

FNCB Bancorp, Inc.  
Form 10-Q  
May 03, 2019

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

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**FORM 10-Q**

**(Mark One)**

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

**For the quarterly period ended March 31, 2019**

**OR**

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

**For the transition period from            to**

Commission File No. 001-38408

**FNCB BANCORP, INC.**



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

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

<b>Title of each class</b>	<b>Trading Symbol(s)</b>	<b>Name of each exchange on which registered</b>
Common stock, \$1.25 par value	FNCB	Nasdaq Capital Market

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date: 20,109,713 shares as of May 3, 2019

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**FNCB  
BANCORP, INC.  
AND  
SUBSIDIARIES  
CONSOLIDATED  
STATEMENTS  
OF FINANCIAL  
CONDITION  
(unaudited)**

	<b>March 31, 2019</b>	<b>December 31, 2018</b>
<b>(in thousands, except share data)</b>		
<b>Assets</b>		
Cash and cash equivalents:		
Cash and due from banks	\$25,683	\$26,673
Interest-bearing deposits in other banks	7,062	9,808
Total cash and cash equivalents	32,745	36,481
Available-for-sale debt securities, at fair value	274,114	296,032
Equity securities, at fair value	903	891
Restricted stock, at cost	3,120	3,123
Loans held for sale	609	820
Loans, net of allowance for loan and lease losses of \$9,253 and \$9,519	829,611	829,581
Bank premises and equipment, net	14,991	14,425
Accrued interest receivable	3,706	3,614
Bank-owned life insurance	31,146	31,015
Other real estate owned	919	919
Net deferred tax assets	9,194	10,693
Other assets	13,393	10,138
<b>Total assets</b>	<b>\$1,214,451</b>	<b>\$1,237,732</b>
<b>Liabilities</b>		
Deposits:		
Demand (non-interest-bearing)	\$157,073	\$156,600
Interest-bearing	883,017	939,029
Total deposits	1,040,090	1,095,629
Borrowed funds:		
Federal Home Loan Bank of Pittsburgh advances	28,988	18,930
Subordinated debentures	-	5,000
Junior subordinated debentures	10,310	10,310
Total borrowed funds	39,298	34,240
Accrued interest payable	339	338

Other liabilities	10,942	10,306
<b>Total liabilities</b>	<b>1,090,669</b>	<b>1,140,513</b>
<b>Shareholders' equity</b>		
Preferred shares (\$1.25 par)		
Authorized: 20,000,000 shares at March 31, 2019 and December 31, 2018		
Issued and outstanding: 0 shares at March 31, 2019 and December 31, 2018	-	-
Common shares (\$1.25 par)		
Authorized: 50,000,000 shares at March 31, 2019 and December 31, 2018		
Issued and outstanding: 20,108,560 shares at March 31, 2019 and 16,821,371 shares at December 31, 2018	25,135	21,026
Additional paid-in capital	80,827	63,547
Retained earnings	18,809	17,186
Accumulated other comprehensive loss	(989 )	(4,540 )
<b>Total shareholders' equity</b>	<b>123,782</b>	<b>97,219</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$1,214,451</b>	<b>\$1,237,732</b>

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

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**FNCB  
BANCORP, INC.  
AND  
SUBSIDIARIES  
CONSOLIDATED  
STATEMENTS  
OF INCOME  
(unaudited)**

<b>(in thousands, except share data)</b>	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>Interest income</b>		
Interest and fees on loans	\$9,407	\$8,288
Interest and dividends on securities:		
U.S. government agencies	893	890
State and political subdivisions, tax free	37	20
State and political subdivisions, taxable	1,021	1,024
Other securities	205	195
Total interest and dividends on securities	2,156	2,129
Interest on interest-bearing deposits in other banks	46	23
<b>Total interest income</b>	<b>11,609</b>	<b>10,440</b>
<b>Interest expense</b>		
Interest on deposits	2,238	1,067
Interest on borrowed funds:		
Interest on Federal Home Loan Bank of Pittsburgh advances	287	352
Interest on subordinated debentures	24	56
Interest on junior subordinated debentures	114	87
Total interest on borrowed funds	425	495
<b>Total interest expense</b>	<b>2,663</b>	<b>1,562</b>
<b>Net interest income before (credit) provision for loan and lease losses</b>	<b>8,946</b>	<b>8,878</b>
(Credit) provision for loan and lease losses	(154)	720
<b>Net interest income after (credit) provision for loan and lease losses</b>	<b>9,100</b>	<b>8,158</b>
<b>Non-interest income</b>		
Deposit service charges	685	702
Net gain on the sale of available-for-sale debt securities	160	-
Net gain (loss) on equity securities	12	(19)
Net gain on the sale of mortgage loans held for sale	56	49
Net gain on the sale of SBA guaranteed loans	-	251
Net gain on the sale of other real estate owned	-	38
Loan-related fees	79	84
Income from bank-owned life insurance	131	134
Other	392	280
<b>Total non-interest income</b>	<b>1,515</b>	<b>1,519</b>
<b>Non-interest expense</b>		
Salaries and employee benefits	3,899	3,666

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Occupancy expense	550	603
Equipment expense	307	314
Advertising expense	197	113
Data processing expense	781	648
Regulatory assessments	168	201
Bank shares tax	278	267
Expense of other real estate owned	51	45
Professional fees	332	296
Insurance expense	126	135
Other losses	9	41
Other operating expenses	727	903
<b>Total non-interest expense</b>	<b>7,425</b>	<b>7,232</b>
<b>Income before income tax expense</b>	<b>3,190</b>	<b>2,445</b>
Income tax expense	555	426
<b>Net income</b>	<b>\$2,635</b>	<b>\$2,019</b>
<b>Earnings per share</b>		
Basic	\$0.14	\$0.12
Diluted	\$0.14	\$0.12
<b>Cash dividends declared per common share</b>	<b>\$0.05</b>	<b>\$0.04</b>
<b>WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING:</b>		
Basic	18,720,502	16,763,401
Diluted	18,733,652	16,789,336

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



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**FNCB BANCORP,  
INC. AND  
SUBSIDIARIES  
CONSOLIDATED  
STATEMENTS OF  
COMPREHENSIVE  
INCOME (LOSS)  
(unaudited)**

<b>(in thousands)</b>	<b>Three Months Ended March 31, 2019    2018</b>	
Net income	\$2,635	\$2,019
Other comprehensive income (loss):		
Unrealized gains (losses) on available-for-sale debt securities	4,655	(4,976)
Taxes	(978 )	1,044
Net of tax amount	3,677	(3,932)
Reclassification adjustment for gains included in net income	(160 )	-
Taxes	34	-
Net of tax amount	(126 )	-
Total other comprehensive income (loss)	3,551	(3,932)
Comprehensive income (loss)	\$6,186	\$(1,913)

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

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**FNCB BANCORP,  
INC. AND  
SUBSIDIARIES  
CONSOLIDATED  
STATEMENTS OF  
CHANGES IN  
SHAREHOLDERS'  
EQUITY  
For the Three  
Months Ended  
March 31, 2019 and  
2018  
(unaudited)**

(in thousands, except per share data)	Number of Common Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
<b>Balances, December 31, 2017</b>	16,757,963	\$ 20,947	\$ 63,210	\$ 6,779	\$ (1,745 )	\$ 89,191
Net income for the period	-	-	-	2,019	-	2,019
Cash dividends paid, \$0.04 per share	-	-	-	(671 )	-	(671 )
Reclassification of unrealized loss on equity securities, net of tax	-	-	-	(65 )	65	-
Restricted stock awards	-	-	72	-	-	72
Common shares issued through dividend reinvestment / optional cash purchase plan	8,637	11	53	(5 )	-	59
Other comprehensive loss, net of tax of \$1,044	-	-	-	-	(3,932 )	(3,932 )
<b>Balances, March 31, 2018</b>	16,766,600	\$ 20,958	\$ 63,335	\$ 8,057	\$ (5,612 )	\$ 86,738
<b>Balances, December 31, 2018</b>	16,821,371	\$ 21,026	\$ 63,547	\$ 17,186	\$ (4,540 )	\$ 97,219
Net income for the period	-	-	-	2,635	-	2,635
Cash dividends paid, \$0.05 per share	-	-	-	(1,006 )	-	(1,006 )
Common shares issued for capital raise, net	3,285,550	4,107	17,201	-	-	21,308
Restricted stock awards	-	-	67	-	-	67
Common shares issued through dividend reinvestment / optional cash purchase plan	1,639	2	12	(6 )	-	8
Other comprehensive income, net of tax of \$944	-	-	-	-	3,551	3,551
<b>Balances, March 31, 2019</b>	20,108,560	\$ 25,135	\$ 80,827	\$ 18,809	\$ (989 )	\$ 123,782

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



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**FNCB  
BANCORP, INC.  
AND  
SUBSIDIARIES  
CONSOLIDATED  
STATEMENTS  
OF CASH  
FLOWS  
(unaudited)**

<b>(in thousands)</b>	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>Cash flows from operating activities:</b>		
Net income	\$2,635	\$2,019
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Investment securities amortization, net	212	188
Equity in trust	(3 )	(3 )
Depreciation and amortization	802	674
Valuation adjustment for loan servicing rights	1	-
Stock-based compensation expense	67	72
(Credit) provision for loan and lease losses	(154 )	720
Valuation adjustment for off-balance sheet commitments	21	(10 )
Net gain on the sale of available-for-sale debt securities	(160 )	-
Net (gain) loss on equity securities	(12 )	19
Net gain on the sale of mortgage loans held for sale	(56 )	(49 )
Net gain on the sale of SBA guaranteed loans	-	(251 )
Net gain on the sale of other real estate owned	-	(38 )
Valuation adjustment of other real estate owned	-	17
Income from bank-owned life insurance	(131 )	(134 )
Proceeds from the sale of mortgage loans held for sale	1,858	2,878
Funds used to originate mortgage loans held for sale	(1,591 )	(2,100 )
Decrease in net deferred tax assets	555	424
Increase in accrued interest receivable	(92 )	(196 )
(Increase) decrease in prepaid expenses and other assets	(3,257 )	548
Increase in accrued interest payable	1	43
Increase in accrued expenses and other liabilities	603	53
Total adjustments	(1,336 )	2,855
<b>Net cash provided by operating activities</b>	<b>1,299</b>	<b>4,874</b>
<b>Cash flows from investing activities:</b>		
Maturities, calls and principal payments of available-for-sale debt securities	1,230	1,334
Proceeds from the sale of available-for-sale debt securities	25,130	-
Purchases of available-for-sale debt securities	-	(15,353)
Redemption (purchase) of the stock in Federal Home Loan Bank of Pittsburgh	3	(2,940 )

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Net increase in loans to customers	(333 )	(43,006)
Proceeds from the sale of SBA guaranteed loans	-	5,206
Proceeds from the sale of other real estate owned	-	465
Purchases of bank premises and equipment	(894 )	(2,840 )
<b>Net cash provided by (used in) investing activities</b>	<b>25,136</b>	<b>(57,134)</b>

**Cash flows from financing activities:**

Net decrease in deposits	(55,539)	(47,195)
Net proceeds from Federal Home Loan Bank of Pittsburgh advances - overnight	8,400	59,325
Proceeds from Federal Home Loan Bank of Pittsburgh advances - term	8,478	27,631
Repayment of Federal Home Loan Bank of Pittsburgh advances - term	(6,820 )	(10,439)
Principal reduction on subordinated debentures	(5,000 )	-
Proceeds from issuance of common shares, net of discount	21,316	59
Cash dividends paid	(1,006 )	(671 )
<b>Net cash (used in) provided by financing activities</b>	<b>(30,171)</b>	<b>28,710</b>
<b>Net decrease in cash and cash equivalents</b>	<b>(3,736 )</b>	<b>(23,550)</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>36,481</b>	<b>37,746</b>
<b>Cash and cash equivalents at end of period</b>	<b>\$32,745</b>	<b>\$14,196</b>

**Supplemental cash flow information**

Cash paid during the period for:		
Interest	\$2,662	\$1,519
Income taxes	-	18
Other transactions:		
Lease liabilities arising from obtaining right-of-use assets	12	-

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

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**FNCB BANCORP, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**Note 1. Basis of Presentation**

The consolidated financial statements of FNCB are comprised of the accounts of FNCB Bancorp, Inc., and its wholly owned subsidiary, FNCB Bank (the “Bank”), as well as the Bank’s wholly owned subsidiaries (collectively, “FNCB”). The accounting and reporting policies of FNCB conform to accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10-01 of Regulation S-X. Accordingly, they do *not* include all the information and accompanying notes required by GAAP for complete financial statements. In the opinion of management, all adjustments necessary for a fair presentation of the financial position and the results of operations for the periods presented have been included in the consolidated financial statements. All intercompany balances and transactions have been eliminated in consolidation. Prior period amounts have been reclassified when necessary to conform to the current period’s presentation. Such reclassifications did *not* have an impact on the operating results or financial position of FNCB. The operating results and financial position of FNCB for the *three* months ended *March 31, 2019*, may *not* be indicative of future results of operations and financial position.

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to change in the near term are the allowance for loan and lease losses (“ALLL”), securities’ valuation and impairment evaluation, the valuation of other real estate owned (“OREO”), and income taxes.

These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in FNCB’s audited financial statements, included in the Annual Report filed on Form 10-K as of and for the year ended *December 31, 2018*.

**Note 2. New Authoritative Accounting Guidance**

Accounting Standards Update ("ASU") 2016-02, Leases (Topic 842): "Leases" requires organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases with lease terms of more than 12 months. Consistent with current GAAP, the recognition, measurement and presentation of expenses and cash flows arising from a lease by the lessee will primarily depend on its classification as a finance or operating lease. However, unlike current GAAP, which requires only capital leases to be recognized on the balance sheet, the new ASU requires both finance and operating leases to be recognized on the balance sheet. ASU 2016-02 also requires disclosures to help investors and other financial statement users better understand the amount, timing and uncertainty of cash flows arising from leases. The new disclosures include both qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. ASU 2016-02 is effective with fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 for public business entities. An entity may adopt the new guidance either by restating prior periods and recording a cumulative effect adjustment at the beginning of the earliest comparative period presented or by recording a cumulative effect adjustment at the beginning of the period of adoption. FNCB adopted this guidance on January 1, 2019 and applied the standard by recording a cumulative effect adjustment at that date. Management performed a comprehensive evaluation of the effect this guidance may have on its operating results or financial position, including working with various business units within the organization and reviewing contractual arrangements for embedded leases in an effort to identify FNCB's full lease population. Based on management's evaluation, the adoption of ASU 2016-02 resulted in FNCB recording an aggregate lease liability and right of use ("ROU") asset of \$3.6 million for its operating lease commitments.

ASU 2017-08, Receivables – Nonrefundable Fees and Other Costs (Topic 310): "Premium Amortization on Purchased Callable Debt Securities" requires that the amortization period for certain callable debt securities be shortened to the earliest call date. The amortization of callable securities held at a discount is not affected. ASU 2017-08 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018 for public business entities. The adoption of this guidance on January 1, 2019 did not have a material effect on the operating results or financial position of FNCB.

### **Accounting Guidance to be Adopted in Future Periods**

ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): "Measurement of Credit Losses on Financial Instruments," replaces the current loss impairment methodology under GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to form credit loss estimates in an effort to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit. Specifically, the amendments in this ASU will require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The amendments in this update affect entities holding financial assets and net investment in leases that are not accounted for at fair value through net income, including such financial assets as loans, debt securities, trade receivables, net investments in leases, off-balance-sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. On June 17, 2016, the four, federal financial institution regulatory agencies (the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration and the Office of the Comptroller of the Currency), issued a joint statement to provide information about ASU 2016-13 and the initial supervisory views regarding the implementation of the new standard. The joint statement applies to all banks, savings associations, credit unions and financial institution holding companies, regardless of asset size. The statement details the key elements of, and the steps necessary for, the successful transition to the new

accounting standard. In addition, the statement notifies financial institutions that because the appropriate allowance levels are institution-specific amounts, the agencies will not establish benchmark targets or ranges for the change in institutions' allowance levels upon adoption of the ASU, or for allowance levels going forward. Due to the importance of ASU 2016-13, the agencies encourage financial institutions to begin planning and preparing for the transition and state that senior management, under the oversight of the board of directors, should work closely with staff in their accounting, lending, credit risk management, internal audit, and information technology functions during the transition period leading up to, and well after, adoption. ASU 2016-13 is effective for public business entities that are U.S. Securities and Exchange Commission ("SEC") filers for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. All entities may adopt the amendments in this ASU earlier as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Accordingly, FNCB will adopt this guidance on January 1, 2020. FNCB has created a Current Expected Credit Loss ("CECL") task group comprised of members of its finance, credit administration, lending, internal audit, loan operations and information systems units. The CECL task group has become familiar with the provisions of ASU 2016-13 and is in the process of implementing the new guidance, which includes, but is not limited to: (1) identifying segments and sub-segments within the loan portfolio that have similar risk characteristics; (2) determining the appropriate methodology for each segment; (3) implementing changes that are necessary to its core operating system and interfaces to be able to capture appropriate data requirements; and (4) evaluating qualitative factors and economic to develop appropriate forecasts for integration into the model. FNCB plans to begin running parallel computations using the current GAAP incurred loss model in the second quarter of 2019. FNCB is currently evaluating the effect this guidance may have on its operating results and/or financial position, including assessing any potential impact on its capital.

Refer to Note 2 to FNCB's consolidated financial statements included in the 2018 Annual Report on Form 10-K for a discussion of additional accounting guidance applicable to FNCB that will be adopted in future periods.



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The following tables present the amortized cost, gross unrealized gains and losses, and the fair value of FNCB's available-for-sale debt securities at *March 31, 2019* and *December 31, 2018*:

(in thousands)	<b>March 31, 2019</b>			
	<b>Amortized Cost</b>	<b>Gross Holding Gains</b>	<b>Gross Holding Losses</b>	<b>Fair Value</b>
<b>Available-for-sale debt securities:</b>				
Obligations of state and political subdivisions	\$ 132,165	\$ 807	\$ 848	\$ 132,124
U.S. government/government-sponsored agencies:				
Collateralized mortgage obligations - residential	34,365	83	496	33,952
Collateralized mortgage obligations - commercial	75,948	8	813	75,143
Mortgage-backed securities	21,104	113	105	21,112
Private collateralized mortgage obligations	2,782	28	3	2,807
Corporate debt securities	5,000	49	56	4,993
Asset-backed securities	1,573	-	13	1,560
Negotiable certificates of deposit	2,428	-	5	2,423
Total available-for-sale debt securities	\$ 275,365	\$ 1,088	\$ 2,339	\$ 274,114

(in thousands)	<b>December 31, 2018</b>			
	<b>Amortized Cost</b>	<b>Gross Holding Gains</b>	<b>Gross Holding Losses</b>	<b>Fair Value</b>
<b>Available-for-sale debt securities:</b>				
Obligations of state and political subdivisions	\$ 154,268	\$ 214	\$ 2,295	\$ 152,187
U.S. government/government-sponsored agencies:				
Collateralized mortgage obligations - residential	35,147	6	946	34,207
Collateralized mortgage obligations - commercial	76,038	-	2,398	73,640
Mortgage-backed securities	24,165	47	278	23,934
Private collateralized mortgage obligations	2,908	7	2	2,913
Corporate debt securities	5,000	14	78	4,936
Asset-backed securities	1,825	-	23	1,802
Negotiable certificates of deposit	2,428	-	15	2,413
Total available-for-sale debt securities	\$ 301,779	\$ 288	\$ 6,035	\$ 296,032

Except for securities of U.S. government and government-sponsored agencies, there were *no* securities of any individual issuer that exceeded *10.0%* of shareholders' equity at *March 31, 2019*.

At *March 31, 2019* and *December 31, 2018*, securities with a carrying amount of \$264.8 million and \$286.4 million, respectively, were pledged as collateral to secure public deposits and for other purposes.

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The following table presents the maturity information of FNCB's available-for-sale debt securities at *March 31, 2019*. Expected maturities will differ from contractual maturity because issuers *may* have the right to call or prepay obligations with or without call or prepayment penalties. Because collateralized mortgage obligations, mortgage-backed securities and asset-backed securities are *not* due at a single maturity date, they are *not* included in the maturity categories in the following maturity summary.

(in thousands)	March 31, 2019	
	Amortized Cost	Fair Value
Amounts maturing in:		
One year or less	\$1,734	\$1,731
After one year through five years	56,360	56,370
After five years through ten years	77,470	77,490
After ten years	4,029	3,949
Collateralized mortgage obligations	113,095	111,902
Mortgage-backed securities	21,104	21,112
Asset-backed securities	1,573	1,560
Total	\$275,365	\$274,114

Gross proceeds from the sale of available-for-sale debt securities were \$25.1 million for the three months ended March 31, 2019, with gross gains and losses of \$176 thousand and \$16 thousand, respectively realized upon the sale. There were *no* sales of available-for-sale debt securities during the *three* months ended *March 31, 2018*.

The following tables present the number, fair value and gross unrealized losses of available-for-sale debt securities with unrealized losses at *March 31, 2019* and *December 31, 2018*, aggregated by investment category and length of time the securities have been in an unrealized loss position.

(dollars in thousands)	March 31, 2019								
	Less than 12 Months			12 Months or Greater			Total		
	Number of Securities	Gross Fair Value	Gross Unrealized Losses	Number of Securities	Gross Fair Value	Gross Unrealized Losses	Number of Securities	Gross Fair Value	Gross Unrealized Losses
Obligations of state and political subdivisions	2	\$761	\$ 10	54	\$63,226	\$ 838	56	\$63,987	\$ 848
U.S. government/government-sponsored agencies:									
Collateralized mortgage obligations - residential	-	-	-	11	24,424	496	11	24,424	496
	-	-	-	23	71,655	813	23	71,655	813

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Collateralized mortgage obligations -  
commercial

Mortgage-backed securities	-	-	-	6	10,453	105	6	10,453	105
Private collateralized mortgage obligations	1	874	3	-	-	-	1	874	3
Corporate debt securities	1	998	2	1	1,946	54	2	2,944	56
Asset-backed securities	-	-	-	2	1,560	13	2	1,560	13
Negotiable certificates of deposit	-	-	-	10	2,423	5	10	2,423	5
Total available-for-sale debt securities	4	\$2,633	\$ 15	107	\$175,687	\$ 2,324	111	\$178,320	\$ 2,339

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(dollars in thousands)	December 31, 2018								
	Less than 12 Months			12 Months or Greater			Total		
	Number of Securities	Fair Value	Gross Unrealized Losses	Number of Securities	Fair Value	Gross Unrealized Losses	Number of Securities	Fair Value	Gross Unrealized Losses
Obligations of state and political subdivisions U.S. government/government-sponsored agencies:	3	\$7,154	\$205	109	\$112,563	\$2,090	112	\$119,717	\$2,295
Collateralized mortgage obligations - residential	-	-	-	14	31,414	946	14	31,414	946
Collateralized mortgage obligations - commercial	-	-	-	25	73,640	2,398	25	73,640	2,398
Mortgage-backed securities	1	52	-	6	10,294	278	7	10,346	278
Private collateralized mortgage obligations	1	950	2	-	-	-	1	950	2
Corporate debt securities	2	2,922	78	-	-	-	2	2,922	78
Asset-backed securities	1	369	2	1	1,433	21	2	1,802	23
Negotiable certificates of deposit	3	740	3	7	1,673	12	10	2,413	15
Total available-for-sale debt securities	11	\$12,187	\$290	162	\$231,017	\$5,745	173	\$243,204	\$6,035

Management evaluates individual securities in an unrealized loss position quarterly for other than temporary impairment (“OTTI”). As part of its evaluation, management considers, among other things, the length of time a security’s fair value is less than its amortized cost, the severity of decline, any credit deterioration of the issuer, whether or *not* management intends to sell the security, and whether it is more likely than *not* that FNCB will be required to sell the security prior to recovery of its amortized cost.

There were *111* securities in an unrealized loss position at *March 31, 2019*, including 56 obligations of state and political subdivisions, *40* securities issued by a U.S. government or government-sponsored agency, *10* negotiable certificates of deposit, *two* asset-backed securities, two corporate debt securities and one private collateralized mortgage obligation. Management performed a review of all securities in an unrealized loss position as of *March 31, 2019* and determined that changes in the fair values of the securities were consistent with movements in market interest rates. In addition, as part of its review, management noted that there was *no* material change in the credit quality of any of the issuers or any other event or circumstance that *may* cause a significant adverse effect on the fair value of these securities. Moreover, to date, FNCB has received all scheduled principal and interest payments and expects to fully collect all future contractual principal and interest payments on all securities in an unrealized loss position at *March 31, 2019*. FNCB does *not* intend to sell the securities, nor is it more likely than *not* that it will be required to sell the securities, prior to recovery of their amortized cost. Based on the results of its review and considering the attributes of these debt securities, management concluded that the individual unrealized losses were temporary and OTTI did *not* exist at *March 31, 2019*.

*Equity Securities*

FNCB's investment in equity securities consists entirely of a mutual fund investment comprised of *one-* to *four-*family residential mortgage-backed securities collateralized by properties within FNCB's geographical market. At *March 31, 2019*, this mutual fund had an amortized cost of *\$1.0* million and an unrealized loss of *\$96* thousand, resulting in a fair value of *\$903* thousand. In accordance with ASU *2016-01*, Financial Instruments – Overall (Subtopic *825-10*): “Recognition and Measurement of Financial Assets and Financial Liabilities” which became effective *January 1, 2018*, FNCB recognizes any changes in the fair value of this equity security in the consolidated statements of income on a prospective basis. Upon the adoption of this new accounting guidance on *January 1, 2018*, FNCB recorded a *one-*time reclassification between retained earnings and accumulated other comprehensive loss for the unrealized loss on this mutual fund, net of taxes, of *\$65* thousand. The following table presents unrealized and realized gains and losses recognized in net income on equity securities for the *three* months ended *March 31, 2019 and 2018*.

<b>(in thousands)</b>	<b>March 31, 2019</b>	<b>March 31, 2018</b>
Net gains (losses) recognized on equity securities	\$ 12	\$ (19 )
Less: net gains (losses) recognized on equity securities sold	-	-
Unrealized gains (losses) on equity securities held	\$ 12	\$ (19 )

Table of Contents*Restricted Securities*

The following table presents FNCB's investment in restricted securities at March 31, 2019 and December 31, 2018. Restricted securities have limited marketability and are carried at cost.

<b>(in thousands)</b>	<b>March 31, 2019</b>	<b>December 31, 2018</b>
Stock in Federal Home Loan Bank of Pittsburgh	\$3,110	\$ 3,113
Stock in Atlantic Community Banker's Bank	10	10
Total restricted securities, at cost	\$3,120	\$ 3,123

Management noted *no* indicators of impairment for the Federal Home Loan Bank of Pittsburgh or Atlantic Community Banker's Bank stock at *March 31, 2019* and *December 31, 2018*.

*Equity Securities without Readily Determinable Fair Values*

FNCB owns a \$1.7 million investment in the common stock of a privately-held bank holding company. The common stock was purchased during 2017 as part of a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933, *as amended* for offerings *not* involving any public offering. The common stock of such bank holding company is *not* currently traded on any established market and is *not* expected to be traded in the near future on any securities exchange or established over-the-counter market. FNCB has elected to account for this transaction as an investment in an equity security without a readily determinable fair value. An equity security without a readily determinable fair value shall be written down to its fair value if a qualitative assessment indicates that the investment is impaired and the fair value of the investment is less than its carrying value. The \$1.7 million investment is included in other assets in the consolidated statements of financial condition at *March 31, 2019* and *December 31, 2018*. *As part of its qualitative assessment*, management engaged an independent *third* party to provide a valuation of this investment as of *March 31, 2019*, which indicated that the investment was *not* impaired. Management determined that *no* adjustment for impairment was required at *March 31, 2019*.

**Note 4. Loans**

The following table summarizes loans receivable, net, by category at *March 31, 2019* and *December 31, 2018*:

<b>(in thousands)</b>	<b>March 31, 2019</b>	<b>December 31, 2018</b>
Residential real estate	\$ 161,938	\$ 164,833
Commercial real estate	266,617	262,778
Construction, land acquisition and development	22,388	20,813
Commercial and industrial	156,521	150,962
Consumer	168,119	176,784
State and political subdivisions	59,784	59,037
Total loans, gross	835,367	835,207
Unearned income	(68 )	(70 )
Net deferred loan costs	3,565	3,963
Allowance for loan and lease losses	(9,253 )	(9,519 )
Loans, net	\$ 829,611	\$ 829,581

FNCB has granted loans, letters of credit and lines of credit to certain of its executive officers and directors as well as to certain of their related parties. For more information about related party transactions, refer to Note 6, "Related Party Transactions" to these consolidated financial statements.

FNCB originates *one- to four-family* mortgage loans for sale in the secondary market. During the quarter ended *March 31, 2019*, *one-to four-family* mortgages sold on the secondary market were \$1.9 million. Net gains on the sale of residential mortgage loans for the *three* months ended *March 31, 2019* and *2018* were \$56 thousand and \$49 thousand, respectively. FNCB retains servicing rights on mortgages sold on the secondary market. At *March 31, 2019* and *December 31, 2018*, there were \$609 thousand and \$820 thousand in *one-to four-family* residential mortgage loans held for sale, respectively.



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There were *no* sales of guaranteed loans during the *three* months ended *March 31, 2019*. During the *three* months ended *March 31, 2018*, FNCB sold the guaranteed principal balance of loans that were guaranteed by the Small Business Administration (“SBA”) totaling \$5.0 million. Net gains realized upon the sales for the period ended *March 31, 2018* and included in non-interest income totaled \$251 thousand. FNCB retained the servicing rights on these loans. The unpaid principal balance of loans serviced for others, including residential mortgages and SBA guaranteed loans were \$107.6 million at *March 31, 2019* and \$108.4 million at *December 31, 2018*.

FNCB does *not* have any lending programs commonly referred to as subprime lending. Subprime lending generally targets borrowers with weakened credit histories typically characterized by payment delinquencies, previous charge-offs, judgments, and bankruptcies, or borrowers with questionable repayment capacity as evidenced by low credit scores or high debt-burden ratios.

There were *no* material changes to the risk characteristics of FNCB’s loan segments, loan classification and credit grading systems and methodology for determining the adequacy of the ALLL during the *three* months ended *March 31, 2019*. Refer to Note 2, “Summary of Significant Accounting Policies” to FNCB’s consolidated financial statements included in the *2018* Annual Report on Form *10-K* for information about the risk characteristics related to FNCB’s loan segments, loan classification and credit grading systems and methodology for determining the adequacy of the ALLL.

Management evaluates the credit quality of the loan portfolio on an ongoing basis, and performs a formal review of the adequacy of the ALLL on a quarterly basis. This evaluation is inherently subjective, as it requires material estimates that *may* be susceptible to significant revisions based upon changes in economic and real estate market conditions. Actual loan losses *may* be significantly more than the established ALLL, which could have a material negative effect on FNCB’s operating results or financial condition. While management uses the best information available to make its evaluations, future adjustments to the ALLL *may* be necessary if conditions differ substantially from the information used in making the evaluations. Banking regulators, as an integral part of their examination of FNCB, also review the ALLL, and *may* require, based on their judgments about information available to them at the time of their examination, that certain loan balances be charged off or require that adjustments be made to the ALLL.

The following table summarizes activity in the ALLL by loan category for the *three* months ended *March 31, 2019* and *2018*.

(in thousands)	Residential	Commercial	Construction, Land Acquisition and Development	Commercial	Consumer	State and Political Subdivisions	Unallocated	Total
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	<b>Real Estate</b>	<b>Real Estate</b>		<b>and Industrial</b>					
<b>Three months ended March 31, 2019: Allowance for loan losses:</b>									
Beginning balance, January 1, 2019	\$ 1,175	\$ 3,107	\$ 188	\$ 2,552	\$ 2,051	\$ 417	\$ 29	\$9,519	
Charge-offs	-	-	-	(139 )	(315 )	-	-	(454 )	
Recoveries	4	-	81	84	173	-	-	342	
Provisions (credits)	(24 )	(56 )	(163 )	2	54	6	27	(154 )	
Ending balance, March 31, 2019	\$ 1,155	\$ 3,051	\$ 106	\$ 2,499	\$ 1,963	\$ 423	\$ 56	\$9,253	

<b>Three months ended March 31, 2018: Allowance for loan losses:</b>									
Beginning balance, January 1, 2018	\$ 1,236	\$ 3,499	\$ 209	\$ 2,340	\$ 1,395	\$ 355	\$ -	\$9,034	
Charge-offs	(63 )	-	-	(77 )	(260 )	-	-	(400 )	
Recoveries	6	1	30	72	99	-	-	208	
Provisions (credits)	70	(158 )	17	170	588	33	-	720	
Ending balance, March 31, 2018	\$ 1,249	\$ 3,342	\$ 256	\$ 2,505	\$ 1,822	\$ 388	\$ -	\$9,562	

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The following table represents the allocation of the ALLL and the related loan balance, by loan category, disaggregated based on the impairment methodology at *March 31, 2019* and *December 31, 2018*:

(in thousands)	Residential Real Estate	Commercial Real Estate	Construction, Land Acquisition and Development	Commercial and Industrial	Consumer	State and Political Subdivisions	Unallocated	Total
<b>March 31, 2019</b>								
<b>Allowance for loan losses:</b>								
Individually evaluated for impairment	\$ 13	\$ 40	\$ -	\$ 851	\$ 2	\$ -	\$ -	\$ 906
Collectively evaluated for impairment	1,142	3,011	106	1,648	1,961	423	56	8,347
Total	\$ 1,155	\$ 3,051	\$ 106	\$ 2,499	\$ 1,963	\$ 423	\$ 56	\$ 9,253
<b>Loans receivable:</b>								
Individually evaluated for impairment	\$ 1,834	\$ 9,631	\$ 81	\$ 1,546	\$ 380	\$ -	\$ -	\$ 13,472
Collectively evaluated for impairment	160,104	256,986	22,307	154,975	167,739	59,784	-	821,895
Total	\$ 161,938	\$ 266,617	\$ 22,388	\$ 156,521	\$ 168,119	\$ 59,784	\$ -	\$ 835,367
<b>December 31, 2018</b>								
<b>Allowance for loan losses:</b>								
Individually evaluated for impairment	\$ 14	\$ 41	\$ -	\$ 600	\$ 2	\$ -	\$ -	\$ 657
Collectively evaluated for impairment	1,161	3,066	188	1,952	2,049	417	29	8,862
Total	\$ 1,175	\$ 3,107	\$ 188	\$ 2,552	\$ 2,051	\$ 417	\$ 29	\$ 9,519
<b>Loans receivable:</b>								
Individually evaluated for impairment	\$ 1,847	\$ 9,408	\$ 82	\$ 697	\$ 383	\$ -	\$ -	\$ 12,417
Collectively evaluated for	162,986	253,370	20,731	150,265	176,401	59,037	-	822,790

impairment

Total	\$ 164,833	\$ 262,778	\$ 20,813	\$ 150,962	\$ 176,784	\$ 59,037	\$ -	\$ 835,207
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*Credit Quality Indicators – Commercial Loans*

Management continuously monitors and evaluates the credit quality of FNCB's commercial loans by regularly reviewing certain credit quality indicators. Management utilizes credit risk ratings as the key credit quality indicator for evaluating the credit quality of FNCB's loan receivables.

FNCB's loan rating system assigns a degree of risk to commercial loans based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors. Management analyzes these non-homogeneous loans individually by grading the loans as to credit risk and probability of collection for each type of loan. Commercial and industrial loans include commercial indirect auto loans which are *not* individually risk rated, and construction, land acquisition and development loans include residential construction loans which are also *not* individually risk rated. These loans are monitored on a pool basis due to their homogeneous nature as described in "Credit Quality Indicators – Other Loans" below. FNCB risk rates certain residential real estate loans and consumer loans that are part of a larger commercial relationship using a credit grading system as described in "Credit Quality Indicators – Commercial Loans." The grading system contains the following basic risk categories:

1. Minimal Risk
2. Above Average Credit Quality
3. Average Risk
4. Acceptable Risk
5. Pass - Watch
6. Special Mention
7. Substandard - Accruing
8. Substandard - Non-Accrual
9. Doubtful
10. Loss

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This analysis is performed on a quarterly basis using the following definitions for risk ratings:

Pass – Assets rated 1 through 5 are considered pass ratings. These assets show *no* current or potential problems and are considered fully collectible. All such loans are evaluated collectively for ALLL calculation purposes. However, accruing loans restructured under a troubled debt restructuring (“TDRs”) that have been performing for an extended period, do *not* represent a higher risk of loss, and have been upgraded to a pass rating are evaluated individually for impairment.

Special Mention – Assets classified as special mention do *not* currently expose FNCB to a sufficient degree of risk to warrant an adverse classification but do possess credit deficiencies or potential weaknesses deserving close attention. Special mention assets have a potential weakness or pose an unwarranted financial risk which, if *not* corrected, could weaken the asset and increase risk in the future.

Substandard – Assets classified as substandard have well defined weaknesses based on objective evidence, and are characterized by the distinct possibility that FNCB will sustain some loss if the deficiencies are *not* corrected.

Doubtful – Assets classified as doubtful have all the weaknesses inherent in those classified as substandard with the added characteristic that such weaknesses make collection or liquidation in full highly questionable and improbable based on current circumstances.

Loss – Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets is *not* warranted.

*Credit Quality Indicators – Other Loans*

Certain residential real estate loans, consumer loans, and commercial indirect auto loans are monitored on a pool basis due to their homogeneous nature. Loans that are delinquent 90 days or more are placed on non-accrual status unless collection of the loan is in process and reasonably assured. FNCB utilizes accruing versus non-accrual status as the credit quality indicator for these loan pools.

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The following tables present the recorded investment in loans receivable by loan category and credit quality indicator at *March 31, 2019* and *December 31, 2018*:

(in thousands)	Credit Quality Indicators					Subtotal Commercial	Other Loans			Subtotal Other	Total Loans
	March 31, 2019						Accruing	Non-accruing	Subtotal		
	Pass	Special Mention	Substandard	Doubtful	Loss						
Residential real estate	\$31,536	\$252	\$235	\$-	\$-	\$32,023	\$129,194	\$721	\$129,915	\$161,938	
Commercial real estate	254,254	1,661	10,702	-	-	266,617	-	-	-	266,617	
Construction, land acquisition and development	20,343	-	-	-	-	20,343	2,027	18	2,045	22,388	
Commercial and industrial	147,059	463	3,028	-	-	150,550	5,971	-	5,971	156,521	
Consumer	2,389	-	-	-	-	2,389	165,290	440	165,730	168,119	
State and political subdivisions	57,993	1,760	-	-	-	59,753	31	-	31	59,784	
<b>Total</b>	<b>\$513,574</b>	<b>\$4,136</b>	<b>\$13,965</b>	<b>\$-</b>	<b>\$-</b>	<b>\$531,675</b>	<b>\$302,513</b>	<b>\$1,179</b>	<b>\$303,692</b>	<b>\$835,367</b>	

(in thousands)	Credit Quality Indicators					Subtotal Commercial	Other Loans			Subtotal Other	Total Loans
	December 31, 2018						Accruing	Non-accruing	Subtotal		
	Pass	Special Mention	Substandard	Doubtful	Loss						
Residential real estate	\$33,573	\$291	\$154	\$-	\$-	\$34,018	\$130,132	\$683	\$130,815	\$164,833	
Commercial real estate	250,674	1,858	10,246	-	-	262,778	-	-	-	262,778	
Construction, land acquisition and development	17,704	-	757	-	-	18,461	2,352	-	2,352	20,813	
Commercial and industrial	137,888	4,193	2,448	-	-	144,529	6,421	12	6,433	150,962	
Consumer	2,024	-	-	-	-	2,024	174,373	387	174,760	176,784	
State and political subdivisions	57,345	1,665	27	-	-	59,037	-	-	-	59,037	

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Total	\$499,208	\$8,007	\$13,632	\$-	\$-	\$520,847	\$313,278	\$1,082	\$314,360	\$835,207
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Included in loans receivable are loans for which the accrual of interest income has been discontinued due to deterioration in the financial condition of the borrowers. The recorded investment in these non-accrual loans was \$6.2 million and \$4.7 million at *March 31, 2019* and *December 31, 2018*, respectively. Generally, loans are placed on non-accrual status when they become 90 days or more delinquent. Once a loan is placed on non-accrual status, it remains on non-accrual status until it has been brought current, has six months of performance under the loan terms, and factors indicating reasonable doubt about the timely collection of payments *no* longer exist. Therefore, loans *may* be current in accordance with their loan terms, or *may* be less than 90 days delinquent and still be on a non-accrual status. There were *no* loans past due 90 days or more and still accruing at *March 31, 2019* and *December 31, 2018*.

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The following tables present the delinquency status of past due and non-accrual loans at *March 31, 2019* and *December 31, 2018*:

(in thousands)	<b>March 31, 2019</b>				<b>Total</b>
	<b>Delinquency Status</b>				
	<b>0-29</b>	<b>30-59</b>	<b>60-89</b>	<b>&gt;= 90</b>	
	<b>Days</b>	<b>Days</b>	<b>Days</b>	<b>Days</b>	
	<b>Past Due</b>	<b>Past Due</b>	<b>Past Due</b>	<b>Past Due</b>	
<b>Performing (accruing) loans:</b>					
Residential real estate	\$ 160,753	\$ 219	\$ 156	\$ -	\$ 161,128
Commercial real estate	262,514	774	-	-	263,288
Construction, land acquisition and development	22,219	151	-	-	22,370
Commercial and industrial	153,731	1,177	35	-	154,943
Consumer	165,683	1,804	192	-	167,679
State and political subdivisions	59,784	-	-	-	59,784
Total performing (accruing) loans	824,684	4,125	383	-	829,192
<b>Non-accrual loans:</b>					
Residential real estate	569	-	109	132	810
Commercial real estate	1,160	434	-	1,735	3,329
Construction, land acquisition and development	-	-	18	-	18
Commercial and industrial	1,296	-	278	4	1,578
Consumer	163	52	13	212	440
State and political subdivisions	-	-	-	-	-
Total non-accrual loans	3,188	486	418	2,083	6,175
Total loans receivable	\$ 827,872	\$ 4,611	\$ 801	\$ 2,083	\$ 835,367

(in thousands)	<b>December 31, 2018</b>				<b>Total</b>
	<b>Delinquency Status</b>				
	<b>0-29</b>	<b>30-59</b>	<b>60-89</b>	<b>&gt;= 90</b>	
	<b>Days</b>	<b>Days</b>	<b>Days</b>	<b>Days</b>	
	<b>Past Due</b>	<b>Past Due</b>	<b>Past Due</b>	<b>Past Due</b>	
<b>Performing (accruing) loans:</b>					
Residential real estate	\$ 163,690	\$ 319	\$ 136	\$ -	\$ 164,145
Commercial real estate	259,904	-	-	-	259,904
Construction, land acquisition and development	20,813	-	-	-	20,813
Commercial and industrial	150,108	87	20	-	150,215
Consumer	173,890	2,221	286	-	176,397
State and political subdivisions	59,037	-	-	-	59,037
Total performing (accruing) loans	827,442	2,627	442	-	830,511



**Non-accrual loans:**

Residential real estate	443	-	136	109	688
Commercial real estate	1,061	-	-	1,813	2,874
Construction, land acquisition and development	-	-	-	-	-
Commercial and industrial	677	50	-	20	747
Consumer	91	61	74	161	387
State and political subdivisions	-	-	-	-	-
Total non-accrual loans	2,272	111	210	2,103	4,696
Total loans receivable	\$829,714	\$2,738	\$652	\$2,103	\$835,207

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The following tables present a distribution of the recorded investment, unpaid principal balance and the related allowance for FNCB's impaired loans, which have been analyzed for impairment under ASC 310, at *March 31, 2019* and *December 31, 2018*. Non-accrual loans, other than TDRs, with balances less than the \$100 thousand loan relationship threshold are *not* evaluated individually for impairment and accordingly, are *not* included in the following tables. However, these loans are evaluated collectively for impairment as homogeneous pools in the general allowance under ASC Topic 450. Total non-accrual loans, other than TDRs, with balances less than the \$100 thousand loan relationship threshold that were evaluated under ASC Topic 450 amounted to \$0.9 million at *March 31, 2019* and \$0.7 million at *December 31, 2018*.

(in thousands)	March 31, 2019		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
<b>With no allowance recorded:</b>			
Residential real estate	\$342	\$407	\$ -
Commercial real estate	7,401	9,154	-
Construction, land acquisition and development	81	81	-
Commercial and industrial	228	228	-
Consumer	25	27	-
State and political subdivisions	-	-	-
Total impaired loans with no related allowance recorded	8,077	9,897	-
<b>With a related allowance recorded:</b>			
Residential real estate	1,492	1,492	13
Commercial real estate	2,230	2,230	40
Construction, land acquisition and development	-	-	-
Commercial and industrial	1,318	1,318	851
Consumer	355	355	2
State and political subdivisions	-	-	-
Total impaired loans with a related allowance recorded	5,395	5,395	906
<b>Total impaired loans:</b>			
Residential real estate	1,834	1,899	13
Commercial real estate	9,631	11,384	40
Construction, land acquisition and development	81	81	-
Commercial and industrial	1,546	1,546	851
Consumer	380	382	2
State and political subdivisions	-	-	-
Total impaired loans	\$13,472	\$15,292	\$906

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(in thousands)	December 31, 2018		
	Recorded Investment	Unpaid Principal Balance	Related Allowance
<b>With no allowance recorded:</b>			
Residential real estate	\$313	\$ 375	\$ -
Commercial real estate	7,149	8,795	-
Construction, land acquisition and development	82	82	-
Commercial and industrial	-	-	-
Consumer	26	28	-
State and political subdivisions	-	-	-
Total impaired loans with no related allowance recorded	7,570	9,280	-
<b>With a related allowance recorded:</b>			
Residential real estate	1,534	1,534	14
Commercial real estate	2,259	2,259	41
Construction, land acquisition and development	-	-	-
Commercial and industrial	697	697	600
Consumer	357	357	2
State and political subdivisions	-	-	-
Total impaired loans with a related allowance recorded	4,847	4,847	657
<b>Total impaired loans:</b>			
Residential real estate	1,847	1,909	14
Commercial real estate	9,408	11,054	41
Construction, land acquisition and development	82	82	-
Commercial and industrial	697	697	600
Consumer	383	385	2
State and political subdivisions	-	-	-
Total impaired loans	\$12,417	\$ 14,127	\$ 657

The following table presents the average balance and interest income by loan category recognized on impaired loans for the *three* months ended *March 31, 2019* and *2018*:

(in thousands)	Three months ended March 31,			
	2019		2018	
	Average Balance	Interest Income (1)	Average Balance	Interest Income (1)
Residential real estate	\$1,839	\$ 21	\$1,868	\$ 21
Commercial real estate	9,630	77	7,839	77
Construction, land acquisition and development	82	1	84	1
Commercial and industrial	1,047	-	795	-
Consumer	380	5	393	4
State and political subdivisions	-	-	-	-

Total impaired loans	\$12,978	\$ 104	\$10,979	\$ 103
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(1) Interest income represents income recognized on performing TDRs.

The additional interest income that would have been earned on non-accrual and restructured loans had these loans performed in accordance with their original terms approximated \$82 thousand and \$40 thousand for the *three* months ended *March 31, 2019* and *2018*, respectively.

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*Troubled Debt Restructured Loans*

TDRs at *March 31, 2019* and *December 31, 2018* were \$8.9 million and \$9.2 million, respectively. Accruing and non-accruing TDRs were \$8.2 million and \$0.7 million, respectively, at *March 31, 2019*, and \$8.5 million and \$0.7 million, respectively, at *December 31, 2018*. Approximately \$650 thousand in specific reserves have been established for TDRs as of *March 31, 2019* and *December 31, 2018*, respectively. FNCB was *not* committed to lend additional funds to any loan classified as a TDR at *March 31, 2019*.

The modification of the terms of loans classified as TDRs *may* include *one* or a combination of the following, among others: a reduction of the stated interest rate of the loan, an extension of the maturity date, capitalization of real estate taxes, a payment modification under a forbearance agreement, or a permanent reduction of the recorded investment in the loan.

There were *no* loans modified as TDRs during the *three* months ended *March 31, 2019* or *2018*. There were *no* TDRs modified within the previous *12* months that defaulted (defined as past due *90* days or more) during the *three* months ended *March 31, 2019* or *2018*.

*Residential Real Estate Loan Foreclosures*

There were *three* consumer mortgage loans secured by residential real estate properties in the process of foreclosure at *March 31, 2019*. There was *no* aggregate recorded investment to FNCB for these *three* loans at *March 31, 2019*. The balance of *one* loan was previously charged-off in entirety and *two* loans were sold to an investor on the secondary market. There were *no* residential real estate properties foreclosed upon for the *three* months ended *March 31, 2019*, and there was *one* residential real estate property with a carrying value of \$45 thousand included in OREO at *March 31, 2019*.

There were four consumer mortgage loans secured by residential real estate properties with no aggregate recorded investment in the process of foreclosure at *March 31, 2018*. For the *three* months ended *March 31, 2018*, there were *no* residential real estate properties foreclosed upon, and there were *two* residential real estate properties with an aggregate carrying value of \$75 thousand included in OREO at *March 31, 2018*.

**Note 5. Income Taxes**

The following table presents a reconciliation between the effective income tax expense and the income tax expense that would have been provided at the federal statutory tax rate of 21.0% for the *three* months ended *March 31, 2019* and *2018*, respectively.

(dollars in thousands)	For the Three Months Ended			
	March 31,			
	2019		2018	
	Amount	%	Amount	%
Provision at statutory tax rates	\$670	21.00%	\$513	21.00%
Add (deduct):				
Tax effects of tax free interest income	(106)	(3.32)%	(78)	(3.18)%
Non-deductible interest expense	5	0.15%	2	0.10%
Bank-owned life insurance	(28)	(0.86)%	(28)	(1.15)%
Other items, net	14	0.43%	17	0.65%
Income tax provision	\$555	17.40%	\$426	17.42%

FNCB had net deferred tax assets of \$9.2 million at *March 31, 2019*, of which \$5.7 million was related to approximately \$30.0 million in net operating loss carryovers. At *December 31, 2018*, FNCB's net deferred tax assets were \$10.7 million.

Management evaluates the carrying amount of its deferred tax assets on a quarterly basis, or more frequently if necessary, in accordance with guidance set forth in ASC Topic 740 "Income Taxes," and applies the criteria in the guidance to determine whether it is more likely than *not* that some portion, or all, of the deferred tax asset will *not* be realized within its life cycle, based on the weight of available evidence. In evaluating available evidence, management considers, among other factors, historical financial performance, expectation of future earnings, the ability to carry back losses to recoup taxes previously paid, length of statutory carry forward periods, experience with operating loss and tax credit carry forwards *not* expiring unused, tax planning strategies and timing of reversals of temporary differences. In assessing the need for a valuation allowance, management carefully weighs both positive and negative evidence currently available. The weight given to the potential effect of positive and negative evidence must be commensurate with the extent to which it can be objectively verified. If management determines, based on available evidence, both positive and negative, that it is more likely than *not* that some portion or all of the deferred tax asset will *not* be realized in future periods, a valuation allowance is calculated and recorded. These determinations are inherently subjective and depend upon management's estimates and judgments used in their evaluation of both positive and negative evidence.

Management performed an evaluation of FNCB's deferred tax assets at *March 31, 2019* taking into consideration all available positive and negative evidence at that time. Based on this evaluation, management believes that FNCB's future taxable income will be sufficient to utilize deferred tax assets. Accordingly, a valuation allowance for deferred tax assets was *not* required at *March 31, 2019* and *December 31, 2018*.



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In conducting its business, FNCB has engaged in, and intends to continue to engage in, banking and financial transactions with directors, executive officers and their related parties.

FNCB has granted loans, letters of credit and lines of credit to directors, executive officers and their related parties. The following table summarizes the changes in the total amounts of such outstanding loans, advances under lines of credit, net of any participations sold, as well as repayments during the *three* months ended *March 31, 2019* and *2018*.

(in thousands)	For the Three Months Ended March 31,	
	2019	2018
Balance January 1,	\$64,634	\$55,576
Additions, new loans and advances	17,089	31,169
Repayments	(9,573 )	(20,861 )
Balance March 31,	\$72,150	\$65,884

At *March 31, 2019*, there were *no* loans made to directors, executive officers and their related parties that were *not* performing in accordance with the terms of the loan agreements.

Deposits from directors, executive officers and their related parties held by the Bank at *March 31, 2019* and *December 31, 2018* amounted to *\$92.4* million and *\$115.5* million, respectively, a decrease of *\$23.1* million. The decrease was due to cyclical outflows from several large commercial deposit relationships that are owned by, or a related party to, certain directors. Interest paid on the deposits amounted to *\$119* thousand and *\$84* thousand for the *three* months ended on *March 31, 2019* and *2018*, respectively.

In the course of its operations, FNCB acquires goods and services from, and transacts business with, various companies of related parties, which include, but are *not* limited to, employee health insurance, fidelity bond and errors and omissions insurance, legal services, and repair of repossessed automobiles for resale. FNCB recorded payments to related parties for goods and services of *\$528* thousand and *\$553* thousand for the *three* months ended *March 31, 2019* and *2018*, respectively.



On February 8, 2019, FNCB accelerated the final \$5.0 million principal repayment, which was due and payable on September 1, 2019, along with all accrued interest, of which \$3.1 million was paid to directors and/or their related interests. Subordinated notes (the “Notes”) held by directors and/or their related parties totaled \$3.1 million at *December 31, 2018*. Interest expense recorded on the Notes for directors and/or their related parties amounted to \$27 thousand and \$35 thousand for the three months ended March 31, 2019 and 2018, respectively.

On January 28, 2019, FNCB commenced a public offering of shares of its common stock in a firm commitment underwritten offering. The offering closed on February 8, 2019 and FNCB issued 3,285,550 shares of its common stock at an offering price of \$7.00 per share. Shares acquired by directors, executive officers and their related parties as part of this offering were 339,886, or 10.3%, of the total common shares issued. For more information about the public offering, refer to Note 9, “Regulatory Matters/Subsequent Event” to these consolidated financial statements.

Table of Contents**Note 7. Commitments and Contingencies***Leases*

FNCB is obligated under operating leases for certain bank branches, office space and automobiles. Operating lease ROU assets represent our right to use an underlying asset during the lease term and operating liabilities represent our obligation to make lease payments under the lease agreement. ROU assets and operating lease liabilities are recognized at lease commencement based on the present value of the remaining lease payments using a discount rate that represents FNCB's incremental borrowing rate at the commencement date. ROU assets are included in other assets and operating lease liabilities are included in other liabilities in the consolidated statements of financial condition. As of March 31, 2019 ROU assets and lease liabilities were \$ 3.2 million and \$3.6 million, respectively. There were no new operating leases that have not yet commenced as of March 31, 2019.

The following table summarizes the components of FNCB's operating lease expense for the three months ended March 31, 2019. Operating lease expense associated with bank branches and office space is included in occupancy expense, while operating lease expense associated with automobiles is included in equipment expense in the consolidated statements of income.

<b>(in thousands)</b>	<b>Three Months Ended  March 31, 2019</b>
Operating lease cost - bank branches	\$ 85
Operating lease cost - automobiles	2
Short-term lease cost - office space	15
Short-term lease cost - automobiles	3
Variable lease cost	-
Total lease cost	\$ 105

The following table summarizes the maturity of remaining operating lease liabilities as of March 31, 2019:

<b>(in thousands)</b>	<b>March 31,</b>
-----------------------	----------------------

	<b>2019</b>
2019	\$251
2020	363
2021	335
2022	316
2023	312
2024 and thereafter	3,095
Total lease payments	4,672
Less: imputed interest	1,096
Present value of operating lease liabilities	\$3,576

The following table presents other information related to our operating leases:

<b>(dollars in thousands)</b>	<b>March 31, 2019</b>
Weighted average remaining lease term	14.9 years
Weighted average discount rate	3.44 %
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	\$ 116

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*Litigation*

On May 24, 2012, a putative shareholder filed a complaint in the Court of Common Pleas for Lackawanna County (“Shareholder Derivative Suit”) against certain present and former directors and officers of FNCB (the “Individual Defendants”) alleging, inter alia, breach of fiduciary duty, abuse of control, corporate waste, and unjust enrichment. FNCB was named as a nominal defendant. On February 4, 2014, the Court issued a Final Order and Judgment for the matter granting approval of a Stipulation of Settlement (the “Settlement”) and dismissing all claims against FNCB and the Individual Defendants. As part of the Settlement, without admitting any fault, wrongdoing or liability, the Individual Defendants agreed to settle the derivative litigation for \$5.0 million. The \$5.0 million Settlement payment was made to FNCB on March 28, 2014. The Individual Defendants reserved their rights to indemnification under FNCB’s Articles of Incorporation and Bylaws, resolutions adopted by the Board, the Pennsylvania Business Corporation Law and any and all rights they have against FNCB’s and the Bank’s insurance carriers. In addition, in conjunction with the Settlement, FNCB accrued \$2.5 million related to fees and costs of the plaintiff’s attorneys, which was included in non-interest expense in the consolidated statements of income for the year ended December 31, 2013. On April 1, 2014, FNCB paid the \$2.5 million related to fees and costs of the plaintiff’s attorneys and partial indemnification of the Individual Defendants in the amount of \$2.5 million. Commencing on July 1, 2017, FNCB made partial indemnifications to the Individual Defendants through monthly principal payments, made on behalf of the Individual Defendants, of \$25,000 plus accrued interest to First Northern Bank and Trust Co. On April 11, 2018, FNCB indemnified the Individual Defendants by paying in full the \$2.5 million, plus accrued interest to First Northern Bank & Trust Co.

On September 5, 2012, Fidelity and Deposit Company of Maryland (“F&D”) filed an action against FNCB and the Bank, as well as several current and former officers and directors of FNCB, in the United States District Court for the Middle District of Pennsylvania. F&D asserted a claim for the rescission of a directors’ and officers’ insurance policy and a bond that it had issued to FNCB. On November 9, 2012, FNCB and the Bank answered the claim and asserted counterclaims for the losses and expenses already incurred by FNCB and the Bank. FNCB and the other defendants defended the claims and opposed F&D’s requested relief by way of counterclaims. On December 21, 2018, FNCB, the Bank and F&D resolved the dispute by entering into a mutual release of all claims. FNCB recognized a gain of \$6.0 million after expenses in the fourth quarter of 2018 in connection with this insurance recovery.

FNCB has been subject to tax audits, and is also a party to routine litigation involving various aspects of its business, such as employment practice claims, workers compensation claims, claims to enforce liens, condemnation proceedings on properties in which FNCB holds security interests, claims involving the making and servicing of real property loans and other issues incident to its business, none of which has or is expected to have a material adverse impact on the consolidated financial condition, results of operations or liquidity of FNCB.

There have been *no* changes in the status of the other litigation disclosed in FNCB’s Annual Report on Form 10-K for the year ended *December 31, 2018*.

## Note 8. Stock Compensation Plans

FNCB has a Long-Term Incentive Compensation Plan (“LTIP”) for directors, executives and key employees. The LTIP authorizes up to 1,200,000 shares of common stock for issuance and provides the Board of Directors with the authority to offer several different types of long-term incentives, including stock options, stock appreciation rights, restricted stock, restricted stock units, performance units and performance shares. During the *three* months ended *March 31, 2019* and *2018*, the Board of Directors granted 57,684 and 57,829 shares of restricted stock, respectively, under the LTIP. At *March 31, 2019*, there were 865,004 shares of common stock available for award under the LTIP. For the *three* months ended *March 31, 2019* and *2018*, stock-based compensation expense, which is included in salaries and benefits expense in the consolidated statements of income, totaled \$67 thousand and \$72 thousand, respectively. Total unrecognized compensation expense related to unvested restricted stock awards was \$1.1 million and \$883 thousand at *March 31, 2019* and *2018*, respectively. Unrecognized compensation expense related to unvested shares of restricted stock is expected to be recognized over a weighted-average period of 4.4 years.

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The following table summarizes the activity related to FNCB's unvested restricted stock awards during the *three* months ended *March 31, 2019* and *2018*:

	Three Months Ended March 31, 2019		2018	
	Restricted Shares	Weighted- Average Grant Date Fair Value	Restricted Shares	Weighted- Average Grant Date Fair Value
(dollars in thousands)				
Unvested restricted stock awards at January 1,	114,702	\$ 7.50	106,129	\$ 6.23
Awards granted	57,684	7.64	57,829	8.54
Forfeitures	-	-	(1,279 )	6.88
Vestings	-	-	-	-
Unvested restricted stock awards at March 31,	172,386	\$ 7.55	162,679	\$ 7.05

FNCB had an Employee Stock Incentive Plan (the "Stock Incentive Plan"), under which options were granted to key officers and other employees of FNCB. The aggregate number of shares authorized to be issued upon exercise of the options under the Stock Incentive Plan could *not* exceed *1,100,000* shares. Options and rights granted under the Stock Incentive Plan became exercisable *six* months after the date the options were awarded and expire *ten* years after the award date. Upon exercise, the shares are issued from FNCB's authorized but unissued stock. The Stock Incentive Plan expired on *August 30, 2010*. Accordingly, *no* further grants have been, or will be, made under the Stock Incentive Plan. *No* compensation expense related to options under the Stock Incentive Plan was required to be recorded in the *three* months ended *March 31, 2019* and *2018*. *On January 5, 2019, the last 19,200 stock options outstanding under the Stock Incentive Plan expired and were forfeited.*

**Note 9. Regulatory Matters/Subsequent Event**

On January 28, 2019, FNCB announced that it had commenced a public offering of shares of its common stock in a firm commitment underwritten offering. The offering closed on February 8, 2019 and FNCB issued 3,285,550 shares of its common stock, which included 428,550 shares issued upon the exercise in full of the option to purchase additional shares granted to underwriters, at an offering price of \$7.00 per share, less an underwriting discount of \$0.35 per share. FNCB received net proceeds after deducting the underwriting discount and offering expenses of \$21.3 million. Following the receipt of the proceeds, during the first quarter of 2019, FNCB made a capital investment in FNCB Bank, its wholly-owned subsidiary of \$17.8 million.

FNCB's ability to pay dividends to its shareholders is largely dependent on the Bank's ability to pay dividends to FNCB. Bank regulations limit the amount of dividends that *may* be paid without prior approval of the Bank's regulatory agency. For the *three* months ended *March 31, 2019* and *2018*, cash dividends declared and paid by FNCB were *\$0.05* per share and *\$0.04* per share, respectively. FNCB offers a Dividend Reinvestment and Stock Purchase Plan ("DRP") to its shareholders. Effective *July 1, 2017*, shares acquired under the DRP were purchased in open market transactions. Previously, FNCB issued shares under the DRP from authorized but unissued common shares. In *January 2018*, FNCB elected to continue purchasing dividend reinvestment shares in open market transactions, but decided to issue shares from authorized but unissued common shares for optional cash purchases. Common shares issued under the DRP for the *three* months ended *March 31, 2019* and *2018* totaled 1,640 and 8,637, respectively. Additionally, on *April 24, 2019*, FNCB declared a cash dividend for the *second* quarter of *2019* of *\$0.05* per share, which is payable on *June 17, 2019* to shareholders of record as of *June 3, 2019*.

FNCB and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material adverse effect on FNCB's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, FNCB and the Bank must meet specific capital guidelines that involve quantitative measures of FNCB's and the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. FNCB's and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Management believes, as of March 31, 2019, that FNCB and the Bank meet all applicable capital adequacy requirements.

Current quantitative measures established by regulation to ensure capital adequacy require FNCB to maintain minimum amounts and ratios (set forth in the tables below) of Total capital, Tier I capital, and Tier I common equity (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined).

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The following tables present summary information regarding FNCB's and the Bank's risk-based capital and related ratios at *March 31, 2019* and *December 31, 2018*:

(in thousands)	Consolidated		Bank Only		Minimum Required For Capital Adequacy Purposes	Minimum Required For Capital Adequacy Purposes with Conservation Buffer	Minimum Required For Capital Adequacy Purposes	Minimum Required For Capital Adequacy Purposes	Minimum Required To Be Well Capitalized Under Prompt Corrective Regulations*
	Amount	Ratio	Amount	Ratio					
March 31, 2019									
Total capital (to risk-weighted assets)	\$ 138,537	15.06%	\$ 132,980	14.49%	8.00 %	10.50 %	10.00 %		
Tier I capital (to risk-weighted assets)	129,009	14.03%	123,452	13.45%	6.00 %	8.50 %	8.00 %		
Tier I common equity (to risk-weighted assets)	119,009	12.94%	123,452	13.45%	4.50 %	7.00 %	6.50 %		
Tier I capital (to average assets)	129,009	10.45%	123,452	10.07%	4.00 %	4.00 %	5.00 %		
Total risk-weighted assets	919,672		917,523						
Total average assets	1,234,306		1,226,302						
	<b>Consolidated</b>		<b>Bank Only</b>		<b>Minimum Required For Capital Adequacy Purposes</b>	<b>Minimum Required For Capital Adequacy Purposes</b>	<b>Minimum Required To Be Well Capitalized Under Prompt Corrective Regulations*</b>		



(in thousands) December 31, 2018	Amount	Ratio	Amount	Ratio	Purposes		Purposes with		Capitalized	
					Ratio	Ratio	Buffer	Conservation	Under Prompt	Corrective
Total capital (to risk-weighted assets)	\$ 117,213	12.69%	\$ 112,128	12.17%	8.00	%	9.875	%	10.00	%
Tier I capital (to risk-weighted assets)	105,439	11.42%	102,354	11.11%	6.00	%	7.875	%	8.00	%
Tier I common equity (to risk-weighted assets)	96,692	10.47%	102,354	11.11%	4.50	%	6.375	%	6.50	%
Tier I capital (to average assets)	105,439	8.50 %	102,354	8.27 %	4.00	%	4.000	%	5.00	%
Total risk-weighted assets	923,441		921,126							
Total average assets	1,239,898		1,238,347							

\*Applies to the Bank only.

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**Note 10. Fair Value Measurements**

In determining fair value, FNCB uses various valuation approaches, including market, income and cost approaches. Accounting standards establish a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability, which are developed based on market data obtained from sources independent of FNCB. Unobservable inputs reflect FNCB's knowledge about the assumptions the market participants would use in pricing an asset or liability, which are developed based on the best information available in the circumstances.

The fair value hierarchy gives the highest priority to unadjusted quoted market prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). A financial asset or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The fair value hierarchy is broken down into *three* levels based on the reliability of inputs as follows:

Level 1 valuation is based upon unadjusted quoted market prices for identical instruments traded in active markets;

Level 2 valuation is based upon quoted market prices for similar instruments traded in active markets, quoted market prices for identical or similar instruments traded in markets that are *not* active and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by market data; and

Level 3 valuation is derived from other valuation methodologies including discounted cash flow models and similar techniques that use significant assumptions *not* observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in determining fair value.

A description of the valuation methodologies used for assets recorded at fair value is set forth below.

**Available-for-Sale Debt Securities**

The estimated fair values for FNCB's investments in obligations of U.S. government agencies, obligations of state and political subdivisions, government-sponsored agency CMOs and mortgage-backed securities, private collateralized mortgage obligations, asset-backed securities and negotiable certificates of deposit are obtained by FNCB from a nationally-recognized pricing service. This pricing service develops estimated fair values by analyzing like securities

and applying available market information through processes such as benchmark curves, benchmarking of like securities, sector groupings and matrix pricing (Level 2 inputs), to prepare valuations. Matrix pricing is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities. The fair value measurements consider observable data that may include, among other things, dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, and are based on market data obtained from sources independent from FNCB. The Level 2 investments in FNCB's portfolio are priced using those inputs that, based on the analysis prepared by the pricing service, reflect the assumptions that market participants would use to price the assets. Management has determined that the Level 2 designation is appropriate for these securities because, as with most fixed-income securities, those in FNCB's portfolio are not exchange-traded, and such non-exchange-traded fixed income securities are typically priced by correlation to observed market data. FNCB has reviewed the pricing service's methodology to confirm its understanding that such methodology results in a valuation based on quoted market prices for similar instruments traded in active markets, quoted markets for identical or similar instruments traded in markets that are not active and model-based valuation techniques for which the significant assumptions can be corroborated by market data as appropriate to a Level 2 designation.

For those securities for which the inputs used by an independent pricing service were derived from unobservable market information, FNCB evaluated the appropriateness and quality of each price. Management reviewed the volume and level of activity for all classes of securities and attempted to identify transactions which may not be orderly or reflective of a significant level of activity and volume. For securities meeting these criteria, the quoted prices received from either market participants or an independent pricing service may be adjusted, as necessary, to estimate fair value (fair values based on Level 3 inputs). If applicable, the adjustment to fair value was derived based on present value cash flow model projections obtained from third party providers using assumptions similar to those incorporated by market participants.

At March 31, 2019, FNCB owned four corporate debt securities with an aggregate amortized cost and fair value of \$5.0 million and \$4.9 million, respectively. The market for three of the four corporate debt securities at March 31, 2019 was not active and markets for similar securities are also not active. FNCB obtained valuations for these securities from a third-party service provider that prepared the valuations using a discounted cash flow approach. Management takes measures to validate the service provider's analysis and is actively involved in the valuation process, including reviewing and verifying the assumptions used in the valuation calculations. Results of a discounted cash flow test are significantly affected by variables such as the estimate of the probability of default, estimates of future cash flows, discount rates, prepayment rates and the creditworthiness of the underlying issuers. FNCB considers these inputs to be unobservable Level 3 inputs because they are based on estimates about the assumptions market participants would use in pricing this type of asset and developed based on the best information available in the circumstances rather than on observable inputs. As it relates to fair value measurements, once each issuer is categorized and the forecasted default rates have been applied, the expected cash flows are modeled using the variables described above. Discount rates ranging from 6.50% to 7.00% were applied to the expected cash flows to estimate fair value. Management will continue to monitor the market for these securities to assess the market activity and the availability of observable inputs and will continue to apply these controls and procedures to the valuations received from its third-party service provider for the period it continues to use an outside valuation service.

## **Equity Securities**

The estimated fair values of equity securities are determined by obtaining quoted prices on nationally recognized exchanges (Level 1 inputs).

Table of Contents**Assets Measured at Fair Value on a Recurring Basis**

The following tables present the financial assets that are measured at fair value on a recurring basis at *March 31, 2019* and *December 31, 2018*, and the fair value hierarchy of the respective valuation techniques utilized by FNCB to determine the fair value:

<b>Fair Value Measurements at March 31, 2019</b>				
	<b>Fair Value</b>	<b>Quoted Prices in Active Markets for Identical Assets</b>	<b>Significant Other Observable Inputs</b>	<b>Significant Other Unobservable Inputs</b>
		<b>(Level 1)</b>	<b>(Level 2)</b>	<b>(Level 3)</b>
<b>(in thousands)</b>				
<b>Available-for-sale debt securities:</b>				
Obligations of state and political subdivisions	\$ 132,124	\$ -	\$ 132,124	\$ -
U.S. government/government-sponsored agencies:				
Collateralized mortgage obligations - residential	33,952	-	33,952	-
Collateralized mortgage obligations - commercial	75,143	-	75,143	-
Mortgage-backed securities	21,112	-	21,112	-
Private collateralized mortgage obligations	2,807	-	2,807	-
Corporate debt securities	4,993	-	1,023	3,970
Asset-backed securities	1,560	-	1,560	-
Negotiable certificates of deposit	2,423	-	2,423	-
Total available-for-sale debt securities	\$ 274,114	\$ -	\$ 270,144	\$ 3,970
Equity securities, at fair value	\$ 903	\$ 903	\$ -	\$ -

<b>Fair Value Measurements at December 31, 2018</b>				
	<b>Fair Value</b>	<b>Quoted Prices in Active Markets for Identical Assets</b>	<b>Significant Other Observable Inputs</b>	<b>Significant Other Unobservable Inputs</b>
		<b>(Level 1)</b>	<b>(Level 2)</b>	<b>(Level 3)</b>
<b>(in thousands)</b>				
<b>Available-for-sale debt securities:</b>				

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Obligations of state and political subdivisions	\$ 152,187	\$ -	\$ 152,187	\$ -
U.S. government/government-sponsored agencies:				
Collateralized mortgage obligations - residential	34,207	-	34,207	-
Collateralized mortgage obligations - commercial	73,640	-	73,640	-
Mortgage-backed securities	23,934	-	23,934	-
Private collateralized mortgage obligations	2,913	-	2,913	-
Corporate debt securities	4,936	-	1,007	3,929
Asset-backed securities	1,802	-	1,802	-
Negotiable certificates of deposit	2,413	-	2,413	-
Total available-for-sale debt securities	\$ 296,032	\$ -	\$ 292,103	\$ 3,929
Equity securities, at fair value	\$ 891	\$ 891	\$ -	\$ -

There were *no* transfers between levels within the fair value hierarchy during the *three* months ended *March 31, 2019* and *2018*.

The following table presents a reconciliation and statement of operations classifications of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3), which consisted entirely of corporate debt securities, for the three months ended March 31, 2019 and 2018.

**Fair Value Measurements**

**Using Significant Unobservable Inputs (Level 3)**

<b>(in thousands)</b>	<b>Corporate Debt Securities For the Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
Balance at January 1,	\$3,929	\$4,058
Additions	-	-
Payments Received	-	-
Sales	-	-
Total gains or losses (realized/unrealized):		
Included in earnings	-	-
Included in other comprehensive income (loss)	41	(53 )
Balance at March 31,	\$3,970	\$4,005

Table of Contents**Assets Measured at Fair Value on a Non-Recurring Basis**

The following tables present assets and liabilities measured at fair value on a non-recurring basis at *March 31, 2019* and *December 31, 2018*, and additional quantitative information about the valuation techniques and inputs utilized by FNCB to determine fair value. All assets were measured using Level 3 inputs.

(in thousands)	March 31, 2019			Quantitative Information Valuation Technique	Unobservable Inputs	Value/ Range	
	Fair Value Recorded Investment	Valuation Allowance	Fair Value				
Impaired loans - collateral dependent	\$8,635	\$ 605	\$8,030	Appraisal of collateral	Selling cost	10.0	%
Impaired loans - other	4,838	301	4,537	Discounted cash flows	Discount rate	4.0%-7.5%	
Other real estate owned	-	-	-	Appraisal of collateral	Selling cost	10.0	%

(in thousands)	December 31, 2018			Quantitative Information Valuation Technique	Unobservable Inputs	Value/ Range	
	Fair Value Recorded Investment	Valuation Allowance	Fair Value				
Impaired loans - collateral dependent	\$8,020	\$ 606	\$7,414	Appraisal of collateral	Selling cost	10.0	%
Impaired loans - other	4,397	51	4,346	Discounted cash flows	Discount rate	3.7%-7.5%	
Other real estate owned	919	-	919	Appraisal of collateral	Selling cost	10.0	%

The fair value of collateral-dependent impaired loans is determined through independent appraisals or other reasonable offers, which generally include various Level 3 inputs which are *not* identifiable. Management reduces the appraised value by the estimated costs to sell the property and *may* make adjustments to the appraised values as necessary to consider any declines in real estate values since the time of the appraisal. For impaired loans that are *not* collateral-dependent, fair value is determined using the discounted cash flow method. When the measure of the impaired loan is less than the recorded investment in the loan, the impairment is recorded through a valuation allowance or is charged off. The amount shown is the balance of impaired loans, net of any charge-offs and the related allowance for loan losses.

OREO properties are recorded at fair value less the estimated cost to sell at the date of FNCB's acquisition of the property. Subsequent to acquisition of the property, the balance *may* be written down further. It is FNCB's policy to obtain certified external appraisals of real estate collateral underlying impaired loans and OREO, and estimate fair value using those appraisals. Other valuation sources *may* be used, including broker price opinions, letters of intent and executed sale agreements.

The following table summarizes the estimated fair values of FNCB's financial instruments using an exit price notion at *March 31, 2019* and at *December 31, 2018*. FNCB discloses fair value information about financial instruments, whether or *not* recognized in the statements of financial condition, for which it is practicable to estimate that value. The fair value of financial instruments that are not measured at fair value in the financial statements were based on the exit price notion. The following estimated fair value amounts have been determined using available market information and appropriate valuation methodologies. However, management judgment is required to interpret data and develop fair value estimates. Accordingly, the estimates below are *not* necessarily indicative of the amounts FNCB could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies *may* have a material effect on the estimated fair value amounts.

(in thousands)	Fair Value Measurement	March 31, 2019		December 31, 2018	
		Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets					
Cash and short term investments	Level 1	\$32,745	\$32,745	\$36,481	\$36,481
Available-for-sale debt securities	See previous table	274,114	274,114	296,032	296,032
Equity securities, at fair value	Level 1	903	903	891	891
Restricted stock	Level 2	3,120	3,120	3,123	3,123
Loans held for sale	Level 2	609	609	820	820
Loans, net	Level 3	829,611	817,729	829,581	816,234
Accrued interest receivable	Level 2	3,706	3,706	3,614	3,614
Equity securities without readily determinable fair values	Level 3	1,658	1,658	1,658	1,658
Servicing rights	Level 3	350	836	350	878
Financial liabilities					
Deposits	Level 2	1,040,090	1,038,922	1,095,629	1,093,797
Borrowed funds	Level 2	39,298	39,267	34,240	34,108
Accrued interest payable	Level 2	339	339	338	338



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For FNCB, the numerator of both the basic and diluted earnings per share of common stock is net income available to common shareholders. The weighted average number of common shares outstanding used in the denominator for basic earnings per common share is increased to determine the denominator used for diluted earnings per common share by the effect of potentially dilutive common share equivalents utilizing the treasury stock method. Common share equivalents are outstanding stock options to purchase FNCB's shares of common stock and unvested restricted stock.

The following table presents the calculation of both basic and diluted earnings per share of common stock for the *three months ended March 31, 2019 and 2018*:

<b>(in thousands, except share data)</b>	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2019</b>	<b>2018</b>
Net income	\$2,635	\$2,019
Basic weighted-average number of common shares outstanding	18,720,502	16,763,401
Plus: Common share equivalents	13,150	25,935
Diluted weighted-average number of common shares outstanding	18,733,652	16,789,336
Income per common share:		
Basic	\$0.14	\$0.12
Diluted	\$0.14	\$0.12

For the *three months ended March 31, 2019 and 2018*, common stock equivalents reflected in the table above were related entirely to the incremental shares of unvested restricted stock. As of March 31, 2019, there were no other outstanding stock options. Stock options of 19,200 for the *three months ended March 31, 2018* were excluded from common stock equivalents. The exercise prices of stock options exceeded the average market price of FNCB's common shares at March 31, 2018; therefore, inclusion of these common stock equivalents would be anti-dilutive to the diluted earnings per common share calculation.

**Note 12 . Other Comprehensive Income**

The following table summarizes the reclassifications out of accumulated other comprehensive income (loss) for the *three* months ended *March 31, 2019*, comprised entirely of unrealized gains and losses on available-for-sale debt securities:

<b>(in thousands)</b>	<b>Three Months Ended March 31, 2019</b>	<b>Amount</b>	<b>Reclassified</b>	<b>from</b>	<b>Accumulated Line Item in the</b>	<b>Other Consolidated Statements of Income</b>	<b>Comprehensive</b>	<b>Income</b>	<b>(Loss)</b>
Available-for-sale debt securities:									
Reclassification adjustment for net gains reclassified into net income	\$(160)							Net gain (loss) on the sale of available-for-sale debt securities	
Taxes	34							Income taxes	
Net of tax amount	\$(126)								

There were *no* reclassifications out of accumulated other comprehensive income (loss) for the *three* months ended *March 31, 2018*.

The following table summarizes the changes in accumulated other comprehensive (loss) income, net of tax for the *three* months ended *March 31, 2019* and *2018*:

<b>(in thousands)</b>	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
Balance, beginning of period	\$(4,540)	\$(1,745)
Other comprehensive income (loss) before reclassifications	3,677	(3,932)
Amount reclassified from accumulated other comprehensive income (loss)	(126 )	-
Net other comprehensive income (loss) during the period	3,551	(3,932)
Reclassification of net loss on equity securities upon adoption of ASU 2016-1	-	65
Balance, end of period	\$(989 )	\$(5,612)

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**Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”)**

This Quarterly Report should be read in conjunction with the more detailed and comprehensive disclosures included in the Annual Report on Form 10-K for the year ended December 31, 2018 for FNCB Bancorp, Inc. In addition, please read this section in conjunction with the consolidated financial statements and notes to consolidated financial statements contained elsewhere herein.

FNCB Bancorp, Inc. and its subsidiaries ("FNCB") are in the business of providing customary retail and commercial banking services to individuals, businesses and local governments and municipalities through its wholly-owned subsidiary, FNCB Bank, at its 16 full-service branch offices within its primary market area, Northeastern Pennsylvania, and a LPO based in Allentown, Lehigh County, Pennsylvania.

**FORWARD-LOOKING STATEMENTS**

FNCB may from time to time make written or oral “forward-looking statements,” including statements contained in our filings with the Securities and Exchange Commission (“SEC”), in our reports to shareholders, and in our other communications, which are made in good faith by us pursuant to the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements include statements with respect to FNCB’s beliefs, plans, objectives, goals, expectations, anticipations, estimates and intentions, that are subject to significant risks and uncertainties, and are subject to change based on various factors (some of which are beyond our control). The words “may,” “could,” “should,” “will,” “would,” “believe,” “anticipate,” “estimate,” “expect,” “intend,” “plan,” “project,” “future” and similar expressions are used to identify forward-looking statements. The following factors, among others, could cause FNCB’s financial performance to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements: the strength of the United States economy in general and the strength of the local economies in our markets; the effects of, and changes in trade, monetary, fiscal and tax policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System; inflation, interest rate, market and monetary fluctuations; the timely development of and acceptance of new products and services; the ability of FNCB to compete with other institutions for business, including for deposit and loan growth; the composition and concentrations of FNCB’s lending risk and the adequacy of FNCB’s reserves to manage those risks; the valuation of FNCB’s investment securities; the ability of FNCB to pay dividends or repurchase common shares; the ability of FNCB to retain key personnel; the impact of any pending or threatened litigation against FNCB; the marketability of shares of FNCB stock and fluctuations in the value of FNCB’s share price; the effectiveness of FNCB’s system of internal controls; the ability of FNCB to attract additional capital investment; the impact of changes in financial services’ laws and regulations (including laws concerning capital adequacy, taxes, banking, securities and insurance); the ability of FNCB to identify future acquisition targets, complete acquisitions and integrate new teams into FNCB’s

operations; the impact of technological changes and security risks upon our information technology systems; changes in consumer spending and saving habits; the nature, extent, and timing of governmental actions and reforms, and the success of FNCB at managing the risks involved in the foregoing and other risks and uncertainties, including those detailed in FNCB's filings with the SEC.

FNCB cautions that the foregoing list of important factors is not all inclusive. Readers are also cautioned not to place undue reliance on any forward-looking statements, which reflect management's analysis only as of the date of this report, even if subsequently made available by FNCB on its website or otherwise. FNCB does not undertake to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of FNCB to reflect events or circumstances occurring after the date of this report.

Readers should carefully review the risk factors described in the Annual Report and other documents that FNCB periodically files with the SEC, including its Form 10-K for the year ended December 31, 2018.

## **CRITICAL ACCOUNTING POLICIES**

In preparing the consolidated financial statements, management has made estimates, judgments and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated statements of condition and results of operations for the periods indicated. Actual results could differ significantly from those estimates.

FNCB's accounting policies are fundamental to understanding management's discussion and analysis of its financial condition and results of operations. Management has identified the policies on the determination of the allowance for loan and lease losses ("ALLL"), securities' valuation and impairment evaluation, the valuation of other real estate owned ("OREO") and income taxes to be critical, as management is required to make subjective and/or complex judgments about matters that are inherently uncertain and could be most subject to revision as new information becomes available.

The judgments used by management in applying the critical accounting policies discussed below may be affected by changes and/or deterioration in the economic environment, which may impact future financial results. Specifically, subsequent evaluations of the loan portfolio, in light of the factors then prevailing, may result in significant changes in the ALLL in future periods, and the inability to collect on outstanding loans could result in increased loan losses. In addition, the valuation of certain securities in FNCB's investment portfolio could be negatively impacted by illiquidity or dislocation in marketplaces resulting in significantly depressed market prices thus leading to impairment losses.

### *Allowance for Loan and Lease Losses*

Management evaluates the credit quality of FNCB's loan portfolio on an ongoing basis, and performs a formal review of the adequacy of the ALLL on a quarterly basis. The ALLL is established through a provision for loan losses charged to earnings and is maintained at a level management considers adequate to absorb estimated probable losses inherent in the loan portfolio as of the evaluation date. Loans, or portions of loans, determined by management to be uncollectible are charged off against the ALLL, while recoveries of amounts previously charged off are credited to the ALLL.

Determining the amount of the ALLL is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, qualitative factors, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. Banking regulators, as an integral part of their examination of FNCB, also review the ALLL, and may require, based on their judgments about information available to them at the time of their examination, that certain loan balances be charged off or require that adjustments be made to the ALLL. Additionally, the ALLL is determined, in part, by the composition and size of the loan portfolio.

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The ALLL consists of two components, a specific component and a general component. The specific component relates to loans that are classified as impaired. For such loans, an allowance is established when the discounted cash flows, collateral value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers all other loans and is based on historical loss experience adjusted by qualitative factors. The general reserve component of the ALLL is based on pools of unimpaired loans segregated by loan segment and risk rating categories of “Pass”, “Special Mention” or “Substandard and Accruing.” Historical loss factors and various qualitative factors are applied based on the risk profile in each risk rating category to determine the appropriate reserve related to those loans. Substandard loans on non-accrual status above the \$100 thousand loan relationship threshold and all loans considered troubled debt restructurings (“TDRs”) are classified as impaired.

See Note 4, “Loans” of the notes to consolidated financial statements included in Item 1 hereof for additional information about the ALLL.

*Securities Valuation and Evaluation for Impairment*

Management utilizes various inputs to determine the fair value of its investment portfolio. To the extent they exist, unadjusted quoted market prices in active markets (Level 1) or quoted prices for similar assets or models using inputs that are observable, either directly or indirectly (Level 2) are utilized to determine the fair value of each investment in the portfolio. In the absence of observable inputs or if markets are illiquid, valuation techniques are used to determine fair value of any investments that require inputs that are both unobservable and significant to the fair value measurement (Level 3). For Level 3 inputs, valuation techniques are based on various assumptions, including, but not limited to, cash flows, discount rates, adjustments for nonperformance and liquidity, and liquidation values. A significant degree of judgment is involved in valuing investments using Level 3 inputs. The use of different assumptions could have a positive or negative effect on FNCB’s financial condition or results of operations. See Note 3, “Securities” and Note 10, “Fair Value Measurements” of the notes to consolidated financial statements included in Item 1 hereof for additional information about FNCB’s securities valuation techniques.

On a quarterly basis, management evaluates individual investment securities in an unrealized loss position for other than temporary impairment (“OTTI”). The evaluation for OTTI requires the use of various assumptions, including but not limited to, the length of time an investment’s fair value is less than book value, the severity of the investment’s decline, any credit deterioration of the issuer, whether management intends to sell the security, and whether it is more-likely-than-not that FNCB will be required to sell the security prior to recovery of its amortized cost basis. Debt investment securities deemed to have OTTI are written down by the impairment related to the estimated credit loss, and the non-credit related impairment loss is recognized in other comprehensive income. FNCB did not recognize any OTTI charges on investment securities for the three months ended March 31, 2019 and 2018 within the consolidated statements of income.

Refer to Note 3, "Securities," of the notes to consolidated financial statements included in Item 1 hereof for additional information about valuation of securities.

#### *Other Real Estate Owned*

OREO consists of property acquired by foreclosure, abandonment or conveyance of deed in-lieu of foreclosure of a loan, and bank premises that are no longer used for operation or for future expansion. OREO is held for sale and is initially recorded at fair value less costs to sell at the date of acquisition or transfer, which establishes a new cost basis. Upon acquisition of the property through foreclosure or deed-in-lieu of foreclosure, any adjustment to fair value less estimated selling costs is recorded to the ALLL. The determination is made on an individual asset basis. Bank premises no longer used for operations or future expansion are transferred to OREO at fair value less estimated selling costs with any related write-down included in non-interest expense. Subsequent to acquisition, valuations are periodically performed and the assets are carried at the lower of cost or fair value less cost to sell. Fair value is determined through external appraisals, current letters of intent, broker price opinions or executed agreements of sale, unless management determines that conditions exist that warrant an adjustment to the value. Costs relating to the development and improvement of the OREO properties may be capitalized; holding period costs and any subsequent changes to the valuation allowance are charged to expense as incurred.

#### *Income Taxes*

The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in FNCB's consolidated financial statements or tax returns. Fluctuations in the actual outcome of these future tax consequences could impact our consolidated financial condition or results of operations.

FNCB records an income tax provision or benefit based on the amount of tax currently payable or receivable and the change in deferred tax assets and liabilities. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial and tax reporting purposes. Management conducts quarterly assessments of all available positive and negative evidence to determine the amount of deferred tax assets that will more likely than not be realized. FNCB establishes a valuation allowance for deferred tax assets and records a charge to income if management determines, based on available evidence at the time the determination is made, that it is more likely than not that some portion or all of the deferred tax assets will not be realized. In evaluating the need for a valuation allowance, management considers past operating results, estimates of future taxable income based on approved business plans, future capital requirements and ongoing tax planning strategies. This evaluation process involves significant management judgment about assumptions that are subject to change from period to period depending on the related circumstances. The recognition of deferred tax assets requires management to make significant assumptions and judgments about future earnings, the periods in which items will impact taxable income, future corporate tax rates, and the application of inherently complex tax laws. The use of different estimates can result in changes in the amounts of deferred tax items recognized, which may result in equity and earnings volatility because such changes are reported in current period earnings.





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In connection with determining the income tax provision or benefit, management considers maintaining liabilities for uncertain tax positions and tax strategies that it believes contain an element of uncertainty. Periodically, management evaluates each of FNCB's tax positions and strategies to determine whether a liability for uncertain tax benefits is required. As of March 31, 2019 and December 31, 2018, management determined that FNCB did not have any uncertain tax positions or tax strategies and that no liability was required to be recorded.

Refer to Note 5, "Income Taxes," of the notes to consolidated financial statements included in Item 1 hereof for additional information about income taxes.

## **New Authoritative Accounting Guidance and Accounting Guidance to be Adopted in Future Periods**

Refer to Note 2, "New Authoritative Accounting Guidance," of the notes to consolidated financial statements included in Item 1 hereof for information about new authoritative accounting guidance adopted by FNCB during the three months ended March 31, 2019, as well as new accounting guidance issued, but not previously reported, that will be adopted by FNCB in future periods.

## **Executive Summary**

The following overview should be read in conjunction with this MD&A in its entirety.

FNCB recorded consolidated net income of \$2.6 million, or \$0.14 per diluted common share, for the three months ended March 31, 2019, an increase of \$0.6 million, or 30.5%, compared to \$2.0 million, or \$0.12 per diluted common share, for the three months ended March 31, 2018. Annualized return on average assets and return on average equity were 0.86% and 9.70%, respectively, for the three months ended March 31, 2019, compared to 0.70% and 9.44%, respectively, for three months ended March 31, 2018. FNCB paid a dividend of \$0.05 per share to holders of common stock in the first quarter of 2019, an increase of \$0.01 per share, or 25.0%, compared to a dividend of \$0.04 per share paid to holders of common stock in the first quarter of 2018.

The improvement in first quarter earnings primarily reflected a credit for loan and lease losses of \$154 thousand in 2019 compared to a provision for loan and lease losses of \$720 million in 2018 and an increase in net interest income, partially offset by an increases of \$193 thousand, or 2.7%, in non-interest expenses and \$129 thousand, or 30.3%, in income tax expense comparing the three-month periods ended March 31, 2019 and 2018.

Total assets decreased \$23.3 million, or 1.9%, to \$1.214 billion at March 31, 2019 from \$1.238 billion at December 31, 2018. The change in total assets primarily reflected a \$21.9 million, or 7.4%, decrease in available-for-sale debt securities to \$274.1 million at March 31, 2019 from \$296.0 million at December 31, 2018. During the first quarter of 2019, FNCB sold available-for-sale debt securities with an aggregate amortized cost basis of \$25.0 million. The proceeds from the sale of securities were used to supplement cyclical deposit trends and minimize wholesale funding utilization. Total deposits decreased by \$55.5 million, or 5.1%, to \$1.040 billion at March 31, 2019 from \$1.096 billion at December 31, 2018. The decline in deposits was primarily attributable to cyclical net outflows of public funds.

Total shareholders' equity increased \$26.6 million, or 27.3%, to \$123.8 million at March 31, 2019 from \$97.2 million at December 31, 2018. FNCB successfully completed a public offering of its common stock, which resulted in a net increase to capital after offering expenses of \$21.3 million. Also contributing to the increase in capital was net income for the three months ended March 31, 2019 of \$2.6 million and a \$3.6 million decrease in accumulated other comprehensive loss related to appreciation in the fair value of FNCB's available-for-sale securities, net of income taxes. Partially offsetting these increases were dividends declared and paid of \$1.0 million for the first quarter of 2019.

During the second quarter of 2019 FNCB anticipates opening a de novo branch in Mountain Top, Luzerne County, Pennsylvania in a facility that was purchased during in the fourth quarter of 2018. Also, in the second quarter of 2019, FNCB expects to complete the construction and relocation of its main office into a new state-of-the-art facility. The new main office will be located directly across the street at 100 S. Blakely Street, Dunmore, Lackawanna County, Pennsylvania. Both locations will feature the personal banker model and a relaxed, cafe-like atmosphere. The main office relocation project is expected to cost \$2.0 million, which is being funded by cash generated from operations.

For the remainder of 2019, management is focused on growing core deposit relationship, managing funding costs and creating efficiency within the balance sheet through effective asset/liability management strategies. In order to assist in these initiatives, at the beginning of 2019, FNCB appointed a Chief Banking Officer to its Executive Management Team. The Chief Banking Officer, who has extensive retail financial sales and managerial experience will oversee FNCB's commercial lending and retailing lending and banking units.

Table of Contents**Summary of Performance****Net Interest Income**

Net interest income is the difference between (i) interest income, interest and fees on interest-earning assets, and (ii) interest expense, interest paid on deposits and borrowed funds. Net interest income represents the largest component of FNCB's operating income and, as such, is the primary determinant of profitability. Net interest income is impacted by variations in the volume, rate and composition of earning assets and interest-bearing liabilities, changes in general market rates and the level of non-performing assets. Interest income is shown on a fully tax-equivalent basis using the corporate statutory tax rate of 21.0%.

Net interest income on a tax-equivalent basis increased by a modest \$103 thousand, or 1.1%, to \$9.1 million for the three months ended March 31, 2019 from \$9.0 million for the same three months of 2018. Tax-equivalent interest income was positively impacted by increases attributable to both rate and volume of interest-earning assets, but was almost entirely offset by increases in rates paid on interest-bearing liabilities, as the cost of funding earning assets outpaced the increase in yields earned on interest-earning assets. Tax-equivalent interest income increased \$1.2 million, or 11.4%, to \$11.7 million for the three months ended March 31, 2019 from \$10.5 million for the three months ended March 31, 2018. The tax-equivalent yield on interest-earning assets improved by 23 basis points to 4.06% for the three months ended March 31, 2019 from 3.83% for the same three months of 2018, while average interest-earning assets increased by \$57.3 million, to \$1.157 billion at March 31, 2019 from \$1.100 billion at March 31, 2018. Offsetting the improvement in interest income was an increase in the rate paid on interest-bearing liabilities of 42 basis points, or 60.9%, to 1.11% for the three months ended March 31, 2019 as compared to 0.69% for the same three months of 2018. Similarly, the average balance of interest-bearing liabilities increased by \$52.8 million, or 5.8%, comparing first quarter 2019 and 2018. Tax-equivalent net interest margin, a key measurement used in the banking industry to measure income from earning assets relative to the cost to fund those assets, is calculated by dividing tax-equivalent net interest income by average interest-earning assets. FNCB's tax-equivalent net interest margin contracted by 12 basis points due to the factors detailed above, to 3.14% during the three months ended March 31, 2019 from 3.26% for the same three months of 2018. Rate spread, the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities shown on a fully tax-equivalent basis, was 2.95% for the three months ended March 31, 2019, a decrease of 19 basis points compared to 3.14% for the same period of 2018.

Interest income on a tax-equivalent basis increased \$1.2 million, or 11.4%, to \$11.7 million for the three-month period ended March 31, 2019, compared to \$10.5 million in 2018. The increase was attributed to both an increase in average earning assets of \$57.3 million, or 5.2%, as well as increases in the yields earned on the loan and investment portfolios. The largest increase was concentrated in the loan portfolio, as the average balance of loans increased by \$50.8 million, or 6.4%, to \$843.6 million at March 31, 2019 compared to \$792.8 million at March 31, 2018. The increase in the average balance of loans contributed \$541 thousand to the increase in interest income for the three months ended March 31, 2019, while an increase of \$5.7 million in average interest-bearing deposits in other banks contributed an additional \$28 thousand to the increase in interest income. In addition to the growth in average earning

assets, the tax-equivalent yield on earning assets increased by 23 basis points to 4.06% for the three months ended March 31, 2019 compared to 3.83% for the same period of 2018, driven by increases in the federal funds target rate and corresponding increases in the national prime lending rate and general market interest rates. Changes in the yields of earnings assets resulted in a \$622 thousand increase in tax-equivalent interest income. Specifically, the tax-equivalent yield on the loan portfolio contributed the majority of the increase, improving 29 basis points to 4.52% in the first quarter of 2019 from 4.23% for the same quarter of 2018, which resulted in a \$608 thousand increase in tax-equivalent interest income. The tax-equivalent yield on the investment portfolio increased 4 basis points to 2.85% for the first quarter of 2019 from 2.81% for the same period of 2018, which contributed \$19 thousand to the increase in tax-equivalent interest income.

Increases in the federal funds target rate also contributed to an increase in interest expense paid on interest-bearing liabilities. FNCB's net interest income levels were negatively impacted by a \$1.1 million, or 70.5%, increase in interest expense, attributable to an increase in interest expense due to rates of \$1.0 million, combined with an increase in interest expense due to volumes of \$99 thousand. FNCB's cost of funds for the first quarter of 2019 increased by 42 basis points to 1.11% compared to 0.69% for the same quarter of 2018. Higher average rates paid on interest-bearing deposits led to an increase in interest expense of \$908 thousand, concentrated in interest-bearing demand and time deposits. Specifically, the rate paid on interest-bearing demand deposits increased 34 basis points to 0.78% from 0.44% comparing the three months ended March 31, 2019 and 2018, which contributed \$442 thousand to the increase in interest expense paid on deposits. Additionally, the rate paid on time deposits increased by 72 basis points to 1.66% for the first quarter of 2019 compared to 0.94% for the same period of 2018, which contributed \$464 thousand to the increase in interest expense paid on deposits. Similarly, the rate paid on borrowed funds increased by 98 basis points to 2.91% for the three months ended March 31, 2019 as compared to 1.93% for the same three months of 2018, which resulted in an increase to interest expense of \$94 thousand. The average balance of interest-bearing deposits increased by \$97.0 million, or 12.0%, comparing first quarter 2019 and 2018, as deposits were used to offset borrowed funds, which declined \$44.3 million during the same period. Accounting for the majority of the increase in average-interest-bearing liabilities was an increase in average time deposits of \$78.4 million, or 38.2%, which resulted from retail certificate of deposits specials offered and increased utilization of wholesale time deposits. Comparing the three months ended March 31, 2019 and 2018, average retail time deposits increased \$27.1 million, or 14.8% and average wholesale time deposits increased \$51.3 million, which together resulted in a \$230 thousand increase to interest expense. Overall, changes in the volumes of interest-bearing liabilities resulted in an \$99 thousand to the increase in interest expense for the first quarter of 2019.

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Net interest income depends upon the relative amount of interest-earning assets and interest-bearing liabilities and the interest rate earned or paid on them. The following table presents certain information about FNCB's consolidated statements of financial condition and consolidated statements of income for the three-month periods ended March 31, 2019 and 2018, and reflects the average yield on assets and average cost of liabilities for the periods indicated. Such yields and costs are calculated by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods shown. Average balances are derived from average daily balances. The yields include amortization of fees which are considered adjustments to yields.

(dollars in thousands)	Three Months Ended March 31, 2019			March 31, 2018		
	Average Balance	Interest	Yield/ Cost	Average Balance	Interest	Yield/ Cost
<b>Assets</b>						
Earning assets (2)(3)						
Loans-taxable (4)	\$784,359	\$8,940	4.56 %	\$748,375	\$7,934	4.24 %
Loans-tax free (4)	59,220	591	3.99 %	44,383	448	4.04 %
Total loans (1)(2)	843,579	9,531	4.52 %	792,758	8,382	4.23 %
Securities-taxable	299,498	2,119	2.83 %	301,032	2,109	2.80 %
Securities-tax free	4,638	47	4.05 %	2,325	25	4.30 %
Total securities (1)(5)	304,136	2,166	2.85 %	303,357	2,134	2.81 %
Interest-bearing deposits in other banks	9,495	46	1.94 %	3,825	23	2.41 %
Total earning assets	1,157,210	11,743	4.06 %	1,099,940	10,539	3.83 %
Non-earning assets	91,544			85,217		
Allowance for loan and lease losses	(9,676 )			(9,103 )		
Total assets	\$1,239,078			\$1,176,054		
<b>Liabilities and Shareholders' Equity</b>						
Interest-bearing liabilities						
Interest-bearing demand deposits	\$527,722	1,031	0.78 %	\$496,240	552	0.44 %
Savings deposits	91,846	32	0.14 %	104,702	34	0.13 %
Time deposits	283,974	1,175	1.66 %	205,552	481	0.94 %
Total interest-bearing deposits	903,542	2,238	0.99 %	806,494	1,067	0.53 %
Borrowed funds and other interest-bearing liabilities	58,402	425	2.91 %	102,676	495	1.93 %
Total interest-bearing liabilities	961,944	2,663	1.11 %	909,170	1,562	0.69 %
Demand deposits	155,122			169,450		
Other liabilities	11,801			10,663		
Shareholders' equity	110,211			86,771		
Total liabilities and shareholder's equity	\$1,239,078			\$1,176,054		
Net interest income/interest rate spread (6)		9,080	2.95 %		8,977	3.14 %
Tax equivalent adjustment		(134 )			(99 )	
Net interest income as reported		\$8,946			\$8,878	
Net interest margin (7)			3.14 %			3.26 %

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- (1) Interest income is presented on a tax equivalent basis using a 21% rate.
- (2) Loans are stated net of unearned income.
- (3) Non-accrual loans are included in loans within earning assets
- (4) Loan fees included in interest income are not significant
- (5) The yields for securities that are classified as available for sale is based on the average historical amortized cost.
- (6) Interest rate spread represents the difference between the average yield on interest earning assets and the cost of interest bearing liabilities and is presented on a tax equivalent basis.
- (7) Net interest income as a percentage of total average interest earning assets.

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The most significant impact on net income between periods is derived from the interaction of changes in the volume and rates earned or paid on interest-earning assets and interest-bearing liabilities. The volume of earning assets, specifically loans and investments, compared to the volume of interest-bearing liabilities represented by deposits and borrowings, combined with the spread, produces the changes in net interest income between periods. Components of interest income and interest expense are presented on a tax-equivalent basis using the corporate federal income tax rate of 21%.

The following table summarizes the effect that changes in volumes of earning assets and interest-bearing liabilities and the interest rates earned and paid on these assets and liabilities have on net interest income. The net change or mix component attributable to the combined impact of rate and volume changes has been allocated proportionately to the change due to volume and the change due to rate.

	<b>Quarter Ended March 31, 2019 vs. 2018 Increase (Decrease)</b>		
	<b>Due to Volume</b>	<b>Due to Rate</b>	<b>Total Change</b>
<b>(dollars in thousands)</b>			
Interest income:			
Loans - taxable	\$393	\$613	\$ 1,006
Loans - tax free	148	(5 )	143
Total loans	541	608	1,149
Securities - taxable	(11 )	21	10
Securities - tax free	24	(2 )	22
Total securities	13	19	32
Interest-bearing deposits in other banks	28	(5 )	23
Total interest income	582	622	1,204
Interest expense:			
Interest-bearing demand deposits	37	442	479
Savings deposits	(4 )	2	(2 )
Time deposits	230	464	694
Total interest-bearing deposits	263	908	1,171
Borrowed funds and other interest-bearing liabilities	(164)	94	(70 )
Total interest expense	99	1,002	1,101
Net interest income	\$483	\$(380 )	\$ 103

### **Provision for Loan and Lease Losses**

Management closely monitors the loan portfolio and the adequacy of the ALLL by considering the underlying financial performance of the borrower, collateral values and associated credit risks. Future material adjustments may be necessary to the provision for loan and lease losses and the ALLL if economic conditions or loan performance differ substantially from the assumptions management considered in its evaluation of the ALLL. The provision for loan and lease losses is an expense charged against net interest income to provide for probable losses attributable to uncollectible loans and is based on management's analysis of the adequacy of the ALLL. A credit to loan and lease losses reflects the reversal of amounts previously charged to the ALLL.

FNCB recorded a credit for loan and lease losses of \$154 thousand for the three-month period ended March 31, 2019, compared to a provision of \$720 thousand for the three months ended March 31, 2018. The credit in the first quarter of 2019 primarily reflected a decrease in historical net charge-off rates. The provision recorded during the three months ended March 31, 2018 reflected an increase in the balance of net loans of \$37.0 million, coupled with net charge-offs for the period of \$192 thousand.



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**Non-interest Income**

For the three months ended March 31, 2019 and 2018, total non-interest income was relatively unchanged at \$1.5 million. FNCB realized net gains on the sale of available-for-sale debt securities of \$160 thousand during the first quarter of 2019. There were no net gains realized from the sale of available-for-sale debt securities during the same quarter of 2018. Additionally, comparing the three months ended 2019 and 2018, other income and net gains on the sale of mortgage loans increased by \$112 thousand and \$7 thousand, respectively, while deposit service charges decreased by \$17 thousand. During the first quarter of 2019, FNCB recorded a net gain on equity securities of \$12 thousand as compared to a net loss of \$19 thousand during the same period of 2018. Partially offsetting these positive factors were decreases in net gains on the sale of SBA guaranteed loans and other real estate owned of \$251 thousand and \$38 thousand, respectively, which were recorded during the first quarter of 2018, coupled with a decrease in deposit services charges of \$17 thousand.

**Non-interest Expense**

Non-interest expense increased \$193 thousand, or 2.7%, to \$7.4 million for the three months ended March 31, 2019 from \$7.2 million for the same three months of 2018. The change primarily reflected an increase of \$233 thousand, or 6.4%, in salaries and employee benefits expense related to recent staff additions, coupled with an increase in data processing expenses of \$133 thousand attributable to recent technology enhancements, advertising expenses of \$84 thousand and professional fees of \$36 thousand. Partially offsetting these increases were decreases in other operating expenses of \$176 thousand, occupancy expenses of \$53 thousand, regulatory assessments of \$33 thousand, and other losses of \$32 thousand. The decrease in other operating expense included a reduction in telecommunications expense related to network enhancements completed in 2018, coupled with a one-time application fee for FNCB's transition to the Nasdaq Capital Market for listing its shares of common stock paid in 2018.

**Provision for Income Taxes**

FNCB recorded income tax expense of \$555 thousand for the first quarter of 2019, an increase of \$129 thousand, or 30.3%, compared to income tax expense of \$426 thousand for the same quarter of 2018. The increase in income tax expense primarily reflected an increase in pre-tax net income of \$745 thousand, or 30.5%, when comparing the three months ended March 31, 2019 and 2018.

Management evaluates the carrying amount of its deferred tax assets on a quarterly basis, or more frequently, if necessary, in accordance with guidance set forth in ASC Topic 740 "Income Taxes," and applies the criteria in the guidance to determine whether it is more likely than not that some portion, or all, of the deferred tax asset will not be realized within its life cycle, based on the weight of available evidence. If management determines based on available

evidence, both positive and negative, that it is more likely than not that some portion or all of the deferred tax asset will not be realized in future periods, a valuation allowance is calculated and recorded. These determinations are inherently subjective and depend upon management's estimates and judgments used in their evaluation of both positive and negative evidence.

In evaluating available evidence, management considers, among other factors, historical financial performance, expectation of future earnings, the ability to carry back losses to recoup taxes previously paid, length of statutory carry forward periods, experience with operating loss and tax credit carry forwards not expiring unused, tax planning strategies and timing of reversals of temporary differences. In assessing the need for a valuation allowance, management carefully weighs both positive and negative evidence currently available.

Management performed an evaluation of FNCB's deferred tax assets at March 31, 2019 taking into consideration both positive and negative evidence that existed as of that date. Based on this evaluation, management believes that FNCB's future taxable income will be sufficient to utilize deferred tax assets. Accordingly, management concluded that no valuation allowance for deferred tax assets was required at March 31, 2019.

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**FINANCIAL CONDITION**

**Assets**

Total assets decreased \$23.3 million, or 1.9%, to \$1.214 billion at March 31, 2019 from \$1.238 billion at December 31, 2018. The change in total assets primarily reflected a \$21.9 million, or 7.4% decrease in available-for-sale debt securities to \$274.1 million at March 31, 2019 from \$296.0 million at December 31, 2018. Market opportunities allowed for the sale of securities to supplement cyclical deposit trends, minimize wholesale funding utilization and record additional non-interest income. Net loans remained steady, increasing by only \$30 thousand, while total deposits decreased by \$55.5 million, or 5.1%, primarily attributable to cyclical net outflows of municipal deposits. Borrowed funds increased by \$5.1 million, or 14.8%, to \$39.3 million at March 31, 2019 as compared to \$34.2 million at December 31, 2018.

**Cash and Cash Equivalents**

Cash and cash equivalents declined \$3.7 million, or 10.2%, to \$32.7 million at March 31, 2019 from \$36.5 million at December 31, 2018. The reduction was due primarily to cyclical reductions in deposits. FNCB paid a dividend of \$0.05 per share to holders of our common stock during the first quarter of 2019, an increase of 25.0% from \$0.04 per share during the first quarter of 2018.

**Securities**

FNCB's investment securities portfolio provides a source of liquidity needed to meet expected loan demand and interest income to increase profitability. Additionally, the investment securities portfolio is used to meet pledging requirements to secure public deposits and for other purposes. Debt securities are classified as either held-to-maturity or available-for-sale at the time of purchase based on management's intent. Held-to-maturity securities are carried at amortized cost, while available-for-sale securities are carried at fair value, with unrealized holding gains and losses reported as a component of shareholders' equity in accumulated other comprehensive income (loss), net of tax. At March 31, 2019 and December 31, 2018, all debt securities were classified as available-for-sale. Equity securities with readily determinable fair values are carried at fair value, with gains and losses due to fluctuations in market value included in the consolidated statements of income. Securities with limited marketability and/or restrictions, such as FHLB of Pittsburgh stock, are carried at cost. Decisions to purchase or sell investment securities are based upon management's current assessment of long- and short-term economic and financial conditions, including the interest rate environment and asset/liability management, liquidity and tax-planning strategies.

At March 31, 2019, the investment portfolio was comprised principally of fixed-rate securities issued by U.S. government or U.S. government-sponsored agencies, which include mortgage-backed securities and residential and commercial collateralized mortgage obligations (“CMOs”), fixed-rate taxable obligations of state and political subdivisions and corporate debt securities. Except for U.S. government and government-sponsored agencies, there were no securities of any individual issuer that exceeded 10.0% of shareholders’ equity at March 31, 2019.

The following table presents the carrying value of debt securities, all of which were classified as available-for-sale and carried at fair value at March 31, 2019 and December 31, 2018:

### Composition of the Investment Portfolio

<b>(in thousands)</b>	<b>March 31, 2019</b>	<b>December 31, 2018</b>
<b>Available-for-sale debt securities</b>		
Obligations of state and political subdivisions	\$ 132,124	\$ 152,187
U.S. government/ government-sponsored agencies:		
Collateralized mortgage obligations - residential	33,952	34,207
Collateralized mortgage obligations - commercial	75,143	73,640
Mortgage-backed securities	21,112	23,934
Private collateralized mortgage obligations	2,807	2,913
Corporate debt securities	4,993	4,936
Asset-backed securities	1,560	1,802
Negotiable certificates of deposit	2,423	2,413
Total available-for-sale debt securities	\$ 274,114	\$ 296,032

Management monitors the investment portfolio regularly and adjusts the investment strategy to reflect changes in liquidity needs, asset/liability strategy and tax planning requirements. FNCB currently has \$40.5 million in net operating loss carryovers, which it uses to offset any taxable income. Because of this tax position, there is no benefit from holding tax-exempt obligations of state and political subdivisions. Accordingly, management actions during recent periods have reflected current tax planning initiatives focused on generating sustained taxable income to be able to reduce NOL carryovers.

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There were no securities purchased during the three months ended March 31, 2019. During the first quarter of 2019, FNCB sold 19 of its debt securities, including 18 taxable obligations of state and political subdivisions and one agency security. The securities sold had an aggregate amortized cost of \$25.0 million. Gross proceeds received totaled \$25.1 million, with net gains of \$160 thousand realized upon the sales and included in non-interest income.

The following table presents the maturities of available-for-sale debt securities, based on carrying value at March 31, 2019 and the weighted average yields of such securities calculated on the basis of the amortized cost and effective yields weighted for the scheduled maturity of each security. The yields on tax-exempt obligations of state and political subdivisions are presented on a tax-equivalent basis using the federal corporate income tax rate of 21.0%. Because residential, commercial and private collateralized mortgage obligations, mortgage-backed securities and asset-backed securities are not due at a single maturity date, they are not included in the maturity categories in the following summary.

**Maturity Distribution of the Investment Portfolio**

(dollars in thousands)	March 31, 2019				Collateralized		Total	
	Within One Year	>1 - 5 Years	6 - 10 Years	Over 10 Years	Obligations, Mortgage-Backed and Asset-Backed Securities			
<b>Available-for-sale debt securities</b>								
Obligations of state and political subdivisions	\$-	\$55,678	\$72,497	\$3,949	\$ -			\$132,124
Yield		2.60 %	2.87 %	3.60 %				2.78 %
U.S. government/government-sponsored agencies:								
Collateralized mortgage obligations - residential	-	-	-	-	33,952			33,952
Yield					2.85	%	2.85	%
Collateralized mortgage obligations - commercial	-	-	-	-	75,143			75,143
Yield					2.50	%	2.50	%
Mortgage-backed securities	-	-	-	-	21,112			21,112
Yield					2.96	%	2.96	%
Private collateralized mortgage obligations	-	-	-	-	2,807			2,807

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Yield					4.12	%	4.12	%
Corporate debt securities	-	-	4,993	-	-		4,993	
Yield			6.50	%			6.50	%
Asset-backed securities	-	-	-	-	1,560		1,560	
Yield					2.38	%	2.38	%
Negotiable certificates of deposit	1,731	692	-	-	-		2,423	
Yield	2.08	%	2.31	%			2.15	%
Total available-for-sale debt securities	\$1,731	\$56,370	\$77,490	\$3,949	\$134,574		\$274,114	
Weighted average yield	2.08	%	2.60	%	3.10	%	3.60	%
					2.69	%	2.80	%

*OTTI Evaluation*

There was no OTTI recognized during the three months ended March 31, 2019 or 2018. For additional information regarding management's evaluation of securities for OTTI, see Note 3, "Securities" of the notes to consolidated financial statements included in Item 1 hereof.

The following table presents the investment in FNCB's restricted securities, which have limited marketability and are carried at cost:

	<b>March 31, 2019</b>	<b>December 31, 2018</b>
<b>(in thousands)</b>		
Stock in Federal Home Loan Bank of Pittsburgh	\$3,110	\$ 3,113
Stock in Atlantic Community Banker's Bank	10	10
Total restricted securities, at cost	\$3,120	\$ 3,123

Management noted no indicators of impairment for the Federal Home Loan Bank of Pittsburgh or Atlantic Community Banker's Bank stock at March 31, 2019 and December 31, 2018.

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FNCB owns a \$1.7 million investment in the common stock of a privately-held bank holding company. The common stock was purchased during 2017 as part of a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended, for offerings not involving any public offering. The common stock of such bank holding company is not currently traded on any established market and is not expected to be traded in the near future on any securities exchange or established over-the-counter market. FNCB has elected to account for this transaction as an investment in an equity security without a readily determinable fair value. An equity security without a readily determinable fair value shall be written down to its fair value if a qualitative assessment indicates that the investment is impaired, with a fair value less than its carrying value. The \$1.7 million investment is included in other assets in the consolidated statements of financial condition at March 31, 2019 and December 31, 2018. As part of its qualitative assessment, management engaged an independent third party to provide a valuation of this investment as of March 31, 2019, which indicated that the investment was not impaired. Management determined that no adjustment for impairment was required at March 31, 2019.

## **Loans**

During the first three months of 2019, the loan portfolio was relatively flat, as new loan growth was almost entirely offset by principal repayments and payoffs on the existing portfolio balances. Total loans, gross increased only \$0.2 million, or 0.02%, to \$835.4 million at March 31, 2019 from \$835.2 million at December 31, 2018. FNCB experienced moderate growth in its commercial and industrial and commercial real estate portfolios, which was mostly offset by reductions in the consumer and residential real estate portfolios.

Historically, commercial lending activities represent a significant portion of FNCB's loan portfolio. Commercial lending includes commercial and industrial loans, commercial real estate loans and construction, land acquisition and development loans, and represented 53.3% and 52.0% of total loans at March 31, 2019 and December 31, 2018.

From a collateral standpoint, a majority of FNCB's loan portfolio consists of loans secured by real estate. Real estate secured loans, which include commercial real estate, construction, land acquisition and development, residential real estate loans and home equity lines of credit ("HELOCs"), increased \$1.4 million, or 0.3%, to \$469.5 million at March 31, 2019 from \$468.1 million at December 31, 2018. The increase was concentrated in commercial real estate loans. Real estate secured loans represented 56.2% and 56.0% of total loans at March 31, 2019 and December 31, 2018, respectively.

Commercial and industrial loans increased \$5.6 million during the first quarter to \$156.6 million at March 31, 2019 from \$151.0 million at December 31, 2018. Commercial and industrial loans consist primarily of equipment loans, working capital financing, revolving lines of credit and loans secured by cash and marketable securities. Loans secured by commercial real estate increased \$3.8 million, or 1.5%, to \$266.6 million at March 31, 2019 from \$262.8 million at December 31, 2018. Commercial real estate loans include long-term commercial mortgage financing and are primarily secured by first or second lien mortgages. Additionally, construction, land acquisition and

development loans increased by \$1.6 million, or 7.6%, to \$22.4 million at March 31, 2019 from \$20.8 million at December 31, 2018.

Residential real estate loans totaled \$161.9 million at March 31, 2019, a decrease of \$2.9 million, or 1.8%, from \$164.8 million at December 31, 2018. The components of residential real estate loans include fixed-rate and variable-rate, amortizing mortgage loans. HELOCs are not included in this category but are included in consumer loans. FNCB primarily underwrites fixed-rate residential mortgage loans for sale in the secondary market to reduce interest rate risk and provide funding for additional loans. Additionally, FNCB offers a “WOW” mortgage product, which is a non-saleable mortgage with maturity terms of 7.5 to 14.5 years that provides customers with an attractive fixed interest rate, low closing costs and a guaranteed 30-day close.

Consumer loans, which are primarily comprised of indirect automobile loans and HELOCs, decreased by \$8.7 million, or 4.9%, during the first three months of 2019 to \$168.1 million at March 31, 2019 from \$176.8 million at December 31, 2018. The majority of this decrease was concentrated within the indirect auto loan portfolio, as FNCB did not aggressively compete for these loans during the first quarter of 2019. The balance of indirect automobile loans decreased \$7.9 million, or 5.1%, to \$147.2 million at March 31, 2019 from \$155.1 million at December 31, 2018. Loans to state and municipal governments increased \$0.8 million, or 1.3%, to \$59.8 million at March 31, 2019 from \$59.0 million at December 31, 2018.



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The following table presents loans receivable, net by major category at March 31, 2019 and December 31, 2018:

**Loan Portfolio Detail**

<b>(in thousands)</b>	<b>March 31, 2019</b>	<b>December 31, 2018</b>
Residential real estate	\$ 161,938	\$ 164,833
Commercial real estate	266,617	262,778
Construction, land acquisition and development	22,388	20,813
Commercial and industrial	156,521	150,962
Consumer	168,119	176,784
State and political subdivisions	59,784	59,037
Total loans, gross	835,367	835,207
Unearned income	(68 )	(70 )
Net deferred loan costs	3,565	3,963
Allowance for loan and lease losses	(9,253 )	(9,519 )
Loans, net	\$ 829,611	\$ 829,581

Under industry regulations, a concentration is considered to exist when there are amounts loaned to a multiple number of borrowers engaged in similar activities which would cause them to be similarly impacted by economic or other conditions. Typically, industry guidelines require disclosure of concentrations of loans exceeding 10.0% of total loans outstanding. FNCB had no such concentrations at March 31, 2019 or December 31, 2018. In addition to industry guidelines, FNCB's internal policy considers a concentration to exist in its loan portfolio if an aggregate loan balance outstanding to borrowers within a specific industry exceeds 25.0% of capital. However, management regularly reviews loans by all industry categories to determine if a potential concentration exists.

The following table presents industry concentrations within FNCB's loan portfolio at March 31, 2019 and December 31, 2018:

**Loan Concentrations**

<b>(dollars in thousands)</b>	<b>March 31, 2019</b>	<b>December 31, 2018</b>
	<b>Amount</b>	<b>Amount</b>

		<b>% of Gross</b>		<b>% of Gross</b>
		<b>Loans</b>		<b>Loans</b>
Retail space/shopping centers	\$45,831	5.49 %	\$48,021	5.75 %
1-4 family residential investment properties	40,101	4.80 %	38,756	4.64 %
Physicians	28,707	3.44 %	25,379	3.04 %

### Asset Quality

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at the amount of unpaid principal, net of unearned interest, deferred loan fees and costs, and reduced by the ALLL. The ALLL is established through a provision for loan and lease losses charged to earnings.

FNCB has established and consistently applies loan policies and procedures designed to foster sound underwriting and credit monitoring practices. Credit risk is managed through the efforts of loan officers, the Chief Credit Officer, the loan review function, and the Credit Risk Management, ALLL, Officers Loan and Directors Loan Committees, as well as oversight from the Board of Directors. Management continually evaluates its credit risk management practices to ensure it is reacting to problems in the loan portfolio in a timely manner, although, as is the case with any financial institution, a certain degree of credit risk is dependent in part on local and general economic conditions that are beyond management's control.

Under FNCB's risk rating system, loans that are rated pass, special mention, substandard, doubtful, or loss are reviewed regularly as part of the risk management practices. The Credit Risk Management Committee, which consists of key members of management, finance, legal, retail lending and credit administration, meets monthly or more often as necessary to review individual problem credits and workout strategies and provides monthly reports to the Board of Directors.

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A loan is considered impaired when it is probable that FNCB will be unable to collect all amounts due (including principal and interest) according to the contractual terms of the note and loan agreement. For purposes of the analysis, all TDRs, loan relationships with an aggregate outstanding balance greater than \$100 thousand rated substandard and non-accrual, and loans that are identified as doubtful or loss are considered impaired. Impaired loans are analyzed individually to determine the amount of impairment. For collateral-dependent loans, impairment is measured based on the fair value of the collateral supporting the loans. A loan is determined to be collateral dependent when repayment of the loan is expected to be provided through the liquidation of the collateral held. For impaired loans that are secured by real estate, external appraisals are obtained annually, or more frequently as warranted, to ascertain a fair value so that the impairment analysis can be updated. Should a current appraisal not be available at the time of impairment analysis, other sources of valuation may be used, including current letters of intent, broker price opinions or executed agreements of sale. For non-collateral-dependent loans, impairment is measured based on the present value of expected future cash flows, net of any deferred fees and costs, discounted at the loan's original effective interest rate.

Loans to borrowers that are experiencing financial difficulty that are modified and result in the granting of concessions to the borrowers are classified as TDRs. Such concessions generally involve an extension of a loan's stated maturity date, a reduction of the stated interest rate, payment modifications, capitalization of property taxes with respect to mortgage loans or a combination of these modifications. Non-accrual TDRs are returned to accrual status if principal and interest payments, under the modified terms, are brought current, are performing under the modified terms for six consecutive months, and management believes that collection of the remaining interest and principal is probable. FNCB conservatively considers all TDRs to be impaired.

Non-performing loans are monitored on an ongoing basis as part of FNCB's loan review process. Additionally, work-out for non-performing loans and OREO are actively monitored through the Credit Risk Management Committee. A potential loss on a non-performing asset is generally determined by comparing the outstanding loan balance to the fair market value of the pledged collateral, less cost to sell.

Loans are placed on non-accrual when a loan is specifically determined to be impaired or when management believes that the collection of interest or principal is doubtful. This generally occurs when a default of interest or principal has existed for 90 days or more, unless the loan is well secured and in the process of collection, or when management becomes aware of facts or circumstances that the loan would default before 90 days. FNCB determines delinquency status based on the number of days since the date of the borrower's last required contractual loan payment. When the interest accrual is discontinued, all unpaid interest income is reversed and charged back against current earnings. Any subsequent cash payments received are applied, first to the outstanding loan amounts, then to the recovery of any charged-off loan amounts, with any excess treated as a recovery of lost interest. A non-accrual loan is returned to accrual status when the loan is current as to principal and interest payments, is performing according to contractual terms for six consecutive months and future payments are reasonably assured.

Management actively manages impaired loans in an effort to mitigate loss to FNCB by working with customers to develop strategies to resolve borrower difficulties, through sale or liquidation of collateral, foreclosure, and other appropriate means. In addition, management monitors employment and economic conditions within FNCB's market

area, as weakening of conditions could result in real estate devaluations and an increase in loan delinquencies, which could negatively impact asset quality and cause an increase in the provision for loan and lease losses.

Under the fair value of collateral method, the impaired amount of the loan is deemed to be the difference between the loan amount and the fair value of the collateral, less the estimated costs to sell. For real estate secured loans, management generally estimates selling costs using a factor of 10%, which is based on typical cost factors, such as a 6% broker commission, 1% transfer taxes, and 3% various other miscellaneous costs associated with the sales process. If the valuation indicates that the fair value has deteriorated below the carrying value of the loan, the difference between the fair value and the principal balance is charged off. For impaired loans for which the value of the collateral less costs to sell exceeds the loan value, the impairment is determined to be zero.

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The following table presents information about non-performing assets and accruing TDRs at March 31, 2019 and December 31, 2018:

**Non-performing Assets and Accruing TDRs**

<b>(dollars in thousands)</b>	<b>March 31, 2019</b>	<b>December 31, 2018</b>		
Non-accrual loans	\$6,175	\$ 4,696		
Loans past due 90 days or more and still accruing	-	-		
Total non-performing loans	6,175	4,696		
Other real estate owned	919	919		
Other non-performing assets	1,900	1,900		
Total non-performing assets	\$8,994	\$ 7,515		
Accruing TDRs	\$8,215	\$ 8,457		
Non-performing loans as a percentage of gross loans	0.74 %	0.56 %		

Total non-performing assets increased \$1.5 million, or 19.7%, to \$9.0 million at March 31, 2019 from \$7.5 million at December 31, 2018. The increase was attributable to an increase in non-accrual loans, primarily due to two commercial relationships that were placed on non-accrual status during the first quarter of 2019. FNCB's ratio of non-performing loans to total gross loans increased to 0.74% at March 31, 2019 from 0.56% at December 31, 2018. FNCB's ratio of non-performing assets as a percentage of shareholders' equity decreased to 7.3% at March 31, 2019 from 8.7% at December 31, 2018, resulting from the increase in shareholders' equity during the first quarter of 2019. Management is actively managing problem credits through heightened workout efforts focused on developing strategies to resolve borrower difficulties through liquidation of collateral and other appropriate means. Additionally, management continues to monitor non-accrual loans, delinquency trends and economic conditions within FNCB's market area on an on-going basis in order to proactively address any collection-related issues and mitigate any potential losses.

Other non-performing assets at March 31, 2019 and December 31, 2018 is comprised solely of a classified account receivable secured by an evergreen letter of credit in the amount of \$1.9 million, received in 2011 as part of a settlement agreement for a large construction, land acquisition and development loan for a residential development project in the Pocono region of Monroe County, Pennsylvania. The agreement provides for payment to FNCB as real estate building lots are sold. The project was stalled due to a decline in real estate values in this area following the financial crisis of 2008. In 2016, management classified this receivable as substandard due to the length of holding time. Recently, economic development in this market area has improved. Management continues to monitor this project closely and has confirmed that the developer for this project has resumed construction activity, including the completion of substantial infrastructure for the development, and has increased marketing and sales initiatives related to the project. As of March 31, 2019, no single-unit lots have been sold.

There were no loans modified under a TDR during the three months ended March 31, 2019 and 2018. TDRs at March 31, 2019 and December 31, 2018 were \$8.9 million and \$9.2 million, respectively. Accruing and non-accruing TDRs were \$8.2 million and \$0.7 million, respectively at March 31, 2019 and \$8.5 million and \$0.7 million, respectively at December 31, 2018. FNCB was not committed to lend additional funds to any loan classified as a TDR at March 31, 2019.

The average balance of impaired loans was \$13.0 million and \$11.0 million for the three months ended March 31, 2019 and 2018, respectively. FNCB recognized \$104 thousand and \$103 thousand of interest income on impaired loans for the three months ended March 31, 2019 and 2018, respectively.

The following table presents the changes in non-performing loans for the three months ended March 31, 2019 and 2018. Loan foreclosures represent recorded investment at time of foreclosure not including the effect of any guarantees. There were not loans foreclosed upon during the three months ended March 31, 2019 and 2018.

#### Changes in Non-Performing Loans

(in thousands)	March 31,	
	2019	2018
Balance at January 1,	\$4,696	\$2,578
Loans newly placed on non-accrual	2,278	384
Loans returned to performing status	(23 )	-
Loan foreclosures	-	-
Loans charged-off	(447 )	(389 )
Loan payments received	(329 )	(170 )
Balance at March 31,	\$6,175	\$2,403

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The additional interest income that would have been earned on non-accrual and restructured loans had the loans been performing in accordance with their original terms for the quarters ended on March 31, 2019 and 2018 approximated \$82 thousand and \$40 thousand, respectively.

The following table presents accruing loan delinquencies and non-accrual loans as a percentage of gross loans at March 31, 2019 and December 31, 2018:

**Loan Delinquencies and Non-Accrual Loans**

	<b>March 31, 2019</b>		<b>December 31, 2018</b>	
Accruing:				
30-59 days	0.49	%	0.32	%
60-89 days	0.05	%	0.05	%
90+ days	0.00	%	0.00	%
Non-accrual	0.74	%	0.56	%
Total delinquencies	1.28	%	0.93	%

Total delinquencies as a percent of gross loans increased to 1.28% at March 31, 2019 from 0.93% at December 31, 2018. The increase in total delinquent loans was primarily due to an increase in non-accrual loans of \$1.5 million in the commercial and industrial and commercial real estate segments, coupled with an increase in loans 30-59 days past due of \$1.5 million.

**Allowance for Loan and Lease Losses**

The ALLL represents management's estimate of probable loan losses inherent in the loan portfolio. The ALLL is analyzed in accordance with GAAP and is maintained at a level that is based on management's evaluation of the adequacy of the ALLL in relation to the risks inherent in the loan portfolio.

As part of its evaluation, management considers qualitative and environmental factors, including, but not limited to:

- changes in national, local, and business economic conditions and developments, including the condition of various market segments;
- changes in the nature and volume of the loan portfolio;
- changes in lending policies and procedures, including underwriting standards, collection, charge-off and recovery practices and results;
- changes in the experience, ability and depth of lending management and staff;
- changes in the quality of the loan review system and the degree of oversight by the Board of Directors;
- changes in the trend of the volume and severity of past due and classified loans, including trends in the volume of non-accrual loans, TDRs and other loan modifications;
- the existence and effect of any concentrations of credit and changes in the level of such concentrations;
  - the effect of external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the current loan portfolio; and
- analysis of customers' credit quality, including knowledge of their operating environment and financial condition.

Evaluations are intrinsically subjective, as the results are estimated based on management knowledge and experience and are subject to interpretation and modification as information becomes available or as future events occur. Management monitors the loan portfolio on an ongoing basis with emphasis on weakness in both the real estate market and the economy in general and its effect on repayment. Adjustments to the ALLL are made based on management's assessment of the factors noted above.



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For purposes of management’s analysis of the ALLL, all loan relationships with an aggregate balance greater than \$100 thousand that are rated substandard and non-accrual, identified as doubtful or loss, and all TDRs are considered impaired and are analyzed individually to determine the amount of impairment. Circumstances such as construction delays, declining real estate values, and the inability of the borrowers to make scheduled payments have resulted in these loan relationships being classified as impaired. FNCB utilizes the fair value of collateral method for collateral-dependent loans and TDRs for which repayment depends on the sale of collateral. For non-collateral-dependent loans and TDRs, FNCB measures impairment based on the present value of expected future cash flows discounted at the loan’s original effective interest rate. With regard to collateral-dependent loans, appraisals are received at least annually to ensure that impairment measurements reflect current market conditions. Should a current appraisal not be available at the time of impairment analysis, other valuation sources including current letters of intent, broker price opinions or executed agreements of sale may be used. Only downward adjustments are made based on these supporting values. Included in all impairment calculations is a cost to sell adjustment of approximately 10%, which is based on typical cost factors, including a 6% broker commission, 1% transfer taxes and 3% various other miscellaneous costs associated with the sales process. Sales costs are periodically reviewed and revised based on actual experience. The ALLL analysis is adjusted for subsequent events that may arise after the end of the reporting period but before the financial reports are filed.

The ALLL equaled \$9.3 million at March 31, 2019, a decrease of \$0.3 million from \$9.6 million at December 31, 2018. The decrease resulted from a credit for loan and lease losses of \$0.2 million, coupled with net loans charged-off of \$0.1 million for the first three months of 2019.

The ALLL consists of both specific and general components. The component of the ALLL that is related to impaired loans that are individually evaluated for impairment, the guidance for which is provided by ASC 310 “*Impairment of a Loan*” (“ASC 310”), was \$0.9 million, or 9.8%, of the total ALLL at March 31, 2019, compared to \$0.7 million, or 6.9%, of the total ALLL at December 31, 2018. A general allocation of \$8.3 million was calculated for loans analyzed collectively under ASC 450 “*Contingencies*” (“ASC 450”), which represented 90.2% of the total ALLL of \$9.3 million. Comparatively, at December 31, 2018, the general allocation for loans collectively analyzed for impairment amounted to \$8.9 million, or 93.1%, of the total ALLL. The ratio of the ALLL to total loans at March 31, 2019 and December 31, 2018 was 1.10% and 1.13%, respectively, based on loans, net of net deferred loan costs and unearned income of \$838.9 million and \$839.1 million, respectively.

The following table presents an allocation of the ALLL by major loan category and percent of loans in each category to total loans at March 31, 2019 and December 31, 2018:

**Allocation of the ALLL**

<b>March 31, 2019</b>	<b>December 31, 2018</b>
<b>Percentage</b>	<b>Percentage</b>

(dollars in thousands)	of Loans in Each Category		of Loans in Each Category		
	Allowance Amount	Total Loans	Allowance Amount	Total Loans	
Residential real estate	\$1,155	19.39	% \$1,175	19.74	%
Commercial real estate	3,051	31.92	% 3,107	31.46	%
Construction, land acquisition and development	106	2.68	% 188	2.49	%
Commercial and industrial	2,499	18.74	% 2,552	18.07	%
Consumer	1,963	20.12	% 2,051	21.17	%
State and political subdivision	423	7.15	% 417	7.07	%
Unallocated	56	0.00	% 29	0.00	%
Total	\$9,253	100.00	% \$9,519	100.00	%

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The following table presents an analysis of the ALLL by loan category for the three months ended March 31, 2019 and 2018:

**Reconciliation of the ALLL**

<b>(dollars in thousands)</b>	<b>For the three months ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
Balance at beginning of period	\$9,519	\$9,034
Charge-offs:		
Residential real estate	-	63
Commercial real estate	-	-
Construction, land acquisition and development	-	-
Commercial and industrial	139	77
Consumer	315	260
State and political subdivisions	-	-
Total charge-offs	454	400
Recoveries of charged-off loans:		
Residential real estate	4	6
Commercial real estate	-	1
Construction, land acquisition and development	81	30
Commercial and industrial	84	72
Consumer	173	99
State and political subdivisions	-	-
Total recoveries	342	208
Net charge-offs	112	192
(Credit) provision for loan and lease losses	(154 )	720
Balance at end of period	\$9,253	\$9,562
Net charge-offs as a percentage of average loans	0.01 %	0.02 %
Allowance for loan and lease losses as a percentage of gross loans outstanding at period end	1.10 %	1.18 %

**Other Real Estate Owned**

At March 31, 2019 and December 31, 2018, OREO consisted of six properties with an aggregate carrying value of \$0.9 million. There were no properties foreclosed upon or sold during the three months ended March 31, 2019. During the three months ended March 31, 2018, there were no properties foreclosed upon, and there was one sale of a

property with an aggregate carrying value of \$427 thousand, which resulted in a net gain of \$37 thousand. The expenses related to maintaining OREO, not including adjustments to property values subsequent to foreclosure, and net of any income from operation of the properties amounted to \$51 thousand and \$28 thousand for the three months ended March 31, 2019 and 2018, respectively.

Included in OREO are four properties previously held in bank premises and equipment that were transferred to OREO due to a change in their intended use. The properties include two commercial lots previously held for future expansion, the former Route 315 Pittston branch office located in Luzerne County, Pennsylvania and the former Honesdale Route 6 branch office located in Wayne County, Pennsylvania. The aggregate carrying value of these four properties was \$0.7 million and represented 79.2% of OREO at March 31, 2019. The former Route 315 Pittston branch office was subsequently sold on April 26, 2019.

FNCB actively markets OREO properties for sale through a variety of channels including internal marketing and the use of outside brokers/realtors. The carrying value of OREO is generally calculated at an amount not greater than 90% of the most recent fair market appraised value unless specific conditions warrant an exception. A 10% factor is generally used to estimate costs to sell, which is based on typical cost factors, such as 6% broker commission, 1% transfer taxes, and 3% various other miscellaneous costs associated with the sales process. This fair value is updated on an annual basis or more frequently if new valuation information is available. Deterioration in the real estate market could result in additional losses on these properties. There were no valuation adjustments related to OREO properties for the three months ended March 31, 2019. FNCB recorded a valuation adjustment of \$17 thousand related to OREO properties for the three months ended March 31, 2018.

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The following table presents the activity in OREO for the three months ended March 31, 2019 and 2018:

**Activity in OREO**

<b>(in thousands)</b>	<b>Three Months Ended March 31,</b>	
	<b>2019</b>	<b>2018</b>
Balance, beginning of period	\$919	\$1,023
Valuation adjustments	-	(17 )
Carrying value of OREO sold	-	(427 )
Balance, end of period	\$919	\$579

The following table presents a distribution of OREO at March 31, 2019 and December 31, 2018:

**Distribution of OREO**

<b>(in thousands)</b>	<b>March</b>	<b>December</b>
	<b>31, 2019</b>	<b>31, 2018</b>
Land / lots	\$ 436	\$ 436
Commercial real estate	438	438
Residential real estate	45	45
Total other real estate owned	\$ 919	\$ 919

**Liabilities**

Total liabilities were \$1.091 billion at March 31, 2019, a decrease of \$49.8 million, or 4.4%, from \$1.141 billion at December 31, 2018. The decrease was primarily attributable to a \$55.5 million outflow of deposits, specifically interest-bearing deposits, partially offset by a slight increase in borrowed funds of \$5.1 million, or 14.8%. The decrease in total deposits reflected a decrease in municipal deposit accounts primarily attributable to cyclical net

outflows of municipal deposits. Interest-bearing deposits decreased \$56.0 million, or 6.0%, to \$883.0 million at March 31, 2019 compared to \$939.0 million at December 31, 2018, while non-interest-bearing demand deposits increased \$0.5 million, or 0.3%, comparing the same time period.

## **Equity**

Total shareholders' equity increased \$26.6 million, or 27.3%, to \$123.8 million at March 31, 2019 from \$97.2 million at December 31, 2018. The improvement in capital resulted primarily from the completion of a public offering of FNCB's common stock, which resulted in a net increase to capital after offering expenses of \$21.3 million. Also factoring into the capital improvement was net income for the three months ended March 31, 2019 of \$2.6 million and a \$3.6 million decrease in accumulated other comprehensive loss related to appreciation in the fair value of available-for-sale debt securities, net of deferred taxes. These improvements were partially offset by dividends declared and paid for the first quarter of 2019 of \$1.0 million. Book value per common share was \$6.16 at March 31, 2019, an increase of \$0.38, or 6.6%, compared to \$5.78 at December 31, 2018.

## **Liquidity**

The term liquidity refers to the ability to generate sufficient amounts of cash to meet cash flow needs. Liquidity is required to fulfill the borrowing needs of FNCB's credit customers and the withdrawal and maturity requirements of its deposit customers, as well as to meet other financial commitments. FNCB's liquidity position is impacted by several factors, which include, among others, loan origination volumes, loan and investment maturity structure and cash flows, deposit demand and time deposit maturity structure and retention. FNCB has liquidity and contingent funding policies in place that are designed with controls in place to provide advanced detection of potentially significant funding shortfalls, establish methods for assessing and monitoring risk levels, and institute prompt responses that may alleviate a potential liquidity crisis. Management monitors FNCB's liquidity position and fluctuations daily, forecasts future liquidity needs, performs periodic stress tests on its liquidity levels and develops strategies to ensure adequate liquidity at all times.

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The statements of cash flows present the change in cash and cash equivalents from operating, investing and financing activities. Cash and due from banks and interest-bearing deposits in other banks, which comprise cash and cash equivalents, are FNCB's most liquid assets. At March 31, 2019, cash and cash equivalents totaled \$32.7 million, a decrease of \$3.8 million compared to \$36.5 million at December 31, 2018, as net cash provided by operating and investing activities for the first quarter of 2019 were more that entirely offset by cash used in financing activities. Operating activities for the first three months of 2019 provided net cash of \$1.4 million. Net funds provided by investing activities were \$25.0 million for the first quarter of 2019, largely representing proceeds from the sale of debt securities available for sale. Financing activities used \$30.2 million in net cash for the three months ended March 31, 2019, which resulted primarily from a decrease in deposits of \$55.5 million, which was partly offset by net proceeds from the issuance of common shares of \$21.3 million and net proceeds from FHLB advances of \$10.1 million.

## **Interest Rate Risk**

### *Interest Rate Sensitivity*

Market risk is the risk to earnings and/or financial position resulting from adverse changes in market rates or prices, such as interest rates, foreign exchange rates or equity prices. FNCB's exposure to market risk is primarily interest rate risk associated with our lending, investing and deposit gathering activities, all of which are other than trading. Changes in interest rates affect earnings by changing net interest income and the level of other interest-sensitive income and operating expenses. In addition, variations in interest rates affect the underlying economic value of our assets, liabilities and off-balance sheet items.

### *Asset and Liability Management*

FNCB manages these objectives through its Asset and Liability Management Committee ("ALCO") and its Rate and Liquidity and Investment Committees, which consist of certain members of management and certain members of the finance unit. Members of the committees meet regularly to develop balance sheet strategies affecting the future level of net interest income, liquidity and capital. The major objectives of ALCO are to:

- manage exposure to changes in the interest rate environment by limiting the changes in net interest margin to an acceptable level within a reasonable range of interest rates;
- ensure adequate liquidity and funding;
- maintain a strong capital base; and
- maximize net interest income opportunities.

ALCO monitors FNCB's exposure to changes in net interest income over both a one-year planning horizon and a longer-term strategic horizon. ALCO uses net interest income simulations and economic value of equity ("EVE") simulations as the primary tools in measuring and managing FNCB's position and considers balance sheet forecasts, FNCB's liquidity position, the economic environment, anticipated direction of interest rates and FNCB's earnings sensitivity to changes in these rates in its modeling. In addition, ALCO has established policy tolerance limits for acceptable negative changes in net interest income. Furthermore, as part of its ongoing monitoring, ALCO requires quarterly back testing of modeling results, which involves after-the-fact comparisons of projections with FNCB's actual performance to measure the validity of assumptions used in the modeling techniques.

#### *Earnings at Risk and Economic Value at Risk Simulations*

##### *Earnings at Risk*

Earnings-at-risk simulation measures the change in net interest income and net income under various interest rate scenarios. Specifically, given the current market rates, ALCO looks at "earnings at risk" to determine anticipated changes in net interest income from a base case scenario with scenarios of +200, +400, and -200 basis points for simulation purposes. The simulation takes into consideration that not all assets and liabilities re-price equally and simultaneously with market rates (i.e., savings rate).

##### *Economic Value at Risk*

While earnings-at-risk simulation measures the short-term risk in the balance sheet, economic value (or portfolio equity) at risk measures the long-term risk by finding the net present value of the future cash flows from FNCB's existing assets and liabilities. ALCO examines this ratio regularly, and given the current rate environment, has utilized rate shocks of +200, +400, and -200 basis points for simulation purposes. Management recognizes that, in some instances, this ratio may contradict the "earnings at risk" ratio.

While ALCO regularly performs a wide variety of simulations under various strategic balance sheet and treasury yield curve scenarios, the following results reflect FNCB's sensitivity over the subsequent twelve months based on the following assumptions:

- asset and liability levels using March 31, 2019 as a starting point;
- cash flows are based on contractual maturity and amortization schedules with applicable prepayments derived from internal historical data and external sources; and
- cash flows are reinvested into similar instruments so as to keep interest-earning asset and interest-bearing liability levels constant.





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The following table illustrates the simulated impact of parallel and instantaneous interest rate shocks of +400 basis points, +200 basis points, and -200 basis points on net interest income and the change in economic value over a one-year time horizon from the March 31, 2019 levels:

	<b>Rates +200</b>		<b>Rates +400</b>		<b>Rates -200</b>	
	<b>Simulation</b>	<b>Policy</b>	<b>Simulation</b>	<b>Policy</b>	<b>Simulation</b>	<b>Policy</b>
	<b>Results</b>	<b>Limit</b>	<b>Results</b>	<b>Limit</b>	<b>Results</b>	<b>Limit</b>
Earnings at risk:						
Percent change in net interest income	(7.4)%	(12.5)%	(15.0)%	(20.0)%	(2.4)%	(12.5)%
Economic value at risk:						
Percent change in economic value of equity	(2.5)%	(20.0)%	(7.2)%	(35.0)%	(16.5)%	(20.0)%

Model results at March 31, 2019 indicated that FNCB was liability rate sensitive over a one-year time horizon moving to an asset sensitive position in later years of the model. Under the model, FNCB's net interest income is expected to decrease 7.4% under a +200-basis point interest rate shock. However, in the second year of the model for the same scenario, FNCB's net interest income is expected to increase 1.2%. Additionally, model results indicated that FNCB's economic value of equity is expected to decrease 2.4% under a parallel shift in interest rates of +200 basis points. Model results at December 31, 2018 indicated net interest income and economic value of equity were expected to decrease 4.6% and 7.8%, respectively, given a +200-basis point rate shock.

This analysis does not represent a forecast for FNCB and should not be relied upon as being indicative of expected operating results. These simulations are based on numerous assumptions, including but not limited to: the nature and timing of interest rate levels, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, reinvestment/replacements of asset and liability cash flows, and other factors. While assumptions reflect current economic and local market conditions, FNCB cannot make any assurances as to the predictive nature of these assumptions, including changes in interest rates, customer preferences, competition and liquidity needs, or what actions ALCO might take in responding to these changes.

As previously mentioned, as part of its ongoing monitoring, ALCO requires quarterly back testing of modeling results, which involves after-the-fact comparisons of projections with FNCB's actual performance to measure the validity of assumptions used in the modeling techniques. As part of its quarterly review, management compared tax-equivalent net interest income recorded for the three months ended March 31, 2019 with tax-equivalent net interest income that was projected for the same three-month period. The variance between actual and projected tax-equivalent net interest income for the three-month period ended March 31, 2019 was \$80 thousand, or 0.8%. The variance for the first quarter of 2019 was largely attributable to the runoff of lower-yielding automobile loans and a decrease in municipal deposits, partially offset by higher volumes and rates on wholesale funds. ALCO performs a detailed rate/volume analysis between actual and projected results in order to continue to improve the accuracy of its simulation models.

### **Off-Balance Sheet Arrangements**

In the ordinary course of operations, FNCB engages in a variety of financial transactions that, in accordance with GAAP, are not recorded in our consolidated financial statements or are recorded in amounts that differ from the notional amounts. These transactions involve, to varying degrees, elements of credit, interest rate, and liquidity risk. Such transactions may be used for general corporate purposes or for customer needs. Corporate purpose transactions would be used to help manage credit, interest rate and liquidity risk or to optimize capital. Customer transactions are used to manage customers' requests for funding.

For the three months ended March 31, 2019, FNCB did not engage in any off-balance sheet transactions that would have or would be reasonably likely to have a material effect on its consolidated financial condition.

### **Item 3 — Quantitative and Qualitative Disclosures about Market Risk**

There have been no material changes in FNCB's exposure to market risk during the first three months of 2019. For discussion of FNCB's exposure to market risk, refer to Item 7A, Quantitative and Qualitative Disclosures about Market Risk, contained in FNCB's Form 10-K for the year ended December 31, 2018.

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**Item 4 — Controls and Procedures**

FNCB's management, with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of FNCB's disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based on that evaluation, FNCB's Chief Executive Officer and Chief Financial Officer concluded FNCB's disclosure controls and procedures were effective as of March 31, 2019.

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

**PART II Other Information**

**Item 1 — Legal Proceedings.**

On May 24, 2012, a putative shareholder filed a complaint in the Court of Common Pleas for Lackawanna County ("Shareholder Derivative Suit") against certain present and former directors and officers of FNCB (the "Individual Defendants") alleging, inter alia, breach of fiduciary duty, abuse of control, corporate waste, and unjust enrichment. FNCB was named as a nominal defendant. On February 4, 2014, the Court issued a Final Order and Judgment for the matter granting approval of a Stipulation of Settlement (the "Settlement") and dismissing all claims against FNCB and the Individual Defendants. As part of the Settlement, without admitting any fault, wrongdoing or liability, the Individual Defendants agreed to settle the derivative litigation for \$5.0 million. The \$5.0 million Settlement payment was made to FNCB on March 28, 2014. The Individual Defendants reserved their rights to indemnification under FNCB's Articles of Incorporation and Bylaws, resolutions adopted by the Board, the Pennsylvania Business Corporation Law and any and all rights they have against FNCB's and the Bank's insurance carriers. In addition, in conjunction with the Settlement, FNCB accrued \$2.5 million related to fees and costs of the plaintiff's attorneys, which was included in non-interest expense in the consolidated statements of income for the year ended December 31, 2013. On April 1, 2014, FNCB paid the \$2.5 million related to fees and costs of the plaintiff's attorneys and partial indemnification of the Individual Defendants in the amount of \$2.5 million. Commencing on July 1, 2017, FNCB made partial indemnifications to the Individual Defendants through monthly principal payments, made on behalf of the Individual Defendants, of \$25,000 plus accrued interest to First Northern Bank and Trust Co. On April 11, 2018, FNCB indemnified the Individual Defendants by paying in full the \$2.5 million, plus accrued interest to First Northern Bank & Trust Co.

On September 5, 2012, Fidelity and Deposit Company of Maryland (“F&D”) filed an action against FNCB and the Bank, as well as several current and former officers and directors of FNCB, in the United States District Court for the Middle District of Pennsylvania. F&D asserted a claim for the rescission of a directors’ and officers’ insurance policy and a bond that it had issued to FNCB. On November 9, 2012, FNCB and the Bank answered the claim and asserted counterclaims for the losses and expenses already incurred by FNCB and the Bank. FNCB and the other defendants defended the claims and opposed F&D’s requested relief by way of counterclaims. On December 21, 2018, FNCB, the Bank and F&D resolved the dispute by entering into a mutual release of all claims. FNCB recognized a gain of \$6.0 million after expenses in the fourth quarter of 2018 in connection with this insurance recovery.

FNCB has been subject to tax audits, and is also a party to routine litigation involving various aspects of its business, such as employment practice claims, workers compensation claims, claims to enforce liens, condemnation proceedings on properties in which FNCB holds security interests, claims involving the making and servicing of real property loans and other issues incident to its business, none of which has or is expected to have a material adverse impact on the consolidated financial condition, results of operations or liquidity of FNCB.

There have been no changes in the status of the other litigation disclosed in FNCB’s Annual Report on Form 10-K for the year ended December 31, 2018.

**Item 1A — Risk Factors.**

Management of FNCB does not believe there have been any material changes in the risk factors that were previously disclosed in FNCB’s Form 10-K for the year ending December 31, 2018.

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

None.

**Item 3 - Defaults upon Senior Securities.**

None.



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**Item 4 — Mine Safety Disclosures.**

Not applicable.

**Item 5 - Other Information.**

None.

**Item 6 — Exhibits.**

The following exhibits are filed herewith or incorporated by reference.

EXHIBIT 31.1\* Certification of Chief Executive Officer

EXHIBIT 31.2\* Certification of Chief Financial Officer

EXHIBIT 32.1\*\* Section 1350 Certification —Chief Executive Officer and Chief Financial Officer

EXHIBIT 101.INS XBRL INSTANCE DOCUMENT

EXHIBIT 101.SCH XBRL TAXONOMY EXTENSION SCHEMA

EXHIBIT 101.CAL XBRL TAXONOMY EXTENSION CALCULATION LINKBASE

EXHIBIT 101.DEF XBRL TAXONOMY EXTENSION DEFINITION LINKBASE

EXHIBIT 101.LAB XBRL TAXONOMY EXTENSION LABEL LINKBASE

EXHIBIT 101.PRE XBRL TAXONOMY EXTENSION PRESENTATION LINKBASE

\*Filed herewith

\*\*Furnished herewith





