily indicative of future cash flows. The Company does not issue any guarantee that would require liability-recognition or disclosure, other than its standby letters of credit.

The Company guarantees the obligations or performance of customers by issuing standby letters of credit to third parties. These standby letters of credit are frequently issued in support of third party debt, such as corporate debt issuances, industrial revenue bonds and municipal securities. The risk involved in issuing standby letters of credit is essentially the same as the credit risk involved in extending loan facilities to customers and they are subject to the same credit origination guidelines, portfolio maintenance and management procedures in effect to monitor other credit and off-balance sheet products. Typically, these instruments have terms of five years or less and expire unused; therefore, the total amounts do not necessarily represent future cash commitments. Standby letters of credit totaled \$40.5 million at June 30, 2018 and \$41.1 million at December 31, 2017. As of June 30, 2018 and December 31, 2017, the fair value of standby letters of credit was not significant.

## 10. Revenue from Contracts with Customers

Effective January 1, 2018, the Company adopted FASB ASU 2014-09, Revenue from Contracts with Customers (ASC Topic 606) ("ASC 606" and "ASU 2014-09"), and all subsequent ASUs that modified ASC 606. The implementation of ASC 606 did not have a material impact on the measurement or recognition of revenue; as such, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts were not adjusted and continue to be reported in accordance with our historic accounting under ASC 605. ASC 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities and certain noninterest income streams such as fees associated with mortgage servicing rights, financial guarantees, derivatives and certain credit card fees are also not in scope. ASC 606 is applicable to noninterest revenue streams such as trust and asset management income, deposit related fees and annuity and insurance commissions; however, the recognition of these revenue streams did not change significantly upon adoption of ASC 606.



#### Insurance and Other Financial Services Revenue

Insurance and other financial services revenue primarily consists of commissions received on insurance and brokered investment product sales. The Company acts as an intermediary between the Company's customer and the insurance carrier. The Company's performance obligation is generally satisfied upon the issuance of the annuity policy and the Company generally recognizes revenue. Shortly after the policy is issued, the carrier remits the commission payment to the Company. The Company does not earn a significant amount of trailing commission fees on insurance or brokered investment product sales. The majority of the trailing commission fees are calculated based on a percentage of market value of a period end and revenue is recognized when an investment product's market value can be determined.

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### Service Charges on Deposit Accounts

Service charges on deposit accounts consist of overdraft fees, monthly service fees, check orders and other deposit account related fees. Overdraft, monthly service, check orders and other deposit account related fees are transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts.

### ATM and Debit Card Fees

ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. Debit card income is primarily comprised of interchange fees earned whenever the Company's debit cards are processed through card payment networks. The Company's performance obligations for these revenue streams are satisfied, and related revenue recognized, when the services are rendered or upon completion of a transaction. Payment is typically received immediately or in the following month through a direct charge to customer's accounts.

### Retirement Plan Administration Fees

Retirement plan administration fees are primarily generated for services related to the recordkeeping, administration and plan design solutions of defined benefit, defined contribution and revenue sharing plans. Revenue is recognized for services provided in accordance with fees established in contracts with customers or based on rates agreed to with investment trade platforms based on ending investment balances held. The Company's performance obligation is satisfied, and related revenue recognized based on services completed or ending investment balances, for which receivables are recorded at the time of revenue recognition.

### Trust

Trust and asset management income is primarily comprised of fees earned from the management and administration of trusts, pensions and other customer assets. The Company's performance obligation is generally satisfied with the resulting fees recognized monthly, based upon services completed or the month-end market value of the assets under management and the applicable fee rate. Payment is generally received shortly after services are rendered or a few days after month end through a direct charge to customers' accounts. The Company does not earn performance-based incentives.

### Other

Other noninterest income consists of other recurring revenue streams such as account and loan fees, interest rate swap fees, safety deposit box rental fees and other miscellaneous revenue streams. These revenue streams are primarily transactional based and payment is received immediately or in the following month. The Company's performance obligation is satisfied and related revenue recognized at the completion of a transaction.

The following table presents noninterest income, segregated by revenue streams in-scope and out-of-scope of ASC 606, for three and six months ended June 30, 2018 and 2017:

| (In thousands)                                 | Three Months Ended June 30, |          | Six Months Ended June 30, |           |
|--|-----------------------------|----------|---------------------------|-----------|
|  | 2018                        | 2017     | 2018                      | 2017      |
| Noninterest income                             |                             |          |                           |           |
| In-Scope of ASC 606:                           |                             |          |                           |           |
| Insurance and other financial services revenue | \$ 5,826                    | \$ 5,621 | \$ 12,330                 | \$ 12,391 |

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|  |           |           |           |           |
|--|-----------|-----------|-----------|-----------|
| Service charges on deposit accounts              | 4,246     | 4,161     | 8,218     | 8,138     |
| ATM and debit card fees                          | 5,816     | 5,518     | 11,089    | 10,468    |
| Retirement plan administration fees              | 7,296     | 5,437     | 12,635    | 9,609     |
| Trust  | 5,265     | 5,161     | 10,143    | 9,693     |
| Other  | 4,401     | 3,186     | 8,293     | 6,124     |
| Total noninterest income in-scope of ASC 606     | \$ 32,850 | \$ 29,084 | \$ 62,708 | \$ 56,423 |
| Total noninterest income out-of-scope of ASC 606 | \$ 1,308  | \$ 1,220  | \$ 2,727  | \$ 2,631  |
| Total noninterest income                         | \$ 34,158 | \$ 30,304 | \$ 65,435 | \$ 59,054 |

Contract Balances

A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration or before payment is due, which would result in contract receivables or assets, respectively. A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment or for which payment is due from the customer. The Company's noninterest revenue streams are largely based on transactional activity, or standard month-end revenue accruals such as asset management fees based on month-end market values. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of June 30, 2018 and December 31, 2017, the Company did not have any significant contract balances.

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### Contract Acquisition Costs

ASC 606 requires the capitalization, and subsequently amortization into expense, certain incremental costs of obtaining a contract with a customer if these costs are expected to be recovered. The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained. The Company elected the practical expedient, which allows immediate expensing of contract acquisition costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less, and did not capitalize any contract acquisition costs upon adoption of ASC 606 as of or during the three and six months ended June 30, 2018.

## 11. Recent Accounting Pronouncements

### Recently Adopted Accounting Standards

Effective January 1, 2018, the Company early adopted the provisions of FASB ASU 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which was issued in February 2018. ASU 2018-02 allows a reclassification from AOCI to retained earnings for stranded tax effects resulting from the newly enacted federal corporate income tax rate in the Tax Act. The Tax Act included a reduction to the Federal corporate income tax rate from 35% to 21% effective January 1, 2018. The amount of the reclassification from AOCI to retained earnings is the difference between the historical corporate income tax rate and the newly enacted rate and will be accounted for as a cumulative-effect adjustment to the balance sheet. The adoption of ASU 2018-02 resulted in a reclassification that decreased AOCI and increased retained earnings by \$5.6 million, with no net effect on total stockholders' equity. The Company utilizes the individual securities approach when releasing income tax effects from AOCI for its investment securities.

Effective January 1, 2018, the Company early adopted the provisions of FASB ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities, which was issued in August 2017. ASU 2017-12 better aligns the accounting and reporting of hedging relationships with the economics of risk management activities. The amendments of ASU 2017-12 were applied on a modified retrospective basis and adoption did not have an impact on the consolidated financial statements and related disclosures.

Effective January 1, 2018, the Company adopted the provisions of FASB ASU 2017-09, Compensation-Stock Compensation (Topic 718), which was issued in May 2017. ASU 2017-09 provides guidance about which changes to the terms and conditions of a share-based payment award require an entity to apply modification accounting. The amendments of ASU 2017-09 were applied on a prospective basis and adoption did not have an impact on the consolidated financial statements and related disclosures.

Effective January 1, 2018, the Company adopted the provisions of FASB ASU 2017-07, Compensation – Retirement Benefits (Topic 715), which was issued in March 2017. ASU 2017-07 requires the service cost component of net periodic pension and post-retirement benefit cost to be reported separately in the consolidated statements of income from the other components. Additionally, the amendments in the ASU require presentation of the service cost component in the consolidated statements of income in the same line item as other employee compensation costs and presentation of the other components in a different line item from the service cost component. The amendments in ASU 2017-07 were applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic post-retirement benefit cost in the income statement. The adoption of ASU 2017-07 resulted in the reclassification of \$0.4 million and \$0.8 million of other components of net benefit cost from salaries and employee benefits expense to other noninterest expense for the three and six months ended June 30, 2017, respectively.

Effective January 1, 2018, the Company adopted the provisions of FASB ASU 2017-05, Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20), which was issued in February 2017. ASU 2017-05 clarifies the scope of ASC Subtopic 610-20 and adds guidance for partial sales of nonfinancial assets. The amendments define the term in substance nonfinancial assets and clarify that a nonfinancial asset within the scope may include nonfinancial assets transferred within a legal entity to a counterparty, in part, as a financial asset promised to a counterparty in a contract. Additionally, the amendments in the ASU clarify that an entity should identify each distinct nonfinancial asset or in substance nonfinancial assets and allocate consideration to each distinct asset. The amendments of ASU 2017-05 were applied on a modified retrospective basis and adoption did not have a significant impact on the consolidated financial statements and related disclosures.

Effective January 1, 2018, the Company adopted the provisions of FASB ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business, which was issued in January 2017. ASU 2017-01 provides a more robust framework to use in determining when a set of assets and activities is a business and to address stakeholder feedback that the definition of a business in current GAAP is applied too broadly. The primary amendments in the ASU provide a screen to exclude transactions where substantially all of the fair value of the transferred set is concentrated in a single asset, or group of similar assets, from being evaluated as a business. The amendments of ASU 2017-01 were applied on a prospective basis and adoption did not have an impact on the consolidated financial statements and related disclosures.

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Effective January 1, 2018, the Company adopted the provisions of FASB ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments), issued in August 2016. ASU 2016-15 addresses diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. This standard addresses the following eight specific cash flow issues: Debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies; distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The amendments of ASU 2016-15 were applied on a retrospective basis and adoption did not have an impact on the consolidated financial statements and related disclosures.

Effective January 1, 2018, the Company adopted the provisions of FASB ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10) – Recognition and Measurement of Financial Assets and Financial Liabilities, which was issued in January 2016. ASU 2016-01 addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments and requires entities to measure equity investments that do not result in consolidation and are not accounted for under the equity method at fair value. Any changes in fair value on equity investments with readily determinable market value will be recognized in net income unless the investments qualify for a new practicability exception. This ASU also requires entities to recognize changes in instrument-specific credit risk related to financial liabilities measured under the fair value option in OCI. The fair value measurement of loans was modified, with no significant impact, to incorporate illiquidity risk and other market factors in addition to credit risk in order to calculate the exit price fair value in accordance with ASC 820 as required by ASU 2016-01. The adoption of ASU 2016-01 did not have a significant impact on the consolidated financial statements and related disclosures and resulted in a reclassification that decreased AOCI and increased retained earnings by \$2.6 million and had an immaterial effect on total stockholders' equity, equity securities and other assets.

Effective January 1, 2018, the Company adopted the provisions of FASB ASU 2014-09, which was issued in May 2014. ASU 2014-09 is a comprehensive new revenue recognition standard that superseded nearly all previous revenue recognition guidance under GAAP and is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects consideration to which the entity expects to be entitled in exchange for those goods and services. The ASU requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. The adoption included ASU 2014-09 and all related updates to clarify ASU 2014-09, including ASU 2016-08, Principal versus Agent Considerations (Reporting Revenue Gross versus Net), ASU 2016-10, Identifying Performance Obligations and Licensing, ASU 2016-12, Narrow-Scope Improvements and Practical Expedients, and ASU 2016-20, Technical Corrections and Improvements to Topic 606 - Revenue from Contract with Customers.

Management determined that the majority of revenue earned by the Company is from revenue streams not included in the scope of this standard such as interest earned from loans, investment securities and bank owned life insurance income. For applicable revenue streams such as ATM and debit card fees, insurance, other financial services revenue, service charges on deposit accounts, retirement plan administration fees and trust fees, management reviewed the applicable contracts provisions and applied the principles in the new standard for revenue recognition. The amendments of ASU 2014-09 were applied on a modified retrospective basis. There was no cumulative effect adjustment as of January 1, 2018. The adoption of ASU 2014-09 and all related ASU updates to ASC 606 did not have a significant impact on the consolidated financial statements and related disclosures as of and for three and six months ended June 30, 2018. Refer to footnote 10, Revenue from Contracts with Customers, for more information.

Accounting Standards Issued Not Yet Adopted

In February 2018, the FASB issued ASU 2018-03, Technical Correction and Improvement to Financial Instruments – Overall (Subtopic 825-10), to clarify certain aspects of the guidance issued in ASU 2016-01. The provisions of ASU 2018-03 are effective July 1, 2018 for interim financial statements but may be early adopted in any interim period starting January 1, 2018 as long as ASU 2016-01 is also adopted. Management is evaluating the effect that this guidance will have on the consolidated financial statements and related disclosures and does not expect the impact to be material.

In March 2017, the FASB issued ASU 2017-08, Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20). ASU 2017-08 requires amortization of premiums to the earliest call date on debt securities with call features that are explicit, on contingent and callable at fixed prices on present dates. The ASU does not impact securities held at a discount; the discount continues to be amortized to the contractual maturity. The guidance is required to be applied with a modified retrospective approach through a cumulative effect adjustment to retained earnings as of the beginning of the period of adoption. ASU 2017-08 is effective for the Company on January 1, 2019. Early adoption is permitted. Management is evaluating the effect that this guidance will have on the consolidated financial statements and related disclosures and does not expect the impact to be material.

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In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("CECL"). ASU 2016-13 introduces new guidance that make substantive changes to the accounting for credit losses. ASU 2016-13 introduces the CECL model, which applies to financial assets subject to credit losses and measured at amortized cost, as well as certain off-balance sheet credit exposures. This includes loans, loan commitments, standby letters of credit, net investments in leases recognized by a lessor and HTM debt securities. The CECL model requires an entity to estimate credit losses expected over the life of an exposure, considering information about historical events, current conditions and reasonable and supportable forecasts and is generally expected to result in earlier recognition of credit losses. ASU 2016-13 also modifies certain provisions of the current OTTI model for AFS debt securities. Credit losses on AFS debt securities will be limited to the difference between the security's amortized cost basis and its fair value and will be recognized through an allowance for credit losses rather than as a direct reduction in amortized cost basis. ASU 2016-13 also provides for a simplified accounting model for purchased financial assets with more than insignificant credit deterioration since their origination. ASU 2016-13 requires expanded disclosures including, but not limited to, (i) information about the methods and assumptions used to estimate expected credit losses, including changes in the factors that influenced management's estimate and the reasons for those changes, (ii) for financing receivables and net investment in leases measured at amortized cost, further disaggregation of information about the credit quality of those assets and (iii) a rollforward of the allowance for credit losses for HTM and AFS securities. ASU 2016-13 is effective for the Company on January 1, 2020. Early adoption is permitted for all organizations for fiscal years and interim periods within those fiscal years, beginning after December 15, 2018; however, the Company does not intend to early adopt this ASU. Management is evaluating the effect that this guidance will have on the consolidated financial statements and related disclosures, processes and controls and is not currently able to reasonably estimate the impact of adoption on the Company's consolidated financial statements; however, adoption is likely to lead to significant changes in accounting policies related to, and the methods employed in estimating the allowance for loan and lease losses. It is possible that the impact will be material to the Company's consolidated financial statements. To date, the Company has completed a gap analysis, adopted a detailed implementation plan, established a formal governance structure for the project, selected and is in the process of implementing a software solution to serve as its CECL platform.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). ASU 2016-02 requires lessees to recognize right of use assets and lease liabilities on the balance sheet for all leases with terms longer than 12 months. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize a right of use asset and lease liability. Additionally, when measuring assets and liabilities arising from a lease, optional payments should be included only if the lessee is reasonably certain to exercise an option to extend the lease, exercise a purchase option or not exercise an option to terminate the lease. In January 2018, the FASB issued ASU 2018-01, Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842. ASU 2018-01 was issued to address concerns about the cost and complexity of complying with the transition provisions of ASU 2016-02. Both ASU 2016-02 and ASU 2018-01 are effective for the Company on January 1, 2019. Early adoption is permitted in any interim or annual period. Lessees and lessors are required to apply the provisions of ASU 2016-02 at the beginning of the earliest period presented using a modified retrospective approach. Management is in the process of finalizing its evaluation of the impact of adoption of this ASU on its consolidated financial statements and related disclosures, processes and controls. The Company has acquired and is in the process of implementing software to facilitate calculation and reporting of the lease liability and right-of-use asset. The most significant impact of adoption is expected to be the recognition, as lessee, of new right-of-use assets and lease liabilities on the consolidated balance sheet for real estate leases currently classified as operating leases. At its November 29, 2017 meeting, the FASB proposed allowing entities the option of applying the provisions of ASU 2016-02 at the effective date without adjusting the comparative periods presented. In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842, Leases. ASU 2018-10 was issued to provide more detailed guidance and additional clarification for implementing ASU 2016-02. Also in July 2018, the FASB issued ASU 2018-11, Targeted Improvements, which allows for an optional transition method in which the provisions of ASC Topic 842 would be applied upon the adoption date and would not have to be retroactively applied to the earliest reporting period presented in the consolidated financial statements. The Company is monitoring these and other



proposed modifications to the requirements of this ASU.

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NBT BANCORP INC. AND SUBSIDIARIES

Item 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The purpose of this discussion and analysis is to provide a concise description of the financial condition and results of operations of NBT Bancorp Inc. ("NBT") and its wholly owned consolidated subsidiaries, including NBT Bank, National Association (the "Bank"), NBT Financial Services, Inc. ("NBT Financial") and NBT Holdings, Inc. ("NBT Holdings") (collectively referred to herein as the "Company"). This discussion will focus on results of operations, financial condition, capital resources and asset/liability management. Reference should be made to the Company's consolidated financial statements and footnotes thereto included in this Form 10 Q as well as to the Company's Annual Report on Form 10 K for the year ended December 31, 2017 for an understanding of the following discussion and analysis. Operating results for the three and six month periods ending June 30, 2018 are not necessarily indicative of the results of the full year ending December 31, 2018 or any future period.

Forward-looking Statements

Certain statements in this filing and future filings by the Company with the SEC, in the Company's press releases or other public or stockholder communications or in oral statements made with the approval of an authorized executive officer, contain forward-looking statements, as defined in the Private Securities Litigation Reform Act. These statements may be identified by the use of phrases such as "anticipate," "believe," "expect," "forecasts," "projects," "will," "can," "would," "should," "could," "may," or other similar terms. There are a number of factors, many of which are beyond the Company's control that could cause actual results to differ materially from those contemplated by the forward-looking statements. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, among others, the following possibilities: (1) local, regional, national and international economic conditions and the impact they may have on the Company and its customers and the Company's assessment of that impact; (2) changes in the level of nonperforming assets and charge-offs; (3) changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements; (4) the effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board ("FRB"); (5) inflation, interest rate, securities market and monetary fluctuations; (6) political instability; (7) acts of war or terrorism; (8) the timely development and acceptance of new products and services and perceived overall value of these products and services by users; (9) changes in consumer spending, borrowings and savings habits; (10) changes in the financial performance and/or condition of the Company's borrowers; (11) technological changes; (12) acquisitions and integration of acquired businesses; (13) the ability to increase market share and control expenses; (14) changes in the competitive environment among financial holding companies; (15) the effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which the Company and its subsidiaries must comply, including those under the Dodd- Frank Act; (16) the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board ("FASB") and other accounting standard setters; (17) changes in the Company's organization, compensation and benefit plans; (18) the costs and effects of legal and regulatory developments including the resolution of legal proceedings or regulatory or other governmental inquiries and the results of regulatory examinations or reviews; (19) greater than expected costs or difficulties related to the integration of new products and lines of business; and (20) the Company's success at managing the risks involved in the foregoing items.

The Company cautions readers not to place undue reliance on any forward-looking statements, which speak only as of the date made, and advises readers that various factors, including, but not limited to, those described above and other factors discussed in the Company's annual and quarterly reports previously filed with the Securities and Exchange Commission, could affect the Company's financial performance and could cause the Company's actual results or circumstances for future periods to differ materially from those anticipated or projected.

Unless required by law, the Company does not undertake, and specifically disclaims any obligations to, publicly release any revisions that may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

#### Non-GAAP Measures

This Quarterly Report on Form 10-Q contains financial information determined by methods other than in accordance with accounting principles generally accepted in the United States of America ("GAAP"). These measures adjust GAAP measures to exclude the effects of acquisition-related intangible amortization expense on earnings and equity as well as providing a fully taxable equivalent ("FTE") yields on securities and loans. Where non-GAAP disclosures are used in this Form 10-Q, the comparable GAAP measure, as well as a reconciliation to the comparable GAAP measure, is provided in the accompanying tables. Management believes that these non-GAAP measures provide useful information that is important to an understanding of the results of the Company's core business as well as provide information standard in the financial institution industry. Non-GAAP measures should not be considered substitutes for financial measures determined in accordance with GAAP and investors should consider the Company's performance and financial condition as reported under GAAP and all other relevant information when assessing the performance or financial condition of the Company.

#### Critical Accounting Policies

The Company has identified policies as being critical because they require management to make particularly difficult, subjective and/or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. These policies relate to the allowance for loan losses, pension accounting and provision for income taxes.

Management of the Company considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy given the uncertainty in evaluating the level of the allowance required to cover credit losses inherent in the loan portfolio and the material effect that such judgments can have on the results of operations. While management's current evaluation of the allowance for loan losses indicates that the allowance is appropriate, under adversely different conditions or assumptions, the allowance may need to be increased. For example, if historical loan loss experience significantly worsened or if current economic conditions significantly deteriorated, additional provision for loan losses would be required to increase the allowance. In addition, the assumptions and estimates used in the internal reviews of the Company's nonperforming loans and potential problem loans have a significant impact on the overall analysis of the adequacy of the allowance for loan losses. While management has concluded that the current evaluation of collateral values is reasonable under the circumstances, if collateral values were significantly lower, the Company's allowance for loan loss policy would also require additional provision for loan losses.

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Management is required to make various assumptions in valuing the Company's pension assets and liabilities. These assumptions include the expected rate of return on plan assets, the discount rate and the rate of increase in future compensation levels. Changes to these assumptions could impact earnings in future periods. The Company takes into account the plan asset mix, funding obligations and expert opinions in determining the various rates used to estimate pension expense. The Company also considers the Citigroup Pension Liability Index, market interest rates and discounted cash flows in setting the appropriate discount rate. In addition, the Company reviews expected inflationary and merit increases to compensation in determining the rate of increase in future compensation levels.

The Company is subject to examinations from various taxing authorities. Such examinations may result in challenges to the tax return treatment applied by the Company to specific transactions. Management believes that the assumptions and judgments used to record tax-related assets or liabilities have been appropriate. Should tax laws change or the taxing authorities determine that management's assumptions were inappropriate, an adjustment may be required which could have a material effect on the Company's results of operations.

The Company's policies on the allowance for loan losses, pension accounting and provision for income taxes are disclosed in Note 1 to the consolidated financial statements presented in our 2017 Annual Report on Form 10-K. All accounting policies are important and as such, the Company encourages the reader to review each of the policies included in Note 1 to the consolidated financial statements presented in our 2017 Annual Report on Form 10-K to obtain a better understanding of how the Company's financial performance is reported.

Refer to Note 11 to the unaudited interim consolidated financial statements in this Quarterly Report on Form 10-Q for recently adopted accounting standards.

## Overview

Significant factors management reviews to evaluate the Company's operating results and financial condition include, but are not limited to: net income and earnings per share, return on average assets and equity, net interest margin, noninterest income, operating expenses, asset quality indicators, loan and deposit growth, capital management, liquidity and interest rate sensitivity, enhancements to customer products and services, technology advancements, market share and peer comparisons. The following information should be considered in connection with the Company's results for the three and six months ended June 30, 2018:

- Quarter-to-date earnings per share up 8.5% from prior quarter and up 30.6% from prior year
- Quarter-to-date net income up 8.2% from prior quarter and up 31.7% from prior year
- Year-to-date loan growth of 8.4% (annualized)
- Average demand deposits for the six months ended June 30, 2018 up 4.9% from the same period in 2017
- FTE net interest margin of 3.57% for the six months ended June 30, 2018
- Nonperforming assets to total assets decreased 4 basis points ("bps") from prior quarter to 0.32%

## Results of Operations

Net income for the three months ended June 30, 2018 was \$28.1 million, up from \$26.0 million for the first quarter of 2018 and up from \$21.4 million for the second quarter of 2017. Diluted earnings per share for the three months ended June 30, 2018 was \$0.64, as compared with \$0.59 for the prior quarter and \$0.49 for the second quarter of 2017. Return on average assets (annualized) was 1.21% for the three months ended June 30, 2018 as compared to 1.15% for the prior quarter and 0.95% for the same period last year. Return on average equity (annualized) was 11.64% for the three months ended June 30, 2018 as compared to 10.99% for the prior quarter and 9.11% for the three months ended June 30, 2017. Return on average tangible common equity (annualized) was 17.08% for the three months ended June 30, 2018 as compared to 15.95% for the prior quarter and 13.46% for the three months ended June 30, 2017.

Net income for the six months ended June 30, 2018 was \$54.1 million, up 29.9% from \$41.6 million for the same period last year. Diluted earnings per share for the six months ended June 30, 2018 was \$1.23, as compared with \$0.95 for the same period in 2017, an increase of 29.5%. Return on average assets (annualized) was 1.18% for the six months ended June 30, 2018 as compared to 0.94% for the same period last year. Return on average equity (annualized) was 11.32% for the six months ended June 30, 2018 as compared to 9.02% for the six months ended June 30, 2017. Return on average tangible common equity (annualized) was 16.52% for the six months ended June 30, 2018 as compared to 13.36% for the six months ended June 30, 2017.

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Return on average tangible common equity is a non-GAAP measure and excludes amortization of intangible assets (net of tax) from net income and average tangible equity calculated as follows:

|  | Three months ended<br>June 30, |           | Six months ended<br>June 30, |           |
|--|--------------------------------|-----------|------------------------------|-----------|
| (In thousands)                                 | 2018                           | 2017      | 2018                         | 2017      |
| Net income                                     | \$28,121                       | \$21,359  | \$54,107                     | \$41,638  |
| Amortization of intangible assets (net of tax) | 822                            | 642       | 1,508                        | 1,239     |
| Net income, excluding intangible amortization  | \$28,943                       | \$22,001  | \$55,615                     | \$42,877  |
| Average stockholders' equity                   | \$969,029                      | \$940,897 | \$964,064                    | \$930,529 |
| Less: average goodwill and other intangibles   | 289,250                        | 285,388   | 285,161                      | 283,094   |
| Average tangible common equity                 | \$679,779                      | \$655,509 | \$678,903                    | \$647,435 |

## Net Interest Income

Net interest income is the difference between interest income on earning assets, primarily loans and securities and interest expense on interest bearing liabilities, primarily deposits and borrowings. Net interest income is affected by the interest rate spread, the difference between the yield on earning assets and cost of interest bearing liabilities, as well as the volumes of such assets and liabilities. Net interest income is one of the key determining factors in a financial institution's performance as it is the principal source of earnings.

Net interest income was \$75.7 million for the second quarter of 2018, up \$2.3 million or 3.1%, from the previous quarter. FTE net interest margin was 3.57% for the three months ended June 30, 2018, comparable to the previous quarter. The yield on average earning assets increased 7 bps from the prior quarter to 3.99%, primarily reflecting higher loan yields. The cost of interest bearing liabilities increased 10 bps to 0.61% for the quarter ended June 30, 2018, driven by increased short-term borrowings costs, with interest bearing deposit costs increasing 8 bps. Average interest earning assets were up \$174.2 million, or 2.1%, as compared to the prior quarter, primarily driven by a \$158.3 million increase in loans.

Net interest income was \$75.7 million for the second quarter of 2018, up \$6.1 million, or 8.8%, from the second quarter of 2017. FTE net interest margin of 3.57% was up 13 bps from the second quarter of 2017 as the improvement in asset yields was partially offset by the increase in cost of interest bearing liabilities. Average interest earning assets were up \$345.4 million, or 4.2%, from the same period in 2017, primarily driven by a \$456.7 million increase in loans that was partially offset by a \$107.4 million decrease in securities.

Net interest income for the first six months of 2018 was \$149.2 million, up \$11.1 million, or 8.0%, from the same period in 2017. FTE net interest margin of 3.57% for the six months ended June 30, 2018, was up from 3.45% for the same period in 2017 primarily due to increasing asset yields and the Company's deposit costs remaining relatively stable. Average interest earning assets were up \$300.0 million, or 3.7% for the six months ended June 30, 2018, as compared to the same period in 2017, which was driven by a \$419.2 million increase in loans that was partially offset by a \$111.9 million decrease in securities. Interest income increased \$14.2 million, or 9.4% due to the increase in earning assets combined with a 20 bp improvement in loan yields. Interest expense was up \$4.1 million, or 33.4%, for the six months ended June 30, 2018 as compared to the same period in 2017 and resulted primarily from a 13 bp increase in rates driven by higher borrowing costs and a modest 7 bp increase in the cost of deposits. The Federal Reserve began raising their target fed funds rate in December 2015 and has increased the target fed funds rate by 1.75% through June 30, 2018. During this same cycle of increasing rates, the Company's deposit rates have increased by 0.06%, resulting in a full cycle deposit beta of 3.4%, and is calculated as the change in the Company's quarterly deposit costs divided by the change in the Federal Reserve's target fed funds rate. The favorable deposit beta was influenced by a favorable loan to deposit ratio and deposit mix.

### Average Balances and Net Interest Income

The following tables include the condensed consolidated average balance sheet, an analysis of interest income/expense and average yield/rate for each major category of earning assets and interest bearing liabilities on a taxable equivalent basis. Interest income for tax-exempt securities and loans has been adjusted to a taxable-equivalent basis using the statutory Federal income tax rate of 21% for 2018 and 35% for 2017.

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| Three months ended                         | June 30, 2018 |          |        | June 30, 2017 |          |        |
|--|---------------|----------|--------|---------------|----------|--------|
|  | Average       |          | Yield/ | Average       |          | Yield/ |
| (Dollars in thousands)                     | Balance       | Interest | Rates  | Balance       | Interest | Rates  |
| Assets:                                    |               |          |        |               |          |        |
| Short-term interest bearing accounts       | \$3,574       | \$46     | 5.16 % | \$9,497       | \$43     | 1.82 % |
| Securities available for sale (1)(3)       | 1,266,304     | 7,046    | 2.23 % | 1,363,314     | 7,322    | 2.15 % |
| Securities held to maturity (1)            | 503,501       | 3,135    | 2.50 % | 513,888       | 3,374    | 2.63 % |
| FRB and FHLB stock                         | 48,184        | 735      | 6.12 % | 46,132        | 611      | 5.31 % |
| Loans (2)                                  | 6,750,710     | 74,283   | 4.41 % | 6,294,056     | 65,498   | 4.17 % |
| Total interest earning assets              | \$8,572,273   | \$85,245 | 3.99 % | \$8,226,887   | \$76,848 | 3.75 % |
| Other assets (3)                           | \$766,604     |          |        | \$753,383     |          |        |
| Total assets                               | \$9,338,877   |          |        | \$8,980,270   |          |        |
| Liabilities and Stockholders' Equity:      |               |          |        |               |          |        |
| Money market deposit accounts              | \$1,699,956   | \$1,816  | 0.43 % | \$1,723,594   | \$919    | 0.21 % |
| NOW deposit accounts                       | 1,222,889     | 479      | 0.16 % | 1,138,237     | 227      | 0.08 % |
| Savings deposits                           | 1,289,062     | 183      | 0.06 % | 1,232,301     | 172      | 0.06 % |
| Time deposits                              | 858,080       | 2,601    | 1.22 % | 824,398       | 2,218    | 1.08 % |
| Total interest bearing deposits            | \$5,069,987   | \$5,079  | 0.40 % | \$4,918,530   | \$3,536  | 0.29 % |
| Short-term borrowings                      | 706,694       | 2,455    | 1.39 % | 643,971       | 1,366    | 0.85 % |
| Long-term debt                             | 84,676        | 452      | 2.14 % | 99,865        | 599      | 2.41 % |
| Junior subordinated debt                   | 101,196       | 1,040    | 4.12 % | 101,196       | 772      | 3.06 % |
| Total interest bearing liabilities         | \$5,962,553   | \$9,026  | 0.61 % | \$5,763,562   | \$6,273  | 0.44 % |
| Demand deposits                            | \$2,294,023   |          |        | \$2,181,952   |          |        |
| Other liabilities                          | 113,272       |          |        | 93,859        |          |        |
| Stockholders' equity                       | 969,029       |          |        | 940,897       |          |        |
| Total liabilities and stockholders' equity | \$9,338,877   |          |        | \$8,980,270   |          |        |
| Net interest income (FTE)                  |               | \$76,219 |        |               | \$70,575 |        |
| Interest rate spread                       |               |          | 3.38 % |               |          | 3.31 % |
| Net interest margin (FTE)                  |               |          | 3.57 % |               |          | 3.44 % |
| Taxable equivalent adjustment              |               | \$478    |        |               | \$954    |        |
| Net interest income                        |               | \$75,741 |        |               | \$69,621 |        |

(1) Securities are shown at average amortized cost.

(2) For purposes of these computations, nonaccrual loans are included in the average loan balances outstanding.

For purposes of the average balance sheet presentation, equity securities amounts reclassified for the current period from securities available for sale to other assets, related to the adoption of Accounting Standard Update 2016-01,

(3) Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities, in the first quarter of 2018.

| Six months ended                     | June 30, 2018 |           |        | June 30, 2017 |           |        |
|--------------------------------------|---------------|-----------|--------|---------------|-----------|--------|
|                                      | Average       |           | Yield/ | Average       |           | Yield/ |
| (Dollars in thousands)               | Balance       | Interest  | Rates  | Balance       | Interest  | Rates  |
| Assets:                              |               |           |        |               |           |        |
| Short-term interest bearing accounts | \$3,198       | \$82      | 5.17 % | \$11,906      | \$90      | 1.52 % |
| Securities available for sale (1)(3) | 1,269,949     | 14,017    | 2.23 % | 1,357,797     | 14,442    | 2.14 % |
| Securities held to maturity (1)      | 492,996       | 6,081     | 2.49 % | 517,068       | 6,782     | 2.64 % |
| FRB and FHLB stock                   | 47,518        | 1,465     | 6.22 % | 46,228        | 1,183     | 5.16 % |
| Loans (2)                            | 6,672,016     | 144,825   | 4.38 % | 6,252,786     | 129,725   | 4.18 % |
| Total interest earning assets        | \$8,485,677   | \$166,470 | 3.96 % | \$8,185,785   | \$152,222 | 3.75 % |



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|                  |             |             |
|------------------|-------------|-------------|
| Other assets (2) | \$756,444   | \$750,943   |
| Total assets     | \$9,242,121 | \$8,936,728 |

Liabilities and Stockholders' Equity:

|  |             |           |        |             |           |        |
|--|-------------|-----------|--------|-------------|-----------|--------|
| Money market deposit accounts              | \$1,677,755 | \$2,933   | 0.35 % | \$1,705,925 | \$1,814   | 0.21 % |
| NOW deposit accounts                       | 1,216,992   | 882       | 0.15 % | 1,140,720   | 410       | 0.07 % |
| Savings deposits                           | 1,268,859   | 354       | 0.06 % | 1,204,418   | 329       | 0.06 % |
| Time deposits                              | 830,671     | 4,841     | 1.18 % | 835,840     | 4,457     | 1.08 % |
| Total interest bearing deposits            | \$4,994,277 | \$9,010   | 0.36 % | \$4,886,903 | \$7,010   | 0.29 % |
| Short-term borrowings                      | 709,442     | 4,421     | 1.26 % | 650,669     | 2,505     | 0.78 % |
| Long-term debt                             | 86,749      | 928       | 2.16 % | 101,945     | 1,205     | 2.38 % |
| Junior subordinated debt                   | 101,196     | 1,941     | 3.87 % | 101,196     | 1,498     | 2.99 % |
| Total interest bearing liabilities         | \$5,891,664 | \$16,300  | 0.56 % | \$5,740,713 | \$12,218  | 0.43 % |
| Demand deposits                            | \$2,277,083 |           |        | \$2,170,983 |           |        |
| Other liabilities                          | 109,310     |           |        | 94,503      |           |        |
| Stockholders' equity                       | 964,064     |           |        | 930,529     |           |        |
| Total liabilities and stockholders' equity | \$9,242,121 |           |        | \$8,936,728 |           |        |
| Net interest income (FTE)                  |             | \$150,170 |        |             | \$140,004 |        |
| Interest rate spread                       |             |           | 3.40 % |             |           | 3.32 % |
| Net interest margin (FTE)                  |             |           | 3.57 % |             |           | 3.45 % |
| Taxable equivalent adjustment              |             | \$943     |        |             | \$1,892   |        |
| Net interest income                        |             | \$149,227 |        |             | \$138,112 |        |

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(1) Securities are shown at average amortized cost less OTTI write-downs.

(2) For purposes of these computations, nonaccrual loans are included in the average loan balances outstanding.

For purposes of the average balance sheet presentation, equity securities amounts reclassified for the current period from securities available for sale to other assets, related to the adoption of Accounting Standard Update ("ASU") 2016-01, Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"), in the first quarter of 2018.

The following table presents changes in interest income and interest expense attributable to changes in volume (change in average balance multiplied by prior year rate), changes in rate (change in rate multiplied by prior year volume) and the net change in net interest income. The net change attributable to the combined impact of volume and rate has been allocated to each in proportion to the absolute dollar amounts of change.

| Three months ended June 30,<br>(In thousands) | Increase (Decrease)<br>2018 over 2017 |         |         |
|---|---------------------------------------|---------|---------|
|   | Volume                                | Rate    | Total   |
| Short-term interest bearing accounts          | \$(39 )                               | \$42    | \$3     |
| Securities available for sale (1)             | (533 )                                | 257     | (276 )  |
| Securities held to maturity                   | (67 )                                 | (172 )  | (239 )  |
| FRB and FHLB stock                            | 28                                    | 96      | 124     |
| Loans   | 4,906                                 | 3,879   | 8,785   |
| Total interest income (FTE)                   | \$4,295                               | \$4,102 | \$8,397 |
| Money market deposit accounts                 | \$(13 )                               | \$910   | \$897   |
| NOW deposit accounts                          | 18                                    | 234     | 252     |
| Savings deposits                              | 8                                     | 3       | 11      |
| Time deposits                                 | 93                                    | 290     | 383     |
| Short-term borrowings                         | 144                                   | 945     | 1,089   |
| Long-term debt                                | (85 )                                 | (62 )   | (147 )  |
| Junior subordinated debt                      | -                                     | 268     | 268     |
| Total interest expense (FTE)                  | \$165                                 | \$2,588 | \$2,753 |
| Change in net interest income (FTE)           | \$4,130                               | \$1,514 | \$5,644 |

| Six months ended June 30,<br>(In thousands) | Increase (Decrease)<br>2018 over 2017 |         |          |
|---|---------------------------------------|---------|----------|
|   | Volume                                | Rate    | Total    |
| Short-term interest bearing accounts        | \$(103 )                              | \$95    | \$(8 )   |
| Securities available for sale (1)           | (956 )                                | 531     | (425 )   |
| Securities held to maturity                 | (307 )                                | (394 )  | (701 )   |
| FRB and FHLB stock                          | 34                                    | 248     | 282      |
| Loans                                       | 8,936                                 | 6,164   | 15,100   |
| Total interest income (FTE)                 | \$7,604                               | \$6,644 | \$14,248 |
| Money market deposit accounts               | \$(30 )                               | \$1,149 | \$1,119  |
| NOW deposit accounts                        | 29                                    | 443     | 472      |
| Savings deposits                            | 18                                    | 7       | 25       |
| Time deposits                               | (28 )                                 | 412     | 384      |
| Short-term borrowings                       | 244                                   | 1,672   | 1,916    |
| Long-term debt                              | (169 )                                | (108 )  | (277 )   |
| Junior subordinated debt                    | -                                     | 443     | 443      |
| Total interest expense (FTE)                | \$64                                  | \$4,018 | \$4,082  |
| Change in net interest income (FTE)         | \$7,540                               | \$2,626 | \$10,166 |

(1) Equity securities amounts reclassified out of securities available for sale, related to the adoption of ASU 2016-01, in the first quarter of 2018.

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## Noninterest Income

Noninterest income is a significant source of revenue for the Company and an important factor in the Company's results of operations. The following table sets forth information by category of noninterest income for the periods indicated:

|  | Three months ended June 30, |           | Six months ended June 30, |           |
|--|-----------------------------|-----------|---------------------------|-----------|
| (In thousands)                                 | 2018                        | 2017      | 2018                      | 2017      |
| Insurance and other financial services revenue | \$ 5,826                    | \$ 5,621  | \$ 12,330                 | \$ 12,391 |
| Service charges on deposit accounts            | 4,246                       | 4,161     | 8,218                     | 8,138     |
| ATM and debit card fees                        | 5,816                       | 5,518     | 11,089                    | 10,468    |
| Retirement plan administration fees            | 7,296                       | 5,437     | 12,635                    | 9,609     |
| Trust  | 5,265                       | 5,161     | 10,143                    | 9,693     |
| Bank owned life insurance                      | 1,217                       | 1,218     | 2,564                     | 2,629     |
| Net securities gains                           | 91                          | 2         | 163                       | 2         |
| Other  | 4,401                       | 3,186     | 8,293                     | 6,124     |
| Total noninterest income                       | \$ 34,158                   | \$ 30,304 | \$ 65,435                 | \$ 59,054 |

Noninterest income for the three months ended June 30, 2018 was \$34.2 million, up \$2.9 million, or 9.2%, from the prior quarter and up \$3.9 million, or 12.7%, from the second quarter of 2017. The increase from the prior quarter was driven by higher retirement plan administration fees, ATM and debit card fees and other noninterest income that were partially offset by lower insurance and other financial services revenue during the second quarter of 2018. Retirement plan administration fees increased in the second quarter of 2018 as compared to the first quarter of 2018 due to the acquisition of Retirement Plan Services, LLC ("RPS") in the second quarter of 2018. ATM and debit card fees increased from prior quarter due to higher number of accounts and usage. Other noninterest income increased due to higher swap fee income. The increase from the second quarter of 2017 was driven by higher retirement plan administration fees resulting from the RPS acquisition and other noninterest income due primarily to higher swap fees.

Noninterest income for the six months ended June 30, 2018 was \$65.4 million, up \$6.4 million, or 10.8%, from the same period in 2017. The increase from the prior year was driven by higher retirement plan administration fees due to the acquisitions of RPS in the second quarter of 2018 and of Downeast Pension Services in the second quarter of 2017. Other noninterest income in the first half of 2018 increased compared to the same period of 2017 due primarily to higher swap fee income and non-recurring gains recognized in the first six months of 2018.

## Noninterest Expense

Noninterest expenses are also an important factor in the Company's results of operations. The following table sets forth the major components of noninterest expense for the periods indicated:

|  | Three months ended June 30, |           | Six months ended June 30, |           |
|--|-----------------------------|-----------|---------------------------|-----------|
| (In thousands)                         | 2018                        | 2017      | 2018                      | 2017      |
| Salaries and employee benefits         | \$ 37,726                   | \$ 33,503 | \$ 74,293                 | \$ 67,736 |
| Occupancy                              | 5,535                       | 5,184     | 11,654                    | 11,354    |
| Data processing and communications     | 4,508                       | 4,229     | 8,787                     | 8,427     |
| Professional fees and outside services | 3,336                       | 3,609     | 6,828                     | 6,641     |
| Equipment                              | 4,151                       | 3,793     | 8,189                     | 7,491     |
| Office supplies and postage            | 1,504                       | 1,640     | 3,077                     | 3,248     |
| FDIC expenses                          | 1,092                       | 1,136     | 2,293                     | 2,314     |

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|   |           |           |            |            |
|---|-----------|-----------|------------|------------|
| Advertising                                 | 700       | 656       | 1,037      | 1,046      |
| Amortization of intangible assets           | 1,096     | 1,039     | 2,010      | 2,006      |
| Loan collection and other real estate owned | 908       | 664       | 2,245      | 1,943      |
| Other                                       | 4,332     | 4,868     | 8,747      | 9,397      |
| Total noninterest expense                   | \$ 64,888 | \$ 60,321 | \$ 129,160 | \$ 121,603 |

Noninterest expense for the three months ended June 30, 2018 was \$64.9 million, up \$0.6 million, or 1.0%, from the prior quarter and up \$4.6 million, or 7.6%, from the second quarter of 2017. The increase from the prior quarter was driven by a \$1.2 million increase in salaries and employee benefits primarily due to the acquisition of RPS that were partially offset by a decrease in seasonal occupancy expense. The increase from the second quarter of 2017 was driven by an increase in salaries and employee benefits expenses primarily due to the RPS acquisition, wage increases from tax reform initiatives and higher incentive compensation.

Noninterest expense for the six months ended June 30, 2018 was \$129.2 million, up \$7.6 million, or 6.2%, from the same period in 2017. The increase from the prior year was driven by higher salaries and employee benefits and equipment expense that were partially offset by lower other noninterest expenses in the first half of 2018 as compared to the same period of 2017 due primarily to lower retirement plan costs. The increase in salaries and employee benefits was primarily due to the RPS acquisition in second quarter of 2018, the acquisition of Downeast Pension Services in the second quarter of 2017, timing of incentive compensation and wage increases from tax reform initiatives.

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## Income Taxes

Income tax expense for the three months ended June 30, 2018 was \$8.1 million, up \$1.1 million, or 15.7%, from the prior quarter and down \$2.6 million, or 24.0%, from the second quarter of 2017. The effective tax rate of 22.4% for the second quarter of 2018 was up from 21.2% for the first quarter of 2018 and down from 33.3% for the second quarter of 2017. The increase in income tax expense from the prior quarter was due to a lower income tax benefit from equity-based transactions and higher level of taxable income. The decrease in income tax expense from the second quarter of 2017 was due to the lower effective tax rate from the Tax Cuts and Jobs Act partially offset by a higher level of taxable income. Excluding the tax benefit from equity-based transactions, the effective tax rate was 22.5% for both the second quarter of 2018 and the first quarter of 2018.

Income tax expense for the six months ended June 30, 2018 was \$15.1 million, down \$3.9 million, or 20.3%, from the same period of 2017. The effective tax rate of 21.8% for the first six months of 2018 was down from 31.3% for the same period in the prior year. The decrease in income tax expense from the prior year was due to the lower effective tax rate from the Tax Cuts and Jobs Act partially offset by a higher level of taxable income and lower tax benefit from equity-based transactions. Excluding the tax benefit from equity-based transactions, the effective tax rate was 22.5% and 33.9% for the six months ending June 30, 2018 and 2017, respectively.

## ANALYSIS OF FINANCIAL CONDITION

## Securities

Total securities increased \$9.9 million, or 0.6%, from December 31, 2017 to June 30, 2018. The securities portfolio represents 18.6% of total assets as of June 30, 2018 as compared to 19.2% as of December 31, 2017.

The following table details the composition of securities available for sale, securities held to maturity and regulatory investments for the periods indicated:

|                                       | June 30,<br>2018 |   | December<br>31, 2017 |   |
|---------------------------------------|------------------|---|----------------------|---|
| Mortgage-backed securities:           |                  |   |                      |   |
| With maturities 15 years or less      | 28               | % | 28                   | % |
| With maturities greater than 15 years | 5                | % | 5                    | % |
| Collateral mortgage obligations       | 44               | % | 42                   | % |
| Municipal securities                  | 14               | % | 14                   | % |
| U.S. agency notes                     | 8                | % | 10                   | % |
| Equity securities                     | 1                | % | 1                    | % |
| Total                                 | 100              | % | 100                  | % |

The Company's mortgage backed securities, U.S. agency notes and collateralized mortgage obligations are all "prime/conforming" and are guaranteed by Fannie Mae, Freddie Mac, Federal Home Loan Bank, Federal Farm Credit Banks or Ginnie Mae ("GNMA"). GNMA securities are considered equivalent to U.S. Treasury securities, as they are backed by the full faith and credit of the U.S. government. Currently, there are no subprime mortgages in our investment portfolio. Refer to Note 3 to the Company's unaudited interim consolidated financial statements included in this Form 10-Q for information related to other-than-temporary impairment considerations.

## Loans

A summary of loans, net of deferred fees and origination costs, by category for the periods indicated follows:

|                         | June 30,    | December    |
|-------------------------|-------------|-------------|
| (In thousands)          | 2018        | 31, 2017    |
| Commercial              | \$1,299,437 | \$1,258,212 |
| Commercial Real Estate  | 1,891,119   | 1,769,620   |
| Residential Real Estate | 1,350,761   | 1,321,044   |
| Dealer Finance          | 1,252,843   | 1,227,870   |
| Specialty Lending       | 507,618     | 439,326     |
| Home Equity             | 488,493     | 498,179     |
| Other Consumer          | 68,792      | 70,522      |
| Total loans             | \$6,859,063 | \$6,584,773 |

Total loans increased by \$274.3 million, or 4.2%, at June 30, 2018 from December 31, 2017. Loan growth in the first six months of 2018 resulted from growth in the consumer, commercial real estate and residential real estate portfolios. Total loans represent approximately 72.5% of assets as of June 30, 2018, as compared to 72.1% as of December 31, 2017.

#### Allowance for Loan Losses, Provision for Loan Losses and Nonperforming Assets

The allowance for loan losses is maintained at a level estimated by management to provide appropriately for risk of probable incurred losses inherent in the current loan portfolio. The adequacy of the allowance for loan losses is continuously monitored using a methodology designed to ensure that the level of the allowance reasonably reflects the loan portfolio's risk profile. It is evaluated to ensure that it is sufficient to absorb all reasonably estimable incurred credit losses inherent in the current loan portfolio.

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Management considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy given the degree of judgment exercised in evaluating the level of the allowance required to cover credit losses in the portfolio and the material effect that such judgments can have on the consolidated results of operations.

During the first quarter of 2018, the Company adjusted the class segments within the portfolios to better align risk characteristics and reflect the monitoring and assessment of risks as the portfolios continue to evolve. Agricultural Non-Real Estate and Agricultural Real Estate were consolidated with Commercial and Commercial Real Estate, respectively. Agricultural loans are a type of commercial loan with some specific underwriting guidelines however, as of March 31, 2018, the portfolio had decreased to less than 3% of the Commercial portfolio and separation was no longer warranted. The Indirect class segment was further separated into Dealer Finance and Specialty Lending class segments. The growth in our Specialty Lending portfolio to 21% of Consumer Loans as of March 31, 2018 warranted evaluation of this class separately due to different risk characteristics from the Dealer Finance class segment. The Direct and Home Equity class segments were consolidated into Direct to reflect common management, similar underwriting and in-market focus. The change to the class segments in the allowance methodology did not have a significant impact on the allowance for loan losses.

For purposes of evaluating the adequacy of the allowance, the Company considers a number of significant factors that affect the collectability of the portfolio. For individually analyzed loans, these factors include estimates of loss exposure, which reflect the facts and circumstances that affect the likelihood of repayment of such loans as of the evaluation date. For homogeneous pools of loans, estimates of the Company's exposure to credit loss reflect a thorough current assessment of a number of factors, which affect collectability. These factors include: past loss experience; the size, trend, composition and nature of the loans; changes in lending policies and procedures, including underwriting standards and collection, charge-off and recovery practices; trends experienced in nonperforming and delinquent loans; current economic conditions in the Company's market; portfolio concentrations that may affect loss experienced across one or more components of the portfolio; the effect of external factors such as competition, legal and regulatory requirements; and the experience, ability and depth of lending management and staff. In addition, various regulatory agencies, as an integral component of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgment about information available to them at the time of their examination, which may not be currently available to management.

After a thorough consideration and validation of the factors discussed above, required additions or reductions to the allowance for loan losses are made periodically by charges or credits to the provision for loan losses. These are necessary to maintain the allowance at a level which management believes is reasonably reflective of the overall inherent risk of probable loss in the portfolio. While management uses available information to recognize losses on loans, additions or reductions to the allowance may fluctuate from one reporting period to another. These fluctuations are reflective of changes in risk associated with portfolio content and/or changes in management's assessment of any or all of the determining factors discussed above. Management considers the allowance for loan losses to be appropriate based on evaluation and analysis of the loan portfolio.

The following table reflects changes to the allowance for loan losses for the periods presented. The allowance is increased by provisions for losses charged to operations and is reduced by net charge-offs. Charge-offs are made when the ability to collect loan principal within a reasonable time becomes unlikely. Any recoveries of previously charged-off loans are credited directly to the allowance for loan losses.

| Allowance For Loan Losses<br>(Dollars in thousands) | Three months ended |               |
|---|--------------------|---------------|
|   | June 30, 2018      | June 30, 2017 |
| Balance, beginning of period                        | \$70,200           | \$65,700      |
| Recoveries  | 2,029              | 1,415         |
| Charge-offs   | (8,557 )           | (8,082 )      |
| Net charge-offs                                     | \$(6,528 )         | \$(6,667 )    |



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|   |            |       |            |       |
|---|------------|-------|------------|-------|
| Provision for loan losses                   | 8,778      |       | 7,567      |       |
| Balance, end of period                      | \$72,450   |       | \$66,600   |       |
| Composition of Net Charge-offs              |            |       |            |       |
| Commercial and agricultural                 | \$(724 )   | 11 %  | \$(917 )   | 14 %  |
| Residential real estate                     | (62 )      | 1 %   | (688 )     | 10 %  |
| Consumer                                    | (5,742 )   | 88 %  | (5,062 )   | 76 %  |
| Net charge-offs                             | \$(6,528 ) | 100 % | \$(6,667 ) | 100 % |
| Annualized net charge-offs to average loans | 0.39 %     |       | 0.42 %     |       |

|   |                  |       |               |       |
|---|------------------|-------|---------------|-------|
| Allowance For Loan Losses                   | Six months ended |       |               |       |
| (Dollars in thousands)                      | June 30, 2018    |       | June 30, 2017 |       |
| Balance, beginning of period                | \$69,500         |       | \$65,200      |       |
| Recoveries                                  | 3,907            |       | 2,930         |       |
| Charge-offs                                 | (17,231)         |       | (16,476)      |       |
| Net charge-offs                             | \$(13,324)       |       | \$(13,546)    |       |
| Provision for loan losses                   | 16,274           |       | 14,946        |       |
| Balance, end of period                      | \$72,450         |       | \$66,600      |       |
| Composition of Net Charge-offs              |                  |       |               |       |
| Commercial and agricultural                 | \$(1,342 )       | 10 %  | \$(1,764 )    | 13 %  |
| Residential real estate                     | (197 )           | 1 %   | (1,253 )      | 9 %   |
| Consumer                                    | (11,785)         | 89 %  | (10,529)      | 78 %  |
| Net charge-offs                             | \$(13,324)       | 100 % | \$(13,546)    | 100 % |
| Annualized net charge-offs to average loans | 0.40 %           |       | 0.44 %        |       |

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Net charge-offs of \$6.5 million for the three months ended June 30, 2018 were down as compared to \$6.8 million for the prior quarter and \$6.7 million for the second quarter of 2017. Due primarily to loan growth, provision expense was higher at \$8.8 million for the three months ended June 30, 2018, as compared with \$7.5 million for the prior quarter and \$7.6 million for the second quarter of 2017. Annualized net charge-offs to average loans for the second quarter of 2018 was 0.39%, down from 0.42% for the prior quarter and for the second quarter of 2017.

Net charge-offs of \$13.3 million for the six months ended June 30, 2018 were down as compared to \$13.5 million for the same period of 2017. Provision expense was \$16.3 million for the six months ended June 30, 2018, as compared with \$14.9 million for the same period of 2017. Provision expense increased compared to the first six months of 2017 primarily due to loan growth. Annualized net charge-offs to average loans for the first six months of 2018 was 0.40% as compared with 0.44% for the first six months of 2017.

The allowance for loan losses totaled \$72.5 million at June 30, 2018, compared to \$70.2 million at March 31, 2018 and \$66.6 million at June 30, 2017. The allowance for loan losses as a percentage of loans was 1.06% (1.11% excluding acquired loans) at June 30, 2018, compared to 1.06% (1.12% excluding acquired loans) at March 31, 2018 and to 1.05% (1.13% excluding acquired loans) at June 30, 2017.

Nonperforming assets consist of nonaccrual loans, loans 90 days or more past due and still accruing, restructured loans, other real estate owned ("OREO") and nonperforming securities. Loans are generally placed on nonaccrual when principal or interest payments become 90 days past due, unless the loan is well secured and in the process of collection. Loans may also be placed on nonaccrual when circumstances indicate that the borrower may be unable to meet the contractual principal or interest payments. The threshold for evaluating classified and nonperforming loans specifically evaluated for impairment is \$750 thousand. OREO represents property acquired through foreclosure and is valued at the lower of the carrying amount or fair value, less any estimated disposal costs. Nonperforming securities, which include securities which management believes are other-than-temporarily impaired, are carried at their estimated fair value and are not accruing interest.

| (Dollars in thousands)                                  | June 30, 2018 |       | December 31, 2017 |       |
|---|---------------|-------|-------------------|-------|
|   | Amount        | %     | Amount            | %     |
| Nonaccrual loans  |               |       |                   |       |
| Commercial and agricultural loans and real estate       | \$ 11,024     | 47 %  | \$ 12,485         | 48 %  |
| Residential real estate                                 | 5,865         | 24 %  | 5,919             | 23 %  |
| Consumer  | 4,372         | 18 %  | 4,324             | 17 %  |
| Troubled debt restructured loans                        | 2,745         | 11 %  | 2,980             | 12 %  |
| Total nonaccrual loans                                  | \$ 24,006     | 100 % | \$ 25,708         | 100 % |
| Loans 90 days or more past due and still accruing       |               |       |                   |       |
| Residential real estate                                 | \$ 36         | 2 %   | \$ 1,402          | 26 %  |
| Consumer  | 2,173         | 98 %  | 4,008             | 74 %  |
| Total loans 90 days or more past due and still accruing | \$ 2,209      | 100 % | \$ 5,410          | 100 % |
| Total nonperforming loans                               | \$ 26,215     |       | \$ 31,118         |       |
| OREO  | 4,349         |       | 4,529             |       |
| Total nonperforming assets                              | \$ 30,564     |       | \$ 35,647         |       |
| Total nonperforming loans to total loans                | 0.38 %        |       | 0.47 %            |       |
| Total nonperforming assets to total assets              | 0.32 %        |       | 0.39 %            |       |
| Allowance for loan losses to total nonperforming loans  | 276.37 %      |       | 223.34 %          |       |

Nonperforming loans to total loans was 0.38% at June 30, 2018, down 5 bps from 0.43% for the prior quarter and down 12 bps from 0.50% at June 30, 2017. Past due loans as a percentage of total loans were 0.50% at June 30, 2018,

down from 0.53% at March 31, 2018 and 0.59% at June 30, 2017.

For acquired loans that are not deemed to be impaired at acquisition, credit discounts representing the principal losses expected over the life of the loan are a component of the initial fair value and amortized over the life of the asset.

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As a result of the application of this accounting methodology, certain credit-related ratios may not necessarily be directly comparable with periods prior to the acquisition, or comparable with other institutions. The credit metrics most impacted by our acquisitions were the allowance for loan losses to total loans and total allowance for loan losses to nonperforming loans. As of June 30, 2018, the allowance for loan losses to total originated loans and the total allowance for loan losses to originated nonperforming loans were 1.11% and 306.08%, respectively. As of December 31, 2017, the allowance for loan losses to total originated loans and the total allowance for loan losses to originated nonperforming loans were 1.12% and 243.85%, respectively.

In addition to nonperforming loans, the Company has also identified approximately \$57.3 million in potential problem loans at June 30, 2018 as compared to \$57.7 million at December 31, 2017. Potential problem loans are loans that are currently performing, with a possibility of loss if weaknesses are not corrected. Such loans may need to be disclosed as nonperforming at some time in the future. Potential problem loans are classified by the Company's loan rating system as "substandard." Management cannot predict the extent to which economic conditions may worsen or other factors, which may impact borrowers and the potential problem loans. Accordingly, there can be no assurance that other loans will not become 90 days or more past due, be placed on nonaccrual, become restructured or require increased allowance coverage and provision for loan losses. To mitigate this risk the Company maintains a diversified loan portfolio, has no significant concentration in any particular industry and originates loans primarily within its footprint.

## Deposits

Total deposits were \$7.3 billion at June 30, 2018, up \$173.8 million, or 2.4%, from December 31, 2017. Total average deposits increased \$213.5 million, or 3.0%, from the same period last year driven primarily by growth in interest bearing deposits of \$107.4 million, or 2.2%, due to growth in NOW deposit accounts, savings and time accounts partially offset by a decrease in money market deposit accounts, combined with a \$106.1 million, or 4.9%, increase in demand deposits.

## Borrowed Funds

The Company's borrowed funds consist of short-term borrowings and long-term debt. Short-term borrowings totaled \$854.0 million at June 30, 2018 compared to \$719.1 million at December 31, 2017. The notional value of interest rate swaps hedging cash flows related to short-term borrowings totaled \$225.0 million at June 30, 2018 and \$250.0 million at December 31, 2017. Long-term debt was \$73.8 million at June 30, 2018 compared to \$88.9 million at December 31, 2017. Junior subordinated debt was \$101.2 million at June 30, 2018 and December 31, 2017.

For more information about the Company's borrowing capacity and liquidity position, see "Liquidity Risk" below.

## Capital Resources

Stockholders' equity of \$978.9 million represented 10.34% of total assets at June 30, 2018 compared with \$958.2 million, or 10.49% as of December 31, 2017. The increase in stockholders' equity resulted primarily from net income of \$54.1 million for the six months ending June 30, 2018, partially offset by dividends of \$21.0 million during the period and a \$14.5 million decrease in AOCI primarily due to the increase in unrealized gains on investment securities arising during the period.

The Company did not purchase shares of its common stock during the six months ended June 30, 2018. As of June 30, 2018, there were 1,000,000 shares available for repurchase under a plan authorized on October 23, 2017, which expires on December 31, 2019.

The Board of Directors considers the Company's earnings position and earnings potential when making dividend decisions. The Company's Board of Directors approved a 2018 third-quarter cash dividend of \$0.25 per share at a meeting held on July 23, 2018. The dividend will be paid on September 14, 2018 to stockholders of record as of August 31, 2018. The Company does not have a target dividend payout ratio.

As the capital ratios in the following table indicate, the Company remained “well capitalized” at June 30, 2018 under applicable bank regulatory requirements. Capital measurements are well in excess of regulatory minimum guidelines and meet the requirements to be considered well capitalized for all periods presented. To be considered well capitalized, tier 1 leverage, common equity tier 1 capital, tier 1 capital and total risk-based capital ratios must be 5%, 6.5%, 8% and 10%, respectively.

|  | June 30,<br>2018 |   | December 31,<br>2017 |   |
|--|------------------|---|----------------------|---|
| Capital Measurements                         |                  |   |                      |   |
| Tier 1 leverage ratio                        | 9.28             | % | 9.14                 | % |
| Common equity tier 1 capital ratio           | 10.04            | % | 10.06                | % |
| Tier 1 capital ratio                         | 11.35            | % | 11.42                | % |
| Total risk-based capital ratio               | 12.34            | % | 12.42                | % |
| Cash dividends as a percentage of net income | 38.75            | % | 49.20                | % |
| Per common share:                            |                  |   |                      |   |
| Book value                                   | \$ 22.43         |   | \$ 22.01             |   |
| Tangible book value (1)                      | \$ 15.73         |   | \$ 15.54             |   |

(1) Stockholders' equity less goodwill and intangible assets divided by common shares outstanding.

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### Liquidity and Interest Rate Sensitivity Management

#### Market Risk

Interest rate risk is the most significant market risk affecting the Company. Other types of market risk, such as foreign currency exchange rate risk and commodity price risk, do not arise in the normal course of the Company's business activities or are immaterial to the results of operations.

Interest rate risk is defined as an exposure to a movement in interest rates that could have an adverse effect on the Company's net interest income. Net interest income is susceptible to interest rate risk to the degree that interest bearing liabilities mature or reprice on a different basis than earning assets. When interest bearing liabilities mature or reprice more quickly than earning assets in a given period, a significant increase in market rates of interest could adversely affect net interest income. Similarly, when earning assets mature or reprice more quickly than interest bearing liabilities, falling interest rates could result in a decrease in net interest income.

In an attempt to manage the Company's exposure to changes in interest rates, management monitors the Company's interest rate risk. Management's Asset Liability Committee ("ALCO") meets monthly to review the Company's interest rate risk position and profitability and to recommend strategies for consideration by the Board of Directors. Management also reviews loan and deposit pricing and the Company's securities portfolio, formulates investment and funding strategies and oversees the timing and implementation of transactions to assure attainment of the Board's objectives in the most effective manner. Notwithstanding the Company's interest rate risk management activities, the potential effect of changing interest rates is an uncertainty that can have an adverse effect on net income.

In adjusting the Company's asset/liability position, the Board and management attempt to manage the Company's interest rate risk while minimizing net interest margin compression. At times, depending on the level of general interest rates, the relationship between long and short-term interest rates, market conditions and competitive factors, the Board and management may determine to increase the Company's interest rate risk position somewhat in order to increase its net interest margin. The Company's results of operations and net portfolio values remain vulnerable to changes in interest rates and fluctuations in the difference between long and short-term interest rates.

The primary tool utilized by ALCO to manage interest rate risk is earnings at risk modeling (interest rate sensitivity analysis). Information, such as principal balance, interest rate, maturity date, cash flows, next repricing date (if needed) and current rates is uploaded into the model to create an ending balance sheet. In addition, ALCO makes certain assumptions regarding prepayment speeds for loans and mortgage related investment securities along with any optionality within the deposits and borrowings. The model is first run under an assumption of a flat rate scenario (i.e. no change in current interest rates) with a static balance sheet. Two additional models are run in which a gradual increase of 200 bps and a gradual decrease of 100 bps takes place over a 12 month period with a static balance sheet. Under these scenarios, assets subject to prepayments are adjusted to account for faster or slower prepayment assumptions. Any investment securities or borrowings that have callable options embedded into them are handled accordingly based on the interest rate scenario. The resulting changes in net interest income are then measured against the flat rate scenario.

In the declining rate scenario, net interest income is projected to decrease when compared to the forecasted net interest income in the flat rate scenario through the simulation period. The decrease in net interest income is a result of earning assets (particularly prime and LIBOR-based loans) repricing downward faster than interest bearing liabilities that remain at or near their floors. In the rising rate scenarios, net interest income is projected to experience a slight decline from the flat rate scenario; however the potential impact on earnings is dependent on the ability to lag deposit repricing on NOW, savings, MMDA and CD accounts. Net interest income for the next 12 months in the +200 /-100 bp scenarios, as described above, is within the internal policy risk limits of not more than a 7.5% change in net interest income. The following table summarizes the percentage change in net interest income in the rising and declining rate

scenarios over a 12-month period from the forecasted net interest income in the flat rate scenario using the June 30, 2018 balance sheet position:

Interest Rate Sensitivity Analysis

| Change in interest rates<br>(in bps points) | Percent change<br>in<br>net interest<br>income |
|---|--|
| +200  | (1.98%)  |
| -100  | (2.98%)  |

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### Liquidity Risk

Liquidity involves the ability to meet the cash flow requirements of customers who may be depositors wanting to withdraw funds or borrowers needing assurance that sufficient funds will be available to meet their credit needs. ALCO is responsible for liquidity management and has developed guidelines, which cover all assets and liabilities, as well as off-balance sheet items that are potential sources or uses of liquidity. Liquidity policies must also provide the flexibility to implement appropriate strategies. Requirements change as loans grow, deposits and securities mature and payments on borrowings are made. Liquidity management includes a focus on interest rate sensitivity management with a goal of avoiding widely fluctuating net interest margins through periods of changing economic conditions.

The primary liquidity measurement the Company utilizes is called the "Basic Surplus," which captures the adequacy of its access to reliable sources of cash relative to the stability of its funding mix of average liabilities. This approach recognizes the importance of balancing levels of cash flow liquidity from short and long-term securities with the availability of dependable borrowing sources, which can be accessed when necessary. At June 30, 2018, the Company's Basic Surplus measurement was 10.0% of total assets or approximately \$0.9 billion as compared to the December 31, 2017 Basic Surplus of 12.0% or \$1.1 billion and was above the Company's minimum of 5% (calculated at \$473.4 million and \$456.8 million, or period end total assets as June 30, 2018 and December 31, 2017, respectively) set forth in its liquidity policies.

At June 30, 2018 and December 31, 2017, Federal Home Loan Bank ("FHLB") advances outstanding totaled approximately \$787.9 million and \$633.9 million, respectively. The Bank is a member of the FHLB system and had additional borrowing capacity from the FHLB of approximately \$0.8 billion at June 30, 2018 and \$0.9 billion at December 31, 2017. In addition, unpledged securities could have been used to increase borrowing capacity at the FHLB by an additional \$488.6 million and \$541.2 million at June 30, 2018 and December 31, 2017, respectively, or used to collateralize other borrowings, such as repurchase agreements. The Company also has the ability to purchase brokered time deposits and borrow against established borrowing facilities with other banks (Federal funds), which could provide additional liquidity of \$1.4 billion at June 30, 2018 and \$1.3 billion at December 31, 2017. In addition, the Bank has a "Borrower-in-Custody" program with the FRB with the addition of the ability to pledge automobile loans. At June 30, 2018 and December 31, 2017, the Bank had the capacity to borrow \$869.9 million and \$868.0 million, respectively, from this program. The Company's internal policies authorize borrowing up to 25% of assets. Under this policy, remaining available borrowing capacity totaled \$1.5 billion at June 30, 2018 and \$1.6 billion at December 31, 2017.

This Basic Surplus approach enables the Company to manage liquidity appropriately from both operational and contingency perspectives. By tempering the need for cash flow liquidity with reliable borrowing facilities, the Company is able to operate with a more fully invested and, therefore, higher interest income generating securities portfolio. The makeup and term structure of the securities portfolio is, in part, impacted by the overall interest rate sensitivity of the balance sheet. Investment decisions and deposit pricing strategies are impacted by the liquidity position. The Company considered its Basic Surplus position to be strong. However, certain events may adversely impact the Company's position in 2018. Increasing market interest rates may increase competitive pressure on deposit pricing, which, in turn, could result in a decrease in the Company's deposit base or increase funding costs. Additionally, liquidity will come under additional pressure if loan growth exceeds deposit growth in 2018. These scenarios could lead to a decrease in the Company's Basic Surplus measure below the minimum policy level of 5%.

The Company's primary source of funds is the Bank. Certain restrictions exist regarding the ability of the subsidiary bank to transfer funds to the Company in the form of cash dividends. The approval of the Office of Comptroller of the Currency ("OCC") is required to pay dividends when a bank fails to meet certain minimum regulatory capital standards or when such dividends are in excess of a subsidiary bank's earnings retained in the current year plus retained net profits for the preceding two years as specified in applicable OCC regulations. At June 30, 2018, approximately \$137.2 million of the total stockholders' equity of the Bank was available for payment of dividends to



the Company without approval by the OCC. The Bank's ability to pay dividends is also subject to the Bank being in compliance with regulatory capital requirements. The Bank is currently in compliance with these requirements. Under the State of Delaware General Corporation Law, the Company may declare and pay dividends either out of accumulated net retained earnings or capital surplus.

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Item 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Information called for by Item 3 is contained in the Liquidity and Interest Rate Sensitivity Management section of the Management's Discussion and Analysis of Financial Condition and Results of Operations.

Item 4 - CONTROLS AND PROCEDURES

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2018, the Company's disclosure controls and procedures were effective.

There were no changes made in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that have materially affected or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1 – LEGAL PROCEEDINGS

There are no material legal proceedings, other than ordinary routine litigation incidental to the business, to which the Company or any of its subsidiaries is a party or of which any of their property is subject, except as described in the Company's 2017 Annual Report on Form 10-K.

Item 1A – RISK FACTORS

There are no material changes to the risk factors as previously discussed in Part I, Item 1A of our 2017 Annual Report on Form 10-K.

Item 2 – UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) Not applicable

(b) Not applicable

(c) None

Item 3 – DEFAULTS UPON SENIOR SECURITIES

None

Item 4 – MINE SAFETY DISCLOSURES

None

Item 5 – OTHER INFORMATION

None

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Item 6 – EXHIBITS

- 3.1 Restated Certificate of Incorporation of NBT Bancorp Inc. as amended through July 1, 2015 (filed as Exhibit 3.1 to Registrant's Form 10-Q, filed on August 10, 2015 and incorporated herein by reference)
- 3.2 Amended and Restated Bylaws of NBT Bancorp Inc. effective May 22, 2018 (filed as Exhibit 3.1 to Registrant's Form 8-K, filed on May 23, 2018 and incorporated herein by reference).
- 3.3 Certificate of Designation of the Series A Junior Participating Preferred Stock (filed as Exhibit A to Exhibit 4.1 of the Registrant's Form 8-K, filed on November 18, 2004 and incorporated herein by reference).
- 31.1 Certification by the Chief Executive Officer pursuant to Rules 13(a)-14(a)/15(d)-14(e) of the Securities and Exchange Act of 1934.
- 31.2 Certification by the Chief Financial Officer pursuant to Rules 13(a)-14(a)/15(d)-14(e) of the Securities and Exchange Act of 1934.
- 32.1 Certification by the Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document.
- 101.SCH XBRL Taxonomy Extension Schema Document.
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document.
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, this 9th day of August 2018.

NBT BANCORP INC.

By: /s/ Michael J. Chewens  
Michael J. Chewens, CPA  
Senior Executive Vice President  
Chief Financial Officer