2019 ANNUAL REPORT

ALWAYS OUR BEST

Parkway Acquisition Corp.

2019 Annual Report

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Stockholder Information

Requests for Information

Requests for information should be directed to Mrs. Suzanne S. Yearout, Corporate Secretary, at Parkway Acquisition Corp, 101 Jacksonville Circle, P.O. Box 215, Floyd, Virginia 24091; telephone (540) 745-4191.

Independent Registered Public Accounting Firm

Elliott Davis, PLLC
500 East Morehead Street, Ste. 700
Charlotte, North Carolina, 28202

Stock Transfer Agent

Computershare
250 Royal Street
Canton, Massachusetts, 02021

Federal Deposit Insurance Corporation

The Bank is a member of the FDIC. This statement has not been reviewed, or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

Banking Offices

Boone} 189 Boone Heights Drive, Boone, NC 28607 P} 828/264-4260
Carroll} 8351 Carrollton Pike, Galax, VA 24333 P} 276/238-8112
Christiansburg} 2145 Roanoke Street, Christiansburg, VA 24073 P} 540/381-8121
East Independence} 802 East Main Street, Independence, VA 24348 P} 276/773-2821
Elk Creek} 60 Comers Rock Road, Elk Creek, VA 24326 P} 276/655-4011
Floyd} 101 Jacksonville Circle, Floyd, VA 24091 P} 540/745-4191
Galax} 209 West Grayson Street, Galax, VA 24333 P} 276/238-2411
Hillsville} 419 South Main Street, Hillsville, VA 24343 P} 276/728-2810
Independence Main Office & Operations Ctr} 113 West Main Street, Independence, VA 24348 P} 276/773-2811
Lenoir} 509 Wilkesboro Blvd. NE, Lenoir, NC 28645 P} 828/572-0556
Mocksville} 119 Gaither Street, Mocksville, NC 27028 P} 336/477-7010
Radford} 7349 Peppers Ferry Boulevard, Radford, VA 24141 P} 540/633-1680
Roanoke} 4094 Postal Drive, Roanoke, VA 24018 P} 540/774-1111
Roanoke} 3850 Keagy Road, Roanoke, VA 24018 P} 540/387-4533
Sparta} 98 South Grayson Street, Sparta, NC 28675 P} 336/372-2811
Troutdale} 101 Ripshin Road, Troutdale, VA 24378 P} 276/677-3722
West Jefferson} 1055 Mount Jefferson Road, West Jefferson, NC 28694 P} 336-489-7811
Whitetop} 16303 Highlands Parkway, Whitetop, VA 24292 P} 276/388-3811
Wilkesboro} 1422 US Highway 421, Wilkesboro, NC 28697 P} 336/903-4948
Willis} 5598 Floyd Highway South, Willis, VA 24380 P} 540/745-4191
Wytheville} 420 North 4th Street, Wytheville, VA 24382 P} 276/228-6050
Yadkinville} 516 Hawthorne Drive, Yadkinville, NC 27055 P} 336/849-4194
Blacksburg Loan Production Office} 902 South Main Street, Blacksburg, VA 24060 P} 540/250-0280
Hickory Loan Production Office} 340 10th Avenue Drive NE, Suite 2, Hickory, NC 28601 P} 828/228-5150
Shelby Loan Production Office} 809 Lafayette Street, Shelby, NC 28150 P} 704/466-3674

Skyline Support Call Center} 1-866-773-2811

Financial Highlights[1]

	2019	2018	2017	2016	2015
Summary of Operations					
Interest income	$ 30,802	$ 26,186	$ 22,274	$ 17,562	$ 12,703
Interest expense	2,869	1,901	1,474	1,728	2,226
Net interest income	27,933	24,285	20,800	15,834	10,477
Provision for (reduction of) loan losses	655	325	217	(5)	(187)
Other income	4,915	4,637	4,228	4,570	2,511
Other expense	23,258	22,857	19,280	16,816	11,580
Income taxes	1,780	1,214	3,104	1,175	598
Net income	$ 7,155	$ 4,526	$ 2,427	$ 2,418	$ 997
Per Share Data					
Net income	$ 1.16	$ .81	$ .48	$ .60	$ .58
Cash dividends declared	.24	.20	.16	.12	.10
Book value	13.27	12.17	11.39	11.05	17.83
Year-end Balance Sheet Summary					
Loans, net	$ 566,460	$ 532,970	$ 421,418	$ 408,548	$ 237,798
Investment securities	32,881	45,428	50,675	62,540	56,050
Total assets	706,290	680,284	547,961	558,856	331,760
Deposits	611,211	601,868	488,441	499,387	279,876
Stockholders' equity	81,428	75,622	57,182	55,466	30,656
Selected Ratios					
Return on average assets	1.05%	0.75%	0.44%	0.55%	0.30%
Return on average equity	9.10%	7.02%	4.28%	5.62%	3.22%
Average equity to average assets	11.51%	10.66%	10.32%	9.78%	9.33%

[1] In thousands of dollars, except per share data.

Parkway Acquisition Corp.

Dear Fellow Stockholders:

It is our pleasure to present to you the year end 2019 Financial Report for Parkway Acquisition Corp. and Skyline National Bank.

Parkway recorded net income of $7.2 million, or $1.16 per share for the year ended December 31, 2019 compared to net income of $4.5 million, or $0.81 per share for 2018. Earnings for the year ended December 31, 2019 represented a return on average assets ("ROAA") of 1.05% and a return on average equity ("ROAE") of 9.10%, compared to 0.75% and 7.02%, respectively, for the year ended December 31, 2018. Our net interest margin remained strong, at a rate of 4.40% as of December 31, 2019, but was down slightly from recent quarters due to increasing competition in our markets for both loans and deposits as well as decreases in the overall level of interest rates. We expect these trends to continue to place downward pressure on our net interest margin in 2020.

Total assets were $706.3 million at December 31, 2019, an increase of $26.0 million from $680.3 million at December 31, 2018. Loan growth outpaced expectations at a growth rate of 6.3% or $33.9 million during 2019. Total loans were $570.4 million at December 31, 2019, compared to $536.5 million at December 31, 2018. Investment securities decreased by $12.5 million, and Federal Home Loan Bank ("FHLB") advances increased by $10.0 million during 2019. The reduction in investments, along with proceeds from the FHLB advances, were used to fund most of the loan growth experienced during 2019.

Total deposits were $611.2 million at December 31, 2019, an increase of $9.3 million from $601.9 million at December 31, 2018. Noninterest bearing deposits totaled $165.9 million at December 31, 2019, up $5.7 million from $160.2 million at December 31, 2018. Interest bearing deposits were $445.3 million at December 31, 2019, up $3.6 million from December 31, 2018.

Stockholders' equity increased to $81.4 million at December 31, 2019 compared with $75.6 million at December 31, 2018. The increase of $5.8 million was due to earnings of $7.2 million, plus other comprehensive income of $1.0 million, less common stock repurchases of $908 thousand, and the payment of dividends of $1.5 million. The book value of our stock increased from $12.17 per share at December 31, 2018 to $13.27 per share at December 31, 2019.

We are extremely pleased with our financial performance in 2019 and believe we remain well positioned for continued success in 2020 and beyond. In December 2019 we opened our new branch in Mocksville, NC and in March 2020 we opened our newest branch in Lenoir, NC. We greatly appreciate the tremendous community support we have received since our openings in these new markets. We have recently received regulatory approval for future branch locations in Hudson and Hickory, NC, which we expect to open in June 2020. A large part of our strategy in partnering with Great State Bank in July 2018 was to position ourselves for further expansion in adjacent North Carolina markets which, due to industry consolidation, are now underserved by traditional community banks. We are excited to now have the opportunity in 2020 to invest some of our current earnings in the future growth of our bank, and to bring our Skyline brand of true community banking to these new markets.

In March, you should have received your semi-annual dividend of 13 cents per share. This represents an increase of 1 cent per share over the dividend paid in September of last year. Your Board will address dividends again in the Fall of 2020.

Thank you for the opportunity to serve you as shareholders and customers. Please be sure to let us know if you have any questions or comments.

Always Our Best,

Blake M. Edwards Jr.

Blake M. Edwards, Jr.
President and CEO

elliott davis

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors of Parkway Acquisition Corp.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Parkway Acquisition Corp. and its subsidiary (the "Company") as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and 2018, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

Elliott Davis, PLLC

We have served as the Company's auditor since 1995.

Charlotte, North Carolina
March 24, 2020

Consolidated Balance Sheets

December 31, 2019 and 2018

(dollars in thousands)	2019	2018
Assets		
Cash and due from banks	$ 8,388	$ 8,858
Interest-bearing deposits with banks	34,861	12,159
Federal funds sold	1,138	18,990
Investment securities available for sale	32,881	45,428
Restricted equity securities	2,394	2,053
Loans, net of allowance for loan losses of $3,893 at December 31, 2019 and $3,495 at December 31, 2018	566,460	532,970
Cash value of life insurance	17,855	17,413
Foreclosed assets	-	753
Properties and equipment, net	23,437	20,685
Accrued interest receivable	2,072	2,084
Core deposit intangible	3,070	3,892
Goodwill	3,257	3,198
Deferred tax assets, net	985	1,853
Other assets	9,492	9,948
	$ 706,290	$ 680,284
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Noninterest-bearing	$ 165,900	$ 160,166
Interest-bearing	445,311	441,702
Total deposits	611,211	601,868
FHLB Advances	10,000	-
Accrued interest payable	132	89
Other liabilities	3,519	2,705
	624,862	604,662
Commitments and contingencies (Note 18)		
Stockholders' Equity		
Preferred stock, no par value; 5,000,000 shares authorized, none issued	-	-
Common stock, no par value; 25,000,000 shares authorized, 6,137,275 and 6,213,275 issued and outstanding at December 31, 2019 and 2018, respectively	-	-
Surplus	40,752	41,660
Retained earnings	41,600	35,929
Accumulated other comprehensive loss	(924)	(1,967)
	81,428	75,622
	$ 706,290	$ 680,284

See Notes to Consolidated Financial Statements

Consolidated Statements of Income

Years ended December 31, 2019 and 2018

(dollars in thousands except share amounts)	2019	2018
Interest income		
Loans and fees on loans	$ 29,177	$ 24,574
Interest-bearing deposits with banks	288	106
Federal funds sold	249	228
Interest on taxable securities	967	1,181
Dividends	121	97
	30,802	26,186
Interest expense		
Deposits	2,852	1,867
Interest on borrowings	17	34
	2,869	1,901
Net interest income	27,933	24,285
Provision for loan losses	655	325
Net interest income after provision for loan losses	27,278	23,960
Noninterest income		
Service charges on deposit accounts	1,652	1,538
Other service charges and fees	2,004	1,840
Net realized gains on securities	49	5
Mortgage origination fees	459	396
Increase in cash value of life insurance	442	433
Life insurance income	-	303
Other income	309	122
	4,915	4,637
Noninterest expenses		
Salaries and employee benefits	13,245	11,802
Occupancy and equipment	2,953	2,671
Foreclosed asset expense, net	3	32
Data processing expense	1,546	1,353
FDIC Assessments	50	231
Advertising	603	569
Bank franchise tax	438	438
Director fees	356	370
Professional fees	667	452
Telephone expense	371	415
Core deposit intangible amortization	822	578
Merger related expenses	-	1,978
Other expense	2,204	1,968
	23,258	22,857
Income before income taxes	8,935	5,740
Income tax expense	1,780	1,214
Net income	$ 7,155	$ 4,526
Basic earnings per share	$ 1.16	$ 0.81
Weighted average shares outstanding	6,184,133	5,622,224
Dividends declared per share	$ 0.24	$ 0.20

See Notes to Consolidated Financial Statements

Consolidated Statements of Comprehensive Income

Years ended December 31, 2019 and 2018

(dollars in thousands)	**2019**	**2018**
Net Income	$ 7,155	$ 4,526
Other comprehensive income (loss)		
Net change in pension reserve:		
Change in pension reserve during the year	79	(64)
Tax related to change in pension reserve	(16)	13
Unrealized gains (losses) on investment securities available for sale:		
Unrealized gains (losses) arising during the year	1,290	(509)
Tax related to unrealized (gains) losses	(271)	107
Reclassification of net realized gains during the year	(49)	(5)
Tax related to realized gains	10	1
Total other comprehensive income (loss)	1,043	(457)
Total comprehensive income	$ 8,198	$ 4,069

See Notes to Consolidated Financial Statements

Consolidated Statements of Changes in Stockholders' Equity

Years ended December 31, 2019 and 2018

(dollars in thousands except share amounts)

	Common Stock				Accumulated Other Comprehensive	
	Shares	Amount	Surplus	Retained Earnings	Loss	Total
Balance, December 31, 2017	5,021,376	$ -	$ 26,166	$ 32,526	$ (1,510)	$ 57,182
Net income	-	-	-	4,526	-	4,526
Other comprehensive loss	-	-	-	-	(457)	(457)
Issuance of common stock in connection with acquisition of Great State Bank	1,191,899	-	15,495	-	-	15,495
Redemption of fractional shares Issued in acquisition of Great State Bank	-	-	(1)	-	-	(1)
Dividends paid ($0.20 per share)	-	-	-	(1,123)	-	(1,123)
Balance, December 31, 2018	6,213,275	$ -	$ 41,660	$ 35,929	$ (1,967)	$ 75,622
Net income	-	-	-	7,155	-	7,155
Other comprehensive income	-	-	-	-	1,043	1,043
Dividends paid ($0.24 per share)	-	-	-	(1,484)	-	(1,484)
Common stock repurchased	(76,000)	-	(908)	-	-	(908)
Balance, December 31, 2019	6,137,275	$ -	$ 40,752	$ 41,600	$ (924)	$ 81,428

See Notes to Consolidated Financial Statements

Consolidated Statements of Cash Flows

Years ended December 31, 2019 and 2018

(dollars in thousands)	2019	2018
Cash flows from operating activities		
Net income	$ 7,155	$ 4,526
Adjustments to reconcile net income		
to net cash provided by operations:		
Depreciation and amortization	1,224	1,187
Amortization of core deposit intangible	822	578
Accretion of loan discount and deposit premium, net	(2,175)	(1,539)
Provision for loan loss	655	325
Deferred income taxes	591	1,589
Net realized gains on securities	(49)	(5)
Accretion of discount on securities, net of		
amortization of premiums	411	521
Deferred compensation	(10)	19
Gains on sale of properties and equipment	(122)	-
Net realized loss on foreclosed assets	-	10
Life insurance income	-	(303)
Changes in assets and liabilities:		
Cash value of life insurance	(442)	(434)
Accrued interest receivable	12	(13)
Other assets	1,206	(210)
Accrued interest payable	43	3
Other liabilities	95	25
Net cash provided by operating activities	9,416	6,279
Cash flows from investing activities		
Activity in available for sale securities:		
Purchases	(1,037)	-
Sales	8,914	18,366
Maturities/calls/paydowns	5,548	5,252
Purchases of restricted equity securities	(341)	(142)
Net increase in loans	(32,354)	(16,785)
Proceeds from life insurance contracts	-	672
Proceeds from the sale of foreclosed assets	753	480
Purchases of property and equipment, net of sales	(3,854)	(2,830)
Cash received in business combination	-	25,761
Net cash (used in) provided by investing activities	(22,371)	30,774
Cash flows from financing activities		
Net increase (decrease) in deposits	9,727	(16,797)
Net change in FHLB advances	10,000	(2,000)
Cash paid for fractional shares	-	(1)
Common stock repurchased	(908)	-
Dividends paid	(1,484)	(1,123)
Net cash provided by (used in) financing activities	17,335	(19,921)
Net increase in cash and cash equivalents	4,380	17,132
Cash and cash equivalents, beginning	40,007	22,875
Cash and cash equivalents, ending	$ 44,387	$ 40,007

See Notes to Consolidated Financial Statements

Consolidated Statements of Cash Flows
Years ended December 31, 2019 and 2018

(dollars in thousands)	2019	2018
Supplemental disclosure of cash flow information		
Interest paid	$ 2,826	$ 1,858
Taxes paid	$ 850	$ 135
Supplemental disclosure of noncash investing activities		
Effect on equity of change in net unrealized loss on available for sale securities	$ 980	$ (406)
Effect on equity of change in unfunded pension liability	$ 63	$ (51)
Right-of-use assets obtained in exchange for new operating lease liabilities	$ 729	$ -
Transfers of loans to foreclosed properties	$ -	$ 1,163
Business combinations		
Assets acquired	$ -	$ 145,455
Liabilities assumed	-	132,960
Net assets	$ -	$ 12,495
Goodwill recorded	$ 59	$ 3,198
Stock issued to acquire Great State Bank	$ -	$ 15,495

See Notes to Consolidated Financial Statements

Notes to Consolidated Financial Statements

Note 1. Organization and Summary of Significant Accounting Policies

Organization

Parkway Acquisition Corp. ("Parkway" or the "Company") was incorporated as a Virginia corporation on November 2, 2015. Parkway was formed as a business combination shell company for the purpose of completing a business combination transaction between Grayson Bankshares, Inc. ("Grayson") and Cardinal Bankshares Corporation ("Cardinal"). On November 6, 2015, Grayson, Cardinal and Parkway entered into an agreement pursuant to which Grayson and Cardinal merged with and into Parkway, with Parkway as the surviving corporation (the "Cardinal merger"). The merger agreement established exchange ratios under which each share of Grayson common stock was converted to the right to receive 1.76 shares of common stock of Parkway, while each share of Cardinal common stock was converted to the right to receive 1.30 shares of common stock of Parkway. The exchange ratios resulted in Grayson shareholders receiving approximately 60% of the newly issued Parkway shares and Cardinal shareholders receiving approximately 40% of the newly issued Parkway shares. The Cardinal merger was completed on July 1, 2016. Grayson was considered the acquiror and Cardinal was considered the acquiree in the transaction for accounting purposes. Upon completion of the Cardinal merger, the Bank of Floyd, a wholly-owned subsidiary of Cardinal, was merged with and into Grayson National Bank (the "Bank'), a wholly-owned subsidiary of Grayson. Effective March 13, 2017, the Bank changed its name to Skyline National Bank.

On March 1, 2018, Parkway entered into a definitive agreement pursuant to which Parkway acquired Great State Bank ("Great State"), based in Wilkesboro, North Carolina. The agreement provided for the merger of Great State with and into the Bank, with the Bank as the surviving bank (the "Great State merger"). The transaction closed and the merger became effective on July 1, 2018. Each share of Great State common stock was converted into the right to receive 1.21 shares of Parkway common stock. The Company issued 1,191,899 shares and recognized $15.5 million in surplus in the Great State merger. Parkway was considered the acquiror and Great State was considered the acquiree in the transaction for accounting purposes. Pursuant to the Great State merger, the Company acquired $145.5 million of assets, including $95.1 million in loans and assumed $133.0 million in liabilities, including $130.6 million of deposits, on July 1, 2018.

The Bank was organized under the laws of the United States in 1900 and now serves the Virginia counties of Grayson, Floyd, Carroll, Wythe, Montgomery and Roanoke, and the North Carolina counties of Alleghany, Ashe, Burke, Caldwell, Catawba, Cleveland, Davie, Watauga, Wilkes, and Yadkin, and the surrounding areas through twenty two full-service banking offices and three loan production offices. As an FDIC-insured national banking association, the Bank is subject to regulation by the Comptroller of the Currency and the FDIC. Parkway is regulated by the Board of Governors of the Federal Reserve System.

Critical Accounting Policies

Management believes the policies with respect to the methodology for the determination of the allowance for loan losses, and asset impairment judgments involve a higher degree of complexity and require management to make difficult and subjective judgments, such as the recoverability of intangible assets and other-than-temporary impairment of investment securities, involve a higher degree of complexity and require management to make difficult and subjective judgements that often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could cause reported results to differ materially. These critical policies and their application are periodically reviewed with the Audit Committee and the Board of Directors.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and the Bank, which is wholly owned. All significant, intercompany transactions and balances have been eliminated in consolidation.

Note 1. Organization and Summary of Significant Accounting Policies, continued

Business Segments

The Company reports its activities as a single business segment. In determining the appropriateness of segment definition, the Company considers components of the business about which financial information is available and regularly evaluated relative to resource allocation and performance assessment.

Business Combinations

Generally, acquisitions are accounted for under the acquisition method of accounting in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 805, Business Combinations. A business combination occurs when the Company acquires net assets that constitute a business, or acquires equity interests in one or more other entities that are businesses and obtains control over those entities. Business combinations are effected through the transfer of consideration consisting of cash and/or common stock and are accounted for using the acquisition method. Accordingly, the assets and liabilities of the acquired entity are recorded at their respective fair values as of the closing date of the acquisition. Determining the fair value of assets and liabilities, especially the loan portfolio, is a complicated process involving significant judgment regarding methods and assumptions used to calculate estimated fair values. Fair values are subject to refinement for up to one year after the closing date of the acquisition as information relative to closing date fair values becomes available. The results of operations of an acquired entity are included in our consolidated results from the closing date of the merger, and prior periods are not restated. No allowance for loan losses related to the acquired loans is recorded on the acquisition date because the fair value of the loans acquired incorporates assumptions regarding future credit losses. The fair value estimates associated with the acquired loans include estimates related to expected prepayments and the amount and timing of expected principal, interest and other cash flows.

Use of Estimates

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

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowances for loan and foreclosed real estate losses, management obtains independent appraisals for significant properties.

Substantially all of the Bank's loan portfolio consists of loans in its market area. Accordingly, the ultimate collectability of a substantial portion of the Bank's loan portfolio and the recovery of a substantial portion of the carrying amount of foreclosed real estate are susceptible to changes in local market conditions. The regional economy is diverse, but influenced to an extent by the manufacturing and agricultural segments.

While management uses available information to recognize loan and foreclosed real estate losses, future additions to the allowances may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as a part of their routine examination process, periodically review the Bank's allowances for loan and foreclosed real estate losses. Such agencies may require the Bank to recognize additions to the allowances based on their judgments about information available to them at the time of their examinations. Because of these factors, it is reasonably possible that the allowances for loan and foreclosed real estate losses may change materially in the near term.

The Company seeks strategies that minimize the tax effect of implementing their business strategies. As such, judgments are made regarding the ultimate consequence of long-term tax planning strategies, including the likelihood of future recognition of deferred tax benefits. The Company's tax returns are subject to examination by both Federal and State authorities. Such examinations may result in the assessment of additional taxes, interest and penalties. As a result, the ultimate outcome, and the corresponding financial statement impact, can be difficult to predict with accuracy.

Note 1. Organization and Summary of Significant Accounting Policies, continued

Use of Estimates, continued

Accounting for pension benefits, costs and related liabilities are developed using actuarial valuations. These valuations include key assumptions determined by management, including the discount rate and expected long-term rate of return on plan assets. Material changes in pension costs may occur in the future due to changes in these assumptions.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents includes cash and amounts due from banks (including cash items in process of collection), interest-bearing deposits with banks and federal funds sold.

Trading Securities

The Company does not hold securities for short-term resale and therefore does not maintain a trading securities portfolio.

Securities Held to Maturity

Bonds, notes, and debentures for which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity. The Company does not currently hold any securities classified as held to maturity.

Securities Available for Sale

Available for sale securities are reported at fair value and consist of bonds, notes, debentures, and certain equity securities not classified as trading securities or as held to maturity securities.

Unrealized holding gains and losses, net of tax, on available for sale securities are reported as a net amount in a separate component of accumulated other comprehensive income. Realized gains and losses on the sale of available for sale securities are determined using the specific-identification method. Premiums and discounts are recognized in interest income using the interest method over the period to earliest call date.

Declines in the fair value of individual held to maturity and available for sale securities below cost that are other than temporary are reflected as write-downs of the individual securities to fair value. Related write-downs are included in earnings as realized losses.

Loans Receivable

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal amount adjusted for any charge-offs and the allowance for loan losses. Loan origination costs are capitalized and recognized as an adjustment to yield over the life of the related loan.

Interest is accrued and credited to income based on the principal amount outstanding. The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received. Payments received are first applied to principal, and any remaining funds are then applied to interest. When facts and circumstances indicate the borrower has regained the ability to meet the required payments, the loan is returned to accrual status. Past due status of loans is determined based on contractual terms.

Purchased Performing Loans – The Company accounts for performing loans acquired in business combinations using the contractual cash flows method of recognizing discount accretion based on the acquired loans' contractual cash flows. Purchased performing loans are recorded at fair value, including a credit discount. The fair value discount is accreted as an adjustment to yield over the estimated lives of the loans. There is no allowance for loan losses established at the acquisition date for purchased performing loans. A provision for loan losses is recorded for any further deterioration in these loans subsequent to the acquisition

Note 1. Organization and Summary of Significant Accounting Policies, continued

Loans Receivable, continued

Purchased Credit-Impaired (PCI) Loans – Loans purchased with evidence of credit deterioration since origination, and for which it is probable that all contractually required payments will not be collected, are considered credit impaired. Evidence of credit quality deterioration as of the purchase date may include statistics such as internal risk grade and past due and nonaccrual status. Purchased impaired loans generally meet the Company's definition for nonaccrual status. PCI loans are initially measured at fair value, which reflects estimated future credit losses expected to be incurred over the life of the loan. Accordingly, the associated allowance for credit losses related to these loans is not carried over at the acquisition date. Any excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable yield and is recognized into interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference, and is available to absorb credit losses on those loans. Subsequent decreases to the expected cash flows will generally result in a provision for loan losses. Subsequent significant increases in cash flows result in a reversal of the provision for loan losses to the extent of prior charges, or a reclassification of the nonaccretable difference with a positive impact on future interest income.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance, or portion thereof, is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component is calculated on an individual basis for larger-balance, non-homogeneous loans, which are considered impaired. A specific allowance is established when the discounted cash flows, collateral value (less disposal costs), or observable market price of the impaired loan is lower than its carrying value. The specific component of the allowance for smaller- balance loans whose terms have been modified in a troubled debt restructuring (TDR) is calculated on a pooled basis considering historical experience adjusted for qualitative factors. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for all loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

Notes to Consolidated Financial Statements

Note 1. Organization and Summary of Significant Accounting Policies, continued

Troubled Debt Restructurings

Under GAAP, the Bank is required to account for certain loan modifications or restructurings as "troubled debt restructurings" or "troubled debt restructured loans." In general, the modification or restructuring of a debt constitutes a troubled debt restructuring if the Bank for economic or legal reasons related to the borrower's financial difficulties grants a concession to the borrower that the Bank would not otherwise consider. Debt restructuring or loan modifications for a borrower do not necessarily always constitute a troubled debt restructuring, however, and troubled debt restructurings do not necessarily result in non-accrual loans.

Property and Equipment

Land is carried at cost. Bank premises, furniture and equipment are carried at cost, less accumulated depreciation and amortization computed principally by the straight-line method over the following estimated useful lives:

	Years
Buildings and improvements	10-40
Furniture and equipment	5-12

Foreclosed Assets

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value less anticipated cost to sell at the date of foreclosure, establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in foreclosure expense on the consolidated statements of income.

Pension Plan

Prior to the Cardinal merger, both Grayson National Bank (Grayson) and Bank of Floyd (Floyd) had qualified noncontributory defined benefit pension plans in place which covered substantially all of each bank's employees. The benefits in each plan are primarily based on years of service and earnings. Both Grayson and Floyd plans were amended to freeze benefit accruals for all eligible employees prior to the effective date of the Cardinal merger. Grayson's plan is a single-employer plan, the funded status of which is measured as the difference between the fair value of plan assets and the projected benefit obligation. Floyd's plan is a multi-employer plan for accounting purposes and is a multiple-employer plan under the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code.

Transfers of Financial Assets

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

Note 1. Organization and Summary of Significant Accounting Policies, continued

Goodwill and Other Intangible Assets

Goodwill arises from business combinations and is generally determined as the excess of fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquire, over the fair value of the nets assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually or more frequently in events and circumstances exists that indicate that a goodwill impairment test should be performed. The Company has selected July 1 as the date to perform the annual impairment test. The annual impairment test was performed for July 1, 2019, with no impairment found on the goodwill. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on our balance sheet.

Other intangible assets consist of core deposit intangibles that represent the value of long-term deposit relationships acquired in a business combination. Core deposit intangibles are amortized over the estimated useful lives of the deposit accounts acquired. The core deposit intangible as a result of the Cardinal merger, is amortized over an estimated useful life of twenty years on an accelerated basis. For the core deposit intangible as a result of the Great State merger, we used an estimated useful life of seven years on an accelerated basis for the amortization.

Revenue Recognition

On January 1, 2018, we adopted the requirements of Accounting Standards Update ("ASU") 2014-9, *Revenue from Contracts with Customers ("ASU Topic 606")*. The Company completed its overall assessment of revenue streams and review of related contracts potentially affected by the ASU, including deposit related fees, interchange fees, merchant income, and annuity and insurance commissions. Based on this assessment, the Company concluded that ASU 2014-09 did not materially change the method in which the Company currently recognizes revenue for these revenue streams. The Company also completed its evaluation of certain costs related to these revenue streams to determine whether such costs should be presented as expenses or contra-revenue (i.e., gross vs. net). Based on its evaluation, the Company determined that ASU 2014-09 did not materially change the method in which the Company currently classifies certain costs associated with the related revenue streams. The Company adopted ASU 2014-09 and its related amendments on its required effective date of January 1, 2018 utilizing the modified retrospective approach. Since there was no net income impact upon adoption of the new guidance, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Noninterest revenue streams in-scope of Topic 606 are discussed below.

Service Charges on Deposit Accounts - Service charges on deposit accounts consist of monthly service fees, overdraft and nonsufficient funds fees, ATM fees, wire transfer fees and other deposit account related fees. The Company's performance obligation for monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. Wire transfer fees, overdraft and nonsufficient funds fees, 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.

*Other Service Charges and Fees - O*ther service charges include safety deposit box rental fees, check ordering charges, and other service charges. Safe deposit box rental fees are charged to the customer on an annual basis and recognized upon receipt of payment. The Company determined that since rentals and renewals occur fairly consistently over time, revenue is recognized on a basis consistent with the duration of the performance obligation. Check ordering charges are transactional based, and therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time.

Note 1. Organization and Summary of Significant Accounting Policies, continued

Revenue Recognition, continued

Credit and Debit Card Fees - Credit and debit card fees are primarily comprised of interchange fee income and merchant services income. Interchange fees are earned whenever the Company's debit and credit cards are processed through card payment networks such as Visa or Mastercard. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees. The Company's performance obligation for interchange fee income and merchant services income are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month.

Insurance and Investment - Insurance income primarily consists of commissions received on insurance 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 insurance policy. Shortly after the insurance policy is issued, the carrier remits the commission payment to the Company, and the Company recognizes the revenue. Investment income consists of recurring revenue streams such as commissions from sales of mutual funds and other investments. Commissions from the sale of mutual funds and other investments are recognized on trade date, which is when the Company has satisfied its performance obligation. The Company also receives periodic service fees (i.e., trailers) from mutual fund companies typically based on a percentage of net asset value. Trailer revenue is recorded over time, usually monthly or quarterly, as net asset value is determined.

Income Taxes

Provision for income taxes is based on amounts reported in the statements of income (after exclusion of non-taxable income such as interest on state and municipal securities) and consists of taxes currently due plus deferred taxes on temporary differences in the recognition of income and expense for tax and financial statement purposes. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more likely than not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more likely than not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Note 1. Organization and Summary of Significant Accounting Policies, continued

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale and changes in the funded status of the pension plan which are also recognized as separate components of equity. The accumulated balances related to each component of other comprehensive income (loss) are as follows:

(dollars in thousands)	Unrealized Gains And Losses On Available for Sale Securities	Defined Benefit Pension Items	Total
Balance, December 31, 2017	$ (523)	$ (987)	$ (1,510)
Other comprehensive income (loss) before reclassifications	(402)	(51)	(453)
Amounts reclassified from accumulated other comprehensive loss	(4)	-	(4)
Balance, December 31, 2018	$ (929)	$ (1,038)	$ (1,967)
Balance, December 31, 2018	$ (929)	$ (1,038)	$ (1,967)
Other comprehensive income (loss) before Reclassifications	1,019	63	1,082
Amounts reclassified from accumulated other comprehensive loss	(39)	-	(39)
Balance, December 31, 2019	$ 51	$ (975)	$ (924)

Advertising Expense

The Company expenses advertising costs as they are incurred. Advertising expense for the years ended December 31, 2019 and 2018 amounted to $603 thousand and $569 thousand, respectively.

Basic Earnings per Share

Basic earnings per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding during the period, after giving retroactive effect to stock splits and dividends.

Off-Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under line of credit arrangements, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded when they are funded.

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 14. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

Reclassification

Certain reclassifications have been made to the prior years' financial statements to place them on a comparable basis with the current presentation. Net income and stockholders' equity previously reported were not affected by these reclassifications.

Notes to Consolidated Financial Statements

Note 1. Organization and Summary of Significant Accounting Policies, continued

Recent Accounting Pronouncements

The following accounting standards may affect the future financial reporting by the Company:

In February 2016, the FASB amended the Leases topic of the Accounting Standards Codification to revise certain aspects of recognition, measurement, presentation, and disclosure of leasing transactions. The amendments were effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.

Effective January 1, 2019, we adopted the guidance using the modified retrospective method and practical expedients for transition. The practical expedients allow us to largely account for our existing leases consistent with current guidance except for the incremental balance sheet recognition for lessees. We have performed an evaluation of our leasing contracts and activities. We have developed our methodology to estimate the right-of use assets and lease liabilities, which is based on the present value of lease payments. There will not be a material change to the timing of expense recognition. See additional discussion of leases in Note 10 to the consolidated financial statements.

In June 2016, the FASB issued Accounting Standards Update ("ASU") No. 2016-13 to change the accounting for credit losses and modify the impairment model for certain debt securities. The Company will apply the amendments to the ASU through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. We are currently evaluating the impact of the ASU on our consolidated financial statements. We expect the ASU will result in an increase in the recorded allowance for loan losses given the change to estimated losses over the contractual life of the loans adjusted for expected prepayments. The majority of the increase results from longer duration portfolios. In addition to our allowance for loan losses, we will also record an allowance for credit losses on debt securities instead of applying the impairment model currently utilized. The amount of the adjustments will be impacted by each portfolio's composition and credit quality at the adoption date as well as economic conditions and forecasts at that time. In July 2019, the FASB proposed changes to the effective date of the ASU for smaller reporting companies, as defined by the SEC, and other non-SEC reporting entities. The proposal delayed the effective date to fiscal years beginning after December 31, 2022, including interim periods within those fiscal periods. As the Company is a smaller reporting company, the proposed delay would be applicable to the Company, if it is approved by the FASB. On October 16, 2019 the proposed changes were approved by the FASB.

In November 2019, the FASB issued guidance that addresses issues raised by stakeholders during the implementation of ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The amendments affect a variety of Topics in the Accounting Standards Codification. For entities that have not yet adopted the amendments in ASU 2016-13, the amendments are effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal. Early adoption is permitted in any interim period as long as an entity has adopted the amendments in ASU 2016-13. The Company does not expect these amendments to have a material effect on its financial statements.

In January 2017, the FASB amended the Goodwill and Other Topic of the Accounting Standards Codification to simplify the accounting for goodwill impairment for public business entities and other entities that have goodwill reported in their financial statements and have not elected the private company alternative for the subsequent measurement of goodwill. The amendment removes Step 2 of the goodwill impairment test. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The effective date and transition requirements for the technical corrections will be effective for the Company for reporting periods beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect these amendments to have a material effect on its financial statements.

In August 2018, the FASB amended the Intangibles—Goodwill and Other Topic of the Accounting Standards Codification to align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The amendments will be effective for the Company for fiscal years beginning after December 15, 2019. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

Note 1. Organization and Summary of Significant Accounting Policies, continued

Recent Accounting Pronouncements, continued

In August 2018, the FASB amended the Fair Value Measurement Topic of the Accounting Standards Codification. The amendments remove, modify, and add certain fair value disclosure requirements based on the concepts in the FASB Concepts Statement, *Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements*. The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted. An entity is permitted to early adopt any removed or modified disclosures upon issuance of this ASU and delay adoption of the additional disclosures until their effective date. The Company does not expect these amendments to have a material effect on its financial statements.

In March 2019, the FASB issued guidance to address concerns companies had raised about an accounting exception they would lose when assessing the fair value of underlying assets under the leases standard and clarify that lessees and lessors are exempt from a certain interim disclosure requirement associated with adopting the new standard. The amendments will be effective for the Company for reporting periods beginning after December 15, 2019. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In April 2019, the FASB issued guidance that clarifies and improves areas of guidance related to the recently issued standards on credit losses, hedging, and recognition and measurement of financial instruments. The amendments related to credit losses will be effective for the Company for reporting periods beginning after December 15, 2019. The amendments related to hedging will be effective for the Company for annual periods beginning after December 15, 2019, and interim periods within annual reporting periods beginning after December 15, 2020. The amendments related to recognition and measurement of financial instruments will be effective for the Company for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company does not expect these amendments to have a material effect on its financial statements.

In May 2019, the FASB issued guidance to provide entities with an option to irrevocably elect the fair value option, applied on an instrument-by-instrument basis for eligible instruments, upon adoption of ASU 2016-13, Measurement of Credit Losses on Financial Instruments. The amendments will be effective for the Company for reporting periods beginning after December 15, 2022. The Company does not expect these amendments to have a material effect on its financial statements.

In July 2019, the FASB updated various Topics of the Accounting Standards Codification to align the guidance in various SEC sections of the Codification with the requirements of certain SEC final rules. The amendments were effective upon issuance and did not have a material effect on the financial statements.

In November 2019, the FASB issued guidance to defer the effective dates for private companies, not-for-profit organizations, and certain smaller reporting companies applying standards on current expected credit losses ("CECL"). Since the Company is a smaller reporting company, the new effect date for CECL will be fiscal years beginning after December 15, 2022, including interim periods within those fiscal years.

In December 2019, the FASB issued guidance to simplify accounting for income taxes by removing specific technical exceptions that often produce information investors have a hard time understanding. The amendments also improve consistent application of and simplify GAAP for other areas of Topic 740 by clarifying and amending existing guidance. The amendments are effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

Note 1. Organization and Summary of Significant Accounting Policies, continued

Note 2. Business Combinations

On July 1, 2018, Parkway completed its merger with Great State as discussed above in Note 1. Parkway is considered the acquiring entity in this business combination for accounting purposes. Under the terms of the merger agreement, each share of Great State common stock was converted to 1.21 shares of common stock of Parkway which resulted in the issuance of 1,191,899 shares of Parkway stock in the merger. The Company engaged a third party to calculate fair values of all assets and liabilities acquired in the transaction. These valuations were subject to review and refinement for up to one year following the merger date.

Note 2. Business Combinations, continued

The following table presents the Great State assets acquired and liabilities assumed as of July 1, 2018 as well as the related fair value adjustments and determination of goodwill.

(dollars in thousands)	As Reported by Great State	Fair Value Adjustments		As Reported by Parkway
Assets				
Cash and cash equivalents	$ 25,761	$ -	-	$ 25,761
Investment securities	19,630	(229)	(a)	19,401
Restricted equity securities	523	-	-	523
Loans	97,549	(2,441)	(b)	95,108
Allowance for loan losses	(1,436)	1,436	(c)	-
Property and equipment	1,207	189	(d)	1,396
Intangible assets	-	2,425	(e)	2,425
Accrued interest receivable	334	-	-	334
Other assets	599	(151)	(f)	448
Total assets acquired	$ 144,167	$ 1,229		$ 145,396
Liabilities				
Deposits	$ 129,611	$ 940	(g)	$ 130,551
Borrowings	2,000	-	-	2,000
Accrued interest payable	40	-	-	40
Other liabilities	352	17	(h)	369
Total liabilities acquired	$ 132,003	$ 957		$ 132,960
Net assets acquired				12,436
Elimination of Company’s existing investment in Great State				198
Stock consideration				15,495
Goodwill				$ 3,257

Explanation of fair value adjustments:

(a) Reflects the opening fair value of securities portfolio, which was established as the new book basis of the portfolio.

(b) Reflects the fair value adjustment based on the Company’s third party valuation report.

(c) Existing allowance for loan losses eliminated to reflect accounting guidance.

(d) Estimated adjustment to Great State’s real property based upon third-party appraisals and the Company’s evaluation of equipment and other fixed assets.

(e) Reflects the recording of the estimated core deposit intangible based on the Company’s third party valuation report.

(f) Recording of deferred tax asset generated by the net fair value adjustments (tax rate = 21%).

(g) Estimated fair value adjustment to time deposits based on the Company’s third party valuation report on deposits assumed.

(h) Reflects the fair value adjustment based on the Company’s evaluation of acquired other liabilities.

The merger was accounted for under the acquisition method of accounting. The assets and liabilities of Great State have been recorded at their estimated fair values and added to those of Parkway for periods following the merger date. Valuations of acquired Great State assets and liabilities were subject to refinement for up to one year following the merger date.

Note 2. Business Combinations, continued

There are two methods to account for acquired loans as part of a business combination. Acquired loans that contain evidence of credit deterioration on the date of purchase are carried at the net present value of expected future proceeds in accordance with FASB ASC 310-30. All other acquired loans are recorded at their initial fair value, adjusted for subsequent advances, pay downs, amortization or accretion of any premium or discount on purchase, charge-offs and any other adjustment to carrying value in accordance with ASC 310-20.

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

To the extent that current information indicates it is probable that the Company will collect all amounts according to the contractual terms thereof, such loan is not considered impaired and is not considered in the determination of the required allowance for loan losses. To the extent that current information indicates it is probable that the Company will not be able to collect all amounts according to the contractual terms thereon, such loan is considered impaired and is considered in the determination of the required level of allowance for loan and lease losses.

Subsequent to the acquisition date, increases in cash flows expected to be received in excess of the Company's initial estimates are reclassified from nonaccretable difference to accretable yield and are accreted into interest income on a level-yield basis over the remaining life of the loan. Decreases in cash flows expected to be collected are recognized as impairment through the provision for loan losses.

Supplemental Pro Forma Information (dollars in thousands except per share data)

The table below presents supplemental pro forma information as if the Great State acquisition had occurred at the beginning of the earliest period presented, which was January 1, 2018. Pro forma results include adjustments for amortization and accretion of fair value adjustments and do not include any projected cost savings or other anticipated benefits of the merger. Therefore, the pro forma financial information is not indicative of the results of operations that would have occurred had the transactions been effected on the assumed date. Pre-tax merger-related costs of $2.0 million included in the Company's consolidated statements of income for the year ended December 31, 2018 are not included in the pro forma statements below.

	Year Ended December 31, 2018 (Unaudited)
Net interest income	$ 24,262
Net income (a)	$ 4,508
Basic and diluted weighted average shares outstanding (b)	6,213,275
Basic and diluted earnings per common share	$ 1.07

(a) Supplemental pro forma net income includes the impact of certain fair value adjustments. Supplemental pro forma net income does not include assumptions on cost savings or the impact of merger-related expenses.

(b) Weighted average shares outstanding includes the full effect of the common stock issued in connection with the Great State acquisition as of the earliest reporting date.

It is impractical to disclose the net interest income, non-interest income, and net income of Great State from the acquisition date of July 1, 2018 through December 31, 2018 due to the system conversion that occurred on September 7, 2018, which resulted in the combining of the operations of Great State into Parkway.

Note 3. Restrictions on Cash

To comply with banking regulations, the Bank is required to maintain certain average cash reserve balances. At December 31, 2019, the required reserve was met by the Bank's vault cash and no daily average cash reserve requirement was required. The daily average cash reserve requirement as of December 31, 2018 was approximately $6.3 million.

Note 4. Investment Securities

Debt and equity securities have been classified in the consolidated balance sheets according to management's intent. The amortized cost of securities and their approximate fair values at December 31 follow:

(dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
2019				
Available for sale:				
U.S. Government Agencies	$ -	$ -	$ -	$ -
Mortgage-backed securities	19,540	61	(97)	19,504
Corporate securities	1,500	-	(67)	1,433
State and municipal securities	11,777	168	(1)	11,944
	$ 32,817	$ 229	$ (165)	$ 32,881
2018				
Available for sale:				
U.S. Government Agencies	$ 244	$ 1	$ -	$ 245
Mortgage-backed securities	25,627	1	(865)	24,763
Corporate securities	2,970	-	(181)	2,789
State and municipal securities	17,764	31	(164)	17,631
	$ 46,605	$ 33	$ (1,210)	$ 45,428

Restricted equity securities were $2.4 million and $2.1 million at December 31, 2019 and 2018, respectively. Restricted equity securities consist of investments in stock of the Federal Home Loan Bank of Atlanta (FHLB), CBB Financial Corp., Pacific Coast Bankers Bank, and the Federal Reserve Bank of Richmond, all of which are carried at cost. All of these entities are upstream correspondents of the Bank. The FHLB requires financial institutions to make equity investments in the FHLB in order to borrow money. The Bank is required to hold that stock so long as it borrows from the FHLB. The Federal Reserve requires Banks to purchase stock as a condition for membership in the Federal Reserve System. The Bank's stock in CBB Financial Corp. and Pacific Coast Bankers Bank is restricted only in the fact that the stock may only be repurchased by the respective banks.

The following tables details unrealized losses and related fair values in the Company's held to maturity and available for sale investment securities portfolios. This information is aggregated by the length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2019 and 2018.

	Less Than 12 Months		12 Months or More		Total	
(dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
2019						
Available for sale:						
Mortgage-backed securities	$ 8,625	$ (97)	$ -	$ -	$ 8,625	$ (97)
Corporate securities	-	-	1,433	(67)	1,433	(67)
State and municipal securities	1,010	(1)	-	-	1,010	(1)
Total securities available for sale	$ 9,635	$ (98)	$ 1,433	$ (67)	$ 11,068	$ (165)
2018						
Available for sale:						
Mortgage-backed securities	$ 450	$ (1)	$ 24,227	$ (864)	$ 24,677	$ (865)
Corporate securities	-	-	2,789	(181)	2,789	(181)
State and municipal securities	5,518	(19)	6,834	(145)	12,352	(164)
Total securities available for sale	$ 5,968	$ (20)	$ 33,850	$ (1,190)	$ 39,818	$ (1,210)

Note 4. Investment Securities, continued

At December 31, 2019, 7 debt securities with unrealized losses had depreciated 1.47 percent from their total amortized cost basis. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to the length of time and the extent to which the fair value has been less than cost, and the financial condition and near-term prospects of the issuer. The relative significance of these and other factors will vary on a case by case basis. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, the results of reviews of the issuer's financial condition and the issuer's anticipated ability to pay the contractual cash flows of the investments. Since the Company intends to hold all of its investment securities until maturity, and it is more likely than not that the Company will not have to sell any of its investment securities before unrealized losses have been recovered, and the Company expects to recover the entire amount of the amortized cost basis of all its securities, none of the securities are deemed other than temporarily impaired at December 31, 2019. Management continues to monitor all of these securities with a high degree of scrutiny. There can be no assurance that the Company will not conclude in future periods that conditions existing at that time indicate some or all of these securities are other than temporarily impaired, which could require a charge to earnings in such periods.

Proceeds from the sales of investment securities available for sale were $8.9 and $18.4 million for the years ended December 31, 2019 and 2018, respectively. Proceeds from called securities totaled $2.2 million and $1.1 million for the years ended December 31, 2019 and 2018, respectively. Gross realized gains and losses for the years ended December 31 are as follows:

(dollars in thousands)	2019	2018
Realized gains	$ 92	$ 9
Realized losses	(43)	(4)
	$ 49	$ 5

There were no securities transferred between the available for sale and held to maturity portfolios or other sales of held to maturity securities during the periods presented. In the future management may elect to classify securities as held to maturity based upon such considerations as the nature of the security, the Bank's ability to hold the security until maturity, and general economic conditions.

The scheduled maturities of securities available for sale at December 31, 2019, were as follows:

(dollars in thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 1,289	$ 1,290
Due after one year through five years	7,176	7,214
Due after five years through ten years	15,014	14,987
Due after ten years	9,338	9,390
	$ 32,817	$ 32,881

Maturities of mortgage backed securities are based on contractual amounts. Actual maturity will vary as loans underlying the securities are prepaid.

Investment securities with amortized cost of approximately $15.5 million and $13.9 million at December 31, 2019 and 2018 respectively, were pledged as collateral on public deposits and for other purposes as required or permitted by law.

Note 5. Loans Receivable

The major components of loans in the consolidated balance sheets at December 31, 2019 and December 31, 2018 are as follows:

(dollars in thousands)	2019	2018
Construction & development	$ 39,649	$ 33,449
Farmland	34,166	33,291
Residential	253,674	235,689
Commercial mortgage	190,817	176,192
Commercial & agricultural	32,426	37,491
Consumer & other	19,621	20,353
Total loans	570,353	536,465
Allowance for loan losses	(3,893)	(3,495)
Loans, net of allowance for loan losses	$ 566,460	$ 532,970

The major components of loans, net of fair value adjustments, acquired from Great State Bank as of July 1, 2018, the acquisition date, are as follows:

(dollars in thousands)	
Construction & development	$ 7,496
Farmland	720
Residential	26,006
Commercial mortgage	47,953
Commercial & agricultural	11,793
Consumer & other	1,140
Total loans acquired	$ 95,108

As of December 31, 2019 and 2018, substantially all of the Bank's residential 1-4 family loans were pledged as collateral toward borrowings with the Federal Home Loan Bank.

Note 6. Allowance for Loan Losses and Impaired Loans

Allowance for Loan Losses

The allowance for loan losses is maintained at a level believed to be sufficient to provide for estimated loan losses based on evaluating known and inherent risks in the loan portfolio. The allowance is provided based upon management's comprehensive analysis of the pertinent factors underlying the quality of the loan portfolio. These factors include changes in the amount and composition of the loan portfolio, delinquency levels, actual loss experience, current economic conditions, and detailed analysis of individual loans for which the full collectability may not be assured. The detailed analysis includes methods to estimate the fair value of loan collateral and the existence of potential alternative sources of repayment. The allowance consists of specific and general components. The specific component is calculated on an individual basis for larger-balance, non-homogeneous loans, which are considered impaired. A specific allowance is established when the discounted cash flows, collateral value (less disposal costs), or observable market price of the impaired loan is lower than its carrying value. The specific component of the allowance for smaller-balance loans whose terms have been modified in a troubled debt restructuring (TDR) is calculated on a pooled basis considering historical experience adjusted for qualitative factors. These smaller-balance TDRs were collectively evaluated for impairment. The general component covers the remaining loan portfolio, and is based on historical loss experience adjusted for qualitative factors. The appropriateness of the allowance for loan losses on loans is estimated based upon these factors and trends identified by management at the time financial statements are prepared.

Note 6. Allowance for Loan Losses and Impaired Loans, continued

Allowance for Loan Losses, continued

A provision for loan losses is charged against operations and is added to the allowance for loan losses based on quarterly comprehensive analyses of the loan portfolio. The allowance for loan losses is allocated to certain loan categories based on the relative risk characteristics, asset classifications and actual loss experience of the loan portfolio. While management has allocated the allowance for loan losses to various loan portfolio segments, the allowance is general in nature and is available for the loan portfolio in its entirety.

The following table presents activity in the allowance by loan category and information on the loans evaluated individually for impairment and collectively evaluated for impairment as of December 31, 2019 and December 31, 2018:

Allowance for Loan Losses and Recorded Investment in Loans

(dollars in thousands)	Construction & Development	Farmland	Residential	Commercial Mortgage	Commercial & Agricultural	Consumer & Other	Total
December 31, 2019							
Allowance for loan losses:							
Beginning Balance	$ 246	$ 385	$ 1,807	$ 682	$ 281	$ 94	$ 3,495
Charge-offs	-	(13)	(55)	(41)	(77)	(212)	(398)
Recoveries	-	-	8	69	10	54	141
Provision	59	115	62	214	(3)	208	655
Ending Balance	$ 305	$ 487	$ 1,822	$ 924	$ 211	$ 144	$ 3,893
Ending balance: individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance: collectively evaluated for impairment	$ 305	$ 487	$ 1,822	$ 924	$ 211	$ 144	$ 3,893
Loans outstanding:							
Ending Balance	$ 39,649	$ 34,166	$ 253,674	$ 190,817	$ 32,426	$ 19,621	$ 570,353
Ending balance: individually evaluated for impairment	$ -	$ 3,240	$ 909	$ -	$ -	$ -	$ 4,149
Ending balance: collectively evaluated for impairment	$ 39,649	$ 30,926	$ 252,765	$ 190,817	$ 32,426	$ 19,621	$ 566,204
December 31, 2018							
Allowance for loan losses:							
Beginning Balance	$ 239	$ 358	$ 1,875	$ 619	$ 282	$ 80	$ 3,453
Charge-offs	(20)	-	(117)	(142)	(23)	(175)	(477)
Recoveries	-	34	44	69	9	38	194
Provision	27	(7)	5	136	13	151	325
Ending Balance	$ 246	$ 385	$ 1,807	$ 682	$ 281	$ 94	$ 3,495
Ending balance: individually evaluated for impairment	$ -	$ 29	$ 12	$ -	$ -	$ -	$ 41
Ending balance: collectively evaluated for impairment	$ 246	$ 356	$ 1,795	$ 682	$ 281	$ 94	$ 3,454
Loans outstanding:							
Ending Balance	$ 33,449	$ 33,291	$ 235,689	$ 176,192	$ 37,491	$ 20,353	$ 536,465
Ending balance: individually evaluated for impairment	$ -	$ 4,552	$ 1,018	$ -	$ -	$ -	$ 5,570
Ending balance: collectively evaluated for impairment	$ 33,449	$ 28,739	$ 234,671	$ 176,192	$ 37,491	$ 20,353	$ 530,895

As of December 31, 2019 and December 31, 2018, the Bank had no unallocated reserves included in the allowance for loan losses.

Note 6. Allowance for Loan Losses and Impaired Loans, continued

Allowance for Loan Losses, continued

Management closely monitors the quality of the loan portfolio and has established a loan review process designed to help grade the quality of the Bank's loan portfolio. The Bank's loan ratings coincide with the "Substandard," "Doubtful" and "Loss" classifications used by federal regulators in their examination of financial institutions. Generally, an asset is considered Substandard if it is inadequately protected by the current net worth and paying capacity of the obligors and/or the collateral pledged. Substandard assets include those characterized by the distinct possibility that the insured financial institution will sustain some loss if the deficiencies are not corrected. Assets classified as Doubtful have all the weaknesses inherent in assets classified Substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable. Assets classified as Loss are those considered uncollectible, and of such little value that its continuance on the books is not warranted. Assets that do not currently expose the insured financial institutions to sufficient risk to warrant classification in one of the aforementioned categories but otherwise possess weaknesses are designated "Special Mention." Management also maintains a listing of loans designated "Watch". These loans represent borrowers with declining earnings, strained cash flow, increasing leverage and/or weakening market fundamentals that indicate above average risk. As of December 31, 2019 and December 31, 2018, respectively, the Bank had no loans graded "Doubtful" or "Loss" included in the balance of total loans outstanding.

The following table lists the loan grades utilized by the Bank and the corresponding total of outstanding loans in each category as of December 31, 2019 and December 31, 2018:

Credit Risk Profile by Internally Assigned Grades

(dollars in thousands)	Loan Grades				
	Pass	Watch	Special Mention	Substandard	Total
December 31, 2019					
Real Estate Secured:					
Construction & development	$ 34,701	$ 4,801	$ -	$ 147	$ 39,649
Farmland	22,969	4,059	673	6,465	34,166
Residential	231,629	19,887	176	1,982	253,674
Commercial mortgage	163,584	21,960	930	4,343	190,817
Non-Real Estate Secured:					
Commercial & agricultural	27,503	4,346	103	474	32,426
Consumer & other	19,314	300	-	7	19,621
Total	$ 499,700	$ 55,353	$ 1,882	$ 13,418	$ 570,353
December 31, 2018					
Real Estate Secured:					
Construction & development	$ 31,237	$ 2,044	$ 147	$ 21	$ 33,449
Farmland	23,250	4,933	750	4,358	33,291
Residential	213,670	18,794	299	2,926	235,689
Commercial mortgage	148,179	23,468	1,212	3,333	176,192
Non-Real Estate Secured:					
Commercial & agricultural	33,537	2,908	70	976	37,491
Consumer & other	18,975	1,364	-	14	20,353
Total	$ 468,848	$ 53,511	$ 2,478	$ 11,628	$ 536,465

Note 6. Allowance for Loan Losses and Impaired Loans, continued

Allowance for Loan Losses, continued

Loans may be placed in nonaccrual status when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received. Payments received are first applied to principal, and any remaining funds are then applied to interest. Loans are removed from nonaccrual status when they are deemed a loss and charged to the allowance, transferred to foreclosed assets, or returned to accrual status based upon performance consistent with the original terms of the loan or a subsequent restructuring thereof.

The following table presents an age analysis of nonaccrual and past due loans by category as of December 31, 2019 and December 31, 2018:

(dollars in thousands)	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	90+ Days Past Due and Still Accruing	Nonaccrual Loans
December 31, 2019								
Real Estate Secured:								
Construction & development	$ -	$ -	$ 10	$ 10	$ 39,639	$ 39,649	$ -	$ 10
Farmland	893	-	971	1,864	32,302	34,166	-	4,192
Residential	292	48	365	705	252,969	253,674	-	412
Commercial mortgage	185	-	-	185	190,632	190,817	-	198
Non-Real Estate Secured:								
Commercial & agricultural	135	8	163	306	32,120	32,426	-	165
Consumer & other	2	6	2	10	19,611	19,621	-	2
Total	$ 1,507	$ 62	$ 1,511	$ 3,080	$ 567,273	$ 570,353	$ -	$ 4,979
December 31, 2018								
Real Estate Secured:								
Construction & development	$ 29	$ -	$ -	$ 29	$ 33,420	$ 33,449	$ -	$ -
Farmland	71	100	989	1,160	32,131	33,291	-	3,914
Residential	762	145	241	1,148	234,541	235,689	-	653
Commercial mortgage	-	-	604	604	175,588	176,192	-	740
Non-Real Estate Secured:								
Commercial & agricultural	7	-	264	271	37,220	37,491	-	264
Consumer & other	12	18	8	38	20,315	20,353	-	8
Total	$ 881	$ 263	$ 2,106	$ 3,250	$ 533,215	$ 536,465	$ -	$ 5,579

Impaired Loans

A loan is considered impaired when it is probable that the Bank will be unable to collect all contractual principal and interest payments due in accordance with the original or modified terms of the loan agreement. Smaller balance homogenous loans may be collectively evaluated for impairment. Non-homogenous impaired loans are either measured based on the estimated fair value of the collateral less estimated cost to sell if the loan is considered collateral dependent, or measured based on the present value of expected future cash flows if not collateral dependent. The valuation of real estate collateral is subjective in nature and may be adjusted in future periods because of changes in economic conditions. Management considers third-party appraisals, as well as independent fair market value assessments in determining the estimated fair value of particular properties. In addition, as certain of these third-party appraisals and independent fair market value assessments are only updated periodically, changes in the values of specific properties may have occurred subsequent to the most recent appraisals. Accordingly, the amounts of any such potential changes and any related adjustments are generally recorded at the time such information is received. When the measurement of the impaired loan is less than the recorded investment in the loan, impairment is recognized by creating or adjusting an allocation of the allowance for loan losses and uncollected accrued interest is reversed against interest income. If ultimate collection of principal is in doubt, all cash receipts on impaired loans are applied to reduce the principal balance.

Note 6. Allowance for Loan Losses and Impaired Loans, continued

Impaired Loans, continued

As of December 31, 2019 and December 31, 2018, respectively, the recorded investment in impaired loans totaled $7.8 million and $10.3 million. The total amount of collateral-dependent impaired loans at December 31, 2019 and December 31, 2018, respectively, was $2.9 million and $2.8 million. As of December 31, 2019 and December 31, 2018, respectively, $4.1 million and $3.4 million of the recorded investment in impaired loans did not have a related allowance. The Bank had $4.8 million and $7.3 million in troubled debt restructured loans included in impaired loans at December 31, 2019 and December 31, 2018, respectively.

The categories of non-accrual loans and impaired loans overlap, although they are not coextensive. The Bank considers all circumstances regarding the loan and borrower on an individual basis when determining whether an impaired loan should be placed on non-accrual status, such as the financial strength of the borrower, the estimated collateral value, reasons for the delay, payment record, the amount past due and the number of days past due.

In 2015, management began collectively evaluating performing TDRs with a loan balance of $250,000 or less for impairment. As of December 31, 2019 and December 31, 2018, respectively, $3.6 million and $4.7 million of TDRs included in the following table were evaluated collectively for impairment and were deemed to have $174 thousand and $259 thousand of related allowance.

The following table is a summary of information related to impaired loans as of December 31, 2019 and December 31, 2018:

Impaired Loans

(dollars in thousands)	Recorded Investment[1]	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2019					
With no related allowance recorded:					
Construction & development	$ -	$ -	$ -	$ -	$ -
Farmland	3,240	3,240	-	3,505	25
Residential	909	909	-	921	40
Commercial mortgage	-	-	-	-	-
Commercial & agricultural	-	-	-	-	-
Consumer & other	-	-	-	-	-
Subtotal	4,149	4,149	-	4,426	65
With an allowance recorded:					
Construction & development	72	72	3	76	6
Farmland	150	150	2	1,545	70
Residential	3,345	3,495	166	4,161	225
Commercial mortgage	11	56	1	268	11
Commercial & agricultural	31	31	1	34	2
Consumer & other	3	3	1	4	-
Subtotal	3,612	3,807	174	6,088	314
Totals:					
Construction & development	72	72	3	76	6
Farmland	3,390	3,390	2	5,050	95
Residential	4,254	4,404	166	5,082	265
Commercial mortgage	11	56	1	268	11
Commercial & agricultural	31	31	1	34	2
Consumer & other	3	3	1	4	-
Total	$ 7,761	$ 7,956	$ 174	$ 10,514	$ 379

[1] Recorded investment is the loan balance, net of any charge-offs

Note 6. Allowance for Loan Losses and Impaired Loans, continued

Impaired Loans, continued

(dollars in thousands)	Recorded Investment[1]	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2018					
With no related allowance recorded:					
Construction & development	$ -	$ -	$ -	$ -	$ -
Farmland	3,284	3,284	-	3,523	23
Residential	85	85	-	448	13
Commercial mortgage	-	-	-	-	-
Commercial & agricultural	-	24	-	-	-
Consumer & other	-	-	-	-	-
Subtotal	3,369	3,393	-	3,971	36
With an allowance recorded:					
Construction & development	69	69	4	306	11
Farmland	1,539	1,539	38	1,568	86
Residential	5,005	5,162	241	5,348	266
Commercial mortgage	275	358	15	522	27
Commercial & agricultural	37	37	2	47	3
Consumer & other	4	4	-	4	-
Subtotal	6,929	7,169	300	7,795	393
Totals:					
Construction & development	69	69	4	306	11
Farmland	4,823	4,823	38	5,091	109
Residential	5,090	5,247	241	5,796	279
Commercial mortgage	275	358	15	522	27
Commercial & agricultural	37	61	2	47	3
Consumer & other	4	4	-	4	-
Total	$ 10,298	$ 10,562	$ 300	$ 11,766	$ 429

[1] Recorded investment is the loan balance, net of any charge-offs

Troubled Debt Restructuring

A troubled debt restructured loan is a loan for which the Bank, for reasons related to the borrower's financial difficulties, grants a concession to the borrower that the Bank would not otherwise consider.

The loan terms which have been modified or restructured due to a borrower's financial difficulty, include but are not limited to: a reduction in the stated interest rate; an extension of the maturity at an interest rate below current market; a reduction in the face amount of the debt; a reduction in the accrued interest; or re-aging, extensions, deferrals and renewals. The Bank had $4.8 million and $7.3 million in troubled debt restructured loans at December 31, 2019 and December 31, 2018, respectively. Troubled debt restructured loans are considered impaired loans.

Note 6. Allowance for Loan Losses and Impaired Loans, continued

Troubled Debt Restructuring, continued

The following table sets forth information with respect to the Bank's troubled debt restructurings as of December 31, 2019 and December 31, 2018:

(dollars in thousands)	TDRs identified during the period			TDRs identified in the last twelve months that subsequently defaulted[1]		
	Number of contracts	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment	Number of contracts	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment
December 31, 2019						
Construction & development	1	$ 9	$ 11	-	$ -	$ -
Farmland	1	38	37	-	-	-
Residential	1	117	128	-	-	-
Commercial mortgage	-	-	-	-	-	-
Commercial & agricultural	-	-	-	-	-	-
Consumer & other	-	-	-	-	-	-
Total	3	$ 164	$ 176	-	$ -	$ -

During the twelve months ended December 31, 2019, three loans were modified that were considered to be TDRs. Term concessions were granted on all the loans and two loans had additional funds advanced for legal expenses and property taxes. No TDRs identified in the last twelve months subsequently defaulted in the year ended December 31, 2019.

[1] Loans past due 30 days or more are considered to be in default.

(dollars in thousands)	TDRs identified during the period			TDRs identified in the last twelve months that subsequently defaulted[1]		
	Number of contracts	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment	Number of contracts	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment
December 31, 2018						
Construction & development	-	$ -	$ -	-	$ -	$ -
Farmland	-	-	-	-	-	-
Residential	2	80	95	-	-	-
Commercial mortgage	-	-	-	-	-	-
Commercial & agricultural	-	-	-	-	-	-
Consumer & other	1	5	4	-	-	-
Total	3	$ 85	$ 99	-	$ -	$ -

During the twelve months ended December 31, 2018, three loans were modified that were considered to be TDRs. Term concessions were granted and additional funds were advanced for legal expenses and property taxes. No TDRs identified in the last twelve months subsequently defaulted in the year ended December 31, 2018.

[1] Loans past due 30 days or more are considered to be in default.

Note 6. Allowance for Loan Losses and Impaired Loans, continued

Purchased Credit Impaired Loans

During 2018, the Company acquired loans as a result of the Great State merger, for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. The carrying amount of those loans at December 31, 2019 and December 31, 2018 are as follows:

(dollars in thousands)	2019	2018
Residential	$ 150	$ 167
Commercial mortgage	321	347
Commercial & agricultural	146	200
Outstanding balance	$ 617	$ 714
Carrying amount	$ 617	$ 714

There was no accretable yield on purchased credit impaired loans for the periods presented.

There were no purchased credit impaired loans acquired during the year ended December 31, 2019. Purchased credit impaired loans acquired during the year ended December 31, 2018 for which it was probable at acquisition that all contractually required payments would not be collected are as follows:

(dollars in thousands)	December 31, 2018
Contractually required payments receivable of loans purchased during the year:	
Residential	$ 233
Commercial mortgage	1,724
Commercial & agricultural	221
	$ 2,178
Cash flows expected to be collected at acquisition	$ 1,781
Fair value of acquired loans at acquisition	$ 1,781

Income is not recognized on purchased credit impaired loans if the Company cannot reasonably estimate cash flows expected to be collected. The carrying amounts of such loans as of December 31, 2019 and December 31, 2018 are as follows:

(dollars in thousands)	2019	2018
Loans at beginning of year	$ 714	$ -
Loans purchased during the year	$ -	$ 1,781
Loans at end of period	$ 617	$ 714

Note 7. Property and Equipment

Components of property and equipment and total accumulated depreciation at December 31, 2019 and 2018, are as follows:

(dollars in thousands)	2019	2018
Land	$ 5,747	$ 4,935
Buildings and improvements	19,352	17,493
Furniture and equipment	12,482	11,228
	37,581	33,656
Less accumulated depreciation	(14,144)	(12,971)
	$ 23,437	$ 20,685

Depreciation expense for the years ended December 31, 2019 and 2018 amounted to $1.2 million and $1.2 million, respectively.

Note 8. Cash Value of Life Insurance

The Bank is owner and beneficiary of life insurance policies on certain employees and directors. Policy cash values totaled approximately $17.9 million, and $17.4 million at December 31, 2019 and 2018, respectively.

Note 9. Goodwill and Intangible Assets

The change in goodwill during the years ended December 31, 2019 and 2018 is as follows:

(dollars in thousands)	2019	2018
Beginning of year	$ 3,198	$ -
Acquired goodwill as result of Great State merger	-	3,198
Measurement period adjustment	59	-
Impairment	-	-
End of the period	$ 3,257	$ 3,198

Intangible Assets

The following table presents the activity for the Company's core deposit intangible assets, which are the only identifiable intangible assets subject to amortization. Core deposit intangibles at December 31, 2019 and 2018 are as follows:

(dollars in thousands)	2019	2018
Balance at beginning of year, net	$ 3,892	$ 2,045
Core deposit intangible as result of Great State merger	-	2,425
Amortization expense	(822)	(578)
Net book value	$ 3,070	$ 3,892

Note 10. Leases

On January 1, 2019, the Company adopted ASU No. 2016-02 *"Leases (Topic 842)"* and all subsequent ASUs that modified Topic 842. We adopted the guidance using the modified retrospective method and practical expedients for transition. The practical expedients allow us to largely account for our existing leases consistent with current guidance except for the incremental balance sheet recognition for lessees. We have performed an evaluation of our leasing contracts and activities. We have developed our methodology to estimate the right-of use assets and lease liabilities, which is based on the present value of lease payments. Prior to adoption, all of the Company's leases were classified as operating leases and remain operating leases at adoption.

Contracts that commence subsequent to adoption are evaluated to determine whether they are or contain a lease in accordance with Topic 842. The Company has elected the practical expedient provided by Topic 842 not to allocate consideration in a contract between lease and non-lease components. The Company also elected, as provided by the standard, not to recognize right-of-use assets and lease liabilities for short-term leases, defined by the standard as leases with terms of 12 months or less. Since adoption, the Company entered into a new operating lease and recognized right-of-use assets and lease liabilities.

Lease liabilities represent the Company's obligation to make lease payments and are presented at each reporting date as the net present value of the remaining contractual cash flows. Cash flows are discounted at the Company's incremental borrowing rate in effect at the commencement date of the lease. For our incremental borrowing rate, we used the Federal Home Loan Bank available at the time of the lease. The right-of-use assets represent the Company's right to use the underlying asset for the lease term and are calculated as the sum of the lease liability and if applicable, prepaid rent, initial direct costs and any incentives received from the lessor.

The contracts in which the Company is lessee are with parties external to the Company and not related parties. The Company's lease right-of-use assets are included in other assets and the lease liabilities are included in other liabilities. The following tables present information about leases:

(dollars in thousands)	**2019**
Lease liabilities	$ 729
Right-of-use assets	$ 729
Weighted average remaining lease term (years)	8.06
Weighted average discount rate	2.39%

(dollars in thousands)	**2019**
Lease Expense	
Operating lease expense	$ 73
Short-term lease expense	97
Total lease expense	$ 170
Cash paid for amounts included in lease liabilities	$ 73

The following table presents a maturity schedule of undiscounted cash flows that contribute to the lease liabilities:

(dollars in thousands)	
Twelve months ending December 31, 2020	$ 123
Twelve months ending December 31, 2021	128
Twelve months ending December 31, 2022	97
Twelve months ending December 31, 2023	66
Twelve months ending December 31, 2024	68
Thereafter	330
Total undiscounted cash flows	$ 812
Less discount	(83)
Lease liabilities	$ 729

Note 11. Deposits

The aggregate amount of time deposits in denominations of more than $250 thousand at December 31, 2019 and 2018 was $38.7 million, and $30.6 million, respectively. At December 31, 2019, the scheduled maturities of all time deposits are as follows:

(dollars in thousands)

2020	$	61,499
2021		78,377
2022		27,141
2023		12,359
2024		12,612
After Five Years		-
Total	$	191,988

Note 12. Short-Term Debt

At December 31, 2019 and 2018 the Bank had no debt outstanding classified as short-term.

At December 31, 2019, the Bank had established unsecured lines of credit of approximately $52.5 million with correspondent banks to provide additional liquidity if, and as needed. In addition, the Bank has the ability to borrow up to approximately $163.5 million from the Federal Home Loan Bank, subject to the pledging of collateral.

Note 13. Long-Term Debt

At December 31, 2019, the Bank's long-term debt consisted of a $10.0 million advance from FHLB. The advance, which is secured by substantially all the Bank's 1-4 family loans, is scheduled to mature on December 6, 2029. Interest on the advance was fixed at 0.819 percent and the advance is convertible by FHLB to a variable rate quarterly beginning on March 6, 2020. The Bank has the option to repay the advance amount in whole or in part on the conversion date.

At December 31, 2018 the Bank had no debt outstanding classified as long-term.

Note 14. Financial Instruments

FASB ASC 825, "Financial Instruments", requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet. In cases where quoted market prices are not available, fair values are based on estimates using present value of future cash flows or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. FASB ASC 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments as of December 31, 2019 and December 31, 2018. This table excludes financial instruments for which the carrying amount approximates fair value. For short-term financial assets such as cash and cash equivalents, the carrying amount is a reasonable estimate of fair value due to the relatively short time between the origination of the instrument and its expected realization. For non-marketable equity securities such as Federal Home Loan Bank and Federal Reserve Bank stock, the carrying amount is a reasonable estimate of the fair value as these securities can only be redeemed or sold at their par value and only to the respective issuing government supported institution or to another member institution. For financial liabilities such as noninterest-bearing demand, interest-bearing demand, and savings deposits, the carrying amount is a reasonable estimate of fair value due to these products having no stated maturity.

For loans, the carrying amount is net of unearned income and the allowance for loan losses. In accordance with the prospective adoption of ASU No. 2016-01, the fair value of loans as of December 31, 2019 and 2018 was measured using an exit price notion.

			Fair Value Measurements		
(dollars in thousands)	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2019					
Financial Instruments – Assets					
Net Loans	$ 566,460	$ 557,054	$ -	$ 556,851	$ 203
Financial Instruments – Liabilities					
Time Deposits	191,988	192,365	-	192,365	-
FHLB Advances	10,000	10,021	10,021	-	-
December 31, 2018					
Financial Instruments – Assets					
Net Loans	$ 532,970	$ 529,155	$ -	$ 528,784	$ 371
Financial Instruments – Liabilities					
Time Deposits	180,143	176,188	-	176,188	-

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available for sale and derivatives are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as loans or foreclosed assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Note 14. Financial Instruments, continued

Fair Value Hierarchy

Under FASB ASC 820, "Fair Value Measurements and Disclosures", the Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 – Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 – Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques may include the use of option pricing models, discounted cash flow models and similar techniques.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

Investment Securities Available for Sale

Investment securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. If a loan is identified as individually impaired, management measures impairment in accordance with applicable accounting guidance. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2019, a small percentage of the total impaired loans were evaluated based on the fair value of the collateral. In accordance with accounting standards, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price the Company records the impaired loan as nonrecurring Level 2. When the fair value is based on either an external or internal appraisal and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3.

Derivative Assets and Liabilities

Derivative instruments held or issued by the Company for risk management purposes are traded in over-the-counter markets where quoted market prices are not readily available. Management engages third-party intermediaries to determine the fair market value of these derivative instruments and classifies these instruments as Level 2. Examples of Level 2 derivatives are interest rate swaps, caps and floors. No derivative instruments were held during the years ended December 31, 2019 or 2018.

Note 14. Financial Instruments, continued

Foreclosed Assets

Foreclosed assets are adjusted to fair value upon transfer of the loans to foreclosed assets. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price the Company records the foreclosed asset as nonrecurring Level 2. When the fair value of the collateral is based on either an external or internal appraisal and there is no observable market price, the Company records the foreclosed asset as nonrecurring Level 3.

Assets Recorded at Fair Value on a Recurring Basis

(dollars in thousands)	Total	Level 1	Level 2	Level 3
December 31, 2019				
Investment securities available for sale				
U.S. Government Agencies	$ -	$ -	$ -	$ -
Mortgage-backed securities	19,504	-	19,504	-
Corporate securities	1,433	-	1,433	-
State and municipal securities	11,944	-	11,944	-
Total assets at fair value	$ 32,881	$ -	$ 32,881	$ -
December 31, 2018				
Investment securities available for sale				
U.S. Government Agencies	$ 245	$ -	$ 245	$ -
Mortgage-backed securities	24,763	-	24,763	-
Corporate securities	2,789	-	2,789	-
State and municipal securities	17,631	-	17,631	-
Total assets at fair value	$ 45,428	$ -	$ 45,428	$ -

No liabilities were recorded at fair value on a recurring basis as of December 31, 2019 or 2018. There were no significant transfers between levels during the years ended December 31, 2019 or 2018.

Assets Recorded at Fair Value on a Nonrecurring Basis

The Company may be required, from time to time, to measure certain assets and liabilities at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets and liabilities that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. No liabilities were recorded at fair value on a nonrecurring basis at December 31, 2019 or 2018. Assets measured at fair value on a nonrecurring basis are included in the table below.

(dollars in thousands)	Total	Level 1	Level 2	Level 3
December 31, 2019				
Impaired loans	$ 203	$ -	$ -	$ 203
Total assets at fair value	$ 203	$ -	$ -	$ 203

Note 14. Financial Instruments, continued

Assets Recorded at Fair Value on a Nonrecurring Basis, continued

(dollars in thousands)	Total	Level 1	Level 2	Level 3
December 31, 2018				
Impaired loans	$ 371	$ -	$ -	$ 371
Foreclosed assets	753	-	-	753
Total assets at fair value	$ 1,124	$ -	$ -	$ 1,124

For Level 3 assets measured at fair value on a recurring or non-recurring basis as of December 31, 2019 and 2018, the significant unobservable inputs used in the fair value measurements were as follows:

	Fair Value at December 31, 2019	Fair Value at December 31, 2018	Valuation Technique	Significant Unobservable Inputs	General Range of Significant Unobservable Input Values
Impaired Loans	$ 203	$ 371	Appraised Value/Discounted Cash Flows/Market Value of Note	Discounts to reflect current market conditions, ultimate collectability, and estimated costs to sell	0 – 10%
Other Real Estate Owned	$ -	$ 753	Appraised Value/Comparable Sales/Other Estimates from Independent Sources	Discounts to reflect current market conditions and estimated costs to sell	0 – 10%

Note 15. Employee Benefit Plans

Prior to the merger, both Grayson National Bank (Grayson) and Bank of Floyd (Floyd) had qualified noncontributory defined benefit pension plans in place which covered substantially all of each bank's employees. The benefits in each plan are primarily based on years of service and earnings. Both Grayson and Floyd plans were amended to freeze benefit accruals for all eligible employees prior to the effective date of the merger. A summary of each plan follows:

Grayson Plan

The following is a summary of the plan's funded status as of December 31:

(dollars in thousands)	2019	2018
Change in benefit obligation		
Benefit obligation at beginning of year	$ 4,493	$ 5,223
Interest cost	182	173
Actuarial (gain) loss	827	(824)
Benefits paid	(267)	(79)
Settlement (gain) loss	(13)	-
Benefit obligation at end of year	5,222	4,493
Change in plan assets		
Fair value of plan assets at beginning of year	8,092	8,513
Actual return on plan assets	1,332	(342)
Benefits paid	(267)	(79)
Fair value of plan assets at end of year	9,157	8,092
Funded status at the end of the year	$ 3,935	$ 3,599

Note 15. Employee Benefit Plans, continued

Grayson Plan, continued

(dollars in thousands)	**2019**	**2018**
Amounts recognized in the Balance Sheet		
Plan benefit cost	$ 5,169	$ 4,912
Unrecognized net actuarial loss	(1,234)	(1,313)
Amount recognized in other assets	$ 3,935	$ 3,599
Amounts recognized in accumulated comprehensive income (loss)		
Unrecognized net actuarial loss	$ (1,234)	$ (1,313)
Deferred taxes	259	275
Amount recognized in accumulated comprehensive income (loss), net	$ (975)	$ (1,038)
Prepaid benefit detail		
Benefit obligation	$ (5,222)	$ (4,493)
Fair value of assets	9,157	8,092
Unrecognized net actuarial loss	1,234	1,313
Prepaid benefit cost	5,169	4,912
Components of net periodic pension cost		
Interest cost	$ 182	$ 173
Expected return on plan assets	(551)	(576)
Recognized net loss due to settlement	71	-
Recognized net actuarial loss	41	30
Net periodic benefit expense	(257)	(373)
Additional disclosure information		
Accumulated benefit obligation	$ 5,222	$ 4,493
Vested benefit obligation	$ 5,222	$ 4,493
Discount rate used for net periodic pension cost	4.25%	3.50%
Discount rate used for disclosure	3.25%	4.25%
Expected return on plan assets	7.00%	7.00%
Rate of compensation increase	N/A	N/A
Average remaining service (years)	11	12

Using the same fair value hierarchy described in Note 14, the fair values of the Company's pension plan assets, by asset category, are as follows:

(dollars in thousands)	**Total**	**Level 1**	**Level 2**	**Level 3**
December 31, 2019				
Cash equivalents and short term investments	$ -	$ -	$ -	$ -
Mutual funds – equities	4,749	4,749	-	-
Mutual funds – fixed income	4,408	4,408	-	-
Total assets at fair value	$ 9,157	$ 9,157	$ -	$ -
December 31, 2018				
Cash equivalents and short term investments	$ -	$ -	$ -	$ -
Mutual funds – equities	3,848	3,848	-	-
Mutual funds – fixed income	4,244	4,244	-	-
Total assets at fair value	$ 8,092	$ 8,092	$ -	$ -

Note 15. Employee Benefit Plans, continued

Grayson Plan, continued

Estimated Future Benefit Payments

(dollars in thousands)	**Pension Benefits**
2020	$ 430
2021	275
2022	230
2023	1,206
2024	425
2025 – 2029	1,303
	$ 3,869

Funding Policy

It has been Bank practice to contribute the maximum tax-deductible amount each year as determined by the plan administrator. As a result of prior year contributions exceeding the minimum requirements, a Prefunding Balance existed as of December 31, 2019 and there is no required contribution for 2020. Based on this we do not anticipate making a contribution to the plan in 2020.

Long-Term Rate of Return

The plan sponsor selects the expected long-term rate-of-return-on-assets assumption in consultation with their investment advisors and actuary. This rate is intended to reflect the average rate of earnings expected to be earned on the funds invested or to be invested to provide plan benefits. Historical performance is reviewed – especially with respect to real rates of return (net of inflation) – for the major asset classes held, or anticipated to be held by the trust, and for the trust itself. Undue weight is not given to recent experience – that may not continue over the measurement period – with higher significance placed on current forecasts of future long-term economic conditions.

Because assets are held in a qualified trust, anticipated returns are not reduced for taxes. Further – solely for this purpose the plan is assumed to continue in force and not terminate during the period during which the assets are invested. However, consideration is given to the potential impact of current and future investment policy, cash flow into and out of the trust, and expenses (both investment and non-investment) typically paid from plan assets (to the extent such expenses are not explicitly estimated within periodic cost).

Asset Allocation

The pension plan's weighted-average asset allocations at December 31, 2019 and 2018, by asset category are as follows:

	2019	**2018**
Mutual funds – fixed income	48%	52%
Mutual funds – equity	52%	48%
Cash and equivalents	0%	0%
Total	100%	100%

The trust fund is sufficiently diversified to maintain a reasonable level of risk without imprudently sacrificing return, with a targeted asset allocation of 50 percent fixed income and 50 percent equities. The Investment Manager selects investment fund managers with demonstrated experience and expertise, and funds with demonstrated historical performance, for the implementation of the Plan's investment strategy. The Investment Manager will consider both actively and passively managed investment strategies and will allocate funds across the asset classes to develop an efficient investment structure.

Note 15. Employee Benefit Plans, continued

Grayson Plan, continued

It is the responsibility of the Trustee to administer the investments of the Trust within reasonable costs, being careful to avoid sacrificing quality. These costs include, but are not limited to, management and custodial fees, consulting fees, transaction costs and other administrative costs chargeable to the Trust.

Floyd Plan

The Company participates in the Pentegra Defined Benefit Plan for Financial Institutions ("The Pentegra DB Plan"), a tax-qualified defined-benefit pension plan. The Pentegra DB Plan operates as a multi-employer plan for accounting purposes and is a multiple-employer plan under the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code. There are no collective bargaining agreements in place that require contributions to the Pentegra DB Plan.

The Pentegra DB Plan is a single plan under Internal Revenue Code Section 413 (C) and, as a result, all of the assets stand behind all of the liabilities. Accordingly, under the Pentegra DB Plan, contributions made by a participating employer may be used to provide benefits to participants of other participating employers.

Funded Status (market value of plan assets divided by funding target) as of July 1,

Source	**2019 Valuation Report**	**2018 Valuation Report**
Bank of Floyd Plan	103.97%	106.44%

Employer Contributions

Plan expenses paid by the Company totaled approximately $64 thousand and $54 thousand for the years ended December 31, 2019 and 2018, respectively.

Note 16. Deferred Compensation and Supplemental Executive Retirement Plans

Deferred compensation plans have been adopted for certain executive officers and members of the Board of Directors for future compensation upon retirement. Under plan provisions aggregate annual payments ranging from $1,992 to $37,200 are payable for ten years certain, generally beginning at age 65. Reduced benefits apply in cases of early retirement or death prior to the benefit date, as defined. The liability accrued for compensation deferred under the plan amounts to $209 thousand and $258 thousand at December 31, 2019 and 2018, respectively. Expense charged against income and included in salary and benefits expense was $18 thousand and $23 thousand in 2019 and 2018, respectively. Charges to income are based on changes in present value of future cash payments, discounted at 8 percent, consistent with prior years.

Supplemental executive retirement plans for certain executive officers were adopted in 2017. The plans provide for annual payments ranging from $12,875 to $80,000, payable in monthly installments, and continuing for the life of the executive. Reduced benefits apply in cases of early retirement. The liability accrued for this obligation was $222 thousand and $143 thousand at December 31, 2019 and 2018, respectively. Expense charged against income and included in salary and benefits expense was $79 thousand and $107 thousand in 2019 and 2018, respectively, for these supplemental executive retirement plans.

Prior to the Cardinal merger, the Bank of Floyd had adopted supplemental executive plans to provide benefits for two former members of management. Aggregate annual payments of $69 thousand are payable for 20 years, beginning subsequent to the executive's last day of employment. The liability is calculated by discounting the anticipated future cash flows at 4.00%. The liability accrued for this obligation was $728 thousand and $768 thousand at December 31, 2019 and 2018, respectively. Charges to income amounted to approximately $29 thousand and $32 thousand for 2019 and 2018, respectively. These plans are unfunded, however, life insurance has been acquired in amounts sufficient to discharge the obligations of the agreements.

Note 17. Income Taxes

Current and Deferred Income Tax Components

The components of income tax expense (benefit) (substantially all Federal) are as follows:

(dollars in thousands)	2019	2018
Current	$ 1,189	$ (375)
Deferred	591	1,589
	$ 1,780	$ 1,214

Rate Reconciliation

A reconciliation of income tax expense computed at the statutory federal income tax rate to income tax expense (benefit) included in the statements of income follows:

(dollars in thousands)	2019	2018
Tax at statutory federal rate	$ 1,877	$ 1,205
Tax exempt interest income	(52)	(49)
Tax exempt insurance income	(92)	(155)
State income tax, net of federal benefit	48	21
Merger expenses	-	162
Other	(1)	30
Deferred tax asset re-measurement	-	-
	$ 1,780	$ 1,214

Deferred Income Tax Analysis

The significant components of net deferred tax assets (all Federal) at December 31, 2019 and 2018 are summarized as follows:

(dollars in thousands)	2019	2018
Deferred tax assets		
Allowance for loan losses	$ 838	$ 603
Acquired loan credit mark	684	1,061
Deferred compensation	315	322
Investment impairment charge recorded directly to stockholders' equity as a component of other comprehensive income	47	57
Minimum pension liability	259	276
Net operating loss carryforward	1,666	1,738
Alternative minimum tax credit carryforward	-	294
Net unrealized losses on securities available for sale	-	247
Nonaccrual interest income	445	206
Purchase accounting adjustments	1	144
Other	103	216
	$ 4,358	$ 5,164
Deferred tax liabilities		
Deferred loan origination costs	365	635
Core deposit intangible	661	831
Accrued pension costs	1,113	1,049
Depreciation	1,059	795
Merger expenses	161	-
Net unrealized losses on securities available for sale	14	-
Accretion of discount on investment securities, net	-	1
	$ 3,373	$ 3,311
Net deferred tax asset	$ 985	$ 1,853

Note 17. Income Taxes, continued

The Bank has analyzed the tax positions taken or expected to be taken in its tax returns and concluded it has no liability related to uncertain tax positions in accordance with applicable regulations. Tax returns for the years subsequent to 2016 remain subject to examination by both federal and state tax authorities.

Deferred tax assets or liabilities are initially recognized for differences between the financial statement carrying amount and the tax basis of assets and liabilities which will result in future deductible or taxable amounts and operating loss and tax credit carry-forwards. A valuation allowance is then established, as applicable, to reduce the deferred tax asset to the level at which it is “more likely than not” that the tax benefits will be realized. Sources of taxable income that may allow for the realization of tax benefits include (1) taxable income in the current year or prior years that is available through carry-back, (2) future taxable income that will result from the reversal of existing taxable temporary differences, and (3) taxable income generated by future operations. There is no valuation allowance for deferred tax assets as of December 31, 2019 and 2018. The net operating loss of approximately $7.9 million, if not utilized will begin to expire in 2031. It is management’s belief that realization of the deferred tax asset is more likely than not.

Note 18. Commitments and Contingencies

Litigation

In the normal course of business the Bank is involved in various legal proceedings. After consultation with legal counsel, management believes that any liability resulting from such proceedings will not be material to the consolidated financial statements.

Financial Instruments with Off-Balance Sheet Risk

The Bank is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, credit risk in excess of the amount recognized in the consolidated balance sheets.

The Bank’s exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as for on-balance sheet instruments. A summary of the Bank’s commitments at December 31, 2019 and 2018 is as follows:

(dollars in thousands)	2019	2018
Commitments to extend credit	$ 95,190	$ 76,977
Standby letters of credit	1,313	1,227
	$ 96,503	$ 78,204

Note 18. Commitments and Contingencies, continued

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the party. Collateral held varies, but may include accounts receivable, inventory, property and equipment, residential real estate and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required in instances which the Bank deems necessary.

Concentrations of Credit Risk

Substantially all of the Bank's loans, commitments to extend credit, and standby letters of credit have been granted to customers in the Bank's market area and such customers are generally depositors of the Bank. Investments in state and municipal securities involve governmental entities within and outside the Bank's market area. The concentrations of credit by type of loan are set forth in Note 5. The distribution of commitments to extend credit approximates the distribution of loans outstanding. Standby letters of credit are granted primarily to commercial borrowers. The Bank's primary focus is toward small business and consumer transactions, and accordingly, it does not have a significant number of credits to any single borrower or group of related borrowers in excess of $5,000,000. The Bank has cash and cash equivalents on deposit with financial institutions which exceed federally insured limits.

Note 19. Transactions with Related Parties

The Bank has entered into transactions with its directors, significant stockholders and their affiliates (related parties). Such transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features.

Aggregate 2019 and 2018 loan transactions with related parties were as follows:

(dollars in thousands)	**2019**	**2018**
Balance, beginning	$ 7,549	$ 4,769
New loans	2,053	2,662
Repayments	(2,735)	(2,502)
Change in relationship	102	2,620
Balance, ending	$ 6,969	$ 7,549

The Company has accepted deposits during the ordinary course of business from certain directors and executive officers of the Company and from their affiliates and associates. The total amount of these deposits outstanding was $8.6 million, and $8.2 million at December 31, 2019 and 2018, respectively.

Note 20. Regulatory Restrictions

Dividends

The Company's dividend payments are generally made from dividends received from the Bank. Under applicable federal law, the Comptroller of the Currency restricts national bank total dividend payments in any calendar year to net profits of that year, as defined, combined with retained net profits for the two preceding years. The Comptroller also has authority under the Financial Institutions Supervisory Act to prohibit a national bank from engaging in an unsafe or unsound practice in conducting its business. It is possible, under certain circumstances, the Comptroller could assert that dividends or other payments would be an unsafe or unsound practice.

Intercompany Transactions

The Bank's legal lending limit on loans to the Company is governed by Federal Reserve Act 23A, and differs from legal lending limits on loans to external customers. Generally, a bank may lend up to 10 percent of its capital and surplus to its Parent, if the loan is secured. If collateral is in the form of stocks, bonds, debentures or similar obligations, it must have a market value when the loan is made of at least 20 percent more than the amount of the loan, and if obligations of a state or political subdivision or agency thereof, it must have a market value of at least 10 percent more than the amount of the loan. If such loans are secured by obligations of the United States or agencies thereof, or by notes, drafts, bills of exchange or bankers' acceptances eligible for rediscount or purchase by a Federal Reserve Bank, requirements for collateral in excess of the loan amount do not apply. Under this definition, the legal lending limit for the Bank on loans to the Company was approximately $7.9 million at December 31, 2019. No 23A transactions were deemed to exist between the Company and the Bank at December 31, 2019.

Capital Requirements

The Bank is subject to various regulatory capital requirements administered by federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Effective January 1, 2015, the federal banking regulators adopted rules to implement the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. The final rules required the Bank to comply with the following minimum capital ratios: (i) a common equity Tier 1 capital ratio of 4.5% of risk-weighted assets; (ii) a Tier 1 capital ratio of 6% of risk-weighted assets; (iii) a total capital ratio of 8% of risk-weighted assets; and (iv) a leverage ratio of 4% of total assets. As fully phased in on January 1, 2019, the rules require the Bank to maintain (i) a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% common equity Tier 1 ratio, effectively resulting in a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 7% upon full implementation), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of total capital to risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer (which is added to the 8.0% total capital ratio, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation), and (iv) a minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average assets.

Under Basel III Capital requirements, a capital conservation buffer of 0.625% became effective beginning on January 1, 2016. The capital conservation buffer was gradually increased through January 1, 2019 to 2.50%. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banks are now required to maintain levels that meet the required minimum plus the capital conservation buffer in order to make distributions, such as dividends, or discretionary bonus payments. The Banks's capital conservation buffer is 5.53% as of December 31, 2019.

Note 20. Regulatory Restrictions, continued

Capital Requirements, continued

The rules also revised the prompt corrective action framework, which is designed to place restrictions on insured depository institutions if their capital levels begin to show signs of weakness. Under the prompt corrective action requirements, which are designed to complement the capital conservation buffer, insured depository institutions are required to meet the following capital level requirements in order to qualify as "well capitalized:" a common equity Tier 1 capital ratio of 6.5%; a Tier 1 capital ratio of 8%; a total capital ratio of 10%; and a Tier 1 leverage ratio of 5%.

The Company meets eligibility criteria of a small bank holding company in accordance with the Federal Reserve Board's Small Bank Holding Company Policy Statement, and is not obligated to report consolidated regulatory capital. The Bank's actual capital amounts and ratios are presented in the following table as of December 31, 2019 and 2018. These ratios comply with Federal Reserve rules to align with the Basel III Capital requirements effective January 1, 2015.

	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2019						
Total Capital (to risk weighted assets)	$ 78,652	13.53%	$ 46,499	8.00%	$ 58,124	10.00%
Tier 1 Capital (to risk weighted assets)	$ 74,726	12.86%	$ 34,874	6.00%	$ 46,499	8.00%
Common Equity Tier 1 (to risk weighted assets)	$ 74,726	12.86%	$ 26,156	4.50%	$ 37,780	6.50%
Tier 1 Capital (to average total assets)	$ 74,726	10.80%	$ 27,680	4.00%	$ 34,599	5.00%
December 31, 2018						
Total Capital (to risk weighted assets)	$ 71,424	13.00%	$ 43,943	8.00%	$ 54,929	10.00%
Tier 1 Capital (to risk weighted assets)	$ 67,899	12.36%	$ 32,958	6.00%	$ 43,943	8.00%
Common Equity Tier 1 (to risk weighted assets)	$ 67,899	12.36%	$ 24,718	4.50%	$ 35,704	6.50%
Tier 1 Capital (to average total assets)	$ 67,899	10.08%	$ 26,932	4.00%	$ 33,664	5.00%

On September 17, 2019 the Federal Deposit Insurance Corporation finalized a rule that introduces an optional simplified measure of capital adequacy for qualifying community banking organizations (i.e., the community bank leverage ratio ("CBLR") framework, as required by the Economic Growth, Regulatory Relief and Consumer Protection Act. The CBLR framework is designed to reduce burden by removing the requirements for calculating and reporting risk-based capital ratios for qualifying community banking organizations that opt into the framework.

In order to qualify for the CBLR framework, a community banking organization must have a Tier 1 leverage ratio of greater than 9.00%, less than $10.0 billion in total consolidated assets, and limited amounts of off-balance sheet exposures and trading assets and liabilities. A qualifying community banking organization that opts into the CBLR framework and meets all requirements under the framework will be considered to have met the well-capitalized ratio requirements under the prompt corrective action regulations and will not be required to report or calculated risk-based capital.

The CBLR framework will be available for banks to use in their March 31, 2020, Call Report. The Company expects to be able to opt into the CBLR framework for the Bank.

Note 21. Parent Company Financial Information

Condensed financial information of Parkway Acquisition Corp. is presented as follows:

Balance Sheets
December 31, 2019 and 2018

(dollars in thousands)	2019	2018
Assets		
Cash and due from banks	$ 52	$ 1,409
Federal funds sold	532	-
Investment in affiliate bank	80,587	73,813
Other assets	326	468
Total assets	$ 81,497	$ 75,690
Liabilities		
Other liabilities	$ 69	$ 68
Stockholders' Equity		
Common stock	-	-
Surplus	40,752	41,660
Retained earnings	41,600	35,929
Accumulated other comprehensive loss	(924)	(1,967)
Total stockholders' equity	81,428	75,622
Total liabilities and stockholders' equity	$ 81,497	$ 75,690

Statements of Income
For the years ended December 31, 2019 and 2018

(dollars in thousands)	2019	2018
Income		
Dividends from affiliate bank	$ 1,484	$ 1,123
Federal funds sold	3	-
Other income	-	1
	1,487	1,124
Expenses		
Management and professional fees	74	68
Other expenses	5	8
	79	76
Income before tax benefit and equity in undistributed income of affiliate	1,408	1,048
Federal income tax benefit	16	16
Income before equity in undistributed income of affiliate	1,424	1,064
Equity in undistributed income of affiliate	5,731	3,462
Net income	$ 7,155	$ 4,526

Note 21. Parent Company Financial Information, continued

Statements of Cash Flows
For the years ended December 31, 2019 and 2018

(dollars in thousands)	2019	2018
Cash flows from operating activities		
Net income	$ 7,155	$ 4,526
Adjustments to reconcile net income to net cash provided by operations:		
Equity in undistributed income of affiliate	(5,731)	(3,462)
Change in other assets	142	(80)
Change in other liabilities	1	31
Net cash provided by operating activities	1,567	1,015
Cash flows from investing activities		
Net decrease in loans	-	-
Cash received in business combination	-	-
Net cash provided by investing activities	-	-
Cash flows from financing activities		
Cash paid for fractional shares	-	(1)
Common stock repurchased	(908)	-
Dividends paid	(1,484)	(1,123)
Net cash used by financing activities	(2,392)	(1,124)
Net decrease in cash and cash equivalents	(825)	(109)
Cash and cash equivalents, beginning	1,409	1,518
Cash and cash equivalents, ending	$ 584	$ 1,409
Business combinations		
Elimination of Company's existing investment in Great State Bank	$ -	$ 198
Stock issued to acquire Great State Bank	$ -	$ 15,495

Note 22. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed the events occurring through the date the consolidated financial statements were issued and, other than what is disclosed below, no subsequent events occurred requiring accrual or disclosure.

The 2019 novel coronavirus (or "COVID-19") has adversely affected, and may continue to adversely affect economic activity globally, nationally and locally. Following the COVID-19 outbreak in December 2019 and January 2020, market interest rates have declined significantly, with the 10-year Treasury bond falling below 1.00% on March 3, 2020 for the first time. Such events also may adversely affect business and consumer confidence, generally, and the Company and its customers, and their respective suppliers, vendors and processors may be adversely affected. On March 3, 2020, the Federal Open Market Committee ("FOMC") reduced the target federal funds rate by 50 basis points to 1.00% to 1.25%. Subsequently on March 16, 2020, the FOMC further reduced the target federal funds rate by an additional 100 basis points to 0.00% to 0.25%. These reductions in interest rates and other effects of the COVID-19 outbreak may adversely affect the Company's financial condition and results of operations.

Management's Discussion and Analysis

Management's Discussion and Analysis of Operations

Overview

Management's Discussion and Analysis is provided to assist in the understanding and evaluation of Parkway Acquisition Corp's. financial condition and its results of operations. The following discussion should be read in conjunction with the Company's consolidated financial statements.

Parkway Acquisition Corp. ("Parkway" or the "Company") was incorporated as a Virginia corporation on November 2, 2015. Parkway was formed as a business combination shell company for the purpose of completing a business combination transaction between Grayson Bankshares, Inc. ("Grayson") and Cardinal Bankshares Corporation ("Cardinal"). On November 6, 2015, Grayson, Cardinal and Parkway entered into an agreement pursuant to which Grayson and Cardinal merged with and into Parkway, with Parkway as the surviving corporation (the "Cardinal merger"). The merger agreement established exchange ratios under which each share of Grayson common stock was converted to the right to receive 1.76 shares of common stock of Parkway, while each share of Cardinal common stock was converted to the right to receive 1.30 shares of common stock of Parkway. The exchange ratios resulted in Grayson shareholders receiving approximately 60% of the newly issued Parkway shares and Cardinal shareholders receiving approximately 40% of the newly issued Parkway shares. The Cardinal merger was completed on July 1, 2016. Grayson was considered the acquiror and Cardinal was considered the acquiree in the transaction for accounting purposes. Upon completion of the Cardinal merger, the Bank of Floyd, a wholly-owned subsidiary of Cardinal, was merged with and into Grayson National Bank (the "Bank'), a wholly-owned subsidiary of Grayson. Effective March 13, 2017, the Bank changed its name to Skyline National Bank.

On March 1, 2018, Parkway entered into a definitive agreement pursuant to which Parkway acquired Great State Bank ("Great State"), based in Wilkesboro, North Carolina. The agreement provided for the merger of Great State with and into the Bank, with the Bank as the surviving bank (the "Great State merger"). The transaction closed and the merger became effective on July 1, 2018. Each share of Great State common stock was converted into the right to receive 1.21 shares of Parkway common stock. The Company issued 1,191,899 shares and recognized $15.5 million in surplus in the Great State merger. Parkway was considered the acquiror and Great State was considered the acquiree in the transaction for accounting purposes. Pursuant to the Great State merger, the Company acquired $145.5 million of assets, including $95.1 million in loans and assumed $133.0 million in liabilities, including $130.6 million of deposits, on July 1, 2018.

The Bank was organized under the laws of the United States in 1900 and now serves the Virginia counties of Grayson, Floyd, Carroll, Wythe, Montgomery and Roanoke, and the North Carolina counties of Alleghany, Ashe, Burke, Caldwell, Catawba, Cleveland, Davie, Watauga, Wilkes, and Yadkin, and the surrounding areas through twenty two full-service banking offices and three loan production offices. As an FDIC-insured national banking association, the Bank is subject to regulation by the Comptroller of the Currency and the FDIC. Parkway is regulated by the Board of Governors of the Federal Reserve System.

For purposes of this annual report, all information contained herein as of and for periods prior to July 1, 2016 reflects the operations of Grayson prior to the Cardinal merger. Unless this report otherwise indicates or the context otherwise requires, all references to "Parkway" or the "Company" as of and for periods subsequent to July 1, 2016 refer to the combined company and its subsidiary as a combined entity after the Cardinal merger, and all references to the "Company" as of and for periods prior to July 1, 2016 are references to Grayson and its subsidiary as a combined entity prior to the Cardinal merger. All information contained herein as of and for periods prior to July 1, 2018 reflects the operations of Parkway prior to the Great State merger. Unless this report otherwise indicates or the context otherwise requires, all references to "Parkway" or the "Company" as of and for periods subsequent to July 1, 2018 refer to the combined company and its subsidiary as a combined entity after the Great State merger, and all references to "Parkway" or the "Company" as of and for periods prior to July 1, 2018 are references to Parkway and its subsidiary as a combined entity prior to the merger.

Management's Discussion and Analysis

Parkway had net earnings of $7.2 million for 2019 compared to $4.5 million for 2018. Earnings in 2019 and 2018 were impacted significantly by the acquisition of Great State, including merger-related expenses during 2018 and the inclusion of Great State's financial results beginning July 1, 2018. Interest income and interest expense increased due to the acquired loans and deposits, in addition to increases in interest rates earned on loans and paid on deposits. There were no non-recurring merger related expenses in 2019 and approximately $2.0 million in 2018. Earnings for the year ended December 31, 2019 represented a return on average assets of 1.05% and a return on average equity of 9.10%, compared to 0.75% and 7.02%, respectively, for the year ended December 31, 2018.

Forward Looking Statements

From time to time, the Company and its senior managers have made and will make forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements may be contained in this report and in other documents that the Company files with the Securities and Exchange Commission. Such statements may also be made by the Company and its senior managers in oral or written presentations to analysts, investors, the media and others. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. Also, forward-looking statements can generally be identified by words such as "may," "could," "should," "would," "believe," "anticipate," "estimate," "seek," "expect," "intend," "plan" and similar expressions.

Forward-looking statements provide management's expectations or predictions of future conditions, events or results. They are not guarantees of future performance. By their nature, forward-looking statements are subject to risks and uncertainties. These statements speak only as of the date they are made. The Company does not undertake to update forward-looking statements to reflect the impact of circumstances or events that arise after the date the forward-looking statements were made. There are a number of factors, many of which are beyond the Company's control that could cause actual conditions, events or results to differ significantly from those described in the forward-looking statements. These factors, some of which are discussed elsewhere in this report, include:

- any required increase in our regulatory capital ratios;
- inflation, interest rate levels and market and monetary fluctuations;
- the difficult market conditions in our industry;
- trade, monetary and fiscal policies and laws, including interest rate policies of the federal government;
- applicable laws and regulations and legislative or regulatory changes;
- the timely development and acceptance of new products and services of the Company;
- the willingness of customers to substitute competitors' products and services for the Company's products and services;
- the financial condition of the Company's borrowers and lenders;
- the Company's success in gaining regulatory approvals, when required;
- technological and management changes;
- growth and acquisition strategies;
- the Company's critical accounting policies and the implementation of such policies;
- lower-than-expected revenue or cost savings or other issues in connection with mergers and acquisitions;
- changes in consumer spending and saving habits;
- the strength of the United States economy in general and the strength of the local economies in which the Company conducts its operations; and
- the Company's success at managing the risks involved in the foregoing.

Critical Accounting Policies

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States (GAAP). The notes to the audited consolidated financial statements included in the Annual Report for the year ended December 31, 2019 contain a summary of its significant accounting policies. Management believes the Company's policies with respect to the methodology for the determination of the allowance for loan losses, and asset impairment judgments, such as the recoverability of intangible assets and other-than-temporary impairment of investment securities, involve a higher degree of complexity and require management to make difficult and subjective judgments that often require assumptions or estimates about highly uncertain matters. Accordingly, management considers the policies related to those areas as critical.

The allowance for loan losses is an estimate of the losses that may be sustained in the loan portfolio. The allowance is based on two basic principles of accounting: the first of which requires that losses be accrued when they are probable of occurring and estimable, and the second, which requires that losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market, and the loan balance.

The allowance for loan losses has three basic components: (**i**) the formula allowance, (**ii**) the specific allowance, and (**iii**) the unallocated allowance. Each of these components is determined based upon estimates that can and do change when the actual events occur. The formula allowance uses a historical loss view as an indicator of future losses and, as a result, could differ from the loss incurred in the future. However, since this history is updated with the most recent loss information, the errors that might otherwise occur are mitigated. The specific allowance uses various techniques to arrive at an estimate of loss. Historical loss information, expected cash flows and fair market value of collateral are used to estimate these losses. The use of these techniques is inherently subjective and our actual losses could be greater or less than the estimates. The unallocated allowance captures losses that are attributable to various economic events, industry or geographic sectors whose impact on the portfolio have occurred but have yet to be recognized in either the formula or specific allowance.

Table 1. Net Interest Income and Average Balances (dollars in thousands)

	2019			2018			2017		
	Average Balance	Interest Income/ Expense	Yield/ Cost	Average Balance	Interest Income/ Expense	Yield/ Cost	Average Balance	Interest Income/ Expense	Yield/ Cost
Interest-earning assets:									
Interest-bearing deposits	$ 19,082	$ 288	1.51%	$ 9,365	$ 106	1.13%	$ 9,611	$ 48	0.50%
Federal funds sold	9,413	249	2.65%	10,584	228	2.15%	9,703	111	1.14%
Investment securities	42,915	1,088	2.54%	50,504	1,278	2.53%	59,210	1,393	2.35%
Loans [1, 2]	548,611	29,177	5.32%	476,900	24,574	5.15%	417,723	20,722	4.96%
Total	620,021	30,802		547,353	26,186		496,247	22,274	
Yield on average interest-earning assets			4.97%			4.78%			4.49%
Non interest-earning assets:									
Cash and due from banks	8,364			8,218			7,145		
Premises and equipment	21,383			19,055			17,852		
Interest receivable and other	37,310			35,400			33,449		
Allowance for loan losses	(3,768)			(3,435)			(3,539)		
Unrealized gain/(loss) on securities	(263)			(1,283)			(356)		
Total	63,026			57,955			54,551		
Total assets	$683,047			$605,308			$550,798		
Interest-bearing liabilities:									
Demand deposits	$128,645	301	0.23%	$115,409	194	0.17%	$ 59,485	52	0.09%
Savings deposits	124,441	389	0.31%	117,479	347	0.30%	143,895	342	0.24%
Time deposits	184,501	2,162	1.17%	163,932	1,326	0.81%	159,733	1,079	0.68%
Borrowings	3,077	17	0.55%	1,757	34	1.94%	37	1	1.93%
Total	440,664	2,869		398,577	1,901		363,150	1,474	
Cost on average interest-bearing liabilities			0.65%			0.48%			0.41%
Non interest-bearing liabilities:									
Demand deposits	160,858			139,409			128,356		
Interest payable and other	2,913			2,826			2,351		
Total	163,771			142,235			130,707		
Total liabilities	604,435			540,812			493,857		
Stockholder's equity:	78,612			64,496			56,941		
Total liabilities and stockholder's equity	$683,047			$605,308			$550,798		
Net interest income		$27,933			$24,285			$ 20,800	
Net yield on interest-earning assets			4.51%			4.44%			4.19%

[1] Includes nonaccural loans

[2] Interest income includes loan fees

Table 2. Rate/Volume Variance Analysis (dollars in thousands)

	2019 Compared to 2018			2018 Compared to 2017		
	Interest Income/ Expense Variance	Variance Attributable To(1) Rate	Variance Attributable To(1) Volume	Interest Income/ Expense Variance	Variance Attributable To(1) Rate	Variance Attributable To(1) Volume
Interest-earning assets:						
Interest bearing deposits	$ 182	$ 44	$ 138	$ 58	$ 59	$ (1)
Federal funds sold	21	40	(19)	117	106	11
Investment securities	(190)	2	(192)	(115)	121	(236)
Loans	4,603	810	3,793	3,852	827	3,025
Total	4,616	896	3,720	3,912	1,113	2,799
Interest-bearing liabilities:						
Demand deposits	107	83	24	142	70	72
Savings deposits	42	21	21	5	21	(16)
Time deposits	836	653	183	247	218	29
Borrowings	(17)	330	(347)	33	-	33
Total	968	1,087	(119)	427	309	118
Net interest income	$ 3,648	$ (191)	$ 3,839	$ 3,485	$ 804	$ 2,681

(1) The variance in interest attributed to both volume and rate has been allocated to variance attributed to volume and variance attributed to rate in proportion to the absolute value of the change in each.

Net Interest Income

Net interest income, the principal source of Company earnings, is the amount of income generated by earning assets (primarily loans and investment securities) less the interest expense incurred on interest-bearing liabilities (primarily deposits used to fund earning assets). Table 1 summarizes the major components of net interest income for the past three years and also provides yields and average balances.

For the year ended December 31, 2019, total interest income increased by $4.6 million compared to the year ended December 31, 2018. This increase was primarily the result of an increase of $4.6 million in interest income on loans due to the loan growth of $33.9 million experienced in 2019. Accretion of purchased loan discounts increased interest income by $1.8 million in 2019 compared to just $1.2 million in 2018, representing an increase of $579 thousand. The increases in interest income on federal funds sold and interest-bearing deposits in banks was due to the $4.8 million overall balance increase in 2019. Interest income on investment securities decreased $190 thousand in 2019 due to a $12.5 million decrease in investment securities. Interest expense on deposits increased by $985 thousand for the year ended December 31, 2019 compared to the same period last year due to the addition of $3.6 million in interest-bearing deposits from 2018 to 2019, and also due to increased competition for deposits throughout our market areas in 2019. Amortization of premiums on acquired time deposits, which reduces interest expense, totaled $384 thousand in 2019, compared to $327 thousand in 2018, representing an increase of $57 thousand. The increase was due to the Great State merger. The effects of changes in volumes and rates on net interest income in 2019 compared to 2018, and 2018 compared to 2017 are shown in Table 2.

The aforementioned factors led to an increase in net interest income of $3.6 million or 15.02% for 2019 as compared to 2018. The net yield on interest-earning assets increased by 7 basis points to 4.51% in 2019 compared to 4.44% in 2018.

Provision for Credit Losses

The allowance for credit losses is established to provide for expected losses in the Company's loan portfolio. Management determines the provision for credit losses required to maintain an allowance adequate to provide for probable losses. Some of the factors considered in making this decision are the levels and collectability of past due loans, volume of new loans, composition of the loan portfolio, and general economic outlook.

The provision for loan losses was $655 thousand for the year ended December 31, 2019, compared to $325 thousand for the year ended December 31, 2018. Asset quality has remained relatively consistent over the past year; therefore, the increase in loan loss provisions from 2018 to 2019 was due primarily to overall growth in the loan portfolio. The reserve for loan losses at December 31, 2019 was approximately 0.68% of total loans, compared to 0.65% at December 31, 2018. Management's estimate of probable credit losses inherent in the acquired Great State loan portfolio was reflected as a purchase discount which will continue to be accreted into income over the remaining life of the acquired loans in addition to the previously acquired loan portfolio from the merger with Cardinal Bankshares Corporation. As of December 31, 2019, the remaining unaccreted discount on the acquired loan portfolios totaled $3.2 million. Management believes the provision and the resulting allowance for loan losses are adequate. Additional information is contained in Tables 12 and 13, and is discussed in Nonperforming and Problem Assets.

Other Income

Noninterest income consists of revenues generated from a broad range of financial services and activities. The majority of noninterest income is traditionally a result of service charges on deposit accounts including charges for overdrafts and fees charged for non-deposit services. Noninterest income increased by $278 thousand in 2019 compared to 2018. The increase was due to growth and expansion of fee-based products and a change in overdraft fees. Securities gains increased by $44 thousand for the year ended December 31, 2019 compared to the same period last year. Included in other income are nonrecurring gains from sale of bank premises and equipment totaling $122 thousand in 2019. There were no nonrecurring gains from sale of bank premises and equipment in 2018. Noninterest income increased by $409 thousand in 2018 compared to 2017. The increase was due to service-related income from the Company's increased customer base following the merger with Great State as well as nonrecurring proceeds from life insurance contracts totaling $303 thousand in 2018. Securities gains decreased by $237 thousand for the year ended December 31, 2018 compared to December 31, 2017 as increases in interest rates led to decreases in the market value of the Bank's investment securities portfolio.

Table 3. Sources of Noninterest Income (dollars in thousands)

	2019	2018	2017
Service charges on deposit accounts	$ 1,652	$ 1,538	$ 1,326
Increase in cash value of life insurance	442	433	444
Life insurance income	-	303	-
Mortgage originations fees	459	396	293
Safe deposit box rental	91	93	94
Gain on securities	49	5	242
ATM income	1,465	1,324	967
Investment services income	62	126	84
Merchant services income	190	171	147
Interchange income	196	126	305
Other income	309	122	326
Total noninterest income	$ 4,915	$ 4,637	$ 4,228

Other Expense

The major components of noninterest expense for the past three years are illustrated at Table 4.

Total noninterest expenses increased by $401 thousand, or 1.75% for the year ended December 31, 2019, compared to the year ended December 31, 2018. Salary and benefit cost increased by $1.4 million due to the increase in full time equivalent employees from December 31, 2018 to December 31, 2019. Occupancy and equipment expenses increased by $282 thousand and data processing expenses increased by $193 thousand from 2018 to 2019, due to the addition of three branch facilities and two loan production offices from the Great State merger, along with the opening of a loan production office in Hickory, NC and a full service branch in Mocksville, NC. Amortization of core deposit intangibles increased by $244 thousand for the year ended December 31, 2019, compared to same period in 2018. These increases were offset by a decrease in merger related expenses of $2.0 million as no merger related expenses occurred during 2019. Nonrecurring merger related expenses totaled $2.0 million in 2018, compared to $748 thousand in 2017. The increase in noninterest expense in 2018, compared to 2017, was due primarily to the Great State merger.

Table 4. Sources of Noninterest Expense (dollars in thousands)

	2019	2018	2017
Salaries & wages	$ 10,277	$ 9,034	$ 8,230
Employee benefits	2,968	2,768	2,053
Total personnel expense	13,245	11,802	10,283
Director fees	356	370	327
Occupancy expense	1,389	1,260	1,083
Data processing expense	1,546	1,353	1,177
Other equipment expense	1,047	988	1,117
FDIC/OCC assessments	212	390	426
Insurance	131	121	129
Professional fees	667	452	430
Advertising	603	569	612
Postage & freight	396	362	311
Supplies	223	212	277
Franchise tax	438	438	397
Telephone	371	415	370
Travel, dues & meetings	509	490	414
ATM expense	517	423	388
Foreclosure expenses	3	32	44
Core deposit intangible amortization	822	578	282
Merger related expenses	-	1,978	748
Other expense	783	624	465
Total noninterest expense	$ 23,258	$ 22,857	$ 19,280

The overhead efficiency ratio of noninterest expense to adjusted total revenue (net interest income plus noninterest income) was 70.80% in 2019, 79.03% in 2018, and 77.03% in 2017. The ratios for 2018 and 2017, without the effect of nonrecurring merger related costs, would have been 72.19% and 74.05%, respectively.

Income Taxes

Income tax expense is based on amounts reported in the statements of income (after adjustments for non-taxable income and non-deductible expenses) and consists of taxes currently due plus deferred taxes on temporary differences in the recognition of income and expense for tax and financial statement purposes. The deferred tax assets and liabilities represent the future Federal income tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled.

Income tax expense (substantially all Federal) was $1.8 million in 2019 and $1.2 million in 2018, resulting in effective tax rates of 19.9% and 21.1%, respectively. The increase in income tax expense of $566 thousand in 2019 was primarily due to the increase in income before taxes of $3.2 million in 2019 compared to 2018.

Net deferred tax assets of $985 thousand, and $1.9 million existed at December 31, 2019 and 2018 respectively. At December 31, 2019, net deferred tax assets included $14 thousand of deferred tax assets applicable to unrealized gains on investment securities available for sale, and $259 thousand of deferred tax assets applicable to unfunded projected pension benefit obligations. Accordingly, these amounts were not charged to income but recorded directly to the related stockholders' equity account.

Analysis of Financial Condition

Average earning assets increased 13.28% from 2018 to 2019 due to the Great State merger. Total earning assets represented 90.77% of total average assets in 2019 and 90.43% in 2018. The mix of average earning assets changed from 2018 to 2019 as average loans increased by $71.7 million, or 15.04% and average investment securities decreased by $7.6 million, or 15.03%.

Table 5. Average Asset Mix (dollars in thousands)

	2019		2018	
	Average Balance	%	Average Balance	%
Earning assets:				
Loans	$ 548,611	80.32%	$ 476,900	78.79%
Investment securities	42,915	6.28%	50,504	8.34%
Federal funds sold	9,413	1.38%	10,584	1.75%
Deposits in other banks	19,082	2.79%	9,365	1.55%
Total earning assets	620,021	90.77%	547,353	90.43%
Non earning assets:				
Cash and due from banks	8,364	1.23%	8,218	1.36%
Premises and equipment	21,383	3.13%	19,055	3.14%
Other assets	37,310	5.46%	35,400	5.85%
Allowance for loan losses	(3,768)	-0.55%	(3,435)	-0.57%
Unrealized gain (loss) on securities	(263)	-0.04%	(1,283)	-0.21%
Total nonearning assets	63,026	9.23%	57,955	9.57%
Total assets	$ 683,047	100.00%	$ 605,308	100.00%

Average loans for 2019 represented 80.32% of total average assets compared to 78.79% in 2018. Average federal funds sold decreased from 1.75% to 1.38% of total average assets while deposits in other banks increased from 1.55% to 2.79% of total average assets over the same time period. Average investment securities decreased from

8.34% in 2018 to 6.28% of total average assets in 2019. The balances of nonearning assets to total average assets decreased from 9.57% to 9.23%.

Loans

Average loans totaled $548.6 million over the year ended December 31, 2019. This represents an increase of 15.04% from the average of $476.9 million for 2018. The increase was due to loans acquired from the Great State merger along with loan growth of $33.9 million during 2019. Average loans increased by 14.17% from 2017 to 2018.

The loan portfolio consists primarily of real estate and commercial loans. These loans accounted for 95.91% of the total loan portfolio at December 31, 2019. This is up from the 95.35% that the two categories maintained at December 31, 2018. The amount of loans outstanding by type at December 31 of each of the past five years and the maturity distribution for variable and fixed rate loans as of December 31, 2019 are presented in Tables 6 and 7, respectively.

Table 6. Loan Portfolio Summary (dollars in thousands)

	December 31, 2019		December 31, 2018		December 31, 2017	
	Amount	%	Amount	%	Amount	%
Construction and development	$ 39,649	6.95%	$ 33,449	6.23%	$ 25,475	6.00%
Residential, 1-4 families	220,120	38.59%	199,662	37.22%	170,080	40.03%
Residential, 5 or more families	33,554	5.88%	36,027	6.72%	29,040	6.84%
Farm land	34,166	5.99%	33,291	6.21%	33,353	7.85%
Nonfarm, nonresidential	190,817	33.46%	176,192	32.84%	125,661	29.57%
Total real estate	518,306	90.87%	478,621	89.22%	383,609	90.29%
Agricultural	3,697	0.65%	4,600	0.86%	2,792	0.66%
Commercial	28,729	5.04%	32,891	6.13%	22,880	5.38%
Consumer	7,250	1.27%	7,396	1.38%	5,868	1.38%
Other	12,371	2.17%	12,957	2.41%	9,722	2.29%
Total	$ 570,353	100.00%	$ 536,465	100.00%	$ 424,871	100.00%

	December 31, 2016		December 31, 2015	
	Amount	%	Amount	%
Construction and development	$ 26,464	6.42%	$ 14,493	6.01%
Residential, 1-4 families	160,502	38.96%	112,781	46.76%
Residential, 5 or more families	26,686	6.48%	12,203	5.06%
Farm land	33,531	8.14%	31,512	13.06%
Nonfarm, nonresidential	128,515	31.20%	52,463	21.75%
Total real estate	375,698	91.20%	223,452	92.64%
Agricultural	2,779	0.67%	1,383	0.57%
Commercial	23,307	5.66%	11,399	4.73%
Consumer	5,491	1.33%	3,962	1.64%
Other	4,693	1.14%	1,020	0.42%
Total	$ 411,968	100.00%	$ 241,216	100.00%

Table 7. Maturity Schedule of Loans, as of December 31, 2019 (dollars in thousands)

	Real Estate	Agricultural & Commercial	Consumer & Other	Total Amount	Total %
Fixed rate loans:					
Three months or less	$ 6,291	$ 1,490	$ 3,242	$ 11,023	1.93%
Over three to twelve months	14,845	4,362	751	19,958	3.50%
Over one to five years	118,336	14,685	6,899	139,920	24.53%
Over five years	42,021	1,857	6,671	50,549	8.86%
Total fixed rate loans	$ 181,493	$ 22,394	$ 17,563	$ 221,450	38.82%
Variable rate loans:					
Three months or less	$ 3,482	$ 2,183	$ 90	$ 5,755	1.01%
Over three to twelve months	13,373	3,903	100	17,376	3.05%
Over one to five years	12,055	1,766	217	14,038	2.46%
Over five years	307,903	2,180	1,651	311,734	54.66%
Total variable rate loans	$ 336,813	$ 10,032	$ 2,058	$ 348,903	61.18%
Total loans:					
Three months or less	$ 9,773	$ 3,673	$ 3,332	$ 16,778	2.94%
Over three to twelve months	28,218	8,265	851	37,334	6.55%
Over one to five years	130,391	16,451	7,116	153,958	26.99%
Over five years	349,924	4,037	8,322	362,283	63.52%
Total loans	$ 518,306	$ 32,426	$ 19,621	$ 570,353	100.00%

Interest rates charged on loans vary with the degree of risk, maturity and amount of the loan. Competitive pressures, money market rates, availability of funds, and government regulations also influence interest rates. On average, loans yielded 5.32% in 2019 compared to an average yield of 5.15% in 2018. The increase in loan yields was due primarily to the loan portfolio purchased in the Great State merger, increased loan accretion, along with loan growth of $33.9 million in 2019.

Investment Securities

The Company uses its investment portfolio to provide liquidity for unexpected deposit decreases or loan generation, to meet the Bank's interest rate sensitivity goals, and to generate income.

Management of the investment portfolio has always been conservative with the majority of investments taking the form of purchases of U.S. Treasury, U.S. Government Agencies, U.S. Government Sponsored Enterprises and State and Municipal bonds, as well as investment grade corporate bond issues. Management views the investment portfolio as a source of income, and purchases securities with the intent of retaining them until maturity. However, adjustments are necessary in the portfolio to provide an adequate source of liquidity which can be used to meet funding requirements for loan demand and deposit fluctuations and to control interest rate risk. Therefore, from time to time, management may sell certain securities prior to their maturity. Table 8 presents the investment portfolio at the end of 2019 by major types of investments and contractual maturity ranges. Investment securities in Table 8 may have repricing or call options that are earlier than the contractual maturity date. Yields on tax exempt obligations are not computed on a tax-equivalent basis in Table 8.

The total amortized cost of investment securities decreased by approximately $13.8 million from December 31, 2018 to December 31, 2019, while the average balance of investment securities carried throughout the year decreased by approximately $7.6 million from 2018 to 2019. The decrease in total amortized cost came as cash generated from investment maturities, calls, paydowns and liquidating investment securities was used to fund loan growth. The average yield of the investment portfolio increased to 2.54% for the year ended December 31, 2019 compared to 2.53% for 2018.

Table 8. Investment Securities - Maturity/Yield Schedule (dollars in thousands)

	December 31, 2019							
	In One Year or Less	After One Through Five Years	After Five Through Ten Years	After Ten Years	Book Value 12/31/19	Market Value 12/31/19	Book Value 12/31/18	Book Value 12/31/17
Investment securities:								
U.S. Government agencies	$ -	$ -	$ -	$ -	$ -	$ -	$ 244	$ -
Govt. sponsored enterprises	-	-	-	-	-	-	-	-
Mortgage-backed securities	998	1,419	11,481	5,642	19,540	19,504	25,627	28,780
Corporate securities	-	-	1,500	-	1,500	1,433	2,970	3,016
State and municipal securities	291	5,757	2,033	3,696	11,777	11,944	17,764	19,542
Total	$ 1,289	$ 7,176	$ 15,014	$ 9,338	$ 32,817	$ 32,881	$ 46,605	$ 51,338
Weighted average yields:								
U.S. Government agencies	0.00%	0.00%	0.00%	0.00%	0.00%			
Mortgage-backed securities	1.89%	2.12%	2.19%	2.38%	2.22%			
Corporate securities	0.00%	0.00%	2.00%	0.00%	2.00%			
State and municipal securities	3.53%	2.65%	3.20%	2.79%	2.81%			
Total	2.26%	2.55%	2.31%	2.54%	2.42%			

Deposits

The Company relies on deposits generated in its market area to provide the majority of funds needed to support lending activities and for investments in liquid assets. More specifically, core deposits (total deposits less certificates of deposit in denominations of $100,000 or more) are the primary funding source. The Company's balance sheet growth is largely determined by the availability of deposits in its markets, the cost of attracting the deposits, and the prospects of profitably utilizing the available deposits by increasing the loan or investment portfolios. We believe that recent market conditions have resulted in depositors shopping for deposit rates more than in the past. An increased customer awareness of interest rates adds to the importance of rate management. The Company's management must continuously monitor market pricing, competitor's rates, and the internal interest rate spreads to maintain the Company's growth and profitability. The Company attempts to structure rates so as to promote deposit and asset growth while at the same time increasing overall profitability of the Company.

Average total deposits for the year ended December 31, 2019 amounted to $598.4 million, which was an increase of $62.2 million, or 11.60% from 2018. The increase was due primarily to deposits acquired in the Great State merger. Average core deposits totaled $516.2 million in 2019 representing a 8.99% increase over the $473.6 million in 2018. The percentage of the Company's average deposits that are interest-bearing has remained consistent in recent years at 73.9% in 2017, 74.0% in 2018, and 73.1% in 2019. Average demand deposits, which earn no interest, increased 15.39% from $139.4 million in 2018 to $160.9 million in 2019. Average deposits for the periods ended December 31, 2019, 2018, and 2017 are summarized in Table 9.

Table 9. Deposit Mix (dollars in thousands)

	December 31, 2019			December 31, 2018		
	Average Balance	% of Total Deposits	Average Rate Paid	Average Balance	% of Total Deposits	Average Rate Paid
Interest-bearing deposits:						
Interest-bearing DDA accounts	$ 75,498	12.6%	0.12%	$ 66,984	12.5%	0.10%
Money market	53,147	8.9%	0.40%	48,425	9.0%	0.26%
Savings	124,441	20.8%	0.31%	117,479	21.9%	0.30%
Individual retirement accounts	44,581	7.5%	1.13%	45,598	8.5%	0.99%
Small denomination certificates	57,657	9.6%	1.06%	55,700	10.4%	0.57%
Large denomination certificates	82,263	13.7%	1.27%	62,634	11.7%	0.89%
Total interest-bearing deposits	437,587	73.1%	0.65%	396,820	74.0%	0.47%
Noninterest-bearing deposits	160,858	26.9%	0.00%	139,409	26.0%	0.00%
Total deposits	$ 598,445	100.0%	0.48%	$ 536,229	100.0%	0.35%

	December 31, 2017		
	Average Balance	% of Total Deposits	Average Rate Paid
Interest-bearing deposits:			
Interest-bearing DDA accounts	$ 59,485	12.1%	0.09%
Money market	42,711	8.7%	0.21%
Savings	101,184	20.6%	0.25%
Individual retirement accounts	47,045	9.6%	0.91%
Small denomination certificates	59,820	12.2%	0.41%
Large denomination certificates	52,868	10.7%	0.76%
Total interest-bearing deposits	363,113	73.9%	0.41%
Noninterest-bearing deposits	128,356	26.1%	0.00%
Total deposits	$ 491,469	100.0%	0.30%

The average balance of certificates of deposit issued in denominations of $100,000 or more increased by $19.6 million, or 31.34%, for the year ended December 31, 2019 due to the Great State merger. The strategy of management has been to support loan and investment growth with core deposits and not to aggressively solicit the more volatile, large denomination certificates of deposit. Loan growth in 2019 was primarily funded through core deposit growth, reductions in investment securities, in addition to increases in FHLB borrowings, thus reducing management's reliance on large denomination certificates of deposit for funding purposes. Table 10 provides maturity information relating to certificates of deposit of $100,000 or more at December 31, 2019.

Table 10. Large Denomination Certificate of Deposit Maturities (dollars in thousands)

Analysis of certificates of deposit of $100,000 or more at December 31, 2019:

Remaining maturity of three months or less	$ 6,670
Remaining maturity over three months through six months	4,034
Remaining maturity over six months through twelve months	14,219
Remaining maturity over twelve months	63,823
Total certificates of deposit of $100,000 or more	$ 88,746

Equity

Stockholders' equity totaled $81.4 million at December 31, 2019 compared to $75.6 million at December 31, 2018. The increase of $5.8 million was due to earnings of $7.2 million, plus other comprehensive income of $1.0 million, less common stock repurchases of $908 thousand, and the payment of dividends of $1.5 million. Book value increased from $12.17 per share at December 31, 2018 to $13.27 per share at December 31, 2019. Tangible book value increased from $11.03 per share at December 31, 2018 to $12.24 per share at December 31, 2019.

Effective January 1, 2015, the federal banking regulators adopted rules to implement the Basel III regulatory capital reforms from the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. The final rules required the Bank to comply with the following minimum capital ratios: (i) a new common equity Tier 1 capital ratio of 4.5% of risk-weighted assets; (ii) a Tier 1 capital ratio of 6% of risk-weighted assets; (iii) a total capital ratio of 8% of risk-weighted assets; and (iv) a leverage ratio of 4% of total assets. As fully phased in on January 1, 2019, the rules require the Bank to maintain (i) a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% common equity Tier 1 ratio, effectively resulting in a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 7% upon full implementation), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of total capital to risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer (which is added to the 8.0% total capital ratio, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation), and (iv) a minimum leverage ratio of 4%, calculated as the ratio of Tier 1 capital to average assets.

Under Basel III Capital requirements, a capital conservation buffer of 0.625% became effective beginning on January 1, 2016. The capital conservation buffer was gradually increased through January 1, 2019 to 2.50%. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banks are now required to maintain levels that meet the required minimum plus the capital conservation buffer in order to make distributions, such as dividends, or discretionary bonus payments. The Banks's capital conservation buffer is 5.53% as of December 31, 2019.

Table 11. Bank's Year-end Risk-Based Capital (dollars in thousands)

	2019	2018
Tier 1 Capital	$ 74,726	$ 67,899
Unrealized gains on AFS preferred stock	-	-
Qualifying allowance for loan losses (limited to 1.25% of risk-weighted assets)	3,926	3,525
Total regulatory capital	$ 78,652	$ 71,424
Total risk-weighted assets	$ 581,235	$ 549,292
Tier 1 capital as a percentage of risk-weighted assets	12.9%	12.4%
Common Equity Tier 1 capital as a percentage of risk-weighted assets	12.9%	12.4%
Total regulatory capital as a percentage of risk-weighted assets	13.5%	13.0%
Leverage ratio*	10.8%	10.1%

* Tier 1 capital divided by average total assets for the quarter ended December 31 of each year.

Nonperforming and Problem Assets

Certain credit risks are inherent in making loans, particularly commercial and consumer loans. Management prudently assesses these risks and attempts to manage them effectively. The Bank attempts to use shorter-term loans and, although a portion of the loans have been made based upon the value of collateral, the underwriting decision is generally based on the cash flow of the borrower as the source of repayment rather than the value of the collateral. The Bank also attempts to reduce repayment risk by adhering to internal credit policies and procedures. These policies and procedures include officer and customer limits, periodic loan documentation review and follow up on exceptions to credit policies.

Nonperforming assets at December 31, 2019, 2018, 2017, 2016, and 2015 are analyzed in Table 12.

Table 12. Nonperforming Assets (dollars in thousands)

	2019	2018	2017	2016	2015
Nonperforming loans:					
Nonaccrual loans	$ 4,979	$ 5,579	$ 5,335	$ 4,664	$ 1,589
Restructured loans	4,695	6,961	7,743	9,239	10,008
Loans past due 90 days or more and still accruing	-	-	-	-	-
Total nonperforming loans	9,674	12,540	13,078	13,903	11,597
Foreclosed assets	-	753	-	70	408
Total nonperforming assets	$ 9,674	$ 13,293	$ 13,078	$ 13,973	$ 12,005
Total nonperforming loans as a percentage to total loans	1.7%	2.3%	3.1%	3.4%	4.8%
Total nonperforming assets as a percentage to total assets	1.4%	2.0%	2.4%	2.5%	3.6%

Total nonperforming loans were 1.7% and 2.3% of total outstanding loans as of December 31, 2019 and 2018, respectively. The majority of the decrease in nonaccrual loans from 2018 to 2019 came in the "commercial mortgage" category. Nonaccrual loans in this category decreased by $542 thousand. Loans are placed in nonaccrual status when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Loans are removed from nonaccrual status when they are deemed a loss and charged to the allowance, transferred to foreclosed assets, or returned to accrual status based upon performance consistent with the original terms of the loan or a subsequent restructuring thereof. Management's ability to ultimately resolve these loans either with or without significant loss will be determined, to a great extent, by general economic and real estate market conditions.

For the years ended December 31, 2019 and 2018, interest income recognized on loans in nonaccrual status was approximately $47 thousand and $58 thousand, respectively. Had these credits been current in accordance with their original terms, the gross interest income for these credits would have been approximately $196 thousand and $277 thousand, respectively for the years ended December 31, 2019 and 2018.

Restructured loans represent troubled debt restructurings (TDRs) that have returned to accrual status after a period of performance in accordance with their modified terms. The decrease in restructured loans from 2018 to 2019 came primarily in the form of principal reductions. A TDR is considered to be successful if the borrower maintains adequate payment performance under the modified terms and is financially stable.

The decrease in foreclosed assets from 2018 to 2019 resulted from the sale of a nonfarm, nonresidential property during the first quarter of 2019. Sales and market adjustments of foreclosed assets in 2018 resulted in a net loss of $10 thousand. There was no net gains or losses in 2019. More information on nonperforming assets can be found in Note 6 of the "Notes to Consolidated Financial Statements" found in the company's 2019 Annual Report.

As of December 31, 2019 and 2018 we had loans with a current principal balance of $57.2 million and $56.0 million rated "Watch" or "Special Mention". The increase was due primarily to loan risk rating reclassifications. The "Watch" classification is utilized by us when we have an initial concern about the financial health of a borrower that indicate above average risk. We then gather current financial information about the borrower and evaluate our current risk in the credit. After this review we will either move the loan to a higher risk rating category or move it back to its original risk rating. Loans may be left rated "Watch" for a longer period of time if, in management's opinion, there are risks that cannot be fully evaluated without the passage of time, and we want to review it on a more regular basis. Assets that do not currently expose the Bank to sufficient risk to warrant a classification such as "Substandard" or "Doubtful" but otherwise possess weaknesses are designated "Special Mention". Loans rated as "Watch" or "Special Mention" are not considered "potential problem loans" until they are determined by management to be classified as "Substandard". Past due loans are often regarded as a precursor to further credit problems which would lead to future increases in nonaccrual loans or other real estate owned. As of December 31, 2019 loans past due 30-89 days and still accruing totaled $1.1 million compared to $863 thousand at December 31, 2018.

Certain types of loans, such as option ARM products, subprime loans and loans with initial teaser rates, can have a greater risk of non-collection than other loans. The Bank has not offered these types of loans in the past and does not offer them currently. Junior-lien mortgages can also be considered higher risk loans. Our junior-lien portfolio at December 31, 2019 totaled $4.3 million, or 0.75% of total loans. The charge-off rates in this category do not vary significantly from other real estate secured loans in the current year.

The allowance for loan losses is maintained at a level adequate to absorb potential losses. Some of the factors which management considers in determining the appropriate level of the allowance for loan losses are: past loss experience, an evaluation of the current loan portfolio, identified loan problems, the loan volume outstanding, the present and expected economic conditions in general, and in particular, how such conditions relate to the market area that the Bank serves. Bank regulators also periodically review the Bank's loans and other assets to assess their quality. Loans deemed uncollectible are charged to the allowance. Provisions for loan losses and recoveries on loans previously charged off are added to the allowance. The reserve for loan losses at December 31, 2019 was approximately 0.68% of total loans, compared to 0.65% at December 31, 2018. Management's estimate of probable credit losses inherent in the acquired Great State loan portfolio was reflected as a purchase discount which will continue to be accreted into income over the remaining life of the acquired loans in addition to the previously acquired loan portfolio from the merger with Cardinal Bankshares Corporation. As of December 31, 2019, the remaining unaccreted discount on the acquired loan portfolios totaled $3.2 million. This remaining discount can be used for credit losses if a loss occurs on individual loans in the purchased portfolios. When combined with the allowance for loan losses of $3.9 million at December 31, 2019, we have a reserve of approximately 1.24% of total loans, a non-GAAP measure.

To quantify the specific elements of the allowance for loan losses, the Bank begins by establishing a specific reserve for larger-balance, non-homogeneous loans, which have been identified as being impaired. This reserve is determined by comparing the principal balance of the loan with the net present value of the future anticipated cash flows or the fair market value of the related collateral. If the impaired loan is collateral dependent, then any excess in the recorded investment in the loan over the fair value of the collateral that is identified as uncollectible in the near term is charged off against the allowance for loan losses at that time. The bank also collectively evaluates for impairment smaller-balance troubled debt restructurings (TDRs). The specific component of the allowance for smaller-balance TDR loans is calculated on a pooled basis considering historical experience adjusted for qualitative factors. The bank then reviews certain loans in the portfolio and assigns grades to loans which have been reviewed. Loans which are adversely classified are given a specific allowance based on the historical loss experience of similar type loans in each adverse grade with further adjustments for external factors. The remaining portfolio is segregated into loan pools consistent with regulatory guidelines. An allocation is then made to the reserve for these loan pools based on the bank's historical loss experience with further adjustments for external factors. The allowance is allocated according to the amount deemed to be reasonably necessary to provide for the possibility of losses being incurred within the respective categories of loans, although the entire allowance is available to absorb any actual charge-offs that may occur.

The provision for loan losses, net charge-offs, and the resulting allowance for loan losses, are detailed in Table 13. The allocation of the reserve for loan losses is detailed in Table 14.

Table 13. Analysis of the Allowance for Loan Losses (dollars in thousands)

	2019	2018	2017	2016	2015
Allowance for loan losses, beginning	$ 3,495	$ 3,453	$ 3,420	$ 3,418	$ 4,185
Provision for (reduction of) loan losses, added	655	325	217	(5)	(187)
Charge-offs:					
Commercial and agricultural	(77)	(23)	(27)	(19)	(1)
Real estate – construction	-	(20)	(33)	(20)	(186)
Real estate – mortgage	(109)	(259)	(182)	(105)	(469)
Consumer and other	(212)	(175)	(76)	(70)	(30)
Recoveries:					
Commercial and agricultural	10	9	33	8	10
Real estate – construction	-	-	56	98	16
Real estate – mortgage	77	147	23	81	23
Consumer and other	54	38	22	34	57
Net (charge-offs) recoveries	(257)	(283)	(184)	7	(580)
Allowance for loan losses, ending	$ 3,893	$ 3,495	$ 3,453	$ 3,420	$ 3,418
Ratio of net charge-offs during the period to average loans outstanding during the period	0.05%	0.06%	0.04%	0.00%	0.26%

Table 14. Allocation of the Allowance for Loan Losses (dollars in thousands)

Balance at the end of the period applicable to:	December 31, 2019 Amount	December 31, 2019 % of Loans to Total Loans	December 31, 2018 Amount	December 31, 2018 % of Loans to Total Loans	December 31, 2017 Amount	December 31, 2017 % of Loans to Total Loans
Commercial and agricultural	$ 211	5.69%	$ 281	6.99%	$ 282	6.04%
Real estate – construction	305	6.95%	246	6.23%	239	6.00%
Real estate – mortgage	3,233	83.92%	2,874	82.99%	2,852	84.29%
Consumer and other	144	3.44%	94	3.79%	80	3.67%
Total	$ 3,893	100.00%	$ 3,495	100.00%	$ 3,453	100.00%

Balance at the end of the period applicable to:	December 31, 2016 Amount	December 31, 2016 % of Loans to Total Loans	December 31, 2015 Amount	December 31, 2015 % of Loans to Total Loans
Commercial and agricultural	$ 210	6.33%	$ 136	5.30%
Real estate – construction	319	6.42%	344	6.01%
Real estate – mortgage	2,783	84.78%	2,900	86.63%
Consumer and other	108	2.47%	38	2.06%
Total	$ 3,420	100.00%	$ 3,418	100.00%

Financial Instruments with Off-Balance Sheet Risk

The Bank is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, credit risk in excess of the amount recognized in the consolidated balance sheets.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as for on-balance sheet instruments. A summary of the Bank's commitments at December 31, 2019 and 2018 is as follows:

	2019	2018
Commitments to extend credit	$ 95,190	$ 76,977
Standby letters of credit	1,313	1,227
	$ 96,503	$ 78,204

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the party. Collateral held varies, but may include accounts receivable, inventory, property and equipment, residential real estate and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required in instances which the Bank deems necessary.

Quantitative and Qualitative Disclosure about Market Risk

The principal goals of the Bank's asset and liability management strategy are the maintenance of adequate liquidity and the management of interest rate risk. Liquidity is the ability to convert assets to cash to fund depositors' withdrawals or borrowers' loans without significant loss. Interest rate risk management balances the effects of interest rate changes on assets that earn interest or liabilities on which interest is paid, to protect the Bank from wide fluctuations in its net interest income which could result from interest rate changes.

Management must insure that adequate funds are available at all times to meet the needs of its customers. On the asset side of the balance sheet, maturing investments, loan payments, maturing loans, federal funds sold, and unpledged investment securities are principal sources of liquidity. On the liability side of the balance sheet, liquidity sources include core deposits, the ability to increase large denomination certificates, federal fund lines from correspondent banks, borrowings from the Federal Home Loan Bank, as well as the ability to generate funds through the issuance of long-term debt and equity.

The liquidity ratio (the level of liquid assets divided by total deposits plus short-term liabilities) was 9.9% at December 31, 2019 compared to 11.6% at December 31, 2018. These ratios are considered to be adequate by management.

The Bank uses cash and federal funds sold to meet its daily funding needs. If funding needs are met through holdings of excess cash and federal funds, then profits might be sacrificed as higher-yielding investments are foregone in the interest of liquidity. Therefore management determines, based on such items as loan demand and deposit activity, an appropriate level of cash and federal funds and seeks to maintain that level.

The primary goals of the investment portfolio are liquidity management and maturity gap management. As investment securities mature the proceeds are reinvested in federal funds sold if the federal funds level needs to be increased, otherwise the proceeds are reinvested in similar investment securities. The majority of investment security transactions consist of replacing securities that have been called or matured. The Bank keeps a portion of its investment portfolio in unpledged assets that are less than 60 months to maturity or next repricing date. These investments are a preferred source of funds in that they can be disposed of in most interest rate environments without causing significant damage to that quarter's profits.

Interest rate risk is the effect that changes in interest rates would have on interest income and interest expense as interest-sensitive assets and interest-sensitive liabilities either reprice or mature. Management attempts to maintain the portfolios of interest-earning assets and interest-bearing liabilities with maturities or repricing opportunities at levels that will afford protection from erosion of net interest margin, to the extent practical, from changes in interest rates. Table 15 shows the sensitivity of the Bank's balance sheet on December 31, 2019. This table reflects the sensitivity of the balance sheet as of that specific date and is not necessarily indicative of the position on other dates. At December 31, 2019, the Bank appeared to be cumulatively asset-sensitive (interest-earning assets subject to interest rate changes exceeding interest-bearing liabilities subject to changes in interest rates). However, in the one year window liabilities subject to changes in interest rates exceed assets subject to interest rate changes (non asset-sensitive).

Matching sensitive positions alone does not ensure the Bank has no interest rate risk. The repricing characteristics of assets are different from the repricing characteristics of funding sources. Thus, net interest income can be impacted by changes in interest rates even if the repricing opportunities of assets and liabilities are perfectly matched.

Table 15. Interest Rate Sensitivity (dollars in thousands)

	December 31, 2019 Maturities/Repricing				
	1 to 3 Months	4 to 12 Months	13 to 60 Months	Over 60 Months	Total
Interest-Earning Assets:					
Interest bearing deposits	$ 34,861	$ -	$ -	$ -	$ 34,861
Federal funds sold	1,138	-	-	-	1,138
Investments	1,494	1,290	7,213	22,884	32,881
Loans	98,098	49,347	332,337	90,571	570,353
Total	$ 135,591	$ 50,637	$ 339,550	$ 113,455	$ 639,233
Interest-Bearing Liabilities:					
Interest-bearing DDA accounts	$ 78,310	$ -	$ -	$ -	$ 78,310
Money market	53,336	-	-	-	53,336
Savings	121,677	-	-	-	121,677
Time deposits	16,830	44,669	130,489	-	191,988
Borrowings	-	-	-	10,000	10,000
Total	$ 270,153	$ 44,669	$ 130,489	$ 10,000	$ 455,311
Interest sensitivity gap	$ (134,562)	$ 5,968	$ 209,061	$ 103,455	$ 183,922
Cumulative interest sensitivity gap	$ (134,562)	$ (128,594)	$ 80,467	$ 183,922	$ 183,922
Ratio of sensitivity gap to total earning assets	-21.1%	0.9%	32.7%	16.2%	28.8%
Cumulative ratio of sensitivity gap to total earning assets	-21.1%	-20.1%	12.6%	28.8%	28.8%

The Company uses a number of tools to monitor its interest rate risk, including simulating net interest income under various scenarios, monitoring the present value change in equity under the same scenarios, and monitoring the difference or gap between rate sensitive assets and rate sensitive liabilities over various time periods (as displayed in Table 15).

The earnings simulation model forecasts annual net income under a variety of scenarios that incorporate changes in the absolute level of interest rates, changes in the shape of the yield curve, and changes in interest rate relationships. Management evaluates the effect on net interest income and present value equity from gradual changes in rates of up to 400 basis points up or down over a 12-month period. Table 16 presents the Bank's twelve-month forecasts for changes in net interest income and market value of equity resulting from changes in rates of up to 300 basis points up or down, as of December 31, 2019.

Table 16. Interest Rate Risk (dollars in thousands)

	Rate Shocked Net Interest Income and Market Value of Equity						
Rate Change	**-300bp**	**-200bp**	**-100bp**	**0bp**	**+100bp**	**+200bp**	**+300bp**
Net Interest Income:							
Net interest income	$ 25,148	$ 25,180	$ 26,133	$ 27,244	$ 27,306	$ 27,403	$ 27,476
Change	$ (2,096)	$ (2,064)	$ (1,111)	$ -	$ 62	$ 159	$ 232
Change percentage	-7.69%	-7.58%	-4.08%		0.23%	0.58%	0.85%
Market Value of Equity	$ 116,963	$ 100,842	$ 109,983	$ 118,447	$ 121,448	$ 122,584	$ 121,569

Impact of Inflation and Changing Prices

The consolidated financial statements and the accompanying notes presented elsewhere in this document have been prepared in accordance with generally accepted accounting principles which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, virtually all Company assets and liabilities are monetary in nature, therefore the impact of inflation is reflected primarily in the increased cost of operations. As a result, interest rates have a greater impact on performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Table 17. Key Financial Ratios

	2019	**2018**	**2017**
Return on average assets	1.05%	0.75%	0.44%
Return on average equity	9.10%	7.02%	4.28%
Dividend payout ratio	20.74%	24.81%	33.09%
Average equity to average assets	11.51%	10.66%	10.32%


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