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

Table of Contents

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

FORM 10-Q

(Mark One)
☒ **Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
for the quarterly period ended September 30, 2018.
Or
☐ **Transition Report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**

for the transition period from to .

Commission File Number: 333-158525

HOMETOWN BANKSHARES CORPORATION

(Exact name of the registrant as specified in its charter)

Virginia **(State or other jurisdiction of Incorporation or organization)**	**26-4549960** **(I.R.S. Employer Identification No.)**
202 South Jefferson Street, Roanoke, Virginia **(Address of principal executive offices)**	**24011** **(Zip Code)**

Registrant's telephone number: (540) 345-6000
(Former name, former address, and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer	☐	Accelerated filer	☐
Non-accelerated filer	☐	(Do not check if a smaller reporting company)	
		Smaller reporting company	☒
		Emerging growth company	☐

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

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

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

As of November 9, 2018, 5,809,789 shares of common stock, par value $5.00 per share, of the issuer were outstanding.

HOMETOWN BANKSHARES CORPORATION
Form 10-Q

INDEX

All schedules have been omitted because they are inapplicable or the required information is provided in the financial statements, including the notes thereto.

HomeTown Bankshares Corporation
Consolidated Balance Sheets
September 30, 2018 and December 31, 2017

Dollars In Thousands, Except Share and Per Share Data	September 30, 2018 (Unaudited)	December 31, 2017 *
Assets		
Cash and due from banks	$ 18,126	$ 21,714
Federal funds sold	193	180
Securities available for sale, at fair value	45,704	55,344
Restricted equity securities, at cost	2,359	2,371
Loans held for sale	1,378	1,587
Loans, net of allowance for loan losses of $3,947 in 2018 and $3,758 in 2017	462,396	440,437
Property and equipment, net	13,096	12,937
Other real estate owned, net of valuation allowance of $954 in 2018 and $797 in 2017	3,196	3,249
Bank owned life insurance	8,147	8,669
Accrued income	2,639	2,681
Other assets	1,507	1,084
Total assets	$ 558,741	$ 550,253
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing	$ 121,598	$ 106,956
Interest-bearing	361,899	370,364
Total deposits	483,497	477,320
Federal Home Loan Bank borrowings	10,728	11,028
Subordinated notes	7,277	7,254
Other borrowings	1,348	1,558
Accrued interest payable	556	368
Other liabilities	2,365	1,833
Total liabilities	505,771	499,361
Commitments and contingencies		
Stockholders' equity:		
Common stock, $5 par value; authorized 10,000,000 shares, issued and outstanding 5,809,789 (includes 42,495 restricted shares) at September 30, 2018 and 5,775,597 (includes 32,087 restricted shares) at December 31, 2017	28,836	28,777
Surplus	18,151	17,980
Retained earnings	6,798	3,767
Accumulated other comprehensive loss	(1,158)	(141)
Total HomeTown Bankshares Corporation stockholders' equity	52,627	50,383
Noncontrolling interest in consolidated subsidiary	343	509
Total stockholders' equity	52,970	50,892
Total liabilities and stockholders' equity	$ 558,741	$ 550,253

****Derived from consolidated audited financial statements.***
See Notes to Consolidated Financial Statements

HomeTown Bankshares Corporation
Consolidated Statements of Income
For the three and nine months ended September 30, 2018 and 2017

Dollars in Thousands, Except Share and Per Share Data	For the Three Months Ended September 30, 2018	For the Three Months Ended September 30, 2017	For the Nine Months Ended September 30, 2018	For the Nine Months Ended September 30, 2017
	(Unaudited)	*(Unaudited)*	*(Unaudited)*	*(Unaudited)*
Interest and dividend income:				
Loans and fees on loans	$ 5,344	$ 4,797	$ 15,374	$ 14,123
Taxable investment securities	262	244	824	744
Nontaxable investment securities	56	75	172	239
Dividends on restricted stock	38	33	111	98
Other interest income	48	68	138	160
Total interest and dividend income	5,748	5,217	16,619	15,364
Interest expense:				
Deposits	761	588	1,998	1,694
Subordinated notes	134	134	402	402
Other borrowed funds	85	58	243	171
Total interest expense	980	780	2,643	2,267
Net interest income	4,768	4,437	13,976	13,097
Provision for loan losses	24	40	371	575
Net interest income after provision for loan losses	4,744	4,397	13,605	12,522
Noninterest income:				
Service charges on deposit accounts	139	120	419	415
ATM and interchange income	265	206	754	612
Mortgage banking	195	263	587	725
Gains on sales of investment securities, net	-	18	60	60
Income from life insurance death benefit	-	-	642	-
Other income	165	150	478	675
Total noninterest income	764	757	2,940	2,487
Noninterest expense:				
Salaries and employee benefits	2,113	2,099	6,465	6,153
Occupancy and equipment expense	416	391	1,253	1,245
Data processing expense	355	309	1,152	954
ATM processing expense	21	57	62	180
Advertising and marketing expense	136	112	491	383
Professional fees	76	89	350	454
Bank franchise taxes	106	100	313	299
FDIC insurance expense	26	78	182	181
Losses on sales and write-downs of other real estate owned, net	2	-	160	380
Other real estate owned expense	44	28	249	66
Directors' fees	91	97	294	306
Merger-related expense	65	-	65	-
Other expense	407	444	1,289	1,308
Total noninterest expense	3,858	3,804	12,325	11,909
Net income before income taxes	1,650	1,350	4,220	3,100
Income tax expense	308	413	687	930
Net income	1,342	937	3,533	2,170
Less net income attributable to non-controlling interest	10	20	38	54
Net income attributable to HomeTown Bankshares Corporation	$ 1,332	$ 917	$ 3,495	$ 2,116
Basic earnings per common share	$ 0.23	$ 0.16	$ 0.60	$ 0.37
Diluted earnings per common share	$ 0.23	$ 0.16	$ 0.60	$ 0.37
Weighted average common shares outstanding	5,810,618	5,770,175	5,804,251	5,767,602
Diluted weighted average common shares outstanding	5,861,082	5,794,777	5,854,715	5,792,204

See Notes to Consolidated Financial Statements

HomeTown Bankshares Corporation
Consolidated Statements of Comprehensive Income
For the three and nine months ended September 30, 2018 and 2017

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
Dollars In Thousands	*(Unaudited)*	*(Unaudited)*	*(Unaudited)*	*(Unaudited)*
Net income	$ 1,342	$ 937	$ 3,533	$ 2,170
Other comprehensive income (loss):				
Net unrealized holding gains (losses) on securities available for sale during the period	(306)	(201)	(1,227)	307
Deferred income tax benefit (expense) on unrealized holding gains on securities available for sale	64	68	258	(104)
Reclassification adjustment for gains on sales of investment securities included in net income	-	(18)	(60)	(60)
Tax expense related to realized gains on securities sold	-	6	13	20
Total other comprehensive income (loss)	(242)	(145)	(1,016)	163
Comprehensive income	1,100	792	2,517	2,333
Less: Comprehensive income attributable to the non-controlling interest	10	20	38	54
Comprehensive income attributable to HomeTown Bankshares Corporation	$ 1,090	$ 772	$ 2,479	$ 2,279

See Notes to Consolidated Financial Statements

HomeTown Bankshares Corporation
Consolidated Statements of Cash Flows
For the nine months ended September 30, 2018 and 2017

Dollars in Thousands	2018	2017
	(Unaudited)	*(Unaudited)*
Cash flows from operating activities:		
Net income	$ 3,533	$ 2,170
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	511	545
Provision for loan losses	371	575
Amortization of premium on securities, net	327	351
Amortization of discount on subordinated notes	23	23
Gains on sales of loans held for sale	(421)	(516)
Losses on sales and writedowns of other real estate, net	160	380
Gains on sales of investment securities	(60)	(60)
Increase in value of life insurance contracts	(152)	(146)
Income from life insurance benefit	(642)	–
Stock compensation expense	159	109
Originations of loans held for sale	(21,728)	(24,759)
Proceeds from sales of loans held for sale	22,358	24,940
Changes in assets and liabilities:		
Accrued income	42	(330)
Other assets	104	(222)
Deferred taxes, net	(257)	(71)
Accrued interest payable	188	122
Other liabilities	538	227
Net cash flows provided by operating activities	5,054	3,338
Cash flows from investing activities:		
Net increase in federal funds sold	(13)	(90)
Purchases of available for sale securities	(900)	(18,099)
Sales, maturities, and calls of available for sale securities	8,986	17,436
Redemption (purchase) of restricted equity securities, net	12	(158)
Net increase in loans	(23,027)	(17,074)
Purchase of other real estate at foreclosure	–	(274)
Proceeds from sales of other real estate	590	876
Purchase of bank owned life insurance	–	(500)
Death benefit from bank owned life insurance	1,316	–
Supplemental executive retirement plan payments	(6)	–
Purchases of property and equipment	(670)	(272)
Net cash flows used in investing activities	(13,712)	(18,155)
Cash flows from financing activities:		
Net increase in noninterest-bearing deposits	14,642	18,895
Net increase (decrease) in interest-bearing deposits	(8,465)	9,201
Net increase (decrease) in FHLB borrowings	(300)	3,361
Net decrease in other borrowings	(210)	(125)
Distribution of equity of noncontrolling interest	(204)	–
Common stock cash dividends paid	(464)	–
Exercise of stock options	91	28
Net settlement of vested restricted stock	(20)	(17)
Net cash flows provided by financing activities	5,070	31,343
Net increase (decrease) in cash and cash equivalents	(3,588)	16,526
Cash and cash equivalents, beginning	21,714	18,229
Cash and cash equivalents, ending	$ 18,126	$ 34,755
Supplemental disclosure of cash flow information:		
Cash payments for interest	$ 2,455	$ 2,122
Cash payments for income taxes	$ 790	$ 1,211
Supplemental disclosure of noncash investing and financing activities:		
Transfer from loans to other real estate owned	$ 697	$ 750
Change in unrealized gains and losses on available for sale securities	$ (1,287)	$ 247

See Notes to Consolidated Financial Statements

Notes to Consolidated Financial Statements

Note 1. Organization and Summary of Significant Accounting Policies

Organization

On September 4, 2009, Hometown Bankshares Corporation (the “Company”) acquired all outstanding stock of HomeTown Bank (the “Bank”) in an exchange for shares of the Company on a one-for-one basis to become a single-bank holding company with the Bank becoming a wholly-owned subsidiary. The Bank was organized and incorporated under the laws of the State of Virginia on November 9, 2004 and commenced operations on November 14, 2005. The Bank currently serves Roanoke City, Virginia, the County of Roanoke, Virginia, the City of Salem, Virginia, Christiansburg, Virginia, and surrounding areas. As a state chartered bank which is a member of the Federal Reserve System, the Bank is subject to regulation by the Virginia Bureau of Financial Institutions, the Federal Deposit Insurance Corporation and the Federal Reserve Board.

On October 1, 2018, the Company and American National Bankshares, Inc. (“American National”) announced a definitive agreement to combine in a strategic merger (the “Merger Agreement”) pursuant to which the Company will merge with and into American National (the “Merger”). As a result of the Merger, the holders of shares of the Company's common stock will receive 0.4150 shares of American National common stock for each share of the Company's common stock held immediately prior to the effective date of the Merger. The transaction is expected to be completed in the first quarter of 2019, subject to approval of both companies' shareholders, regulatory approvals and other customary closing conditions.

In preparing these financial statements, management has evaluated all other subsequent events and transactions for potential recognition or disclosure through the date these financial statements were issued. Management has concluded there were no additional material subsequent events to be disclosed.

Basis of Presentation

The consolidated financial statements as of September 30, 2018 and for the periods ended September 30, 2018 and 2017 included herein, have been prepared by HomeTown Bankshares Corporation, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission.

Management believes that all interim adjustments for the periods ended September 30, 2018 are of a normal recurring nature. In the opinion of management, the information furnished in the interim consolidated financial statements reflects all adjustments necessary to present fairly the Company’s financial position, results of operations and cash flows for such interim periods. These consolidated financial statements should be read in conjunction with the Company’s audited financial statements and the notes thereto as of December 31, 2017, included in the Company’s Form 10-K for the year ended December 31, 2017. Interim financial performance is not necessarily indicative of performance for the full year.

The accounting and reporting policies of the Company follow generally accepted accounting principles and general practices within the financial services industry.

The consolidated financial statements of HomeTown Bankshares Corporation include the accounts of its wholly-owned subsidiary HomeTown Bank and the accounts of its subsidiary, HomeTown Residential Mortgage LLC. HomeTown Bank owns a 49% interest in HomeTown Residential Mortgage LLC which originates and sells mortgages secured by personal residences. Due to the marketing support and direction provided by HomeTown Bank to HomeTown Residential Mortgage LLC, along with guarantees of warehouse lines of credit used in its operation, the Company is deemed to exercise control of this entity. The ownership interest in HomeTown Residential Mortgage LLC not owned by the Company is reported as Non-Controlling Interest in a Consolidated Subsidiary. All significant intercompany balances and transactions have been eliminated in consolidation.

Except as noted below, the Company’s accounting policies and basic principles have not changed since the summary disclosure of these in our Annual Report on Form 10-K. Please refer to Form 10-K for these policies.

Adoption of New Accounting Standards

During the first quarter of 2018, the Company adopted ASU 2016-01, "Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The amendments in ASU 2016-01, among other things: (1) requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (2) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (3) Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables); and (4) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The adoption of ASU No. 2016-01 on January 1, 2018 did not have a material impact on the Company’s Consolidated Financial Statements. In accordance with (2) above, the Company measured the fair value of its loan and deposit portfolios as of September 30, 2018 using an exit price notion (see Note 7 Fair Value Measurement).

During the first quarter of 2018, the Company adopted ASU 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing." This standard is on the recognition of revenue from contracts with customers with the core principle being for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. The new standard also results in enhanced disclosures about revenue, provides guidance for transactions that were not previously addressed comprehensively and improves guidance for multiple-element arrangements. Our revenue is comprised of net interest income on financial assets and liabilities, which is explicitly excluded from the scope of the new guidance, and noninterest income. The contracts that are in scope of the guidance are primarily related to service charges on deposit accounts, cardholder and merchant income, other service charges and fees, sales of other real estate and miscellaneous fees. We have performed an analysis of contracts for customer service charges, ATM fees and miscellaneous income. The adoption of ASU 2016-10 did not have a material impact on our consolidated financial statements.

Revenue Recognition

On January 1, 2018, the Company adopted ASU No. 2016-10 “Revenue from Contracts with Customers” (Topic 606) and all subsequent ASUs that modified Topic 606. As stated previously, the implementation of the new standard did not have a material impact on the measurement or recognition of revenue; as such, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with our historic accounting under Topic 605.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain noninterest income streams such as fees associated with mortgage servicing rights, financial guarantees, derivatives, and certain credit card fees are also not in scope of the new guidance. Topic 606 is applicable to noninterest revenue streams such as trust and asset management income, deposit related fees, interchange fees, merchant income, and annuity and insurance commissions. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all of the Company’s revenue is generated from contracts with customers. Noninterest revenue streams in-scope of Topic 606 are discussed below.

Service Charges on Deposit Accounts

Service charges on deposit accounts consist of account analysis fees (i.e., net fees earned on analyzed business and public checking accounts), monthly service fees, check orders, and other deposit account related fees. The Company’s performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Check orders and other deposit account related fees are largely transactional based, and therefore, the Company’s performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers’ accounts.

Fees, Exchange, and Other Service Charges

Fees, exchange, and other service charges are primarily comprised of debit and credit card income, ATM fees, merchant services income, and other service charges. Debit and credit card income is primarily comprised of interchange fees earned whenever the Company’s debit and credit cards are processed through card payment networks such as Visa. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees. Other service charges include revenue from processing wire transfers, bill pay service, cashier’s checks, and other services. The Company’s performance obligation for fees, exchange, and other service charges 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.

Annuity and Insurance

Annuity and insurance income primarily consists of commissions received on annuity product sales. The Company acts as an intermediary between the Company’s customer and the insurance carrier. The Company’s performance obligation is generally satisfied upon the issuance of the annuity policy. Shortly after the policy is issued, the carrier remits the commission payment to the Company, and the Company recognizes the revenue. The Company does not earn a significant amount of trailer fees on annuity sales. The majority of the trailer fees relates to variable annuity products and are calculated based on a percentage of market value at period end. Revenue is not recognized until the annuity’s market value can be determined.

Other

Other noninterest income consists of other recurring revenue streams such as commissions from sales of mutual funds and other investments, investment advisor fees from wealth management products, safety deposit box rental fees, and other miscellaneous revenue streams. 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. Investment advisor fees from wealth management products are earned over time and based on an annual percentage rate of the net asset value. The investment advisor fees are charged to the customer’s account in advance on the first month of the quarter, and the revenue is recognized over the following three-month period. 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.

Note 2. Investment Securities

The amortized cost and fair value of available-for-sale securities as of September 30, 2018 and December 31, 2017, are as follows:

(Dollars In Thousands)	September 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U. S. Government agency securities	$ 11,130	$ 9	$ (339)	$ 10,800
Mortgage-backed securities and CMO's	20,279	-	(954)	19,325
Corporate securities	6,641	21	(74)	6,588
Municipal securities	9,120	64	(193)	8,991
	$ 47,170	$ 94	$ (1,560)	$ 45,704

(Dollars In Thousands)	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U. S. Government agency securities	$ 13,475	$ 61	$ (101)	$ 13,435
Mortgage-backed securities and CMO's	24,344	12	(375)	23,981
Corporate securities	6,991	118	(42)	7,067
Municipal securities	10,713	213	(65)	10,861
	$ 55,523	$ 404	$ (583)	$ 55,344

U. S. Government agency securities: The unrealized losses on thirty-two of the Company's investments in obligations of the U. S. government were caused by increases in market interest rates over the yields available at the time the securities were purchased. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments before recovery of their amortized cost basis which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at September 30, 2018.

Mortgage-backed securities and CMO's: The unrealized losses on thirty-seven of the Company's investments in government-sponsored entity mortgage-backed securities and collateralized mortgage obligations ("CMOs") were caused by increases in market interest rates over the yields available at the time the securities were purchased. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at September 30, 2018.

Corporate securities: The unrealized losses on five of the Company's investments in corporate securities were caused by increases in market interest rates over the yields available at the time the securities were purchased. Because the decline in market value is attributable to changes in interest rates and not credit quality, the Company does not consider those investments to be other-than-temporarily impaired at September 30, 2018.

Municipal securities: The unrealized losses on ten of the Company's investments in municipal securities were caused by increases in market interest rates over the yields available at the time the securities were purchased. All municipal securities are investment grade. Because the decline in market value is attributable to changes in interest rates, credit spreads, and not credit quality, and because the Company does not intend to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at September 30, 2018.

The following tables demonstrate the unrealized loss position of available-for-sale securities at September 30, 2018 and December 31, 2017. This information summarizes the amount of time individual securities have been in a continuous, unrealized loss position.

	September 30, 2018					
	Less than 12 months		12 months or more		Total	
(Dollars In Thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U. S. Government agency securities	$ 3,717	$ (76)	$ 6,330	$ (263)	$ 10,047	$ (339)
Mortgage-backed securities and CMO's	4,567	(211)	14,758	(743)	19,325	(954)
Corporate securities	1,661	(38)	1,446	(36)	3,107	(74)
Municipal securities	1,781	(36)	2,670	(157)	4,451	(193)
	$ 11,726	$ (361)	$ 25,204	$ (1,199)	$ 36,930	$ (1,560)

	December 31, 2017					
	Less than 12 months		12 months or more		Total	
(Dollars In Thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Government agency securities	$ 6,859	$ (44)	$ 2,995	$ (57)	$ 9,854	$ (101)
Mortgage-backed securities and CMO's	15,624	(192)	7,386	(183)	23,010	(375)
Corporate securities	1,438	(42)	-	-	1,438	(42)
Municipal securities	453	(3)	2,332	(62)	2,785	(65)
	$ 24,374	$ (281)	$ 12,713	$ (302)	$ 37,087	$ (583)

There are 84 debt securities with fair values totaling $36.9 million considered temporarily impaired at September 30, 2018. As of September 30, 2018, the Company does not consider any bond in an unrealized loss position to be other-than-temporarily impaired.

The Company realized gains of $69 thousand and $9 thousand of losses on sales of securities in the first nine months of 2018. The Company realized gains of $165 thousand and $105 thousand of losses during the same period last year.

The amortized cost and fair values of investment securities available for sale at September 30, 2018, by contractual maturity are as follows:

(Dollars In Thousands)	Amortized Cost	Fair Value
One year or less	$ 250	$ 248
Over one through five years	2,462	2,401
Over five through ten years	14,010	13,797
Greater than 10 years	30,448	29,258
	$ 47,170	$ 45,704

Note 3. Loans Receivable

The major classifications of loans in the consolidated balance sheets at September 30, 2018 and December 31, 2017 were as follows:

(Dollars In Thousands)	September 30, 2018	December 31, 2017
Construction loans:		
Residential	$ 19,062	$ 15,221
Land acquisition, development & commercial	26,048	35,601
Real estate:		
Residential	141,728	121,649
Commercial	187,894	173,999
Commercial, industrial & agricultural	54,782	61,129
Equity lines	28,675	28,835
Consumer	8,003	7,693
Overdrafts	151	68
Total	466,343	444,195
Less allowance for loan losses	(3,947)	(3,758)
Loans, net	$ 462,396	$ 440,437

The past due and nonaccrual status of loans as of September 30, 2018 was as follows:

(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	Nonaccrual Loans
Construction loans:							
Residential	$ –	$ –	$ –	$ –	$ 19,062	$ 19,062	$ –
Land acquisition, development & commercial	253	–	–	253	25,795	26,048	124
Real estate:							
Residential	870	73	–	943	140,785	141,728	546
Commercial	136	83	–	219	187,675	187,894	468
Commercial, industrial & agricultural	28	46	–	74	54,859	54,933	169
Equity lines	303	104	–	407	28,268	28,675	147
Consumer	2	–	–	2	8,001	8,003	–
Total	$ 1,592	$ 306	$ –	$ 1,898	$ 464,445	$ 466,343	$ 1,454

The past-due and nonaccrual status of loans as of December 31, 2017 was as follows:

(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	Nonaccrual Loans
Construction:							
Residential	$ –	$ –	$ –	$ –	$ 15,221	$ 15,221	$ –
Land acquisition, development & commercial	43	–	274	317	35,284	35,601	274
Real Estate:							
Residential	589	870	546	2,005	119,644	121,649	173
Commercial	278	19	209	506	173,493	173,999	209
Commercial, industrial & agricultural	130	143	392	665	60,532	61,197	403
Equity lines	544	49	–	593	28,242	28,835	49
Consumer	17	2	36	55	7,638	7,693	36
Total	$ 1,601	$ 1,083	$ 1,457	$ 4,141	$ 440,054	$ 444,195	$ 1,144

There were no loans which were past due ninety days or more and still accruing interest as of September 30, 2018. There was one loan, totaling $373 thousand, which was past due ninety days or more and still accruing interest at December 31, 2017.

Impaired loans, which include TDR's of $4.0 million, and the related allowance at September 30, 2018, were as follows:

September 30, 2018 **With no related allowance:** *(Dollars In Thousands)*	Recorded Investment in Loans	Unpaid Principal Balance	Related Allowance	Average Balance Total Loans	Interest Income Recognized
Construction loans:					
Residential	$ –	$ –	$ –	$ –	$ –
Land acquisition, development & commercial	43	43	–	43	1
Real estate:					
Residential	667	667	–	683	16
Commercial	4,264	4,264	–	4,367	120
Commercial, industrial & agricultural	180	180	–	185	2
Equity lines	298	298	–	298	10
Consumer	–	–	–	–	–
Total loans with no allowance	$ 5,452	$ 5,452	$ –	$ 5,576	$ 149

September 30, 2018 **With an allowance recorded:** *(Dollars In Thousands)*	Recorded Investment in Loans	Unpaid Principal Balance	Related Allowance	Average Balance Total Loans	Interest Income Recognized
Construction loans:					
Residential	$ –	$ –	$ –	$ –	$ –
Land acquisition, development & commercial	–	–	–	–	–
Real estate:					
Residential	–	–	–	–	–
Commercial	–	–	–	–	–
Commercial, industrial & agricultural	–	–	–	–	–
Equity lines	–	–	–	–	–
Consumer	–	–	–	–	–
Total loans with an allowance	$ –	$ –	$ –	$ –	$ –

Impaired loans, which include TDRs of $4.1 million, and the related allowance at December 31, 2017, were as follows:

December 31, 2017 **With no related allowance:** *(Dollars In Thousands)*	Recorded Investment in Loans	Unpaid Principal Balance	Related Allowance	Average Balance Total Loans	Interest Income Recognized
Construction:					
Residential	$ –	$ –	$ –	$ –	$ –
Land acquisition, development & commercial	181	331	–	331	10
Real Estate:					
Residential	360	640	–	638	30
Commercial	4,098	4,273	–	4,166	161
Commercial, industrial & agricultural	379	379	–	379	15
Equity lines	299	299	–	300	14
Consumer	–	–	–	–	–
Total loans with no allowance	$ 5,317	$ 5,922	$ –	$ 5,814	$ 230

December 31, 2017 **With an allowance recorded:** *(Dollars In Thousands)*	Recorded Investment in Loans	Unpaid Principal Balance	Related Allowance	Average Balance Total Loans	Interest Income Recognized
Construction:					
Residential	$ –	$ –	$ –	$ –	$ –
Land acquisition, development & commercial	–	–	–	–	–
Real Estate:					
Residential	–	–	–	–	–
Commercial	–	–	–	54	–
Commercial, industrial & agricultural	–	–	–	–	–
Equity lines	–	–	–	–	–
Consumer	–	–	–	–	–
Total loans with an allowance	$ –	$ –	$ –	$ 54	$ –

Troubled Debt Restructurings

At September 30, 2018, four loans totaling $4.0 million were classified as troubled debt restructurings (“TDRs”). This compares to four loans totaling $4.1 million at December 31, 2017. Two of the four loans totaling $3.8 million were performing in accordance with their restructured terms and were not on nonaccrual status at September 30, 2018. The other two loans to one borrower totaled $200 thousand and were on nonaccrual status at September 30, 2018.

No loans were modified in a TDR during the first nine months of 2018 or 2017.

Management considers troubled debt restructurings and subsequent defaults in restructured loans in the determination of the adequacy of the Company’s allowance for loan losses. When identified as a TDR, a loan is evaluated for potential loss based on the present value of expected future cash flows discounted at the loan’s effective interest rate, the loan’s observable market price, or the estimated fair value of the collateral, less any selling costs if the loan is collateral dependent. Loans identified as TDRs frequently are on non-accrual status at the time of the restructuring and, in some cases, partial charge-offs may have already been taken against the loan and a specific allowance may have already been established for the loan. As a result of any modification as a TDR, if a specific reserve is associated with the loan it may be increased. Additionally, loans modified in a TDR are closely monitored for delinquency as an early indicator of possible future defaults. If loans modified in a TDR subsequently default, the Company evaluates the loan for possible further impairment. As a result, any specific allowance may be increased, adjustments may be made in the allocation of the total allowance balance, or partial charge-offs may be taken to further write-down the carrying value of the loan. Management exercises significant judgment in developing estimates for potential losses associated with TDRs.

Note 4. Allowance for Loan Losses

The following table presents, as of September 30, 2018, the total allowance for loan losses, the allowance by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment), the total loans and loans by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment).

September 30, 2018	**Allowance for loan losses**							**Loans**		
Class of Loan *(Dollars in Thousands)*	Beginning balance	Charge-offs	Recoveries	Provisions	Ending balance	Ending balance: individually evaluated for impairment	Ending balance: collectively evaluated for impairment	Ending balance	Ending balance: individually evaluated for impairment	Ending balance: collectively evaluated for impairment
Construction loans:										
Residential	$ 94	$ –	$ 10	$ 7	$ 111	$ –	$ 111	$ 19,062	$ –	$ 19,062
Land acquisition, development & commercial	311	–	–	(97)	214	–	214	26,048	43	26,005
Real estate:		–								
Residential	955	(96)	30	200	1,089	–	1,089	141,728	667	141,061
Commercial	1,603	–	1	147	1,751	–	1,751	187,894	4,264	183,630
Commercial, industrial & agricultural	441	(37)	2	(11)	395	–	395	54,933	180	54,753
Equity lines	237	–	–	(27)	210	–	210	28,675	298	28,377
Consumer	108	(114)	22	98	114	–	114	8,003	–	8,003
Unallocated	9	–	–	54	63	–	63	–	–	–
Total	$ 3,758	$ (247)	$ 65	$ 371	$ 3,947	$ –	$ 3,947	$ 466,343	$ 5,452	$ 460,891

The following table presents, as of December 31, 2017, the total allowance for loan losses, the allowance by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment), the total loans and loans by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment).

December 31, 2017	**Allowance for loan losses**							**Loans**		
Class of Loan *(Dollars in Thousands)*	Beginning balance	Charge-offs	Recoveries	Provisions	Ending balance	Ending balance: individually evaluated for impairment	Ending balance: collectively evaluated for impairment	Ending balance	Ending balance: individually evaluated for impairment	Ending balance: collectively evaluated for impairment
Construction loans:										
Residential	$ 63	$ –	$ –	$ 31	$ 94	$ –	$ 94	$ 15,221	$ –	$ 15,221
Land acquisition, development & commercial	173	(150)	–	288	311	–	311	35,601	181	35,420
Real estate:										
Residential	866	(293)	–	382	955	–	955	121,649	360	121,289
Commercial	1,516	(454)	43	498	1,603	–	1,603	173,999	4,098	169,901
Commercial, industrial & agricultural	461	(80)	–	60	441	–	441	61,197	379	60,818
Equity lines	338	–	–	(101)	237	–	237	28,835	299	28,536
Consumer	97	(101)	15	97	108	–	108	7,693	–	7,693
Unallocated	122	–	–	(113)	9	–	9	–	–	–
Total	$ 3,636	$ (1,078)	$ 58	$ 1,142	$ 3,758	$ –	$ 3,758	$ 444,195	$ 5,317	$ 438,878

Loans by credit quality indicators as of September 30, 2018 were as follows:

(Dollars in Thousands)	Pass Accruing	Special Mention Accruing	Special Mention Nonaccrual	Substandard Accruing	Substandard Nonaccrual	Doubtful Nonaccrual	Total
Construction loans:							
Residential	$ 19,062	$ –	$ –	$ –	$ –	$ –	$ 19,062
Land acquisition, development & commercial	25,465	–	82	458	43	–	26,048
Real estate loans:							
Residential	140,428	369	255	385	236	55	141,728
Commercial	184,717	2,137	–	573	467	–	187,894
Commercial, industrial, agricultural	54,593	171	–	–	169	–	54,933
Equity lines	28,230	–	147	298	–	–	28,675
Consumer	8,003	–	–	–	–	–	8,003
Total Loans	$ 460,498	$ 2,677	$ 484	$ 1,714	$ 915	$ 55	$ 466,343

Loans by credit quality indicators as of December 31, 2017 were as follows:

(Dollars in Thousands)	Pass	Special Mention	Substandard Accruing	Substandard Nonaccrual	Doubtful Nonaccrual	Total
Construction loans:						
Residential	$ 15,221	$ –	$ –	$ –	$ –	$ 15,221
Land acquisition, development & commercial	31,433	3,987	–	181	–	35,601
Real estate loans:						
Residential	120,575	342	559	–	173	121,649
Commercial	165,760	7,386	644	209	–	173,999
Commercial, industrial, agricultural	59,042	1,249	503	379	24	61,197
Equity lines	28,536	–	299	–	–	28,835
Consumer	7,658	–	–	35	–	7,693
Total Loans	$ 428,225	$ 12,964	$ 2,005	$ 804	$ 197	$ 444,195

At September 30, 2018 and December 31, 2017, the Company does not have any loans classified as Loss.

Note 5. Other Real Estate Owned

Changes in other real estate owned for the nine months ended September 30, 2018 were as follows:

(Dollars in Thousands)	Other Real Estate Owned	Valuation Allowance	Net
Balance at the beginning of the year	$ 4,046	$ (797)	$ 3,249
Additions	697	—	697
Write downs	—	(157)	(157)
Sales	(593)	—	(593)
Balance at the end of the period	$ 4,150	$ (954)	$ 3,196

Changes in other real estate owned for the nine months ended September 30, 2017 were as follows:

(Dollars in Thousands)	Other Real Estate Owned	Valuation Allowance	Net
Balance at the beginning of the year	$ 4,619	$ (825)	$ 3,794
Additions	1,024	—	1,024
Write downs	—	(380)	(380)
Sales	(1,492)	616	(876)
Balance at the end of the period	$ 4,151	$ (589)	$ 3,562

The major classifications of other real estate owned in the consolidated balance sheets at September 30, 2018 and December 31, 2017 were as follows:

(Dollars in Thousands)	September 30, 2018	December 31, 2017
Residential lots	$ 1,243	$ 1,745
Residential development	366	—
Residential real estate	1,197	1,024
Commercial lots	—	90
Commercial buildings	390	390
Total Other Real Estate Owned	$ 3,196	$ 3,249

There were no residential real estate loans in the process of foreclosure at September 30, 2018 or December 31, 2017.

Other real estate owned related expenses in the consolidated statements of income for the three and nine months ended September 30, 2018 and September 30, 2017 include:

(Dollars In Thousands)	Three months Ended September 30, 2018	Three months Ended September 30, 2017	Nine months Ended September 30, 2018	Nine months Ended September 30, 2017
Provision for unrealized losses	$ 2	$ —	$ 160	$ 380
Operating expenses	44	28	249	66
Total Other Real Estate Owned	$ 46	$ 28	$ 409	$ 446

Note 6. Stock Based Compensation

The Company recorded stock-based compensation expense of $159 thousand and $109 thousand for the years to date September 30, 2018 and 2017, respectively.

The 2005 Stock Option Plan (the Plan) pursuant to which the Board of Directors granted stock options to directors, officers and employees expired in 2016, thus there are no options available for future issuance. Under the fair value recognition provisions of relevant accounting guidance, stock-based compensation cost was measured at the grant date based on the fair value of the award and was and continues to be recognized as expense on a straight-line basis over the requisite service period, which is the vesting period.

The Company used the Black-Scholes option pricing model to determine the fair value of stock options. The fair value of the stock based payment awards was affected by the price of the Company's stock and a number of financial assumptions and variables. These variables included the risk-free interest rate, expected dividend rate, expected stock price volatility and the expected life of the options. No stock options were granted during 2018 or 2017. Compensation expense is charged to income ratably over the vesting period and was $53 thousand each of the years to date September 30, 2018 and September 30, 2017, respectively. As of September 30, 2018, there was $78 thousand of total unrecognized compensation cost related to nonvested stock options granted under the Plan. The cost will be recognized over the next 1.25 years.

A summary of option activity under the 2005 stock option plan year to date September 30, 2018 is as follows:

	Options Outstanding	Weighted Average Exercise Price	Aggregate Intrinsic Value (1)	Weighted Average Contractual Term (years)
Balance at December 31, 2017	187,000	$ 7.78		
Granted	–	–		
Exercised	(18,300)	7.83		
Expired	(31,500)	10.79		
Forfeited	–	–		
Balance at September 30, 2018	137,200	$ 7.08	$ 867,250	6.22
Exercisable at September 30, 2018	80,000	$ 7.21	$ 495,450	5.82

(1) The aggregate intrinsic value of a stock option in the table above represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on September 30, 2018.

In 2009, the Board of Directors authorized 132,000 shares of common stock for issuance under the Restricted Stock Plan. On July 11, 2016, a 4% stock dividend was distributed and added 5,280 to the total number of shares authorized for issuance and currently raising the total available to 137,280. The plan provides for restricted stock awards to key employees. Restricted shares awarded to employees generally vest over a five-year period and compensation expense is charged to income ratably over the vesting period and was $106 thousand and $56 thousand for the years to date September 30, 2018 and 2017, respectively. Compensation is accounted for using the fair market value of the Company's common stock on the date the restricted shares are awarded. The Company granted 22,649 and 8,258 shares of restricted stock under the plan during the years to date September 30, 2018 and September 30, 2017, respectively. The weighted-average grant date fair value of restricted stock granted in 2018 was $11.32 compared to $9.87 in 2017.

As of September 30, 2018, there was $367 thousand of total unrecognized compensation cost related to restricted stock granted under the Plan. The cost is expected to be recognized through 2023. A summary of the activity for restricted stock awards for the periods indicated is presented below:

	For the Nine Months Ended September 30, 2018		For the Nine Months Ended September 30, 2017	
	Shares	Weighted-Average Grant Date Fair Value	Shares	Weighted-Average Grant Date Fair Value
Nonvested at beginning of year	32,087	$ 8.63	31,546	$ 7.03
Granted	22,649	11.32	8,258	9.87
Vested	(12,241)	7.71	(11,125)	6.03
Forfeited	-	-	-	-
Nonvested at the end of the period	42,495	$ 10.33	28,679	$ 8.23

The Restricted Stock Plan provides for the adjustment of the total number of shares reserved for issuance under the plan and the number of shares covered by each outstanding Award for stock dividends and stock splits.

Note 7. Fair Value Measurement

The Company uses a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. The three levels of the fair value hierarchy based on these two types of inputs are as follows:

Level 1 - Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 - Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 - Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

The following describes the valuation techniques used by the Company to measure certain financial assets and liabilities recorded at fair value on a recurring basis in the consolidated financial statements:

Securities available for sale: Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2).

The following tables present the balances of financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2018 and December 31, 2017:

(Dollars in Thousands)		Carrying value at September 30, 2018		
Description	Balance as of September 30, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
U.S. Government agency securities	$ 10,800	$ –	$ 10,800	$ –
Mortgage-backed securities and CMO's	19,325	–	19,325	–
Corporate securities	6,588	–	6,588	–
Municipal securities	8,991	–	8,991	–

(Dollars in Thousands)		Carrying value at December 31, 2017		
Description	Balance as of December 31, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
U.S. Government agency securities	$ 13,435	$ –	$ 13,435	$ –
Mortgage-backed securities and CMO's	23,981	–	23,981	–
Corporate securities	7,067	–	7,067	–
Municipal securities	10,861	–	10,861	–

Certain assets are measured at fair value on a nonrecurring basis in accordance with generally accepted accounting principles (GAAP). Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Company to measure certain assets recorded at fair value on a nonrecurring basis in the consolidated financial statements:

Impaired 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 a specific reserve 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. Once a loan is identified as individually impaired, management measures the extent of any loss. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value, and discounted cash flow. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investment in such loans. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. If carried at market price based on appraised value less selling costs using observable market data, it is recorded as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraisal value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3.

Loans held for sale: The carrying value of these loans approximates the fair value. These loans close in the name of the Bank's consolidated joint venture subsidiary HomeTown Residential Mortgage, LLC, but are generally sold within a two-week period.

Other Real Estate Owned (OREO): The carrying amount of real estate owned by the Company resulting from foreclosures is estimated at the lesser of cost or the fair value of the real estate based on an observable market price or a current appraised value less selling costs. If carried at market price based on appraised value using observable market data, it is recorded as nonrecurring Level 2. When an appraised value is not available or is not current, or management determines the fair value of the real estate is further impaired below the appraised value or there is no observable market price, the Company records the real estate as nonrecurring Level 3.

The following tables summarize the Company's assets that were measured at fair value on a nonrecurring basis as of September 30, 2018 and December 31, 2017.

(Dollars in Thousands)

		Carrying value at September 30, 2018		
Description	Balance as of September 30, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Loans held for sale	$ 1,378	$ –	$ 1,378	$ –
Other real estate owned	3,196	–	697	2,499

(Dollars in Thousands)

		Carrying value at December 31, 2017		
Description	Balance as of December 31, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Loans held for sale	$ 1,587	$ –	$ 1,587	$ –
Other real estate owned	3,249	–	–	3,249

At September 30, 2018 and December 31, 2017, the Company did not have any liabilities measured at fair value on a nonrecurring basis.

The following table displays quantitative information about Level 3 Fair Value Measurements for September 30, 2018:

(Dollars in Thousands)

	Quantitative information about Level 3 Fair Value Measurements for September 30, 2018			
Assets	Fair Value	Valuation Technique(s)	Unobservable input	Range (Weighted Average)
Other real estate owned	$ 1,922	Discounted appraised value	Selling cost	6% - 10% (8%)
			Discount for lack of marketability and age of appraisal	0% - 10% (0%)
	$ 577	Internal evaluations	Internal evaluations	29% - 29% (29%)

The following table displays quantitative information about Level 3 Fair Value Measurements for December 31, 2017:

(Dollars in Thousands)

	Quantitative information about Level 3 Fair Value Measurements for December 31, 2017			
Assets	Fair Value	Valuation Technique(s)	Unobservable input	Range (Weighted Average)
Other real estate owned	$ 2,254	Discounted appraised value	Selling cost	6% - 10% (8%)
			Discount for lack of marketability and age of appraisal	0% - 43% (7%)
	$ 995	Internal evaluations	Internal evaluations	19% - 19% (19%)

The following tables summarize the estimated fair values of the Company's financial instruments at September 30, 2018 and at December 31, 2017. The Company discloses fair value information about financial instruments, whether or not recognized in the statements of financial condition, for which it is practicable to estimate that value. The following estimated fair value amounts have been determined using available market information and appropriate valuation methodologies. However, management judgment is required to interpret data and develop fair value estimates. Accordingly, the estimates below are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

During the first quarter of 2018, the Company adopted ASU 2016-01 Financial Instruments – Overall (Subtopic 825-10): "Recognition and Measurement of Financial Assets and Financial Liabilities", which among other things, requires a public business entity to base their fair value disclosures for financial instruments that are not measured at fair value in the financial statements on the exit price notion. In accordance with this guidance, the Company has adopted the exit price disclosure requirements for the below table on a prospective basis for the period ended September 30, 2018. The disclosure included for the period ended December 31, 2017 continues to be presented utilizing the entry price assumption previously utilized.

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

(Dollars in Thousands)

		Fair value at September 30, 2018			
Description	Carrying value as of September 30, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Approximate Fair Values
Financial assets					
Cash and due from banks	$ 18,126	$ 18,126	$ –	$ –	$ 18,126
Federal funds sold	193	193	–	–	193
Securities available for sale	45,704	–	45,704	–	45,704
Restricted equity securities	2,359	–	2,359	–	2,359
Loans held for sale	1,378	–	1,378	–	1,378
Loans, net	462,396	–	–	453,266	453,266
Bank owned life insurance	8,147	–	8,147	–	8,147
Accrued income	2,639	–	2,639	–	2,639
Financial liabilities					
Total deposits	483,497	–	483,157	–	483,157
FHLB borrowings	10,728	–	10,710	–	10,710
Subordinated notes	7,277	–	7,622	–	7,622
Other borrowings	1,348	–	1,348	–	1,348
Accrued interest payable	556	–	556	–	556

The carrying amounts and approximate fair values of the Company's financial instruments are as follows at December 31, 2017:

(Dollars in Thousands)

		Fair value at December 31, 2017			
Description	Carrying value as of December 31, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Approximate Fair Values
Financial assets					
Cash and due from banks	$ 21,714	$ 21,714	$ –	$ –	$ 21,714
Federal funds sold	180	180	–	–	180
Securities available for sale	55,344	–	55,344	–	55,344
Restricted equity securities	2,371	–	2,371	–	2,371
Loans held for sale	1,587	–	1,587	–	1,587
Loans, net	440,437	–	–	438,449	438,449
Bank owned life insurance	8,669	–	8,669	–	8,669
Accrued income	2,681	–	2,681	–	2,681
Financial liabilities					
Total deposits	477,320	–	477,599	–	477,599
FHLB borrowings	11,028	–	11,150	–	11,150
Subordinated notes	7,254	–	7,890	–	7,890
Other borrowings	1,558	–	1,558	–	1,558
Accrued interest payable	368	–	368	–	368

Note 8. Reclassifications Out of Other Comprehensive Income

Items reclassified in their entirety to net income for the three and nine months ended September 30, 2018 and 2017 are as follows:

Details about Other Comprehensive Components	**Amounts Reclassified from Other Comprehensive Income for the Three Months Ended September 30,**		**Affected Line Item in the Statement Where Net Income is Presented**
(Dollars In Thousands)	**2018**	**2017**	
Available for sale securities			
Realized gains on sales of securities held for sale during the period consider available for sale	$ -	$ 18	Gains on sales of investment securities
Tax expense related to realized gains on securities sold	-	6	Income tax expense
	$ -	$ 12	Net income

Details about Other Comprehensive Components	**Amounts Reclassified from Other Comprehensive Income for the Nine Months Ended September 30,**		**Affected Line Item in the Statement Where Net Income is Presented**
(Dollars In Thousands)	**2018**	**2017**	
Available for sale securities			
Realized gains on sales of securities held for sale during the period consider available for sale	$ 60	$ 60	Gains on sales of investment securities
Tax expense related to realized gains on securities sold	13	20	Income tax expense
	$ 47	$ 40	Net income

Note 9. Earnings per Common Share

The following tables show the weighted average number of shares used in computing earnings per common share and the effect on weighted average number of shares of diluted potential common stock.

	For the Three Months Ended September 30,					
	2018			**2017**		
Dollars in Thousands, except share and per share data	**Weighted Average Common Shares Outstanding**	**Net Income Available to Common Shareholders**	**Per Share Amount**	**Weighted Average Common Shares Outstanding**	**Net Income Available to Common Shareholders**	**Per Share Amount**
Earnings per common share, basic	5,810,618	$ 1,332	$ 0.23	5,770,175	$ 917	$ 0.16
Effect of dilutive securities:						
Dilutive stock options	50,464	–	-	24,602	–	–
Earnings per common share, diluted	5,861,082	$ 1,332	$ 0.23	5,794,777	$ 917	$ 0.16

	For the Nine Months Ended September 30,					
	2018			**2017**		
Dollars in Thousands, except share and per share data	**Weighted Average Common Shares Outstanding**	**Net Income Available to Common Shareholders**	**Per Share Amount**	**Weighted Average Common Shares Outstanding**	**Net Income Available to Common Shareholders**	**Per Share Amount**
Earnings per common share, basic	5,804,251	$ 3,495	$ 0.60	5,767,602	$ 2,116	$ 0.37
Effect of dilutive securities:						
Dilutive stock options	50,464	–	–	24,602	–	–
Earnings per common share, diluted	5,854,715	$ 3,495	$ 0.60	5,792,204	$ 2,116	$ 0.37

At September 30, 2018, as a result of the increase in the Corporation's stock price, there were no stock options considered antidilutive. At September 30, 2017, the number of stock options considered antidilutive and excluded from the calculation of diluted weighted average shares was 33,000. Nonvested restricted shares were included in weighted average common shares outstanding for computing basic earnings per share, as the holder has voting rights and would share in a stock or cash dividend during the vesting period.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Forward-looking Statements

HomeTown Bankshares makes forward-looking statements in this report. These forward-looking statements may include: statements of goals, intentions, earnings expectations, and other expectations; estimates of risks and of future costs and benefits; assessments of probable loan and lease losses; assessments of market risk; and statements of the ability to achieve financial and other goals. Forward-looking statements are typically identified by words such as "believe," "expect," "anticipate," "intend," "outlook," "estimate," "forecast," "project" and other similar words and expressions. Forward-looking statements are subject to numerous assumptions, risks and uncertainties, which change over time. Forward-looking statements speak only as of the date they are made. The Company does not assume any duty and does not undertake to update its forward-looking statements. Because forward-looking statements are subject to assumptions and uncertainties, actual results or future events could differ, possibly materially, from those that the Company anticipated in its forward-looking statements; and future results could differ materially from historical performance.

The Company's forward-looking statements are subject to the following principal risks and uncertainties: general economic conditions and trends, either nationally or locally; conditions in the securities markets; changes in interest rates; changes in deposit flows, and in the demand for deposit, loan, and investment products and other financial services; changes in real estate values; changes in the quality or composition of the Company's loan or investment portfolios; changes in competitive pressures among financial institutions or from non-financial institutions; the Company's ability to retain key members of management; changes in legislation, regulation, and policies; and a variety of other matters which, by their nature, are subject to significant uncertainties. The Company provides greater detail regarding some of these factors in its Form 10-K for the year ended December 31, 2017. The Company's forward-looking statements may also be subject to other risks and uncertainties, including those that it may discuss elsewhere in this report or in its other filings with the SEC.

On October 1, 2018, the Company and American National Bankshares, Inc. ("American National") announced a definitive agreement to combine in a strategic merger (the "Merger Agreement") pursuant to which the Company will merge with and into American National (the "Merger"). In addition to the factors described above, the Company's operations, performance, business strategy and results may be affected by the following factors:

- the businesses of the Company and/or American National may not be integrated successfully or such integration may be more difficult, time-consuming or costly than expected;
- expected revenue synergies and cost savings from the merger may not be fully realized or realized within the expected timeframe;
- revenues following the merger may be lower than expected;
- customer and employee relationships and business operations may be disrupted by the merger; and
- the ability to obtain required regulatory and shareholder approvals, and the ability to complete the merger on the expected timeframe may be more difficult, time-consuming or costly than expected.

Our Business

HomeTown Bankshares provides a full complement of consumer and commercial banking services to its primary service area which includes the Roanoke Valley, the New River Valley and Smith Mountain Lake. The Company serves these markets through a network of six branches, seven ATM's, HomeTown Mortgage and HomeTown Investments. A high level of responsive and personal service coupled with local decision-making are the hallmarks of the Company's customer oriented strategy. The Company offers a broad range of commercial and retail banking products and services including checking, savings and time deposits, individual retirement accounts, residential and commercial mortgages, home equity loans, consumer installment loans, commercial loans, and lines and letters of credit. In addition to its main office, the Company has offices in Franklin County, Virginia at Westlake; in the town of Christiansburg, Virginia at 2950 Market Street; in Roanoke County, Virginia at the intersection of Colonial Avenue and Virginia Route 419; in the City of Roanoke, Virginia at 3521 Franklin Road; and in the City of Salem, Virginia at 852 West Main Street. HomeTown Bank, with a 49% interest in the joint venture HomeTown Residential Mortgage, LLC, operates a dedicated mortgage office on Colonial Ave., next to the existing branch. The Company has a secure Operations Center at 4633 Brambleton Avenue in Roanoke.

HomeTown Investments provides diverse investment products and financial advisory services to existing and prospective customers. These products and services provide another source of revenue for the Company. Investment and insurance products and services are offered through an unaffiliated entity LPL Financial, Member FINRA/SIPC. HomeTown Investments is a subsidiary of the Bank. Products and services made available through LPL Financial are not insured by the FDIC or any other agency of the United States and are not deposits or obligations of nor guaranteed or insured by any bank or bank affiliate. These products are subject to investment risk, including the possible loss of value.

The Private Banking Group offers personalized banking solutions to work with customers to clarify financial goals and bring together professionals to satisfy their investment, credit, and other financial needs.

The following is a discussion of factors that significantly affected the financial condition and results of operations of HomeTown Bankshares Corporation. This discussion should be read in connection with the financial statements presented herein.

Critical Accounting Policies

The Company's significant accounting policies are set forth in Note 1 of the Notes to Financial Statements in the Annual Report for the year ended December 31, 2017. The Company's financial position and results of operations are affected by management's application of accounting policies, including estimates, assumptions and judgments made to arrive at the carrying value of assets and liabilities and amounts reported for revenues and expenses.

The allowance for loan losses is an estimate of the losses that may be sustained in our loan portfolio. The allowance is based on two basic principles of accounting: (i) that losses be accrued when they are probable of occurring and are capable of estimation and (ii) that losses on impaired loans be accrued based on the differences between the value of collateral less cost to sell, present value of future cash flows or values that are observable in the secondary market and the loan balance. The allowance for loan losses is maintained at a level, which, in management’s judgment, is adequate to absorb credit losses inherent in the loan portfolio.

The amount of the allowance is based on management’s evaluation of the collectability of the loan portfolio, including the nature of the portfolio, credit concentrations, trends in historical loss experience, specific impaired loans, economic conditions, and other risks inherent in the portfolio. Management reviews the past due reports and risk-rated loans and discusses individually the loans on these reports with the responsible loan officers. Management uses these tools and provides a detailed quarterly analysis of the allowance based on the Company’s historical loan loss experience, risk-rated loans, past dues, concentrations of credit, unsecured loans, loan exceptions, and economic trends. These are generally grouped by homogeneous loan pools. Allowances for impaired loans are generally determined based on collateral values less cost to sell, or the present value of estimated cash flows. This allowance, then, is designated as a specific reserve. Although management uses available information to recognize losses on loans, because of uncertainties associated with local economic conditions, collateral values, and future cash flows on impaired loans, it is reasonably possible that a material change could occur in the allowance for loan losses in the near term. However, the amount of the change that is reasonably possible cannot be estimated. The allowance is increased by a provision for loan losses, which is charged to expense, and reduced by charge-offs, net of recoveries. Changes in the allowance relating to impaired loans are charged or credited to the provision for loan losses. Past due status is determined based on contractual terms.

Discussion of Operations

Executive Summary

Net income available to common shareholders for the third quarter of 2018 totaled $1.3 million, an improvement of $415 thousand over the prior year due primarily to increased net interest income on higher loan yields and the favorable impact of the tax rate change.. The fully diluted earnings per common share was $0.23 and $0.16 for the three months ended September 30, 2018 and 2017, respectively. The Company paid its first cash dividend of $0.04 per common share in the second quarter of 2018. Subsequently the Company paid a second dividend of $0.04 per common share in the third quarter of 2018. On October 31, 2018 a dividend of $0.04 per common share was declared to be paid in the fourth quarter of 2018.

Net income available to common shareholders amounted to $3.5 million for the first nine months of 2018 compared to $2.1 million for the same period last year. Excluding a nonrecurring gain on bank owned life insurance of $642 thousand, net income available to shareholders was $737 thousand or 35% more than the prior year. Fully diluted earnings per common share amounted to $0.60 per share for the first nine months of 2018 compared to $0.37 per share for the first nine months of 2017.

Three Months Ended September 30, 2018

Net income attributable to HomeTown Bankshares was $1.3 million for the third quarter of 2018, which was 45% higher than the $917 thousand earned in the third quarter of 2017. Higher net interest income and lower income tax expense were the main contributing factors to higher earnings in 2018.

Net interest income for the three months ended September 30, 2018 totaled $4.8 million, and was $331 thousand or 7.5% greater than the third quarter of 2017. The expansion of average earning assets by $18.8 million provided $321 thousand in additional interest income. Loan growth fueled the increase in earning assets. Average loans for the quarter were $465 million, $30.7 million or 7.1% more than the third quarter of 2017, and was funded primarily by deposit growth, and the utilization of available liquid funds. Average total deposits for the three months ended September 30, 2018 totaled $485 million and were $16.5 million more than average deposits for the same quarter last year.

The net interest margin was 3.56% for the quarter ended September 30, 2018, an increase of 10 basis points over the 3.46% for the same quarter last year. Excess funds were shifted from lower yielding interest bearing deposits at other banks to fund loan growth. As the Federal Reserve continues to steadily increase interest rates, loan yields increased 17 basis points, essentially keeping pace with the 18 basis point rise in interest bearing deposits for the third quarter of 2018 over the third quarter of 2017. Spread compression may occur in future quarters as competition for loans exerts a downward pressure on loan rates; the promotions of higher interest rate CD and money market deposit products may attract funding unfavorably impacting the mix of deposits and may push up the cost of funds.

	For the Three Months Ended September 30, 2018			For the Three Months Ended September 30, 2017		
(Dollars in thousands)	**Average Balance**	**Interest Income/ Expense**	**Yield/ Rate**	**Average Balance**	**Interest Income/ Expense**	**Yield/ Rate**
Assets:						
Federal funds sold	$ 231	$ 1	1.50%	$ 124	$ —	1.00%
Deposits in banks	9,119	47	2.03	20,903	68	1.28
Securities, taxable	40,517	262	2.58	37,303	244	2.61
Securities, nontaxable (1)	7,903	56	3.61	11,302	75	4.04
Restricted equity securities	2,493	38	6.20	2,371	33	5.57
Loans held for sale	576	7	4.79	705	7	4.10
Loans (1)	464,848	5,337	4.50	434,170	4,790	4.33
Total earnings assets	525,687	5,748	4.30	506,877	5,217	4.07
Less: Allowance for loan losses	(3,962)			(3,692)		
Total non-earning assets	40,983			36,896		
Total Assets	$ 562,708			$ 540,081		
Liabilities and shareholders' equity						
Interest bearing deposits:						
Checking	$ 103,923	$ 79	0.30%	$ 95,588	$ 50	0.21%
Money market savings	81,830	126	0.61	73,699	48	0.26
Regular savings	49,601	54	0.43	51,904	47	0.36
Time Deposits	130,907	502	1.52	138,458	443	1.27
FHLB borrowings	14,699	78	2.06	11,485	51	1.72
Subordinated notes	7,272	134	7.38	7,242	134	7.41
Other borrowings	628	7	4.57	709	7	3.98
Total interest bearing liabilities	388,860	980	1.00	379,085	780	0.82
Non-interest bearing liabilities:						
Demand deposits	118,328			108,487		
Other liabilities	2,531			1,873		
Total liabilities	509,719			489,445		
Total HomeTown Bankshares Corporation stockholders' equity	52,653			50,164		
Non-controlling interest in consolidated subsidiary	336	—		472	—	
Total Liabilities and Stockholders' Equity	$ 562,708	980		$ 540,081	780	
Net interest income		$ 4,768			$ 4,437	
Interest rate spread			3.30			3.25
Interest expense to average earning assets			0.74			0.61
Net interest margin			3.56%			3.46%

(1) Yields are reported on a tax equivalent basis assuming a federal income tax rate of 21 percent for 2018 and 34 percent for 2017.

(Dollars in thousands)	Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017		
	Increase (Decrease)	Change Due To:	
		Rate	Volume
Interest income:			
Federal funds sold	$ 1	$ —	$ 1
Deposits in banks	(21)	39	(60)
Securities, taxable	18	(9)	27
Securities, nontaxable	(19)	5	(24)
Restricted equity securities	5	4	1
Loans held for sale	—	1	(1)
Loans	547	170	377
Total interest income	531	210	321
Interest expense:			
Interest bearing liabilities:			
Checking	29	23	6
Money market savings	78	65	13
Regular savings	7	10	(3)
Time Deposits	59	82	(23)
FHLB borrowings	27	10	17
Subordinated notes	—	(1)	1
Other borrowings	—	1	(1)
Total interest expense	200	190	10
Net interest income	$ 331	$ 20	$ 311

Noninterest income for the third quarter of 2018 was $764 thousand, $7 thousand higher than the $757 thousand earned during the same period in 2017. Lower mortgage banking income was partially offset by higher ATM and interchange income as well as service charge income which resulted from deposit growth.

For the three months ended September 30, 2018, noninterest expense totaled $3.9 million, a $54 thousand increase from $3.8 million recorded in the same quarter last year. The third quarter of 2018 included $65 thousand in expense related to the company’s recently announced merger agreement with American National Bankshares Inc.

Nine Months Ended September 30, 2018

Net income attributable to HomeTown Bankshares was $3.5 million for the first nine months of 2018. Without the nonrecurring gain of $642 thousand, net income attributable to HomeTown Bankshares would have been $2.9 million, an increase of $737 thousand over the $2.1 million for the first nine months of 2017. Favorable variances in net interest income, the provision for loan losses and income tax expense were offset by higher noninterest expense.

Net interest income for the nine months ended September 30, 2018 totaled $14.0 million, and was $879 thousand or 6.7% greater than the first nine months of 2017. The expansion of average earning assets by $19.6 million provided $897 thousand in additional interest income. Average loans for the first nine months of the year were $458 million, $28.2 million or 6.6% more than the first nine months of 2017. Average total deposits for the nine months ended September 30, 2018 totaled $479 million and were $16.2 million more than average deposits for the same period last year. While deposit growth was the primary source of funds supporting the growth of loans since last year, the utilization of available interest bearing deposits at other banks provided $9.1 million of additional funding.

The net interest margin was 3.55% for the nine months ended September 30, 2018, compared to 3.48% for the nine months ended September 30, 2017. The interest rate spread was 4 basis points higher than the prior year. The yield on earning assets rose 15 basis points as the result of increasing interest rates and a favorable change in the mix of earning assets, as higher yielding loans comprised a greater percentage of all earning assets. The yield on loans increased 9 basis points compared to an increase of 10 basis points for interest bearing deposits for the first nine months of 2018 from the previous year. This may lead to margin compression in future periods, as rising deposit costs may not be offset by increasing earning asset yields.

	For the Nine Months Ended September 30, 2018			For the Nine Months Ended September 30, 2017		
(Dollars in thousands)	**Average Balance**	**Interest Income/ Expense**	**Yield/ Rate**	**Average Balance**	**Interest Income/ Expense**	**Yield/ Rate**
Assets:						
Federal funds sold	$ 208	$ 2	1.45%	$ 74	$ —	0.88%
Deposits in banks	10,297	136	1.76	19,363	160	1.10
Securities, taxable	42,175	824	2.60	37,977	744	2.61
Securities, nontaxable (1)	8,054	172	3.61	12,114	239	3.99
Restricted equity securities	2,580	111	5.75	2,372	98	5.53
Loans held for sale	564	19	4.55	642	20	4.08
Loans (1)	457,618	15,355	4.43	429,398	14,103	4.34
Total earnings assets	521,496	16,619	4.23	501,940	15,364	4.08
Less: Allowance for loan losses	(3,876)			(3,718)		
Total non-earning assets	39,335			37,038		
Total Assets	$ 556,955			$ 535,260		
Liabilities and shareholders' equity						
Interest bearing deposits:						
Checking	$ 106,119	$ 214	0.27%	$ 93,769	$ 130	0.18%
Money market savings	76,133	241	0.42	72,356	135	0.25
Regular savings	52,818	170	0.43	49,625	130	0.35
Time Deposits	130,442	1,373	1.41	141,480	1,299	1.23
FHLB borrowings	15,060	223	1.95	11,959	148	1.63
Subordinated notes	7,264	402	7.38	7,234	402	7.41
Other borrowings	583	20	4.46	1,208	23	2.52
Total interest bearing liabilities	388,419	2,643	0.91	377,631	2,267	0.80
Non-interest bearing liabilities:						
Demand deposits	113,831			105,904		
Other liabilities	2,482			1,925		
Total liabilities	504,732			485,460		
Total HomeTown Bankshares Corporation stockholders' equity	51,767			49,347		
Non-controlling interest in consolidated subsidiary	456	—		453	—	
Total Liabilities and Stockholders' Equity	$ 556,955	2,643		$ 535,260	2,267	
Net interest income		$ 13,976			$ 13,097	
Interest rate spread			3.32			3.28
Interest expense to average earning assets			0.68			0.60
Net interest margin			3.55%			3.48%

(1) Yields are reported on a tax equivalent basis assuming a federal income tax rate of 21 percent for 2018 and 34 percent for 2017.

(Dollars in thousands)	Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017 Increase (Decrease)	Change Due To: Rate	Volume
Interest income:			
Federal funds sold	$ 2	$ —	$ 2
Deposits in banks	(24)	95	(119)
Securities, taxable	80	(22)	102
Securities, nontaxable	(67)	20	(87)
Restricted equity securities	13	4	9
Loans held for sale	(1)	2	(3)
Loans	1,252	259	993
Total interest income	1,255	358	897
Interest expense:			
Interest bearing liabilities:			
Checking	84	59	25
Money market savings	106	94	12
Regular savings	40	30	10
Time Deposits	74	176	(102)
FHLB borrowings	75	29	46
Subordinated notes	—	(1)	1
Other borrowings	(3)	4	(7)
Total interest expense	376	391	(15)
Net interest income	$ 879	$ (33)	$ 912

Noninterest income for the first nine months of 2018 was $2.9 million, compared to $2.5 million for the same period in 2017; noninterest income, net of non-recurring income amounted to $2.2 million during the first nine months of 2018 vs. $2.3 million in the first nine months of 2017. The non-recurring income during 2018 was the recognition of a nontaxable net death benefit proceeds of $642 thousand from bank owned life insurance; while other income in the prior year included a one-time bankruptcy settlement of $172 thousand. The slight decrease in non-interest income, net of the non-recurring items, was primarily the result of several small items, as declines in mortgage banking income were offset by an increase in ATM and interchange income related to new account growth.

For the nine months ended September 30, 2018, noninterest expense was $12.3 million, $416 thousand or 3.5% more than the $11.9 million recorded in the same period last year. Salaries and employee benefits for the nine months ended September 30, 2018 were $312 thousand more than the same nine months of 2017, and were partially offset by the $104 thousand decrease in professional fees. The current period includes the wages for the position of Chief Risk Officer that was open in the same period last year. In 2017 much of the Company's internal audit work was outsourced and the cost included in professional fees. Other factors contributing to higher personnel expense was annual merit raises, and the acceleration of the vesting of all remaining restricted stock related to the death of a former executive. Data processing expense was up $198 thousand over the prior year.

Financial Condition

The Company’s management, under the direction of the Asset/Liability Committee (ALCO) of the Board of Directors, reviews the mix of monetary assets and liabilities to ensure the Company maintains an adequate level of liquidity while maximizing interest rate spreads.

Assets totaled $559 million at September 30, 2018, an increase of $8.5 million or 1.5% since year end 2017. The continuing expansion of the net loan portfolio by $22.0 million during the nine months since December 31, 2017 was partially offset by a decrease in the investment portfolio.

The Company’s liabilities at September 30, 2018 totaled $506.0 million compared to $499.4 million at December 31, 2017, an increase of $6.4 million or 1.3%. Total deposits increased $6.2 million during the same period to $483.5 million at September 30, 2018, while FHLB borrowings declined $0.3 million from year end 2017.

At September 30, 2018 and December 31, 2017, the stockholders’ equity of HomeTown Bankshares was $53.0 million and $50.9 million, respectively, an increase of $2.1 million or 4.1%. The change in stockholders’ equity in the first nine months of 2018 was mainly the result of net income, partially offset by increases in unrealized losses in the investment portfolio caused by market volatility.

Non-performing Assets

Non-performing assets consist of nonaccrual loans, restructured loans, and repossessed and foreclosed assets.

(Dollars in thousands)	September 30, 2018	December 31, 2017
Real Estate:		
Construction and land development	$ 124	$ 274
Residential 1-4 families	546	173
Commercial real estate	468	209
Commercial loans	169	403
Equity lines	147	49
Loans to individuals	-	36
Total nonperforming loans	1,454	1,144
Other real estate owned	3,196	3,249
Total nonperforming assets, excluding performing restructured loans	4,650	4,393
Performing restructured loans	3,796	3,889
Total nonperforming assets, including restructured loans	$ 8,446	$ 8,282

At September 30, 2018, four loans totaling $4.0 million were classified as troubled debt restructurings (“TDRs”). Two of the four loans totaling $3.8 million were performing in accordance with their restructured terms and were accruing interest at September 30, 2018. The other two loans from one borrower totaled $200 thousand and were on nonaccrual status at September 30, 2018. See Note 3 for more information.

The major classifications of other real estate owned in the consolidated balance sheets at September 30, 2018 and December 31, 2017 are included in Note 5, and the activity in other real estate owned for the first nine months of 2018 and 2017 is also included in Note 5.

Allowance for Loan Losses

The allowance for loan losses is increased by charges to income and decreased by charge-offs, net of recoveries. The allowance consists of three components: specific, general, and unallocated. Their adequacy is evaluated separately. Management’s periodic evaluation of the adequacy of the allowance is based on the Company’s past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower’s ability to repay, the estimated value of any underlying collateral, and current economic conditions. Based on the Company’s allowance for loan losses calculation and analysis at the end of the first nine months of 2018, a provision of $371 thousand was recorded. Charged off loans exceeded recoveries of previous charge offs by $182 thousand and $505 thousand for the first nine months of 2018 and 2017, respectively.

Specific reserves are determined on a loan by loan basis and relate to loans classified as impaired. Management classifies loans as impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement.   Included in potentially impaired loan category are current “watch list” credits plus any additional credits which have been past due three or more times within the past 12-month period. Management individually reviews these potentially impaired loans based on generally accepted accounting principles (GAAP) related to receivables and makes a determination if the loan in fact is impaired. Management does not consider a loan impaired during a period of delay in payment if management expects the ultimate collection of all amounts due. If a loan is found to be impaired, an allowance is established when the collateral value less estimated cost to dispose, discounted cash flows, or observable market price of the impaired loan is lower than the carrying value of that loan. There were no specific reserves for loans individually evaluated for impairment at September 30, 2018 and December 31, 2017. Impaired loans totaled $5.5 million at September 30, 2018, $135 thousand higher than the balance at year end 2017.

The percentage of the allowance for loan losses to total loans was 0.85% at September 30, 2018, and December 31, 2017. Unallocated reserves were $63 thousand at September 30, 2018 and $9 thousand at December 31, 2017. Some surplus or unallocated reserve is desirable given the inherent weakness in this type of predictive analysis. The allowance for loan losses to nonaccrual loans was 271% at September 30, 2018 and 328% at December 31, 2017. Past due and non-accruing loans to total loans was 0.72% at September 30, 2018 compared to 0.93% at December 31, 2017.

Liquidity

Liquidity is identified as the ability to generate or acquire sufficient amounts of cash when needed and at a reasonable cost to accommodate withdrawals, payments of debt, and increased loan demand. Liquid assets include cash, federal funds sold, securities classified as available for sale as well as loans and securities maturing within one year. As a result of the Company's management of liquid assets and the ability to generate liquidity through liability funding, management believes the Company maintains overall liquidity sufficient to satisfy its depositors' requirements and meet its customers' credit needs.

The Company's management, under the direction of the Asset/Liability Committee of the Board of Directors, reviews the mix of monetary assets and liabilities to ensure the Company maintains an adequate level of liquidity at all times. This ensures that the Company's sources of funds, primarily net fluctuations in customer deposits, investment securities and correspondent banking relationships, must be balanced with the Company's obligations, commitments, and operational requirements, to maintain overall liquidity in conjunction with the maximization of interest rate spreads.

The Company's asset based liquidity position, cash and due from bank balances, federal funds sold, loans held for sale, securities available for sale, net of securities pledged and cash balance requirements totaled $53.2 million at September 30, 2018, compared to $65.2 million at December 31, 2017. Commercial interest bearing deposits remain volatile and withdrawals may result in less liquidity in the future. Surges and declines in commercial deposits will continue to impact liquidity in an unpredictable manner.

The Company's primary source of funding is its retail deposit base. The Company aggressively markets in its trade area and seeks demand deposits through service-related tactics and savings and time deposits through competitive pricing tactics. If deposits are not an attractive source for funding, either for reasons of maturity or pricing, alternative sources include FHLB advances, brokered deposits, fed funds purchased and lines of credit. The Company is approved to borrow 25% of our total assets from the FHLB subject to providing qualifying collateral. At September 30, 2018, the Company had borrowed $10.7 million of the $21.3 million of lendable collateral value, leaving $10.6 million of unused credit immediately available. The Company also had $41.0 million of fed funds lines of credit available at September 30, 2018. In addition, the Company had borrowed none of the available $10.0 million credit line through Promontory's Insured Cash Sweep (ICS) one way buy program at a rate of the one month LIBOR plus 11 basis points but not less than 20 basis points. At September 30, 2018 there were no advances on the fed funds or credit lines.

Capital

To enable future growth of the Company, there must be an adequate level of capital. Management reviews the Company's capital to ensure that the amount, composition and quality of the Company's assets and liabilities satisfy regulatory requirements, meet or exceed industry standards, and support projected Company growth. The Company's stock is traded on the NASDAQ Capital Market under the symbol "HMTA."

The ability to pay cash dividends to common stockholders is limited by regulatory restrictions and the need to maintain sufficient capital in the Company and in our subsidiaries. The Company must consider different factors to ensure that any future cash dividends to common stockholders would be prudent relative to the organization's financial position and not based on overly optimistic earnings scenarios. The Company had $6.8 million of retained earnings at September 30, 2018. On May 15, 2018 at the annual shareholders meeting the Board of Directors declared the Company's first cash dividend. The cash dividend of $0.04 per common share was paid on June 15, 2018 to shareholders of record on May 31, 2018. The Board declared cash dividends of $0.04 per common share for each of the two subsequent quarters.

The Basel III capital framework represents the most comprehensive overhaul of the U.S. banking capital framework in over two decades. This new capital framework and related changes to the standardized calculations of risk-weighted assets are complex and create additional compliance burdens. Basel III rules became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule. The Basel III Capital Rules require significantly more capital and adopted more demanding regulatory capital risk weightings and calculations. As a result of the Basel III Capital Rules, many community banks could be forced to limit banking operations and activities, and growth of loan portfolios, in order to focus on retention of earnings to improve capital levels. The Company believes that it maintains sufficient levels of Tier 1 and Common Equity Tier 1 capital to comply with the Basel III Final Rules. However, increased capital requirements imposed by the Basel III Capital Rules may require the Company to limit its banking operations, retain net income to improve regulatory capital levels, which could negatively affect our business, financial condition and results of operations.

The table presents the Bank's capital amounts and ratios calculated using the Basel III rules in effect at September 30, 2018 and December 31, 2017.

Risk Based Capital Analysis

Capital Analysis

HomeTown Bank (Dollars in thousands)	**September 30, 2018**	**December 31, 2017**
Common Equity Tier 1 Capital:		
Common Stock	$ 14,697	$ 14,697
Surplus	32,385	32,226
Retained Earnings	14,043	10,551
Common Equity Tier 1 Capital	61,125	57,474
Tier 1 Capital:		
Tier 1 Minority Interest	31	25
Tier 1 Capital	61,156	57,499
Total Capital:		
Allowance for Loan Losses (allowable portion)	3,947	3,758
Total Capital	$ 65,103	$ 61,257

The Bank's total capital increased $3.8 million from December 31, 2017 to September 30, 2018, primarily as the result of retaining the $3.5 million of year to date September 30, 2018 net income attributable to the bank and noncontrolling interest.

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 issued in February 2015, and is no longer obligated to report consolidated regulatory capital. In July 2013, the Federal Reserve Bank issued revised final rules that made technical changes to its market risk capital rules to align it with the Basel III regulatory capital framework and meet certain requirements of the Dodd-Frank Act. The final new capital rules required the Bank to comply with the following new minimum capital ratios, effective January 1, 2015: (1) a new common equity Tier 1 capital ratio of 4.5% of risk-weighted assets; (2) a Tier 1 capital ratio of 6% of risk-weighted assets (increased from the previous requirement of 4%); (3) a total capital ratio of 8% of risk-weighted assets (unchanged from current requirement); and, (4) a leverage ratio of 4% of total assets. Beginning January 1, 2016, a capital conservation buffer of .625% became effective. The capital conservation buffer will be gradually increased through January 1, 2019 to 2.5%. Banks will be required to maintain capital levels that meet the required minimum plus the capital conservation buffer in order to make distributions or discretionary bonus payments.

The Bank's actual capital amounts and ratios are also presented in the following tables:

HomeTown Bank September 30, 2018	**Actual**		**Minimum Capital Requirement**		**Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions**	
(in thousands except for percentages)	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Total Capital (to Risk-Weighted Assets)	$ 65,103	12.48%	$ 51,514	9.875	$ 52,166	10.00%
Tier I Common Equity (to Risk-Weighted Assets)	61,125	11.72	33,248	6.375	33,901	6.50
Tier I Capital (to Risk-Weighted Assets)	61,156	11.73	41,057	7.875	41,709	8.00
Tier I Capital (to Average Assets)	61,156	10.87	22,505	4.00	28,131	5.00

HomeTown Bank December 31, 2017	**Actual**		**Minimum Capital Requirement**		**Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions**	
(in thousands except for percentages)	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Total Capital (to Risk-Weighted Assets)	$ 61,257	12.48%	$ 45,403	9.25	$ 49,084	10.00%
Tier I Common Equity (to Risk-Weighted Assets)	57,474	11.71	28,222	5.75	31,903	6.50
Tier I Capital (to Risk-Weighted Assets)	57,499	11.72	35,569	7.25	39,248	8.00
Tier I Capital (to Average Assets)	57,499	10.39	22,136	4.00	27,670	5.00

Financial Instruments with Off-Balance-Sheet Risk

In the normal course of business to meet the financing needs of its customers, the Company is a party to financial instruments with off-balance-sheet risk. These financial instruments involve commitments to extend credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit is represented by the contractual amount of those instruments. The same credit policy is used in making commitments as is used for on-balance-sheet risk.

At September 30, 2018, outstanding commitments to extend credit including letters of credit were $131.9 million. There are no commitments to extend credit on impaired loans.

Commitments to extend credit are agreements to lend to a customer as long as there is no breach of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments may expire without ever being drawn upon; therefore, the total commitment amounts do not necessarily represent future cash outlays for the Company.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently assessing the impact that ASU 2016-02 will have on its consolidated financial statements.

During June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this ASU are effective for SEC filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Bank has formed a committee to address the compliance requirements, data gathering, archiving and analysis efforts. The Bank began tracking data during the 2nd quarter of 2018 and will reassess its position during the 4th quarter of 2018. Additionally, the Bank has begun to analyze various software solutions that will assist in complying with this Standard.

During March 2017, the FASB issued ASU 2017-08, “Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities.” The amendments in this ASU shorten the amortization period for certain callable debt securities purchased at a premium. Upon adoption of the standard, premiums on these qualifying callable debt securities will be amortized to the earliest call date. Discounts on purchased debt securities will continue to be accreted to maturity. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. Upon transition, entities should apply the guidance on a modified retrospective basis, with a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption and provide the disclosures required for a change in accounting principle. The Company is currently assessing the impact that ASU 2017-08 will have on its consolidated financial statements.

In August 2017, the FASB issued ASU 2017-12, “Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities.” The amendments in this ASU modify the designation and measurement guidance for hedge accounting as well as provide for increased transparency regarding the presentation of economic results on both the financial statements and related footnotes. Certain aspects of hedge effectiveness assessments will also be simplified upon implementation of this update. The amendments are effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2018. Early adoption is permitted, including adoption in any interim period. The Company does not expect the adoption of ASU 2017-12 to have a material impact on its consolidated financial statements.

In February 2018, the FASB issued ASU 2018-03, “Technical Corrections and Improvements to Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.” The amendments provide targeted improvements to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Specifically, the amendments include clarifications related to: measurement elections, transition requirements, and adjustments associated with equity securities without readily determinable fair values; fair value measurement requirements for forward contracts and purchased options on equity securities; presentation requirements for hybrid financial liabilities for which the fair value option has been elected; and measurement requirements for liabilities denominated in a foreign currency for which the fair value option has been elected. The amendments are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years beginning after June 15, 2018. Early adoption is permitted. The Company does not expect the adoption of ASU 2018-03 to have a material impact on its consolidated financial statements.

In June 2018, the FASB issued ASU 2018-07, “Compensation- Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting.” The amendments expand the scope of Topic 718 to include share-based payments issued to non-employees for goods or services, which were previously excluded. The amendments will align the accounting for share-based payments to nonemployees and employees more similarly. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Company does not expect the adoption of ASU 2018-07 to have a material impact on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, “Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement.” The amendments modify the disclosure requirements in Topic 820 to add disclosures regarding changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements and the narrative description of measurement uncertainty. Certain disclosure requirements in Topic 820 are also removed or modified. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Certain of the amendments are to be applied prospectively while others are to be applied retrospectively. Early adoption is permitted. The Company does not expect the adoption of ASU 2018-13 to have a material impact on its consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable to smaller reporting companies.

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company’s management, including the Company’s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended.) Based upon that evaluation, the Company’s Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures were effective.

The Company’s management is also responsible for establishing and maintaining adequate internal control over financial reporting. There were no changes in the Company’s internal control over financial reporting identified in connection with the evaluation of it that occurred during the Company’s last fiscal quarter that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings.

In the normal course of business, the Company becomes involved in litigation arising from the banking, financial and other activities it conducts. Management, after consultation with legal counsel, does not anticipate that the ultimate liability, if any, arising from these matters will have a material effect on the Company’s financial condition, operating results or liquidity.

Item 1A. Risk Factors.

The following risk factors relate to the Company’s proposed merger with American National.

Regulatory approvals may not be received, may take longer than expected or may impose conditions that are not presently anticipated or that could have an adverse effect on American National following the merger.
Before the merger of the Company into American National, or the merger of the Company's bank subsidiary into American National's bank subsidiary, may be completed, American National and the Company must obtain approvals from certain bank regulatory authorities. Other approvals, waivers or consents from regulators may also be required. In determining whether to grant these approvals the regulators consider a variety of factors, including the regulatory standing of each party and the competitive effects of the contemplated transactions. An adverse development in either party’s regulatory standing or these factors could result in an inability to obtain approval or delay their receipt. The Community Reinvestment Act of 1977, as amended, and the regulations issued thereunder (collectively, the “CRA”) also requires that the bank regulatory authorities, in deciding whether to approve the merger and the subsidiary bank merger, assess the records of performance of American National and the Company's bank subsidiaries in meeting the credit needs of the communities they serve, including low and moderate income neighborhoods. As part of the review process under the CRA, it is not unusual for the bank regulatory authorities to receive protests and other adverse comments from community groups and others. Any such protests or adverse comments could prolong the period during which the merger and the subsidiary bank merger are subject to review by the bank regulatory authorities.

These regulators may impose conditions on the completion of the merger or the subsidiary bank merger or require changes to the terms of the merger or the subsidiary bank merger. Such conditions or changes could have the effect of delaying or preventing completion of the merger or the subsidiary bank merger or imposing additional costs on or limiting the revenues of the Company following the merger and the subsidiary bank merger, any of which might have an adverse effect on the Company following the merger.

The merger and the subsidiary bank merger may distract management of the Company and American National from their other responsibilities.
The merger and the subsidiary bank merger could cause the respective management groups of the Company and American National to focus their time and energies on matters related to the transaction that otherwise would be directed to their business and operations. Any such distraction on the part of either company’s management could affect its ability to service existing business and develop new business and adversely affect the business and earnings of the Company or American National before the merger, or the business and earnings of American National after the merger.

Termination of the Merger Agreement could negatively impact the Company.
If the Merger Agreement is terminated, the Company’s business may be impacted adversely by the failure to pursue other beneficial opportunities due to the focus of management on the merger, without realizing any of the anticipated benefits of completing the merger. Additionally, if the Merger Agreement is terminated, the market price of the Company’s common stock could decline to the extent that the current market prices reflect a market assumption that the merger will be completed. Furthermore, costs relating to the merger, such as legal, accounting and financial advisory fees, must be paid even if the merger is not completed.

The Company and American National will be subject to business uncertainties and contractual restrictions while the merger is pending.
Uncertainty about the effect of the merger on employees and customers may have an adverse effect on the Company and American National. These uncertainties may impair the Company’s and American National’s ability to attract, retain and motivate key personnel until the merger is completed, and could cause customers and others that deal with the Company and American National to seek to change existing business relationships with the Company and American National. Retention of certain employees by the Company and American National may be challenging while the merger is pending, as certain employees may experience uncertainty about their future roles with the Company or American National. If key employees depart because of issues relating to the uncertainty and difficulty of integration or a desire not to remain with the Company or American National, the Company’s or American National s business, or the business of the combined company following the merger, could be harmed. In addition, subject to certain exceptions, the Company and American National have each agreed to operate its business in the ordinary course prior to closing and refrain from taking certain specified actions until the merger occurs, which may prevent the Company or American National from pursuing attractive business opportunities that may arise prior to completion of the merger.

If the merger is not completed, the Company will have incurred substantial expenses without realizing the expected benefits of the merger.
The Company has incurred and will incur substantial expenses in connection with the negotiation and completion of the transactions contemplated by the Merger Agreement, as well as the costs and expenses of filing, printing and mailing the joint proxy statement/prospectus to shareholders to approve the merger and all filing and other fees paid to the SEC in connection with the merger. If the merger is not completed, the Company would have to incur these expenses without realizing the expected benefits of the merger.

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

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosure

Not applicable.

Item 5. Other Information

None

Item 6. Exhibits

(a) Exhibits

Exhibit No.	
31.1	Certification of Chief Executive of Officer (302 Certification).
31.2	Certification of Chief Financial Officer (302 Certification).
32	Certification pursuant to 18 U.S.C. Section 1350 (906 Certification).
101*	Pursuant to Rule 405 of Regulation S-T, the following financial information from the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2018, is formatted in XBRL interactive data files: (i) Consolidated Balance Sheets at September 30, 2018, and December 31, 2017; (ii) Consolidated Statements of Income for the three and nine months ended September 30, 2018, and 2017; (iii) Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2018, and 2017; (iv) Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017; and (v) Notes to Consolidated Financial Statements.

* As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HOMETOWN BANK

Date: November 13, 2018	By: /S/ SUSAN K. STILL **Susan K. Still** **President** **Chief Executive Officer**
Date: November 13, 2018	By: /S/ VANCE W. ADKINS **Vance W. Adkins** **Executive Vice President** **Chief Financial Officer**

(Back To Top)

Section 2: EX-31.1 (EXHIBIT 31.1)

Exhibit 31.1

CERTIFICATION

I, Susan K. Still certify that:

1. I have reviewed this quarterly report on Form 10-Q of HOMETOWN BANKSHARES CORPORATION.

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

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

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

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

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

   c) evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report; and

   d) disclosed in this report any changes in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

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

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

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

Date: November 13, 2018	/s/ Susan K. Still Susan K. Still President and Chief Executive Officer

(Back To Top)

Section 3: EX-31.2 (EXHIBIT 31.2)

Exhibit 31.2

CERTIFICATION

I, Vance W. Adkins certify that:

1. I have reviewed this quarterly report on Form 10-Q of HOMETOWN BANKSHARES CORPORATION.

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

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

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

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

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

   c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report; and

   d) disclosed in this report any changes in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

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

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

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

Date: November 13, 2018

/s/ Vance W. Adkins
Vance W. Adkins
Executive Vice President
Chief Financial Officer

(Back To Top)

Section 4: EX-32 (EXHIBIT 32)

Exhibit 32

CERTIFICATION OF FINANCIAL REPORTS PURSUANT TO 18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

The undersigned hereby certifies that, to his/her knowledge, (i) the Form 10-Q filed by HOMETOWN BANKSHARES CORPORATION (the "Issuer") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and (ii) the information contained in that report fairly presents, in all material respects, the financial condition and results of operations of the Issuer.

HOMETOWN BANKSHARES CORPORATION

Date: November 13, 2018

By: /s/ Susan K. Still
Susan K. Still
President and Chief Executive Officer

Date: November 13, 2018

By: /s/ Vance W. Adkins
Vance W. Adkins
Executive Vice President
Chief Financial Officer

(Back To Top)