

# UNITED TENNESSEE BANKSHARES, INC.

## 2017 ANNUAL REPORT





# United Tennessee Bankshares, Inc.

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To our Stockholders,

We are pleased to present this Annual Report to our shareholders. United Tennessee Bankshares looks forward to the upcoming year and we are in a good position for the future.

The total assets of United Tennessee Bankshares, Inc. increased to \$203 million and our deposits grew to \$178 million as of December 31, 2017. The net income was \$1,234,000 or \$1.46 per share, which is the tenth consecutive year of earnings of one million dollars or more. We congratulate the staff for their hard work that made these results possible.

The Board of Directors is pleased to have increased our dividend to \$0.54 during our February 20, 2018 Board Meeting. The investors who purchased UNTN stock at its initial offering in 1998 have received cumulative cash dividends in excess of their initial investment.

Please review this Annual Report, which more fully describes our performance. We look forward to 2018 being another good year. We continue to be a well-capitalized institution poised to take advantage of any and all opportunities afforded to us in our competitive market place. We appreciate your investment in United Tennessee Bankshares, Inc. and invite your continued support of Newport Federal Bank which is Newport's truly home owned community bank.

I would also like to mention that the Bank lost two Directors this past year, Robert Self, a retired Director, and William Henry, Director Emeritus. We thank their families for sharing them with us over the past many years and we appreciate their service and commitment to the Bank and the Community.

Sincerely,

A handwritten signature in dark ink, appearing to read "Chris Triplett". The signature is fluid and cursive, with a large initial "C" and "T".

Chris Triplett, President  
UNITED TENNESSEE  
BANKSHARES, INC.

United Tennessee Bankshares, Inc. (the "Company") became the holding company for Newport Federal Bank (the "Bank") upon its conversion from mutual to stock form (the "Conversion"), which was completed on January 1, 1998. Prior to January 1, 1998, the Company had no assets or liabilities and engaged in no business activities. The Company's assets primarily consist of its investment in the Bank.

The Company's executive offices are located at 170 W. Broadway, Newport, Tennessee 37821-2325, and its telephone number is (423) 623-6088. Our web site is [www.newportfederalbank.com](http://www.newportfederalbank.com).

The Bank was organized as a federally chartered mutual savings institution in 1934 under the name Newport Federal Savings and Loan Association. Effective January 1, 1998, the Bank became a stock savings bank and changed its name to Newport Federal Bank. The Bank currently operates through three full-service banking offices located in Newport, Tennessee. The Bank's deposits are insured to applicable limits by the Federal Deposit Insurance Corporation ("FDIC").

## MARKET FOR COMMON STOCK AND RELATED STOCKHOLDER MATTERS

The Company's Common Stock trades on the OTC Markets Group (OTCQB) under the symbol "UNTN." As of December 31, 2017, there are approximately 848,109 shares of the Company's Common Stock outstanding, and approximately 100 record holders.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The Company's principal business activities are conducted through its wholly owned subsidiary, the Bank. The Bank's principal business consists of accepting deposits from the general public through its main office and branch offices then investing those funds in loans secured by one-to-four-family residential properties located in its primary market area. The Bank also maintains a portfolio of investment securities in addition to originating a limited amount of commercial real estate loans and consumer loans. The Bank's investment securities portfolio consists of U.S. government corporations and agency securities, municipal bonds of governmental entities in Tennessee, and corporate debt and mortgage-backed securities, which are guaranteed as to principal and interest by the FHLMC, GNMA, FNMA or other governmental agencies. The Bank also maintains an investment in FHLB of Cincinnati common stock.

The Bank's net income primarily depends on its net interest income, which is calculated by deducting the interest paid on customers' deposits and other borrowing from the interest income earned on loans and investments securities. The Bank's net income is also affected by noninterest income, such as service charges on customers' deposit accounts, loan service charges and fees, and noninterest expense, primarily consisting of compensation expense, deposit insurance and other expenses incidental to its operations.

The Bank's operations, as well as those of the banking industry as a whole, are significantly affected by prevailing economic conditions and competition, along with the monetary and fiscal policies of governmental agencies. The Bank's lending activities are influenced by the demand for and supply of housing in addition to the competition among lenders, along with the level of interest rates in its market area. The Bank's deposit flows and costs of funds are influenced by prevailing market rates of interest, primarily on competing investments, account maturities and the levels of personal income and savings in its market area.

is the primary component of the Company's net income, is determined by the difference or "spread" between the yields earned on its interest-earning assets and the rates paid on its interest-bearing liabilities, in conjunction with the relative amounts of such assets and liabilities. Key components of an asset/liability strategy are the monitoring and managing of interest rate sensitivity on both the interest earning assets and interest-bearing liabilities.

An asset or liability is interest rate sensitive within a specific time period if it will mature or reprice within that time period. If the Company's assets mature or reprice more quickly or to a greater extent than its liabilities, its net interest income would tend to increase during periods of rising interest rates but decrease during periods of falling interest rates. If its assets mature or reprice more slowly or to a lesser extent than its liabilities, its net interest income would tend to decrease during periods of rising interest rates, but increase during periods of falling interest rates. The Company's policy has been to mitigate the interest rate risk inherent in the traditional savings institution business of originating long term loans funded by short-term deposits by pursuing the following strategies: (i) it has historically maintained liquidity and capital levels to compensate for unfavorable movements in market interest rates; and (ii) in order to mitigate the adverse effect of interest rate risk on future operations, it emphasizes the origination of variable rate mortgage loans, and it makes limited amounts of shorter term consumer loans.

#### Comparison of Financial Condition at December 31, 2017 and December 31, 2016

Total assets increased \$2.6 million, or 1.3%, from \$200.1 million at December 31, 2016 to \$202.7 million at December 31, 2017. The Company's asset increase was attributable principally to an increase in net loans receivable, offset by a decrease in investments and interest earning deposits.

Investment securities available for sale decreased approximately \$2.2 million, or 2.6%, from \$87.8 million at December 31, 2016 to \$85.6 million at December 31, 2017. The Bank used the proceeds from investment maturities and payments to help fund the growth in the net loans receivable.

Loans receivable increased \$6.2 million, or 6.7% from \$94.1 million at December 31, 2016 to \$100.3 million at December 31, 2017. The bank had an excellent year in loan demand. The Bank had increases in residential real estate along with increases in construction and land development loans.

Total deposits increased \$1.5 million, or 1.0% from \$176.8 million at December 31, 2016 to \$178.3 million at December 31, 2017. The Bank strives to offer competitive interest rates in this continued low interest rate environment.

The Company's shareholders' equity increased \$1.1 million, or 5.4% from \$21.1 million at December 31, 2016 to \$22.2 million at December 31, 2017. The increase was primarily due to net income of \$1,234,000 plus and an increase in accumulated other comprehensive income of \$265,000, offset by dividends paid to shareholders of \$449,000. The Company had stock transactions in the net amount of \$96,000. The change in accumulated comprehensive income was a result of a decrease of bond market prices during the year ended December 31, 2017. The Bank generally holds bond investment securities until maturity but is required to use mark-to-market valuation for its bonds on a quarterly basis.

#### Comparison of Results of Operations for the Years Ended December 31, 2017 and December 31, 2016

Net income was \$1,234,000 for the year ended December 31, 2017 compared to net income of \$1,495,000 for the year ended December 31, 2016. The decrease in net income during 2017 was primarily due to an increase in income tax expense resulting from accounting adjustments as a result of the Tax Cuts and Jobs Act passed in December 2017. Income before income taxes increased \$145,000 or 6.9% from \$2,099,000 for the year ending December 31, 2016 to \$2,244,000 for the year ending December 31, 2017. Net income for 2017 represented a return on average assets of 0.61% compared to 0.75% for 2016, and a return on average equity of 5.70% for 2017 as compared to 7.18% for 2016.

Interest income totaled \$6.9 million for 2017 and \$6.7 million for 2016. Interest income on loans for the year ended December 31, 2017, was \$5.3 million compared to \$5.2 million for the year ended December 31, 2016. Interest income on investment securities for the year ended December 31, 2017 was \$1.7 million compared to \$1.4 million for the year ended December 31, 2016. The average yield on interest earning assets was 3.61% in 2017 and 3.50% in 2016.

The Company's primary source of interest income is from loans receivable. Interest income from loans receivable was \$5.25 million for the year ended December 31, 2017 and the average yield earned on loans receivable was 5.30%.

Interest expense totaled \$1,033,000 and \$996,000 for the years ended December 31, 2017 and 2016, respectively. The increase in interest expense of \$38,000 during 2017 was due to the increase in deposit balances and a slight increase in average cost of funds.

Net interest income was \$5.94 million and \$5.69 million for the years ended December 31, 2017 and 2016. The net interest spread for 2017 was 3.03% compared to 2.93% in 2016. The ratio of average interest-earning assets to average interest-bearing liabilities decreased slightly to 108.80% in 2017 from 108.92% in 2016. The Company's net interest margin increased in 2017 to 3.08% from 2.98% in 2016.

The provision for loan losses was \$0 in 2017 and 2016. The amount of provision for any period is determined as of the end of the period based on a comparison of the amount of existing loan loss reserves with management's analysis of various risk factors that affect the loan portfolio. At December 31, 2017, the ratio of the allowance to impaired loans was 78.32%.

Noninterest income for the years ended December 31, 2017 and 2016 was \$469,000 and \$489,000, respectively. Noninterest income consists primarily of customer service fees related to customers' deposit accounts, loan service charges, and increases in the cash surrender value of life insurance. The decrease was primarily attributable to the decrease in deposit account service charges.

Noninterest expense for the years ended December 31, 2017 and 2016 was \$4.2 million and \$4.1 million, respectively. Noninterest expense consists primarily of compensation and benefits, occupancy and equipment, federal deposit insurance premiums and data processing fees.

The Company's operating efficiency, measured by its efficiency ratios (noninterest expense divided by the total of net interest income and noninterest income), for the years ended December 31, 2017 and 2016 was 64.99% and 66.04%.

The Company's effective tax rate was 45.04% and 28.78% for the years ended December 31, 2017 and 2016, respectively. For a full discussion of the impact of the Tax Cuts and Job Act of 2017 and the related income tax effect please see Note 9 in the accompanying Report on Financial Statements prepared by Pugh CPAs.

#### Sources of Capital and Liquidity

The Company has historically maintained substantial levels of capital. The assessment of capital adequacy depends on several factors, including asset quality, earnings trends, liquidity and economic conditions. The Company seeks to maintain high levels of regulatory capital to give the Company maximum flexibility in the changing regulatory environment and to respond to changes in market and economic conditions. These levels of capital have been achieved through consistent earnings enhanced by low levels of noninterest expense and have been maintained at those high levels as a result of its policy of moderate growth generally confined to its market area. Average equity to average total assets at December 31, 2017 and 2016 was 10.75% and 10.50%, respectively. At December 31, 2017, the Bank exceeded all current regulatory capital requirements and met the definition of a "well capitalized" institution, the highest regulatory category.

The Company seeks to maintain a relatively high level of liquidity in order to retain flexibility in terms of lending and investment opportunities and deposit pricing, and in order to meet funding needs of deposit outflows and loan commitments. Historically, the Company has been able to meet its liquidity demands through internal sources of funding.

The Company's most liquid assets are cash and amounts due from depository institutions, which are short-term highly liquid investments with original maturities of less than three months that are readily convertible to known amounts of cash. The levels of these assets are dependent on its operating, financing and investing activities during any given period. At December 31, 2017 and 2016, cash and amounts due from depository institutions totaled \$4.4 million and \$5.3 million, respectively.

The Company's primary sources of funds are deposits and proceeds from principal and interest payments on loans and investment securities. While scheduled principal repayments on loans and investment securities are a relatively predictable source of funds, deposit flows and loan and investment securities prepayments are greatly influenced by general interest rates, economic conditions, competition and other factors. The Company does not solicit deposits outside of its market area through brokers or other financial institutions.

The Company has also designated all of its investment securities as available for sale in order to meet liquidity demands. At December 31, 2017, it had designated securities with a fair value of \$85.6 million as available for sale. In addition to internal sources of funding, the Company, as a member of the FHLB of Cincinnati, has substantial borrowing authority with the FHLB. The Company's use of a particular source of funds is based on need, comparative total costs and availability.

At December 31, 2017, the Company had commitments of approximately \$5.5 million in undisbursed portions of construction loans, unused lines of credit and outstanding letters of credit. At the same date, the total amount of certificates of deposit which were scheduled to mature in one year or less was \$59.4 million. The Company anticipates that it will have resources to meet its current commitments through internal funding sources described above. Historically, it has been able to retain a significant amount of its certificates of deposit as they mature.

## Selected Ratios

	At or for the Year Ended December 31,				
	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
<b>Performance Ratios:</b>					
Return on average assets (net income divided by average total assets)	0.61%	0.75%	0.86%	0.80%	0.89%
Return on average equity (net income divided by average equity)	5.70%	7.18%	8.33%	8.07%	9.43%
Dividend payout ratio (dividends per share divided by earnings per share)	36.30%	29.21%	25.63%	27.93%	25.00%
Interest rate spread (combined weighted average interest rate earned less combined weighted average interest rate cost)	3.03%	2.93%	3.04%	3.37%	3.51%
Net interest margin (net interest income divided by average interest earning assets)	3.08%	2.98%	3.09%	3.41%	3.55%
Ratio of average interest-earning assets to average interest-bearing liabilities	108.80%	108.92%	108.52%	107.51%	107.97%
Ratio of noninterest expense to average total assets	2.07%	2.06%	1.96%	2.00%	2.08%
Efficiency ratio (noninterest expense divided by total of net interest income and noninterest income)	64.99%	66.04%	61.01%	57.60%	55.14%
<b>Asset Quality Ratios:</b>					
Impaired assets to total assets at end of period	1.25%	1.05%	1.30%	1.54%	2.32%
Impaired loans to total loans at end of period	2.19%	2.06%	2.36%	2.52%	3.39%
Allowance for loan losses to total loans at end of period	1.72%	1.93%	2.13%	2.28%	2.16%
Allowance for loan losses to impaired loans at end of period	78.32%	93.43%	90.14%	90.42%	63.78%
Provision for loan losses to total loans	0.00%	0.00%	0.00%	0.65%	0.73%
Net charge-offs to average loans outstanding	0.10%	0.19%	0.14%	0.55%	1.01%
<b>Capital Ratios:</b>					
Equity to total assets at end of period	10.97%	10.54%	10.45%	10.16%	9.57%
Average equity to average assets	10.75%	10.50%	10.31%	9.89%	9.49%
Stock Price (last trade prior to December 31):	\$ 21.60	\$ 19.00	\$ 17.75	\$ 15.15	\$ 13.03



**UNITED TENNESSEE BANKSHARES, INC.  
AND SUBSIDIARY**

**Newport, Tennessee**

**CONSOLIDATED FINANCIAL STATEMENTS  
AND OTHER INFORMATION**

**December 31, 2017, 2016 and 2015**



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PUGH & COMPANY, P.C.  
www.pughcpas.com

## INDEPENDENT AUDITOR’S REPORT

Board of Directors and Senior Management  
United Tennessee Bankshares, Inc. and Subsidiary  
Newport, Tennessee

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of United Tennessee Bankshares, Inc. and its subsidiary, (the “ Company”), which comprise the consolidated statements of financial condition as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in shareholders’ equity and cash flows for the years ended December 31, 2017, 2016 and 2015, and the related notes to the consolidated financial statements (collectively, the financial statements).

### Management’s Responsibility for the Financial Statements

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

### Auditor’s Responsibility

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

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

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

### Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of United Tennessee Bankshares, Inc. and its subsidiary as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years ended December 31, 2017, 2016 and 2015, in accordance with accounting principles generally accepted in the United States of America.

*Pugh & Company, P.C.*  
Certified Public Accountants  
Knoxville, Tennessee  
March 9, 2018



An independently owned member  
**RSM US Alliance**



**TSCPA**  
Members of the Tennessee Society  
Of Certified Public Accountants

**UNITED TENNESSEE BANKSHARES, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

	As of December 31,	<u>2017</u>	<u>2016</u>
<b>ASSETS</b>			
Cash and Amounts Due from Depository Institutions	\$	4,394,859	\$ 5,333,796
Interest-Bearing Deposits in Other Banks		2,092,000	4,333,000
Investment Securities Available for Sale, at Fair Value		85,560,441	87,821,250
Loans Receivable, Net		100,317,551	94,059,276
Equity Securities, at Cost		1,218,975	1,209,550
Premises and Equipment, Net		2,577,300	2,683,497
Accrued Interest Receivable		827,513	774,810
Foreclosed Real Estate		304,151	124,950
Cash Surrender Value of Life Insurance		4,369,098	2,345,710
Deferred Income Tax Benefit		769,573	1,309,701
Prepaid Expenses and Other Assets		<u>247,378</u>	<u>122,858</u>
<b>TOTAL ASSETS</b>	<b>\$</b>	<b><u>202,678,839</u></b>	<b>\$ <u>200,118,398</u></b>
<b>LIABILITIES AND EQUITY</b>			
<b>LIABILITIES</b>			
Deposits:			
Demand	\$	83,285,154	\$ 77,058,941
Term		<u>94,990,238</u>	<u>99,750,192</u>
<b>Total Deposits</b>		178,275,392	176,809,133
Accrued Interest Payable		24,479	24,531
Accrued Income Taxes		6,905	123,357
Accrued Benefit Plan Liabilities		1,894,945	1,850,985
Other Liabilities		<u>246,569</u>	<u>225,536</u>
<b>Total Liabilities</b>		<u>180,448,290</u>	<u>179,033,542</u>
<b>SHAREHOLDERS' EQUITY</b>			
Common Stock - No Par Value, Authorized 20,000,000 Shares; Issued 848,109 Shares in 2017 (842,509 Shares in 2016); Outstanding 848,109 Shares in 2017 (842,509 Shares in 2016)		4,489,422	4,393,270
Retained Earnings		18,411,743	17,519,813
Accumulated Other Comprehensive Income (Loss)		<u>(670,616)</u>	<u>(828,227)</u>
<b>Total Shareholders' Equity</b>		<u>22,230,549</u>	<u>21,084,856</u>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$</b>	<b><u>202,678,839</u></b>	<b>\$ <u>200,118,398</u></b>

The accompanying notes are an integral part of these consolidated financial statements.

## UNITED TENNESSEE BANKSHARES, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENTS OF INCOME

	For the Years Ended December 31,		
	2017	2016	2015
<b>INTEREST INCOME</b>			
Loans	\$ 5,250,204	\$ 5,213,159	\$ 5,419,902
Investment Securities	1,659,640	1,412,867	1,222,289
Other Interest-Earning Assets, Net	67,090	63,429	65,755
<b>Total Interest Income</b>	<u>6,976,934</u>	<u>6,689,455</u>	<u>6,707,946</u>
<b>INTEREST EXPENSE</b>			
Deposits	<u>1,033,138</u>	<u>995,530</u>	<u>958,359</u>
<b>NET INTEREST INCOME</b>	5,943,796	5,693,925	5,749,587
<b>PROVISION FOR LOAN LOSSES</b>	<u>0</u>	<u>0</u>	<u>0</u>
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<u>5,943,796</u>	<u>5,693,925</u>	<u>5,749,587</u>
<b>NONINTEREST INCOME</b>			
Deposit Account Service Charges	311,120	345,980	324,899
Loan Service Charges and Fees	39,086	49,338	37,094
Net Gain (Loss) on Sales of Investment Securities Available for Sale	3,774	9,524	11,260
Increase in Cash Surrender Value of Life Insurance	23,388	26,528	11,142
Other	91,138	57,419	82,385
<b>Total Noninterest Income</b>	<u>468,506</u>	<u>488,789</u>	<u>466,780</u>
<b>NONINTEREST EXPENSE</b>			
Compensation and Benefits	2,380,364	2,254,363	2,088,052
Occupancy and Equipment	444,723	406,940	391,213
Federal Deposit Insurance and Regulatory Assessments	142,415	169,282	185,243
Data Processing Fees	464,896	494,961	419,034
Advertising and Promotion	83,129	86,670	77,187
Loss on Foreclosed Real Estate	30,980	55,485	9,002
Other	621,498	615,678	623,444
<b>Total Noninterest Expense</b>	<u>4,168,005</u>	<u>4,083,379</u>	<u>3,793,175</u>
<b>INCOME BEFORE INCOME TAXES</b>	2,244,297	2,099,335	2,423,192
<b>INCOME TAXES</b>	<u>(1,010,765)</u>	<u>(604,141)</u>	<u>(757,776)</u>
<b>NET INCOME</b>	<u>\$ 1,233,532</u>	<u>\$ 1,495,194</u>	<u>\$ 1,665,416</u>
<b>EARNINGS PER SHARE</b>	<u>\$ 1.46</u>	<u>\$ 1.78</u>	<u>\$ 1.99</u>

The accompanying notes are an integral part of these consolidated financial statements.

**UNITED TENNESSEE BANKSHARES, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	For the Years Ended December 31,	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>NET INCOME</b>		\$ <u>1,233,532</u>	\$ <u>1,495,194</u>	\$ <u>1,665,416</u>
<b>OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:</b>				
Unrealized Gains (Losses) on Investment Securities Available for Sale		424,120	(984,753)	(196,088)
Reclassification Adjustment for (Gains) Losses Included in Net Income		3,774	9,524	11,260
Income Taxes Related to Unrealized Gains/Losses on Investment Securities Available for Sale		<u>(162,599)</u>	<u>370,587</u>	<u>70,235</u>
<b>Other Comprehensive Income (Loss), Net of Tax</b>		<u>265,295</u>	<u>(604,642)</u>	<u>(114,593)</u>
<b>COMPREHENSIVE INCOME</b>		\$ <u><u>1,498,827</u></u>	\$ <u><u>890,552</u></u>	\$ <u><u>1,550,823</u></u>

The accompanying notes are an integral part of these consolidated financial statements.

**UNITED TENNESSEE BANKSHARES, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

**For the Three Years Ended December 31, 2017**

	Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
<b><u>Balances, January 1, 2015</u></b>	\$ 4,293,082	\$ 15,224,737	\$ (17,758)	\$ (108,992)	\$ 19,391,069
Net Income	0	1,665,416	0	0	1,665,416
Issuance of Common Stock	35,424	0	0	0	35,424
Dividends Paid	0	(427,741)	0	0	(427,741)
Purchase of Common Stock	0	0	(1,854)	0	(1,854)
Proceeds from Sale of Treasury Stock	7,674	0	17,758	0	25,432
Other Comprehensive Income (Loss)	0	0	0	(114,593)	(114,593)
<b><u>Balances, December 31, 2015</u></b>	4,336,180	16,462,412	(1,854)	(223,585)	20,573,153
Net Income	0	1,495,194	0	0	1,495,194
Issuance of Common Stock	57,096	0	0	0	57,096
Dividends Paid	0	(437,793)	0	0	(437,793)
Purchase of Common Stock	0	0	(93,750)	0	(93,750)
Proceeds from Sale of Treasury Stock	(6)	0	95,604	0	95,598
Other Comprehensive Income (Loss)	0	0	0	(604,642)	(604,642)
<b><u>Balances, December 31, 2016</u></b>	4,393,270	17,519,813	0	(828,227)	21,084,856
Net Income	0	1,233,532	0	0	1,233,532
Issuance of Common Stock	96,152	0	0	0	96,152
Dividends Paid	0	(449,286)	0	0	(449,286)
Reclassification of Income Tax Effects of the Tax Cuts and Job Act	0	107,684	0	(107,684)	0
Other Comprehensive Income (Loss)	0	0	0	265,295	265,295
<b><u>Balances, December 31, 2017</u></b>	<b><u>\$ 4,489,422</u></b>	<b><u>\$ 18,411,743</u></b>	<b><u>\$ 0</u></b>	<b><u>\$ (670,616)</u></b>	<b><u>\$ 22,230,549</u></b>

The accompanying notes are an integral part of these consolidated financial statements.

## UNITED TENNESSEE BANKSHARES, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Years Ended December 31,		
	2017	2016	2015
<b>OPERATING ACTIVITIES</b>			
Net Income	\$ 1,233,532	\$ 1,495,194	\$ 1,665,416
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Depreciation	130,756	136,745	142,711
Amortization of Investment Securities Premiums and Discounts, Net	981,033	902,654	888,143
Increase (Decrease) in Unearned Loan Fees	19,705	5,054	6,403
Net Loss (Gain) on Sales of Foreclosed Real Estate	(24,529)	19,917	(44,480)
Write-downs of Foreclosed Real Estate	28,260	11,738	22,500
Increase in Cash Surrender Value of Life Insurance	(23,388)	(26,528)	(11,142)
Net (Gain) Loss on Sales of Investment Securities Available for Sale	(3,774)	(9,524)	(11,260)
Deferred Income Tax (Benefit)	377,529	48,723	80,950
(Increase) Decrease in:			
Accrued Interest Receivable	(52,703)	(302)	19,085
Prepaid Expenses and Other Assets	(124,520)	48,219	(88,645)
Increase (Decrease) in:			
Accrued Interest Payable	(52)	(3,517)	521
Accrued Income Taxes	(116,452)	87,466	(12,509)
Accrued Benefit Plan Liabilities	43,960	28,130	76,788
Other Liabilities	21,033	(16,215)	33,616
Total Adjustments	<u>1,256,858</u>	<u>1,232,560</u>	<u>1,102,681</u>
<b>Net Cash Provided by (Used in) Operating Activities</b>	<u>2,490,390</u>	<u>2,727,754</u>	<u>2,768,097</u>
<b>INVESTING ACTIVITIES</b>			
Purchase of Investment Securities Available for Sale	(15,450,292)	(34,179,629)	(33,417,035)
Proceeds from Sales of Investment Securities Available for Sale	3,489,131	8,903,586	6,092,631
Proceeds from Maturities and Calls of Investment Securities Available for Sale	4,825,000	11,350,000	11,595,000
Principal Payments Received on Investment Securities Available for Sale	8,847,605	9,538,636	8,568,956
Purchase of Equity Securities	(9,425)	0	(18,850)
Net (Increase) Decrease in Interest-Bearing Deposits in Other Banks			
	2,241,000	996,000	996,000
Net (Increase) Decrease in Loans	(6,699,688)	(920,180)	(767,051)
Purchases of Premises and Equipment	(24,559)	(44,205)	(132,193)
Proceeds from Sales of Foreclosed Real Estate	238,776	316,596	496,475
Purchase of Bank Owned Life Insurance	(2,000,000)	0	0
<b>Net Cash Provided by (Used in) Investing Activities</b>	<u>(4,542,452)</u>	<u>(4,039,196)</u>	<u>(6,586,067)</u>

The accompanying notes are an integral part of these consolidated financial statements.

**UNITED TENNESSEE BANKSHARES, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**

	For the Years Ended December 31,	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>FINANCING ACTIVITIES</b>				
Dividends Paid, Net		(449,286)	(437,793)	(427,741)
Proceeds from Sale of Treasury Stock		0	95,598	25,432
Proceeds from Issuance of Common Stock		96,152	57,096	35,424
Purchase of Common Stock for Treasury Stock		0	(93,750)	(1,854)
Net Increase (Decrease) in Deposits		<u>1,466,259</u>	<u>2,721,782</u>	<u>4,693,477</u>
<b>Net Cash Provided by (Used in) Financing Activities</b>		<u>1,113,125</u>	<u>2,342,933</u>	<u>4,324,738</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>		(938,937)	1,031,491	506,768
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>		<u>5,333,796</u>	<u>4,302,305</u>	<u>3,795,537</u>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>		<u>\$ 4,394,859</u>	<u>\$ 5,333,796</u>	<u>\$ 4,302,305</u>
<b>Supplementary Disclosures of Cash Flow Information:</b>				
Cash Paid During the Year for:				
Interest		\$ 1,033,190	\$ 999,047	\$ 957,838
Income Taxes		\$ 825,870	\$ 390,421	\$ 780,582
<b>Supplementary Disclosures of Noncash Investing Activities:</b>				
Acquisition of Foreclosed Real Estate		\$ 637,689	\$ 286,750	\$ 489,250
Sale of Foreclosed Real Estate by Origination of Mortgage Loans		\$ 215,981	\$ 125,562	\$ 254,480
Change in Unrealized Gain/Loss on Investment Securities Available for Sale		\$ 427,894	\$ (975,229)	\$ (184,828)
Change in Deferred Income Taxes Associated with Unrealized Gain/Loss on Investment Securities Available for Sale		\$ 162,599	\$ (370,587)	\$ (70,235)
Change in Net Unrealized Gain/Loss on Investment Securities Available for Sale		\$ 265,295	\$ (604,642)	\$ (114,593)

The accompanying notes are an integral part of these consolidated financial statements.



**UNITED TENNESSEE BANKSHARES, INC.  
AND SUBSIDIARY**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2017, 2016 and 2015**

**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES**

**Accounting Principles** - The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) as promulgated by the Financial Accounting Standards Board (FASB).

**Basis of Consolidation** - On January 1, 1998, Newport Federal Savings and Loan Association converted from a mutual savings association to a capital stock savings bank, changed its name to Newport Federal Bank and was simultaneously acquired by its holding company, United Tennessee Bankshares, Inc. ("Company"). See Note 17 for additional information concerning the Association's stock conversion. The consolidated financial statements include the accounts of United Tennessee Bankshares, Inc. and its wholly-owned subsidiary, Newport Federal Bank ("Bank"). All intercompany accounts have been eliminated.

**Nature of Operations** - The Bank provides a variety of financial services to individuals and corporate customers through its three offices in Newport, Tennessee. The Bank's primary deposit products are interest-bearing checking and savings accounts and certificates of deposit. Its primary lending products are one-to-four family first mortgage loans.

**Consolidated Statement of Comprehensive Income** - The objective of this statement is to report a measure of all changes in equity of an enterprise that results from transactions and other economic events of the period other than transactions with owners. Items included in comprehensive income include revenues, gains and losses that under accounting principles generally accepted in the United States of America are directly charged to equity. Examples include foreign currency translations, pension liability adjustments and net unrealized gains and losses on investment securities available for sale.

**Use of Estimates** - The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans and the valuation of foreclosed real estate (see below).

**Cash and Cash Equivalents** - Cash and cash equivalents include "Cash and Amounts Due from Depository Institutions."

**Cash and Amounts Due from Depository Institutions** - Cash and amounts due from depository institutions include the following approximate amounts on deposit with the Federal Home Loan Bank of Cincinnati (FHLB) as of December 31:

	<u>2017</u>	<u>2016</u>
Unrestricted Deposits at FHLB	\$ 2,208,842	\$ 3,711,822

**Interest-Bearing Deposits in Other Banks** - These deposits mature within one to four years, are covered by FDIC insurance and are carried at cost which approximates estimated fair value.

**Investment Securities** - The Bank has classified all its investment securities in the available for sale category. These securities are carried at estimated fair value (see Note 18). Securities may be sold in response to changes in interest rates, liquidity needs, or for other purposes. Any unrealized gain or loss is reported in the consolidated statements of comprehensive income, net of any deferred tax effect. Realized gains or losses on the sales of securities are based on the net proceeds and amortized cost of the securities sold, using the specific identification method. See Note 2 for additional information on investment securities.

## **NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Equity Securities Carried at Cost** - The Bank maintains a required investment in the Federal Home Loan Bank ("FHLB") of Cincinnati totaling \$1,125,700. The investment in FHLB stock is in part based on the amount of borrowings from the FHLB (see Note 8). The Bank also has purchased stock in its data processing provider at a cost of \$65,000 as well as stock in Bankers Title of East Tennessee, LLC at a cost of \$28,275 (\$18,850 as of December 31, 2016). These investments are carried at cost because they are not readily marketable and there is no established market price.

**Allowance for Loan and Lease Losses** - The allowance for loan and lease losses (ALLL) 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 and economic conditions. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated future cash flows. The ALLL is increased by a provision for loan losses, which is charged to expense and reduced by charge-offs, net of recoveries. Because of uncertainties associated with regional economic conditions, collateral values and future cash flows on impaired loans, it is reasonably possible that management's estimate of credit losses inherent in the loan portfolio and the related ALLL may change materially in the near term. In addition, regulatory agencies, as an integral part of their examination process, periodically review the ALLL. Such agencies may require the Bank to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the ALLL may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated. See Note 4 for more information.

**Loan Fees** - Loan fees, net of estimated initial direct costs related to initiating and closing long-term mortgage loans have been deferred and are being amortized into interest income over the contractual lives of the loans as an adjustment of yield, using the level yield method.

**Recognition of Interest on Loans** - Interest on loans is calculated using the simple interest method on the principal outstanding. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that collection of interest is doubtful. Management reviews all loans that are contractually past-due 90 days to determine if accrual of interest should be discontinued. Loans are returned to accrual status when all amounts contractually due are brought current and future payments are reasonably assured. Interest payments received on impaired loans are recorded as interest income unless collection of the loan is doubtful, in which case payments are recorded as a reduction of principal.

**Premises and Equipment, Net** - Premises and equipment are stated at cost less accumulated depreciation. Depreciation, computed principally using the straight-line method for financial accounting purposes and accelerated methods for income tax reporting purposes, is based on estimated useful lives of three to thirty-nine years.

**Foreclosed Real Estate** - Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value less costs to sell at the date of foreclosure establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less costs to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other noninterest expenses. Expenditures for improvements are added to the carrying amount of the property if they increase the fair value of the property. The Bank's historical average holding period for such properties is approximately 12-18 months.

**Advertising and Promotion** - Advertising and promotion costs are expensed as incurred.

**Income Taxes** - Income taxes are provided for the tax effects of the transactions reported in the consolidated financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the basis of investment securities, allowance for loan losses, deferred loan fees and other deferred items and accumulated depreciation for financial accounting and income tax reporting. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. An appropriate provision is made in the consolidated financial statements for deferred income taxes in recognition of these differences.

**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Earnings Per Share** - Earnings per share is based on the weighted average number of shares outstanding of 847,119, 840,287 and 838,261 for 2017, 2016 and 2015, respectively. The Company did not have any dilutive securities during these periods.

**Recent Accounting Pronouncements** - The Bank adopted Accounting Standards Update No. 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. This guidance allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects from the newly enacted corporate income tax rate. See Note 9.

**Evaluation of Subsequent Events** - Management has evaluated subsequent events through March 9, 2018, which is the date the consolidated financial statements were available to be issued, and has determined that there are no subsequent events that require disclosure.

**NOTE 2 - INVESTMENT SECURITIES**

The amortized cost and estimated fair value of investment securities are as follows:

	Investment Securities Available for Sale			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b><u>December 31, 2017</u></b>				
<b>Debt Securities:</b>				
Obligations of U.S. Government Corporations and Agencies	\$ 17,943,522	\$ 31,152	\$ (69,166)	\$ 17,905,508
Residential Mortgage-Backed and Related Securities	28,352,804	3,793	(601,056)	27,755,541
Corporate Debt Securities	9,940,378	25,142	(43,736)	9,921,784
Obligations of States and Political Subdivisions	30,231,694	101,656	(355,742)	29,977,608
<b>Total Debt Securities</b>	<b>\$ 86,468,398</b>	<b>\$ 161,743</b>	<b>\$ (1,069,700)</b>	<b>\$ 85,560,441</b>
<b><u>December 31, 2016</u></b>				
<b>Debt Securities:</b>				
Obligations of U.S. Government Corporations and Agencies	\$ 10,181,392	\$ 26,725	\$ (43,552)	\$ 10,164,565
Residential Mortgage-Backed and Related Securities	33,784,967	17,001	(551,072)	33,250,896
Corporate Debt Securities	10,812,200	20,415	(126,061)	10,706,554
Obligations of States and Political Subdivisions	34,378,542	116,948	(796,255)	33,699,235
<b>Total Debt Securities</b>	<b>\$ 89,157,101</b>	<b>\$ 181,089</b>	<b>\$ (1,516,940)</b>	<b>\$ 87,821,250</b>

Gross realized gains and losses from sales of investment securities classified as available for sale are as follows:

	For the Years Ended December 31,		
	2017	2016	2015
Gross Realized Gains	\$ 10,748	\$ 64,043	\$ 78,349
Gross Realized Losses	(6,974)	(54,519)	(67,089)
	<b>\$ 3,774</b>	<b>\$ 9,524</b>	<b>\$ 11,260</b>

**NOTE 2 - INVESTMENT SECURITIES (Continued)**

The amortized cost and estimated fair value of debt securities available for sale as of December 31, 2017 by contractual maturity, are as follows:

	Available for Sale	
	Amortized Cost	Estimated Fair Value
Due in One Year or Less	\$ 2,628,020	\$ 2,626,602
Due After One Year To Five Years	14,819,400	14,814,489
Due After Five Years To Ten Years	10,744,691	10,690,833
Due After Ten Years	12,979,961	12,760,287
	<u>41,172,072</u>	<u>40,892,211</u>
Mortgage-Backed and SBA Pooled Securities	45,296,326	44,668,230
	<u>\$ 86,468,398</u>	<u>\$ 85,560,441</u>

Expected maturities can differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

Investments with book values of approximately \$41,394,000 and \$36,155,000 (which approximates market values) as of December 31, 2017 and 2016, respectively, were pledged to secure deposits of public funds.

Investment securities with gross unrealized losses at December 31, 2017 and 2016, aggregated by investment category and length of time that individual securities have been in a continuous loss position are as follows:

	Less than 12 Months		12 Months or Greater		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
<b>As of December 31, 2017</b>						
<b>Debt Securities:</b>						
Obligations of U.S. Government Corporations and Agencies	\$ 10,535,600	\$ (42,019)	\$ 1,990,985	\$ (27,147)	\$ 12,526,585	\$ (69,166)
Residential Mortgage-Backed and Related Securities	4,225,323	(50,162)	22,787,168	(550,894)	27,012,491	(601,056)
Corporate Debt Securities	2,233,912	(13,447)	2,992,185	(30,289)	5,226,097	(43,736)
Obligations of States and Political Subdivisions	<u>7,708,202</u>	<u>(55,111)</u>	<u>11,633,841</u>	<u>(300,631)</u>	<u>19,342,043</u>	<u>(355,742)</u>
<b>Total Debt Securities</b>	<u>\$ 24,703,037</u>	<u>\$ (160,739)</u>	<u>\$ 39,404,179</u>	<u>\$ (908,961)</u>	<u>\$ 64,107,216</u>	<u>\$ (1,069,700)</u>
<b>As of December 31, 2016</b>						
<b>Debt Securities:</b>						
Obligations of U.S. Government Corporations and Agencies	\$ 4,700,386	\$ (36,442)	\$ 1,489,719	\$ (7,110)	\$ 6,190,105	\$ (43,552)
Residential Mortgage-Backed and Related Securities	21,146,477	(348,570)	10,573,636	(202,502)	31,720,113	(551,072)
Corporate Debt Securities	2,470,988	(66,937)	3,801,571	(59,124)	6,272,559	(126,061)
Obligations of States and Political Subdivisions	<u>24,368,973</u>	<u>(796,255)</u>	<u>0</u>	<u>0</u>	<u>24,368,973</u>	<u>(796,255)</u>
<b>Total Debt Securities</b>	<u>\$ 52,686,824</u>	<u>\$ (1,248,204)</u>	<u>\$ 15,864,926</u>	<u>\$ (268,736)</u>	<u>\$ 68,551,750</u>	<u>\$ (1,516,940)</u>

Management evaluates securities for other-than-temporary impairment on at least a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

**NOTE 2 - INVESTMENT SECURITIES (Continued)**

At December 31, 2017, the 120 investment securities with unrealized losses have depreciated approximately 2% from the Bank's amortized cost basis. Except for the corporate debt securities, these securities are guaranteed by U.S. government agencies or corporations, or issued by state and local governments. These unrealized losses relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition.

Since management has the ability to hold all of its investment securities until maturity, or for the foreseeable future if classified as available for sale, no declines in fair value are deemed to be other-than-temporary. Accordingly, management has not recorded any permanent write downs in the carrying value of its investment securities.

**NOTE 3 - LOANS RECEIVABLE**

The Bank provides mortgage and consumer lending services to individuals primarily in the East Tennessee area. Loans receivable are summarized as follows:

	As of December 31,	
	2017	2016
Loans Secured by Real Estate		
Residential	\$ 83,165,644	\$ 81,328,796
Construction and Land Development	10,100,032	7,398,084
Commercial Properties	5,859,405	4,598,871
Total Loans Secured by Real Estate	99,125,081	93,325,751
Commercial and Industrial Loans	466,512	377,878
Consumer Loans	2,778,710	2,485,282
	3,245,222	2,863,160
Net Deferred Loan Origination Fees	(301,043)	(281,337)
Allowance for Loan and Lease Losses (see Note 4)	(1,751,709)	(1,848,298)
Net Loans	\$ 100,317,551	\$ 94,059,276

In the ordinary course of business, the Bank has entered into off-balance-sheet financial instruments consisting of commitments to extend credit, lines of credit and commercial letters of credit. These financial instruments are recorded in the consolidated financial statements when they become payable. Unadvanced lines of credit and commitments to extend credit were approximately \$5,536,000 and \$5,333,000 at December 31, 2017 and 2016. Outstanding letters of credit were \$104,000 and \$109,000 at December 31, 2017 and 2016.

It is the Bank's policy to extend loans to directors, officers and their affiliates subject to regulatory requirements, established internal guidelines and according to the same basic terms as loans to other customers. However, each specific director or executive officer loan must be submitted to and approved by the Bank's Board of Directors. The amount of outstanding loans to directors, officers and their affiliates at December 31, 2017 and 2016 totaled approximately \$1,341,000 and \$1,381,000, respectively.

**NOTE 4 - LOAN QUALITY**

Management performs a quarterly evaluation of the adequacy of the allowance for loan and lease losses (ALLL). Consideration is given to a variety of factors in establishing this estimate including, but not limited to, current economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, borrowers' actual or perceived financial and managerial strengths, the adequacy of the underlying collateral (if collateral dependent) and other relevant factors. It is management's general practice to obtain a new appraisal or asset valuation for any loan that it has rated as substandard or lower, including loans on nonaccrual of interest. Management, at its discretion, may determine that additional adjustments to the appraisal or valuation are required. Valuation adjustments will be made as necessary based on other factors including, but not limited to, the economy, maintenance and general condition of the collateral, industry, type of property/equipment/vehicle and the knowledge management has about a particular situation. In addition, the cost to sell or liquidate the collateral is also estimated when determining the realizable value to the Bank.

#### **NOTE 4 - LOAN QUALITY (Continued)**

Certain factors involved in the evaluation are inherently subjective, as they require material estimates that may be susceptible to significant change, including the amounts and timing of future cash flows expected to be received on impaired loans.

For the purposes of calculating the ALLL, the Bank segregates its loan portfolio into the following segments based primarily on the type of supporting collateral: construction loans, residential real estate, commercial real estate, commercial and industrial loans and loans to individuals for consumer purposes. The construction segment contains loans to individuals to construct their own homes as well as loans to contractors and developers to construct homes or buildings for resale or develop residential or commercial real estate. The construction segment has its own unique risk characteristics including the need to periodically inspect the property during construction to ensure the funds disbursed are used properly and the real estate held for collateral maintains its value in relation to the amount owed on it. The construction segment also has risk characteristics related to the probability of eventual sale of the finished project or the ability to generate sufficient rental income to service the debt. The residential real estate segment is segregated from the commercial real estate segment due to the obvious differences in inherent risks in each of these types of properties and borrower types. Commercial and industrial loans can be secured by all types of collateral owned by local small and medium-sized businesses, or they can be unsecured. These loans have inherent risks associated with each particular business and its ability to service its debt through the company's regular operations. The collateral associated with this loan type is usually unique to the industry in which the entity operates and is not necessarily marketable to a wide range of other businesses. Loans to individuals can be secured by vehicles, other consumer goods, or they could be unsecured. They have risk characteristics including the volatility of the collateral's value and the inherent risk of loaning on collateral that is mobile and subject to damage without proper insurance coverage. Unsecured loans have the risk characteristics of not being collateralized and relying on the integrity and ability of the borrower to repay them from discretionary funds. The loan portfolio is also evaluated by the risk ranking assigned to the loan by the lending officer and re-assessed periodically by the loan review function.

The analysis for determining the ALLL is consistent with guidance set forth in generally accepted accounting principles (GAAP) and the Interagency Policy Statement on the Allowance for Loan and Lease Losses. The analysis has two components: specific and general allocations. The specific component addresses specific reserves established for loans that were individually evaluated and deemed to be impaired. For these impairment evaluations, the Bank assesses loans with balances exceeding \$200,000 that show signs of possible impairment based on payment status, internal risk rating, or other credit quality factors. A loan is considered to be impaired when, based on current information and events, it is probable that the Bank will be unable to collect all interest and principal payments due according to the originally contracted terms of the loan agreement. Expected cash flow or collateral values discounted for market conditions and selling costs are used to establish specific allocations. Loans measured for the ALLL under the specific allocation method normally tend to be impaired loans secured by real estate loans.

The general component addresses the reserves established for pools of homogenous loans, including primarily non-classified loans. The general component includes a quantitative and qualitative analysis. The quantitative analysis includes the Bank's historical loan loss experience (weighted towards most recent periods) and other factors derived from economic and market conditions that have been determined to have an effect on the probability and magnitude of a loss. The qualitative analysis utilizes factors such as: loan volume, management characteristics, levels of nonperforming loans, results of the loan review process, specific credit concentrations and legal and regulatory issues. Input for these factors is determined on the basis of management's observation, judgment and experience. As a result of this input, additional loss percentages can be assigned to each pool of loans.

The total allowance reflects the Bank's estimate of loan losses inherent in the loan portfolio and management considers the ALLL to be adequate to cover losses inherent in the portfolio as of December 31, 2017 and 2016.

**NOTE 4 - LOAN QUALITY (Continued)**

The following tables present, by loan segment, the ALLL and changes to the ALLL for the years ended December 31, 2017 and 2016.

<i>(Dollars in thousands)</i>	<b>Residential Real Estate</b>	<b>Construction &amp; Land</b>	<b>Commercial Real Estate</b>	<b>Commercial &amp; Industrial</b>	<b>Consumer</b>	<b>Unallocated</b>	<b>Total</b>
<b>Allowance at</b>							
<b>December 31, 2015</b>	\$ 1,378	\$ 79	\$ 129	\$ 24	\$ 67	\$ 352	\$ 2,029
Charge-offs	(215)	0	0	0	(18)	0	(233)
Recoveries	15	24	0	0	13	0	52
Provision	238	(26)	33	(11)	(6)	(228)	0
<b>Allowance at</b>							
<b>December 31, 2016</b>	1,416	77	162	13	56	124	1,848
Charge-offs	(155)	(10)	0	0	(53)	0	(218)
Recoveries	7	104	0	0	11	0	122
Provision	128	(68)	(102)	(4)	62	(16)	0
<b>Allowance at</b>							
<b>December 31, 2017</b>	<u>\$ 1,396</u>	<u>\$ 103</u>	<u>\$ 60</u>	<u>\$ 9</u>	<u>\$ 76</u>	<u>\$ 108</u>	<u>\$ 1,752</u>

The following tables present, by loan segment, loans that were evaluated for the ALLL under the specific reserve (individually) and those that were evaluated under the general reserve (collectively) as of December 31, 2017 and 2016.

<i>(Dollars in thousands)</i>	<b>Residential Real Estate</b>	<b>Construction &amp; Land</b>	<b>Commercial Real Estate</b>	<b>Commercial &amp; Industrial</b>	<b>Consumer</b>	<b>Unallocated</b>	<b>Total</b>
<b>December 31, 2017</b>							
Loans Evaluated for							
Allowance:							
Individually	\$ 229	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 229
Collectively	82,937	10,100	5,859	466	2,779	0	102,141
Total	<u>\$ 83,166</u>	<u>\$ 10,100</u>	<u>\$ 5,859</u>	<u>\$ 466</u>	<u>\$ 2,779</u>	<u>\$ 0</u>	<u>\$ 102,370</u>
Allowance Established for Loans Evaluated:							
Individually	\$ 24	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 24
Collectively	1,372	103	60	9	76	108	1,728
Allowance at December 31, 2017	<u>\$ 1,396</u>	<u>\$ 103</u>	<u>\$ 60</u>	<u>\$ 9</u>	<u>\$ 76</u>	<u>\$ 108</u>	<u>\$ 1,752</u>
<b>December 31, 2016</b>							
Loans Evaluated for							
Allowance:							
Individually	\$ 991	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 991
Collectively	80,338	7,398	4,599	378	2,485	0	95,198
Total	<u>\$ 81,329</u>	<u>\$ 7,398</u>	<u>\$ 4,599</u>	<u>\$ 378</u>	<u>\$ 2,485</u>	<u>\$ 0</u>	<u>\$ 96,189</u>
Allowance Established for Loans Evaluated:							
Individually	\$ 86	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 86
Collectively	1,330	77	162	13	56	124	1,762
Allowance at December 31, 2016	<u>\$ 1,416</u>	<u>\$ 77</u>	<u>\$ 162</u>	<u>\$ 13</u>	<u>\$ 56</u>	<u>\$ 124</u>	<u>\$ 1,848</u>

**NOTE 4 - LOAN QUALITY (Continued)**

The following tables show additional information about those loans considered to be impaired at December 31, 2017 and 2016.

(Dollars in thousands)	December 31,			For the Year Ended December 31,	
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
<b>2017</b>					
<b>Impaired Loans with Specific Allowance:</b>					
Residential Real Estate:					
1-4 Family First Liens	\$ 229	\$ 229	\$ 24	\$ 232	\$ 14
<b>Totals</b>	<u>\$ 229</u>	<u>\$ 229</u>	<u>\$ 24</u>	<u>\$ 232</u>	<u>\$ 14</u>
<b>2016</b>					
<b>Impaired Loans with Specific Allowance:</b>					
Residential Real Estate:					
1-4 Family First Liens	\$ 991	\$ 991	\$ 86	\$ 999	\$ 51
<b>Totals</b>	<u>\$ 991</u>	<u>\$ 991</u>	<u>\$ 86</u>	<u>\$ 999</u>	<u>\$ 51</u>

The following tables present the aging of the loan portfolio at December 31:

(Dollars in thousands)	Current	Past Due Loans			Non-Accrual	Total Loans
		30-89 Days	90 + Days	Total		
<b>December 31, 2017</b>						
Residential Real Estate:						
1-4 Family First Liens and Farmland	\$ 78,767	\$ 1,412	\$ 0	\$ 1,412	\$ 564	\$ 80,743
1-4 Family Junior Liens	633	0	0	0	0	633
MultiFamily	1,790	0	0	0	0	1,790
Total	<u>81,190</u>	<u>1,412</u>	<u>0</u>	<u>1,412</u>	<u>564</u>	<u>83,166</u>
Construction & Land:						
1-4 Family	2,066	0	0	0		2,066
Land & Other	7,910	0	0	0	124	8,034
Total	<u>9,976</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>124</u>	<u>10,100</u>
Commercial Real Estate:						
Owner-Occupied Nonfarm Properties	4,381	11	0	11	0	4,392
Other Nonfarm Properties	1,467	0	0	0	0	1,467
Total	<u>5,848</u>	<u>11</u>	<u>0</u>	<u>11</u>	<u>0</u>	<u>5,859</u>
Commercial & Industrial	<u>466</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>466</u>
Consumer:						
Automobiles	943	22	0	22	0	965
Other	1,804	10	0	10	0	1,814
Total	<u>2,747</u>	<u>32</u>	<u>0</u>	<u>32</u>	<u>0</u>	<u>2,779</u>
Total	<u>\$ 100,227</u>	<u>\$ 1,455</u>	<u>\$ 0</u>	<u>\$ 1,455</u>	<u>\$ 688</u>	<u>\$ 102,370</u>

(Table Continued on Next Page)



**NOTE 4 - LOAN QUALITY (Continued)**

<i>(Dollars in thousands)</i>	<b>Past Due Loans</b>				<b>Non-Accrual</b>	<b>Total Loans</b>
	<b>Current</b>	<b>30-89 Days</b>	<b>90 + Days</b>	<b>Total</b>		
<b>December 31, 2016</b>						
Residential Real Estate:						
1-4 Family First Liens	\$ 77,113	\$ 2,572	\$ 0	\$ 2,572	\$ 752	\$ 80,437
1-4 Family Junior Liens	248	0	0	0	0	248
MultiFamily	644	0	0	0	0	644
Total	<u>78,005</u>	<u>2,572</u>	<u>0</u>	<u>2,572</u>	<u>752</u>	<u>81,329</u>
Construction & Land:						
1-4 Family	1,215	0	0	0	0	1,215
Land & Other	6,014	13	0	13	156	6,183
Total	<u>7,229</u>	<u>13</u>	<u>0</u>	<u>13</u>	<u>156</u>	<u>7,398</u>
Commercial Real Estate:						
Owner-Occupied Nonfarm Properties	4,278	20	0	20	69	4,367
Other Nonfarm Properties	232	0	0	0	0	232
Total	<u>4,510</u>	<u>20</u>	<u>0</u>	<u>20</u>	<u>69</u>	<u>4,599</u>
Commercial & Industrial	<u>378</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>378</u>
Consumer:						
Automobiles	998	27	0	27	0	1,025
Other	1,438	22	0	22	0	1,460
Total	<u>2,436</u>	<u>49</u>	<u>0</u>	<u>49</u>	<u>0</u>	<u>2,485</u>
Total	<u>\$ 92,558</u>	<u>\$ 2,654</u>	<u>\$ 0</u>	<u>\$ 2,654</u>	<u>\$ 977</u>	<u>\$ 96,189</u>

In addition to monitoring the performance status of the loan portfolio, the Bank also utilizes a risk rating scale (1 - 8) to evaluate loan asset quality. Loans that are rated 1 - 4 are classified as Pass credits. Loans rated a 5 (Special Mention) are pass credits but have been identified as credits that warrant additional attention and monitoring. Loans that are risk rated 6 or higher (Substandard, Doubtful, or Loss) are placed on the Bank's internal watch list. Loans on the watch list are adversely criticized/classified because the borrowers are experiencing weakening cash flow and there is concern that the Bank may not receive all of the remaining payments when due. If these trends continue, the Bank has an increasing likelihood that it will need to liquidate collateral or use other means for repayment. The Bank's watch list includes loans that may or may not be delinquent or on nonaccrual of interest, loans that may or may not be considered impaired, and potential problem loans. Potential problem loans are loans on the watch list that represent borrowers that may or may not be able to comply with current loan terms, but exclude loans that are 90 days or more past due and nonaccrual loans. Management emphasizes early identification and monitoring of these loans to proactively minimize any risk of loss.

In the normal course of loan portfolio management, the account officer assigned to a particular relationship is responsible for reviewing the relationship monthly and assigning the appropriate risk rating based on the Bank's 8-point risk rating scale. The loan review function also assesses the risk ratings quarterly and makes recommendations for changes as needed. In the event a credit relationship is downgraded to a risk rating of 6 or higher, the relationship is reviewed no less than quarterly at the Bank's loan committee meeting.

Loans excluded from the scope of the annual review process are generally classified as pass credit until: (a) they become past due; (b) management becomes aware of deterioration in the credit worthiness of the borrower; or (c) the customer contacts the Bank for a modification. In these circumstances, the customer relationship is specifically evaluated for potential classification as to special mention, substandard or doubtful, or could even be considered for charge-off. The Bank uses the following definitions for risk ratings:

**Pass** – Strong credit with no existing or known potential weaknesses deserving management's close attention.

**Special Mention** – Loans included in this category are currently protected but are potentially weak. These loans constitute an undue and unwarranted credit risk but do not presently expose the Bank to a sufficient degree of risk to warrant adverse classification. As a general rule, for the purpose of calculating a loan loss reserve, loans in this category will have the historical loss reserve percentage applied and will remain in a pool with loans that are considered acceptable or better when determining the general valuation reserves. Loans classified as special mention have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

**NOTE 4 - LOAN QUALITY (Continued)**

**Substandard** – Substandard loans are inadequately protected by the current net worth and financial capacity of the borrower or of the collateral pledged, if any. The borrower or guarantor is unwilling or unable to meet loan terms or loan covenants for the foreseeable future.

**Doubtful** – Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full highly questionable or improbable, based on currently existing facts, condition and values.

**Loss** – Loans classified as losses are uncollectible or no longer a bankable asset. This classification does not mean that the asset has absolutely no recoverable value. Certain salvage value is inherent in these loans. Nevertheless, it is not practical or desirable to defer writing off a portion or whole of a perceived asset even though partial recovery may be collected in the future.

The following tables report the internal credit rating for loans at December 31:

<i>(Dollars in thousands)</i>	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
<b>December 31, 2017</b>					
Residential Real Estate	\$ 80,057	\$ 1,252	\$ 1,857	\$ 0	\$ 83,166
Construction & Land	9,937	0	163	0	10,100
Commercial Real Estate	5,848	11	0	0	5,859
Commercial & Industrial	329	137	0	0	466
Consumer	2,774	0	5	0	2,779
Total	<u>\$ 98,945</u>	<u>\$ 1,400</u>	<u>\$ 2,025</u>	<u>\$ 0</u>	<u>\$ 102,370</u>
<b>December 31, 2016</b>					
Residential Real Estate	\$ 78,118	\$ 1,481	\$ 1,730	\$ 0	\$ 81,329
Construction & Land	7,242	0	156	0	7,398
Commercial Real Estate	4,434	76	89	0	4,599
Commercial & Industrial	378	0	0	0	378
Consumer	2,481	1	3	0	2,485
Total	<u>\$ 92,653</u>	<u>\$ 1,558</u>	<u>\$ 1,978</u>	<u>\$ 0</u>	<u>\$ 96,189</u>

Certain loan modifications are considered troubled debt restructurings (TDRs) when the Bank, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. The Bank uses various restructuring techniques, including, but not limited to, deferral of past due interest or principal, reduction of interest rates, extending maturities and modification of amortization schedules. The Bank typically does not forgive principal balances or past due interest prior to pay off or surrender of the collateral. Loans considered to be TDRs are classified as impaired loans for purposes of determination of the allowance for loans losses, until the Bank determines the loans are performing based on terms specified by the restructuring agreements. The allowance for these loans is calculated in the same manner as other impaired loans, as described above. As of December 31, 2017 and 2016, the Bank did not have any commitments to lend additional funds to borrowers whose loan terms have been modified as TDRs, nor were there any loans modified as TDRs within the previous 12 months and for which there was a payment default during the period. Additionally, the Bank did not have any loans modified as TDRs during the years ending December 31, 2017 and 2016.

**NOTE 5 - PREMISES AND EQUIPMENT, NET**

Premises and equipment, net are summarized as follows:

	As of December 31,	
	2017	2016
Land	\$ 510,262	\$ 510,262
Buildings	3,414,962	3,414,962
Furniture and Equipment	1,003,008	978,449
	<u>4,928,232</u>	<u>4,903,673</u>
Less Accumulated Depreciation	<u>(2,350,932)</u>	<u>(2,220,176)</u>
	<u>\$ 2,577,300</u>	<u>\$ 2,683,497</u>

**NOTE 6 - FORECLOSED REAL ESTATE**

An analysis of foreclosed real estate for the years ended December 31, 2017 and 2016 follows:

	2017	2016
Balance at Beginning of Year	\$ 124,950	\$ 312,013
Transfers from Loans	637,689	286,750
Foreclosed Real Estate Sold	(430,228)	(462,075)
Write-downs of Foreclosed Real Estate	<u>(28,260)</u>	<u>(11,738)</u>
Balance at End of Year	<u>\$ 304,151</u>	<u>\$ 124,950</u>

Expenses applicable to foreclosed real estate for the year ended December 31, 2017 and 2016 include the following:

	2017	2016
Net (Gain) Loss on Sales of Foreclosed Real Estate	\$ (24,529)	\$ 19,917
Write-downs of Foreclosed Real Estate	28,260	11,738
Operating Expenses, Net of Rental Income	<u>27,249</u>	<u>23,830</u>
	<u>\$ 30,980</u>	<u>\$ 55,485</u>

**NOTE 7 - DEPOSITS**

A summary of deposits is as follows:

	As of December 31,	
	2017	2016
<b>Demand Deposits:</b>		
Noninterest-Bearing Accounts	\$ 25,331,248	\$ 7,120,350
NOW Accounts	20,611,934	18,973,910
Money Market Deposit Accounts	10,837,464	25,236,583
Passbook Savings	<u>26,504,508</u>	<u>25,728,098</u>
<b>Total Demand Deposits</b>	<u>83,285,154</u>	<u>77,058,941</u>
<b>Term Deposits:</b>		
Less Than \$250,000	70,183,348	73,186,411
\$250,000 or More	<u>24,806,890</u>	<u>26,563,781</u>
<b>Total Term Deposits</b>	<u>94,990,238</u>	<u>99,750,192</u>
<b>Total Deposits</b>	<u>\$ 178,275,392</u>	<u>\$ 176,809,133</u>

Deposits in excess of \$250,000 may not be federally insured, depending upon ownership.

**NOTE 7 - DEPOSITS (Continued)**

The scheduled maturities of certificates of deposit as of December 31, 2017 are as follows:

2018	\$ 59,351,238
2019	26,742,225
2020	6,575,039
2021	2,321,736
	<u>\$ 94,990,238</u>

**NOTE 8 - ADVANCES FROM FEDERAL HOME LOAN BANK**

The Bank maintains a line of credit advance agreement with the Federal Home Loan Bank (FHLB) which allows borrowings up to approximately \$8,000,000. Pursuant to the Bank's collateral agreement with the FHLB, advances are secured by the Bank's FHLB stock and qualifying first mortgage loans. There were no advances outstanding as of December 31, 2017 and 2016.

**NOTE 9 - INCOME TAXES**

The Company files income tax returns in the U.S. federal jurisdiction and Tennessee state jurisdiction. The Company has not accrued or expensed any amounts for interest or penalties associated with income taxes for the years ended December 31, 2017, 2016 and 2015.

Income taxes as shown in the consolidated statements of income differ from the amounts computed using the statutory federal income tax rate as follows:

	2017		2016		2015	
	Amount	Percent of Pretax Income	Amount	Percent of Pretax Income	Amount	Percent of Pretax Income
Federal Income Tax at Statutory Rate	\$ 763,061	34.0 %	\$ 713,774	34.0 %	\$ 823,885	34.0 %
State Income Tax, Net	79,226	3.5	75,143	3.6	82,915	3.4
Tax Exempt Interest	(212,497)	(9.5)	(195,715)	(9.3)	(154,564)	(6.4)
Other Nontaxable Income	(8,291)	(0.4)	(10,420)	(0.5)	(3,827)	(0.2)
Nondeductible Expenses	34,413	1.5	11,705	0.6	9,598	0.4
Change in Federal Tax Rate	354,879	15.8	0	0.0	0	0.0
Credits and Other, Net	(26)	(0.0)	9,654	0.5	(231)	(0.0)
	<u>\$ 1,010,765</u>	<u>45.0 %</u>	<u>\$ 604,141</u>	<u>28.8 %</u>	<u>\$ 757,776</u>	<u>31.3 %</u>
Income Taxes (Benefit) Consist of :						
Current	\$ 633,236		\$ 555,418		\$ 676,826	
Deferred Taxes (Benefit)	377,529		48,723		80,950	
	<u>\$ 1,010,765</u>		<u>\$ 604,141</u>		<u>\$ 757,776</u>	

**NOTE 9 - INCOME TAXES (Continued)**

Deferred tax liabilities have been provided for taxable temporary differences related to accumulated depreciation, FHLB stock dividends and loan fees. Deferred tax assets have been provided for deductible temporary differences related to the allowance for loan losses, deferred loan fees, unrealized losses on investment securities, nonqualified retirement plans and deferred compensation plans. The net deferred tax assets in the accompanying consolidated statements of financial condition include the following components:

	As of December 31,	
	2017	2016
Deferred Tax Assets	\$ 1,243,489	\$ 2,032,582
Deferred Tax Liabilities	(473,916)	(722,881)
Net Deferred Tax Assets	\$ <u>769,573</u>	\$ <u>1,309,701</u>

Included in the 2017 deferred tax assets above is \$237,340 of deferred tax effect on the net unrealized losses on investment securities available for sale (\$507,623 in deferred tax assets on net unrealized losses in 2016).

On December 22, 2017, the Tax Cuts and Jobs Act was signed into law. This legislation reduces the federal corporate tax rate from 34% to 21% for tax years beginning after December 31, 2017. In accordance with GAAP, the Company has accounted for the effects of this reduction in the tax rate on deferred taxes in the period of enactment. As a result, the Company's deferred tax assets and liabilities as of December 31, 2017 have been adjusted to reflect the effect of the change in enacted tax rates, resulting in additional deferred tax expense of \$354,879 for the year ending December 31, 2017.

Additionally, effective December 31, 2017, management has adopted Accounting Standards Update 2018-02, *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. As allowed by this update, management has elected to reclassify the income tax effects of the Tax Cuts and Jobs Act from accumulated other comprehensive income to retained earnings. The amount of this reclassification was \$107,684 for the year ended December 31, 2017, and is equal to the amount of additional deferred tax expense incurred during 2017 to reflect the effect of the change in enacted tax rates on the Company's deferred tax assets related to the net unrealized losses in investment securities available for sale.

**NOTE 10 - REGULATORY MATTERS**

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank and Company to maintain minimum amounts and ratios (set forth in the table below) of Total and Tier 1 Capital (as defined in the regulations) to Risk-Weighted Assets (as defined), Common Equity Tier 1 Capital (as defined) to Total Risk-Weighted Assets (as defined), and of Tier 1 Capital (as defined) to Average Assets (as defined). Management believes, as of December 31, 2017 and 2016, that the Bank and Company meet all capital adequacy requirements to which they are subject.

As of December 31, 2017 and 2016, the Bank is categorized as *well capitalized* under the regulatory framework for prompt corrective action. To be categorized as *well capitalized*, the Bank must maintain minimum Total Risk-Based, Tier I Risk-Based, Common Equity Tier 1 Risk-Based Capital, and Tier I Leverage ratios as set forth in the table below. There are no conditions or events since that date that management believes have changed the Bank's category.

**NOTE 10 - REGULATORY MATTERS (Continued)**

The Bank and Company must also maintain a capital conservation buffer consisting of additional Common Equity Tier 1 capital greater than 1.25% of risk-weighted assets above the required minimum risk-based capital levels in order to avoid limitations on distributions, including dividend payments, and certain discretionary bonuses to executive officers. The capital conservation buffer requirement began to phase in on January 1, 2016 when a buffer greater than 0.6250% of risk-weighted assets was required, which amount increases each year until the buffer requirement is fully implemented on January 1, 2019. At December 31, 2017, the Bank and Company continued to exceed the minimum required capital ratios applicable to them under the capital adequacy guidelines.

The Company's and Bank's actual capital amounts and ratios as of December 31, 2017 and 2016 are also presented in the following table. All dollar amounts are in thousands of dollars.

	Actual		To Comply With Absolute Minimum Capital Requirements		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b><u>As of December 31, 2017</u></b>						
Total Capital (to Risk-Weighted Assets):						
Company (Consolidated)	\$ 24,052	26.3%	\$ 7,321	8.0%	N/A	N/A
Bank	\$ 22,877	25.0%	\$ 7,321	8.0%	\$ 9,151	10.0%
Common Equity Tier I Capital (to Risk-Weighted Assets):						
Company (Consolidated)	\$ 22,901	25.0%	\$ 4,118	4.5%	N/A	N/A
Bank	\$ 21,726	23.7%	\$ 4,118	4.5%	\$ 5,948	6.5%
Tier I Capital (to Risk-Weighted Assets):						
Company (Consolidated)	\$ 22,901	25.0%	\$ 5,491	6.0%	N/A	N/A
Bank	\$ 21,726	23.7%	\$ 5,491	6.0%	\$ 7,321	8.0%
Tier I Capital (to Average Assets):						
Company (Consolidated)	\$ 22,901	11.2%	\$ 8,172	4.0%	N/A	N/A
Bank	\$ 21,726	10.6%	\$ 8,163	4.0%	\$ 10,203	5.0%
<b><u>As of December 31, 2016</u></b>						
Total Capital (to Risk-Weighted Assets):						
Company (Consolidated)	\$ 22,991	26.9%	\$ 6,843	8.0%	N/A	N/A
Bank	\$ 22,242	26.0%	\$ 6,843	8.0%	\$ 8,554	10.0%
Common Equity Tier I Capital (to Risk-Weighted Assets):						
Company (Consolidated)	\$ 21,913	25.6%	\$ 3,849	4.5%	N/A	N/A
Bank	\$ 21,164	24.7%	\$ 3,849	4.5%	\$ 5,560	6.5%
Tier I Capital (to Risk-Weighted Assets):						
Company (Consolidated)	\$ 21,913	25.6%	\$ 5,132	6.0%	N/A	N/A
Bank	\$ 21,164	24.7%	\$ 5,132	6.0%	\$ 6,843	8.0%
Tier I Capital (to Average Assets):						
Company (Consolidated)	\$ 21,913	10.9%	\$ 8,044	4.0%	N/A	N/A
Bank	\$ 21,164	10.5%	\$ 8,035	4.0%	\$ 10,043	5.0%

**NOTE 11 - RETIREMENT PLANS**

**401(k) Retirement Plan** - The Bank has established a 401(k) retirement plan, which allows eligible officers and employees to contribute up to the maximum allowed by law and the Plan on a tax-deferred basis. The Bank has the option, at the discretion of the Board of Directors, to make contributions to the plan. Total 401(k) retirement plan expense was \$135,000, \$132,000 and \$144,000 for the years ended December 31, 2017, 2016 and 2015, respectively.

## NOTE 12 - STOCK PURCHASE PLANS

The Company has a Director Stock Purchase Plan and an Employee Stock Purchase Plan, which are more fully described below.

**Directors Stock Purchase Plan** - The maximum number of shares of common stock that can be sold under this plan is 120,000 shares. Each participant cannot be sold more than 1,200 shares of common stock per a year and the purchase price is 85% of the fair value of the common stock, as determined by the Board of Directors. Options to purchase shares are required to be exercised in March of each year and in the same year that they are granted.

<u>Directors Plan Activity:</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Number of Shares Purchased	4,800	2,400	1,200
Total Cost of Shares Purchased	\$ 82,416	\$ 38,064	\$ 17,712

**Employees Stock Purchase Plan** - The maximum number of shares of common stock that can be sold under this plan is 40,000 shares. All full-time employees and certain part-time employees are eligible to purchase shares and the purchase price is 85% of the fair value of the common stock, as determined by the Board of Directors. Options to purchase shares are required to be exercised in the same year that they are granted and expire if not exercised by year-end.

<u>Employees Plan Activity:</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Number of Shares Purchased	800	1,200	1,200
Total Cost of Shares Purchased	\$ 13,736	\$ 19,032	\$ 17,712

## NOTE 13 - DIRECTORS AND OFFICERS DEFERRED COMPENSATION

The Company maintains a deferred compensation plan whereby directors, at their option, can defer all or portions of the fees they earn each year. Fees not paid are accrued for the benefit of the directors and their accounts receive a rate equivalent to the Bank's IRA deposit account rate.

The Bank maintains an executive bonus/retention plan for certain executive officers which utilizes safety and soundness factors to compute an annual bonus based on how well the Bank performs. Prior to age 65, half of the calculated bonus is paid in cash immediately and half is deferred and paid when the officer retires at age 65. After age 65, all annual bonus amounts are paid immediately if the officer is still employed by the Bank. Reduced deferred benefits are available for officers who retire or leave the Bank after attaining age 55 and prior to age 65, and no deferred amounts are paid if the officer retires or leaves the Bank prior to age 55. The plan also includes certain death and disability benefits before retirement age is attained.

Activity in the plans for the years ended December 31 is as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Balances, Beginning of Year	\$ 1,572,457	\$ 1,553,115	\$ 1,501,096
Directors Fees Deferred During Year	50,200	47,600	47,600
Amounts Accrued and Expensed for Officers Plan	10,466	11,991	10,729
Income During Year	22,538	17,451	15,195
Withdrawals	(72,813)	(57,700)	(21,505)
Balances, End of Year	<u>\$ 1,582,848</u>	<u>\$ 1,572,457</u>	<u>\$ 1,553,115</u>

#### **NOTE 14 - SPLIT DOLLAR LIFE INSURANCE BENEFITS**

The Company provides life insurance benefits to certain employees under split-dollar insurance contracts. Accrued liabilities for these benefits were \$115,353 at December 31, 2017 (\$51,266 at December 31, 2016). Expense related to this plan was \$65,587, \$0 and \$0 for the years ended December 31, 2017, 2016 and 2015, respectively.

#### **NOTE 15 - SIGNIFICANT GROUP CONCENTRATIONS OF CREDIT RISK**

Most of the Bank's business activity is with customers located within East Tennessee. Note 2 discusses the types of securities the Bank invests in. Investments in obligations of U.S. Government corporations and agencies are guaranteed by the FHLB, FHLMC and FNMA. Investments in residential mortgage-backed securities are guaranteed by GNMA, FNMA and FHLMC. Investments in state and municipal securities involve governmental entities within the State of Tennessee. Note 3 discusses the types of loans the Bank invests in. As of December 31, 2017, the Bank had concentrations of loans in real estate lending. Generally, these loans are secured by the underlying real estate. The usual risks associated with such concentrations are generally mitigated by being spread over several hundred unrelated borrowers and by adequate loan-to-collateral value ratios.

#### **NOTE 16 - COMMITMENTS AND CONTINGENT LIABILITIES**

The Company and Bank are subject to claims and lawsuits which arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the financial position of the Company or Bank.

#### **NOTE 17 - STOCK CONVERSION**

In May 1997, the Board of Directors approved a plan of reorganization from a mutual savings association to a capital stock savings bank and the concurrent formation of a holding company. In November 1997, the Office of Thrift Supervision approved the plan of conversion subject to the approval of the members, and in December 1997 the members of the Association also approved the plan of conversion. The conversion was accomplished effective January 1, 1998 through amendment of the Association's charter and the sale of the Holding Company's common stock in an amount equal to the appraised pro forma consolidated market value of the Holding Company and the Association after giving effect to the conversion. A subscription offering of the shares of common stock was offered to depositors, borrowers, directors, officers, employees, and employee benefit plans of the Bank, and to certain other eligible subscribers. On January 1, 1998, in accordance with its approved plan of conversion, the Holding Company issued 1,454,750 of its \$10 par value stock providing gross receipts of \$14,547,500. On January 1, 1998, the Bank changed its name to Newport Federal Bank and issued 100,000 shares of its \$1 par value stock to the Holding Company in exchange for \$7,100,000. Total conversion costs of \$571,822 were deducted from the proceeds of the shares sold in the conversion.

At the time of the conversion, the Bank was required to establish a liquidation account in an amount equal to its capital as of June 30, 1997. The liquidation account will be maintained for the benefit of eligible accountholders who continue to maintain their accounts at the Bank after the conversion. The liquidation account will be reduced annually to the extent that eligible accountholders have reduced their qualifying deposits as of each anniversary date. Subsequent increases will not restore an eligible accountholder's interest in the liquidation account. In the event of a complete liquidation, each eligible accountholder will be entitled to receive a distribution from the liquidation account in an amount proportionate to the current adjusted qualifying balances for accounts then held. The Bank and the Holding Company are subject to several restrictions concerning the repurchase of stock and dividend payment restrictions pursuant to the applicable rules and policies of the OCC.



## NOTE 18 - FAIR VALUE DISCLOSURES

GAAP generally permits the measurement of selected eligible financial instruments at fair value at specified election dates. The Bank has not elected to adopt the fair value option for any financial instruments. However, other accounting pronouncements require the Bank to measure certain assets at fair value as described below.

GAAP defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. It also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. GAAP describes three levels of inputs that may be used to measure fair value:

- Level 1: Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An active market for the asset and liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2: Inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or the liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- Level 3: Inputs are unobservable inputs for the asset or liability. Unobservable inputs are used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. Unobservable inputs reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability

A description of valuation methodologies used for assets and liabilities recorded at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is shown below. The categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

**Investment Securities Available-for-Sale** - Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement for these securities is based upon quoted prices of like or similar securities, utilizing Level 2 inputs. These measurements are obtained from a service provider who considers observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the securities' terms and conditions, among other things.

**Impaired Loans** - The Bank does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired in accordance with GAAP and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. If the recorded investment in the impaired loan exceeds the measure of fair value, a valuation allowance is established as a component of the allowance for loan losses. The fair value of individually identified impaired loans is measured based on the present value of expected payments or the collateral value if the loan is collateral dependent. Impaired loans are classified within Level 3 of the valuation hierarchy.

**Foreclosed Real Estate** - Foreclosed real estate is recorded at fair value on a nonrecurring basis. Fair value measurement is based on management's estimate of the amount that will be realized when the property is sold and is classified within Level 3 of the valuation hierarchy.

**NOTE 18 - FAIR VALUE DISCLOSURES (Continued)****Assets Recorded at Fair Value on a Recurring Basis**

The tables below present information about certain assets measured at fair value:

	Fair Value Measurements Using			
	Carrying Amount in the Balance Sheet	Quoted Prices in Active Market for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b><u>As of December 31, 2017</u></b>				
Obligations of U.S. Government Corporations and Agencies	\$ 17,905,508	\$ 0	\$ 17,905,508	\$ 0
Residential Mortgage-Backed and Related Securities	27,755,541	0	27,755,541	0
Corporate Debt Securities	9,921,784	0	9,921,784	0
Obligations of States and Political Subdivisions	<u>29,977,608</u>	<u>0</u>	<u>29,977,608</u>	<u>0</u>
Investment Securities Available for Sale	<u>\$ 85,560,441</u>	<u>\$ 0</u>	<u>\$ 85,560,441</u>	<u>\$ 0</u>
<b><u>As of December 31, 2016</u></b>				
Obligations of U.S. Government Corporations and Agencies	\$ 10,164,565	\$ 0	\$ 10,164,565	\$ 0
Residential Mortgage-Backed and Related Securities	33,250,896	0	33,250,896	0
Corporate Debt Securities	10,706,554	0	10,706,554	0
Obligations of States and Political Subdivisions	<u>33,699,235</u>	<u>0</u>	<u>33,699,235</u>	<u>0</u>
Investment Securities Available for Sale	<u>\$ 87,821,250</u>	<u>\$ 0</u>	<u>\$ 87,821,250</u>	<u>\$ 0</u>

**Assets Recorded at Fair Value on a Nonrecurring Basis**

The Bank may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis are included in the table below.

	Fair Value Measurements Using			
	Carrying Amount in the Balance Sheet	Quoted Prices in Active Market for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b><u>As of December 31, 2017</u></b>				
Impaired Loans, Net of Allowance	\$ 205,000	\$ 0	\$ 0	\$ 205,000
Foreclosed Real Estate	304,151	0	0	304,151
	<u>\$ 509,151</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 509,151</u>
<b><u>As of December 31, 2016</u></b>				
Impaired Loans, Net of Allowance	\$ 905,000	\$ 0	\$ 0	\$ 905,000
Foreclosed Real Estate	124,950	0	0	124,950
	<u>\$ 1,029,950</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 1,029,950</u>

GAAP also requires the Company to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized in the balance sheets, for which it is practicable to estimate fair value and which are not already recorded at fair value.

## NOTE 18 - FAIR VALUE DISCLOSURES (Continued)

A financial instrument is defined as cash, evidence of an ownership interest in an entity, or a contract that both: (1) imposes on one entity a contractual obligation to deliver cash or another financial instrument to a second entity, or to exchange other financial instruments on potentially unfavorable terms with the second entity, and (2) conveys to that second entity a contractual right to receive cash or another financial instrument from the first entity, or to exchange other financial instruments on potentially favorable terms with the first entity.

For the Bank, as for most financial institutions, the majority of its assets and liabilities are considered financial instruments as defined above. However, a large majority of those assets and liabilities do not have an active trading market nor are their characteristics similar to other financial instruments for which an active trading market exists. In addition, it is the Bank's practice and intent to hold the majority of its financial instruments to maturity and not to engage in trading or sales activities. Therefore, much of the information as well as the amounts disclosed below are highly subjective and judgmental in nature. The subjective factors include estimates of cash flows, risk characteristics, credit quality and interest rates, all of which are subject to change. Because the fair value is estimated as of December 31, 2017 and 2016, the amounts which will actually be realized or paid upon settlement or maturity of the various financial instruments could be significantly different.

The estimates of fair value are based on existing financial instruments without attempting to estimate the value of anticipated future business or activity nor the value of assets and liabilities that are not considered financial instruments. For example, the value of mortgage loan servicing rights and the value of the Bank's long-term relationships with depositors, commonly known as core deposit intangibles, have not been considered in the estimates of fair values presented below. In addition, the tax implications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been included in the estimated fair values below.

The following methods and assumptions were used to estimate the fair value of the following classes of financial instruments:

**Cash and Amounts Due from Depository Institutions** - For these short-term instruments, the recorded book value is a reasonable estimate of fair value.

**Interest-Bearing Deposits in Other Banks** - For these short-term instruments, the recorded book value is a reasonable estimate of fair value.

**Investment Securities Available for Sale** - See disclosure above.

**Loans Receivable, Net** - The estimated fair value of fixed rate mortgage loans is calculated by discounting future cash flows to their present value. Future cash flows, consisting of both principal and interest payments, are discounted using current local market rates for similar loans with similar maturities. The estimated fair value of variable rate loans is considered equal to recorded book value. The estimated fair value of the allowance for loan losses is considered to be its recorded book value. Additionally, the credit exposure known to exist in the loan portfolio is embodied in the allowance for loan losses. Fair values for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable and are disclosed above.

**Cash Surrender Value of Life Insurance** - The recorded book value is a reasonable estimate of fair value.

**Equity Securities, at Cost** - Management does not consider it practicable to estimate the fair value of equity securities carried at cost and also considers their carrying values to be immaterial in relation to the Company's other financial instruments. Therefore, no estimate of fair value for these investments is disclosed.

**Deposits** - The estimated fair value of demand, savings, NOW and money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar maturities.

**NOTE 18 - FAIR VALUE DISCLOSURES (Continued)**

**Off-Balance-Sheet Loan Commitments** - The fair value of loan commitments is based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of these items is not material to the Bank as of the dates indicated below.

The recorded book value and estimated fair value of the Company's financial instruments which are not carried at fair value as of December 31, 2017 and 2016 are as follows:

	As of December 31, 2017		As of December 31, 2016	
	Recorded Book Value	Estimated Fair Value	Recorded Book Value	Estimated Fair Value
<b>FINANCIAL ASSETS:</b>	<i>(amounts in thousands)</i>			
Cash and Amounts Due				
from Depository Institutions	\$ 4,395	\$ 4,395	\$ 5,334	\$ 5,334
Interest Bearing Deposits in Other Banks	\$ 2,092	\$ 2,092	\$ 4,333	\$ 4,333
Net Loans, Excluding Net Impaired Loans	\$ 100,113	\$ 99,715	\$ 93,154	\$ 93,010
Cash Surrender Value of Life Insurance	\$ 4,369	\$ 4,369	\$ 2,346	\$ 2,346
<b>FINANCIAL LIABILITIES:</b>				
Deposits	\$ 178,275	\$ 178,329	\$ 176,809	\$ 177,008

## **CONSOLIDATING INFORMATION**

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PUGH & COMPANY, P.C.  
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**INDEPENDENT AUDITOR'S REPORT ON CONSOLIDATING INFORMATION**

Board of Directors and Senior Management  
United Tennessee Bankshares, Inc. and Subsidiary  
Newport, Tennessee

We have audited the consolidated financial statements of United Tennessee Bankshares, Inc. and its subsidiary as of December 31, 2017 and 2016 and for the years ended December 31, 2017, 2016 and 2015 and have issued our report thereon, dated March 9, 2018, which contains an unmodified opinion on those consolidated financial statements. See page 1. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole.

The accompanying consolidating information is presented for purposes of additional analysis rather than to present the financial position, results of operations and cash flows of the individual companies and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

*Pugh & Company, P.C.*

Certified Public Accountants  
Knoxville, Tennessee  
March 9, 2018



An independently owned member  
**RSM US Alliance**



**TSCPA**  
Members of the Tennessee Society  
Of Certified Public Accountants

**UNITED TENNESSEE BANKSHARES, INC. AND SUBSIDIARY**  
**CONSOLIDATING SCHEDULE – STATEMENT OF FINANCIAL CONDITION**

**As of December 31, 2017**

	United Tennessee Bankshares, Inc.	Newport Federal Bank	Intercompany Eliminations	Consolidated
<b>ASSETS</b>				
Cash and Amounts Due from Depository Institutions	\$ 664,956	\$ 4,155,037	\$ (425,134)	\$ 4,394,859
Interest-Bearing Deposits in Other Banks	500,000	2,092,000	(500,000)	2,092,000
Investment Securities Available for Sale, at Fair Value	0	85,560,441	0	85,560,441
Loans Receivable, Net	0	100,317,551	0	100,317,551
Equity Securities, at Cost	0	1,218,975	0	1,218,975
Premises and Equipment, Net	0	2,577,300	0	2,577,300
Accrued Interest Receivable	0	827,513	0	827,513
Foreclosed Real Estate	0	304,151	0	304,151
Cash Surrender Value of Life Insurance	0	4,369,098	0	4,369,098
Investment in Subsidiary	21,726,144	0	(21,726,144)	0
Deferred Income Tax Benefit	0	769,573	0	769,573
Prepaid Expenses and Other Assets	10,847	236,531	0	247,378
	<u>22,901,947</u>	<u>202,428,170</u>	<u>(22,651,278)</u>	<u>202,678,839</u>
<b>TOTAL ASSETS</b>	<b>\$ 22,901,947</b>	<b>\$ 202,428,170</b>	<b>\$ (22,651,278)</b>	<b>\$ 202,678,839</b>
<b>LIABILITIES AND EQUITY</b>				
<b>LIABILITIES</b>				
Deposits:				
Demand	\$ 0	\$ 83,710,288	\$ (425,134)	\$ 83,285,154
Term	0	95,490,238	(500,000)	94,990,238
<b>Total Deposits</b>	<b>0</b>	<b>179,200,526</b>	<b>(925,134)</b>	<b>178,275,392</b>
Accrued Interest Payable	0	24,479	0	24,479
Accrued Income Taxes	782	6,123	0	6,905
Accrued Benefit Plan Liabilities	0	1,894,945	0	1,894,945
Other Liabilities	0	246,569	0	246,569
<b>Total Liabilities</b>	<b>782</b>	<b>181,372,642</b>	<b>(925,134)</b>	<b>180,448,290</b>
<b>SHAREHOLDERS' EQUITY</b>				
Common Stock	4,489,422	7,100,000	(7,100,000)	4,489,422
Retained Earnings	18,411,743	14,626,144	(14,626,144)	18,411,743
Accumulated Other Comprehensive Income (Loss)	0	(670,616)	0	(670,616)
<b>Total Shareholders' Equity</b>	<b>22,901,165</b>	<b>21,055,528</b>	<b>(21,726,144)</b>	<b>22,230,549</b>
	<u>22,901,947</u>	<u>202,428,170</u>	<u>(22,651,278)</u>	<u>202,678,839</u>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$ 22,901,947</b>	<b>\$ 202,428,170</b>	<b>\$ (22,651,278)</b>	<b>\$ 202,678,839</b>

See Independent Auditor's Report on Consolidating Information.

UNITED TENNESSEE BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATING SCHEDULE – STATEMENT OF INCOME

For the Year Ended December 31, 2017

	United Tennessee Bankshares, Inc.	Newport Federal Bank	Intercompany Eliminations	Consolidated
<b>INTEREST INCOME</b>				
Loans	\$ 0	\$ 5,250,204	\$ 0	\$ 5,250,204
Investment Securities	0	1,659,640	0	1,659,640
Other Interest-Earning Assets, Net	4,947	65,446	(3,303)	67,090
<b>Total Interest Income</b>	<u>4,947</u>	<u>6,975,290</u>	<u>(3,303)</u>	<u>6,976,934</u>
<b>INTEREST EXPENSE</b>				
Deposits	0	1,036,441	(3,303)	1,033,138
<b>NET INTEREST INCOME</b>	4,947	5,938,849	0	5,943,796
<b>PROVISION FOR LOAN LOSSES</b>	0	0	0	0
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<u>4,947</u>	<u>5,938,849</u>	<u>0</u>	<u>5,943,796</u>
<b>NONINTEREST INCOME</b>				
Deposit Account Service Charges	0	311,120	0	311,120
Loan Service Charges and Fees	0	39,086	0	39,086
Net Gain (Loss) on Sales of Investment Securities				
Available for Sale	0	3,774	0	3,774
Income of Subsidiary	1,254,591	0	(1,254,591)	0
Increase in Cash Surrender Value of Life Insurance	0	23,388	0	23,388
Other	0	91,138	0	91,138
<b>Total Noninterest Income</b>	<u>1,254,591</u>	<u>468,506</u>	<u>(1,254,591)</u>	<u>468,506</u>
<b>NONINTEREST EXPENSE</b>				
Compensation and Benefits	0	2,380,364	0	2,380,364
Occupancy and Equipment	0	444,723	0	444,723
Federal Deposit Insurance and Regulatory Assessments	0	142,415	0	142,415
Data Processing Fees	0	464,896	0	464,896
Advertising and Promotion	0	83,129	0	83,129
Loss on Foreclosed Real Estate	0	30,980	0	30,980
Other	39,072	582,426	0	621,498
<b>Total Noninterest Expense</b>	<u>39,072</u>	<u>4,128,933</u>	<u>0</u>	<u>4,168,005</u>
<b>INCOME BEFORE INCOME TAXES</b>	1,220,466	2,278,422	(1,254,591)	2,244,297
<b>INCOME TAX BENEFIT (EXPENSE)</b>	<u>13,066</u>	<u>(1,023,831)</u>	<u>0</u>	<u>(1,010,765)</u>
<b>NET INCOME</b>	<u>\$ 1,233,532</u>	<u>\$ 1,254,591</u>	<u>\$ (1,254,591)</u>	<u>\$ 1,233,532</u>

See Independent Auditor's Report on Consolidating Information.



## **OTHER INFORMATION**

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PUGH & COMPANY, P.C.  
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To the Board of Directors and Senior Management  
United Tennessee Bankshares, Inc. and Subsidiary  
Newport, Tennessee

In planning and performing our audit of the consolidated financial statements of United Tennessee Bankshares, Inc. and subsidiary (the “Company”) as of and for the year ended December 31, 2017, in accordance with auditing standards generally accepted in the United States of America, we considered the Company’s internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control. Accordingly, we do not express an opinion on the effectiveness of the Company’s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations, we did not identify any deficiencies in internal control during our audit that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

This communication is intended solely for the information and use of senior management, the Board of Directors and appropriate federal banking regulatory agencies, and is not intended to be and should not be used by anyone other than these specified parties.

*Pugh & Company, P.C.*

Certified Public Accountants  
Knoxville, Tennessee  
March 9, 2018



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