AMES NATIONAL CORP
Form 10-K
March 12, 2018

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2017. Commission File Number 0-32637.

AMES NATIONAL CORPORATION

(Exact name of registrant as specified in its charter)

IOWA	**42-1039071**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
405 5TH STREET, AMES, IOWA	**50010**
(Address of principal executive offices)	(Zip Code)

(515) 232-6251

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Exchange Act: **NONE**

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

COMMON STOCK, $2.00 PAR VALUE

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes__ No_X_

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes__ No_X_

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

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

Large accelerated filer____ Accelerated filer __X__ Non-accelerated filer ____ Smaller reporting company ____ Emerging growth company____

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

As of June 30, 2017, the aggregate market value of voting stock held by non-affiliates of the registrant, based upon the closing sale price for the registrant's common stock in the NASDAQ Capital Market, was $280,293,001. Shares of common stock beneficially owned by each executive officer and director of the Company have been excluded on the basis that such persons may be deemed to be an affiliate of the registrant. This determination of affiliate status is not necessarily a conclusive determination for any other purpose.

The number of shares outstanding of the registrant's common stock on February 28, 2018, was 9,310,913.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement, as filed with the Securities and Exchange Commission on or about March 16, 2018, are incorporated by reference into Part III of this Form 10-K.

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PART I

ITEM 1. BUSINESS

General

Ames National Corporation (the "Company") is an Iowa corporation and bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company owns 100% of the stock of five banking subsidiaries consisting of two national banks and three state-chartered banks, as described below. All of the Company's operations are conducted in the State of Iowa and primarily within the central and north central Iowa counties of Boone, Hancock, Marshall, Polk and Story where the Company's banking subsidiaries are located. The Company does not engage in any material business activities apart from its ownership of its banking subsidiaries and the management of its own investment and loan portfolios. The principal executive offices of the Company are located at 405 5th Street, Ames, Iowa 50010. The Company's telephone number is (515) 232-6251 and website address is www.amesnational.com.

The Company was organized and incorporated on January 21, 1975 under the laws of the State of Iowa to serve as a holding company for its principal banking subsidiary, First National Bank, Ames, Iowa ("First National") located in Ames, Iowa. In 1983, the Company acquired the stock of the State Bank & Trust Co. ("State Bank") located in Nevada, Iowa; in 1991, the Company, through a newly-chartered state bank known as Boone Bank & Trust Co. ("Boone Bank"), acquired certain assets and assumed certain liabilities of the former Boone State Bank & Trust Company located in Boone, Iowa; in 1995, the Company acquired the stock of the Reliance State Bank, ("Reliance Bank") located in Story City, Iowa; and in 2002, the Company chartered and commenced operations of a new national banking organization, United Bank & Trust NA ("United Bank"), located in Marshalltown, Iowa. First National, State Bank, Boone Bank, Reliance Bank and United Bank are each operated as a wholly owned subsidiary of the Company. These five financial institutions are referred to in this Form 10-K collectively as the "Banks" and individually as a "Bank".

The principal sources of Company revenue are: (i) interest and fees earned on loans made or held by the Company and Banks; (ii) interest on investments, primarily on bonds, held by the Banks; (iii) fees on wealth management services; (iv) service charges on deposit accounts maintained at the Banks; (v) merchant and card fees; (vi) gain on the sale of loans; and (vii) securities gains. The Company's principal expenses are: (i) interest expense on deposit accounts and other borrowings; (ii) salaries and employee benefits; (iii) data processing costs primarily associated with maintaining the Banks' loan and deposit functions; (iv) occupancy expenses for maintaining the Banks' facilities; (v) professional fees; and (vi) business development. The largest component contributing to the Company's net income is net interest income, which is the difference between interest earned on earning assets (primarily loans and investments) and interest paid on interest bearing liabilities (primarily deposit accounts and other borrowings). One of management's principal functions is to manage the spread between interest earned on earning assets and interest paid on interest bearing liabilities in an effort to maximize net interest income while maintaining an appropriate level of interest rate risk.

The Banks' lending activities consist primarily of short-term and medium-term commercial and agricultural real estate loans, residential real estate loans, agricultural and business operating loans and lines of credit, equipment loans, vehicle loans, personal loans and lines of credit, home improvement loans and origination of mortgage loans for sale into the secondary market. The Banks also offer a variety of demand, savings and time deposits, cash management services, merchant credit card processing, safe deposit boxes, wire transfers, direct deposit of payroll and social security checks and automated/video teller machine access. Four of the five Banks also offer trust services, which includes wealth management services.

The Company provides various services to the Banks which include, but are not limited to, management assistance, internal auditing services, human resources services and administration, compliance management, marketing assistance and coordination, loan review, support with respect to computer systems and related procedures, financial reporting, training and the coordination of management activities.

Banking Subsidiaries

First National Bank, Ames, Iowa. First National is a nationally-chartered, commercial bank insured by the FDIC. It was organized in 1903 and became a wholly owned subsidiary of the Company in 1975 through a bank holding company reorganization whereby the then shareholders of First National exchanged all of their First National stock for stock in the Company. First National provides full-service banking to businesses and residents within the Ames community through its three Ames offices and the Greater Des Moines area through its four offices located in Ankeny, West Des Moines and Johnston. It provides a variety of products and services designed to meet the needs of the markets it serves. It has an experienced staff of bank officers including many who have spent the majority of their banking careers with First National and who emphasize long-term customer relationships.

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As of December 31, 2017, First National had capital of $76,640,000 and 115 full-time equivalent employees. Full-time equivalents represent the number of people a business would employ if all its employees were employed on a full-time basis. It is calculated by dividing the total number of hours worked by all full and part-time employees by the number of hours a full-time individual would work for a given period of time. First National had net income for the years ended December 31, 2017, 2016 and 2015 of approximately $7,154,000, $7,858,000 and $7,223,000, respectively. Total assets as of December 31, 2017, 2016 and 2015 were approximately $756,222,000, $755,296,000 and $704,289,000, respectively.

State Bank & Trust Co., Nevada, Iowa. State Bank is an Iowa, state-chartered, FDIC insured commercial bank. State Bank was acquired by the Company in 1983 through a stock transaction whereby the then shareholders of State Bank exchanged all their State Bank stock for stock in the Company. State Bank was organized in 1939 and provides full-service banking to businesses and residents within the Nevada area from its Nevada location. It has a strong presence in agricultural, commercial and residential real estate lending.

As of December 31, 2017, State Bank had capital of $18,478,000 and 20 full-time equivalent employees. State Bank had net income for the years ended December 31, 2017, 2016 and 2015 of approximately $1,672,000, $2,323,000 and $2,311,000, respectively. Total assets as of December 31, 2017, 2016 and 2015 were approximately $158,988,000, $160,739,000 and $154,847,000, respectively.

Boone Bank & Trust Co., Boone, Iowa. Boone Bank is an Iowa, state-chartered, FDIC insured commercial bank. Boone Bank was organized in 1992 by the Company under a new state charter in connection with a purchase and assumption transaction whereby Boone Bank purchased certain assets and assumed certain liabilities of the former Boone State Bank & Trust Company in exchange for a cash payment. It provides full service banking to businesses and residents within the Boone community and surrounding area. It is actively engaged in agricultural, consumer and commercial lending, including real estate, operating and equipment loans. It conducts business from its main office and a full service office, both located in Boone.

As of December 31, 2017, Boone Bank had capital of $14,379,000 and 22 full-time equivalent employees. Boone Bank had net income for the years ended December 31, 2017, 2016 and 2015 of approximately $1,522,000, $1,763,000 and $1,684,000, respectively. Total assets as of December 31, 2017, 2016 and 2015 were approximately $134,278,000, $133,837,000 and $135,767,000, respectively.

Reliance State Bank, Story City, Iowa. Reliance Bank is an Iowa, state-chartered, FDIC insured commercial bank. Reliance Bank was organized in 1928. Reliance Bank was acquired by the Company in 1995 through a stock transaction whereby the then shareholders of Reliance Bank exchanged all their Reliance Bank stock for stock in the Company. In 2012, Reliance Bank completed the purchase of a bank office of Liberty Bank, F.S.B. located in Garner, Iowa (the “Liberty Acquisition”). Reliance Bank provides full banking services to businesses and residents within the Story City and Garner communities and surrounding areas. While its primary emphasis is in agricultural lending, Reliance Bank also provides the traditional lending services typically offered by community banks. It conducts business from its main office located in Story City and full service office located in Garner.

As of December 31, 2017, Reliance Bank had capital of $30,032,000 and 31 full-time equivalent employees. Reliance Bank had net income for the years ended December 31, 2017, 2016 and 2015 of approximately $2,515,000, $2,779,000 and $2,569,000, respectively. Total assets as of December 31, 2017, 2016 and 2015 were approximately $220,385,000, $222,664,000 and $219,452,000, respectively.

United Bank & Trust NA, Marshalltown, Iowa. United Bank is a nationally-chartered, commercial bank insured by the FDIC. It was chartered in 2002 and offers a broad range of deposit and loan products, as well as wealth management services to customers located in the Marshalltown and surrounding Marshall County area. It conducts business from its main office and a full service office, both located in Marshalltown.

As of December 31, 2017, United Bank had capital of $14,118,000 and 19 full-time equivalent employees. United Bank had net income for the years ended December 31, 2017, 2016 and 2015 of approximately $1,033,000, $1,271,000 and $1,296,000, respectively. Total assets as of December 31, 2017, 2016 and 2015 were approximately $107,848,000, $111,226,000 and $112,480,000, respectively.

Business Strategy and Operations

As a multi-bank holding company for five community banks, the Company emphasizes strong personal relationships to provide products and services that meet the needs of the Banks' customers. The Company seeks to achieve growth and maintain a strong return on equity. To accomplish these goals, the Banks focus on small-to-medium size businesses that traditionally wish to develop an exclusive relationship with a single bank. The Banks, individually and collectively, have the size to give the personal attention required by business owners, in addition to the credit expertise to help businesses meet their goals.

The Banks offer a full range of deposit services that are typically available in most financial institutions, including checking accounts, savings accounts and time deposits of various types, ranging from money market accounts to longer-term certificates of deposit. One major goal in developing the Banks' product mix is to keep the product offerings as simple as possible, both in terms of the number of products and the features and benefits of the individual services. The transaction accounts and time certificates are tailored to each Bank's principal market area at rates competitive in that Bank’s market. In addition, retirement accounts such as IRAs (Individual Retirement Accounts) are available. The FDIC insures all deposit accounts up to the maximum amount. The Banks solicit these accounts from small-to-medium sized businesses in their respective primary trade areas, and from individuals who live and/or work within these areas. No material portion of the Banks' deposits has been obtained from a single person or from a few persons. Therefore, the Company does not believe that the loss of the deposits of any person or of a few persons would have an adverse effect on the Banks' operations or erode their deposit base.

Loans are provided to creditworthy borrowers regardless of their race, color, national origin, religion, sex, age, marital status, disability, receipt of public assistance or any other basis prohibited by law. The Banks intend to fulfill this commitment while maintaining prudent credit standards. In the course of fulfilling this obligation to meet the credit needs of the communities which they serve, the Banks give consideration to each credit application regardless of the fact that the applicant may reside in a low to moderate income neighborhood, and without regard to the geographic location of the residence, property or business within their market areas.

The Banks provide innovative, quality financial products, such as Internet banking and trust services that meet the banking needs of their customers and communities. The loan programs and acceptance of certain loans may vary from time-to-time depending on the funds available and regulations governing the banking industry. The Banks offer all basic types of credit to their local communities and surrounding rural areas, including commercial, agricultural and consumer loans. The types of loans within these categories are as follows:

Commercial Loans. Commercial loans are typically made to sole proprietors, partnerships, corporations and other business entities such as municipalities where the loan is to be used primarily for business purposes. These loans are typically secured by assets owned by the borrower and often times involve personal guarantees given by the owners of the business. Approximately 51% of the loan portfolio consists of loans made for commercial purposes.

The types of loans the Banks offer include:

- operating and working capital loans
- loans to finance equipment and other capital purchases
- commercial real estate loans
- business lines of credit
- term loans

- loans to professionals
- financing guaranteed under Small Business Administration programs
- letters of credit

Agricultural Loans. The Banks, by nature of their location in central and north-central Iowa, are directly and indirectly involved in agriculture and agri-business lending. This includes short-term seasonal lending associated with cyclical crop and livestock production, intermediate term lending for machinery, equipment and breeding stock acquisition and long-term real estate lending. These loans are typically secured by the crops, livestock, equipment or real estate being financed. The basic tenet of the Banks' agricultural lending philosophy is a blending of strong, positive cash flow supported by an adequate collateral position, along with a demonstrated capacity to withstand short-term negative impact if necessary. Applicable governmental subsidies and affiliated programs are utilized if warranted to accomplish these parameters. Approximately 20% of the loan portfolio consists of loans made for agricultural purposes.

Consumer Loans. Consumer loans are typically available to finance home improvements and consumer purchases, such as automobiles, household furnishings and boats. These loans are made on both a secured and an unsecured basis. The following types of consumer loans are available:

- automobiles and trucks
- boats and recreational vehicles
- personal loans and lines of credit
- home equity lines of credit
- home improvement and rehabilitation loans
- consumer real estate loans

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Other types of credit programs, such as loans to nonprofit organizations, to public entities, for community development and to other governmental programs also are available.

First National, Boone Bank, State Bank and United Bank offer wealth management services typically found in a commercial bank with trust powers, including the administration of estates, conservatorships, personal and corporate trusts and agency accounts. The Banks also provide farm management, investment and custodial services for individuals, businesses and non-profit organizations.

The Banks earn income from the origination of residential mortgages that are sold in the secondary real estate market without retaining the mortgage servicing rights.

The Banks offer traditional banking services, such as safe deposit boxes, wire transfers, direct deposit of payroll and social security checks, automated/video teller machine access and automatic drafts (ACH) for various accounts.

Lending Credit Management

The Company strives to achieve sound credit risk management. In order to achieve this goal, the Company has established uniform credit policies and underwriting criteria for the Banks' loan portfolios. The Banks diversify in the types of loans offered and are subject to regular credit examinations, annual internal audits and annual review of large loans, as well as quarterly reviews of loans experiencing deterioration in credit quality. The Company attempts to identify potential problem loans early, charge off loans promptly and maintain an adequate allowance for loan losses. The Company has established credit guidelines for the Banks' lending portfolios which include guidelines relating to the more commonly requested loan types, as follows:

Commercial Real Estate Loans - Commercial real estate loans, including agricultural real estate loans, are normally based on loan to appraisal value ratios of not to exceed 80% and secured by a first priority lien position. Loans are typically subject to interest rate adjustments no less frequently than 5 years from origination. Fully amortized monthly repayment terms normally do not exceed twenty five years. Projections and cash flows that show ability to service debt within the amortization period are required. Property and casualty insurance is required to protect the Banks' collateral interests. Commercial and agricultural real estate loans represent approximately 55% of the loan portfolio. Major risk factors for commercial real estate loans, as well as the other loan types described below, include a geographic concentration in central Iowa; the dependence of the local economy upon several large governmental entities, including Iowa State University and the Iowa Department of Transportation; and the health of Iowa's agricultural sector that is dependent on commodity prices, weather conditions and government programs.

Commercial and Agricultural Operating Lines - These loans are typically made to businesses and farm operations with terms up to twelve months. The credit needs are generally seasonal with the source of repayment coming from the entity's normal business cycle. Cash flow reviews are completed to establish the ability to service the debt within the terms of the loan. A first priority lien on the general assets of the business normally secures these types of loans. Loan-to-value limits vary and are dependent upon the nature and type of the underlying collateral and the financial strength of the borrower. Crop and hail insurance is required for most agricultural borrowers. Loans are generally guaranteed by the principal(s).

Commercial and Agricultural Term Loans – These loans are made to businesses and farm operations to finance equipment, breeding stock and other capital expenditures. Terms are generally the lesser of five years or the useful life of the asset. Term loans are normally secured by the asset being financed and are often additionally secured with the general assets of the business. Loan to value is generally 75% of the cost or value of the assets. Loans are normally guaranteed by the principal(s). Commercial and agricultural operating and term loans represent approximately 20% of the loan portfolio.

Residential First Mortgage Loans – Proceeds of these loans are used to buy or refinance the purchase of residential real estate with the loan secured by a first lien on the real estate. Most of the residential mortgage loans originated by the Banks (including servicing rights) are sold in the secondary mortgage market due to the higher interest rate risk inherent in the 15 and 30 year fixed rate terms consumers prefer. Loans that are originated and not sold in the secondary market generally have fixed rates of up to fifteen years. The maximum amortization of first mortgage residential real estate loans is 30 years. The loan-to-value ratios normally do not exceed 90% without credit enhancements such as mortgage insurance. Property insurance is required on all loans to protect the Banks' collateral position. Loans secured by one to four family residential properties, home equity term loans and home equity lines of credit represent approximately 20% of the loan portfolio.

Home Equity Term Loans – These loans are normally for the purpose of home improvement or other consumer purposes and are secured by a junior mortgage on residential real estate. Loan-to-value ratios normally do not exceed 90% of market value.

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Home Equity Lines of Credit - The Banks offer a home equity line of credit generally with a maximum term of 60 months. These loans are secured by a junior mortgage on the residential real estate and normally do not exceed a loan-to-market value ratio of 90% with the interest adjusted quarterly.

Consumer Loans – Consumer loans are normally made to consumers under the following guidelines. Automobiles - loans on new and used automobiles generally will not exceed 90% and 75% of the value, respectively. Recreational vehicles and boats will not exceed 90% and 66% of the value, respectively. Each of these loans is secured by a first priority lien on the assets and requires insurance to protect the Banks' collateral position. Unsecured - The term for unsecured loans generally does not exceed 12 months. Consumer and other loans represent approximately 2% of the loan portfolio.

Investments available-for-sale

The investment policy of the Company generally is to invest funds among various categories of investments and maturities based upon the Company's need for liquidity, to achieve the proper balance between its desire to minimize risk and maximize yield, and to fulfill the Company's asset/liability management policies. The Company's investment portfolios are managed in accordance with a written investment policy adopted by the Board of Directors. It is the Company's general policy to purchase investment securities which are U.S. Government securities, U.S. government agency, state and local government obligations, corporate debt securities, other equity securities and overnight federal funds.

Employees

At December 31, 2017, the Banks had a total of 207 full-time equivalent employees and the Company had an additional 14 full-time employees. The Company and Banks provide their employees with a comprehensive program of benefits, including comprehensive medical, vision and dental plans, long-term and short-term disability coverage, and a 401(k) profit sharing plan. Management considers its relations with employees to be satisfactory. Unions represent none of the employees.

Market Area

The Company operates five commercial banks with locations in Boone, Hancock, Marshall, Polk and Story Counties in central and north central Iowa that all offer a full line of business and consumer loan and retail and commercial deposit services. All banks, but Reliance State, offer trust service, which include wealth management services.

First National is headquartered in Ames, Iowa with a population of 66,191. The major employers are Iowa State University, National Center for Animal Health, Iowa Department of Transportation, Mary Greeley Medical Center, Ames Community Schools, City of Ames, Danfoss and McFarland Clinic. First National maintains four offices in the Des Moines metro area with a population of approximately 600,000. The major employers in the Des Moines metro market are State of Iowa, Principal Financial Group, Wells Fargo, UnityPoint Health, Mercy Medical Center, Nationwide Insurance, DuPont Pioneer, Hy-Vee Food Corp and John Deere. First National has a minimum exposure to agricultural lending.

Boone Bank is located in Boone, Iowa with a population of 12,661. Boone is the county seat of Boone County. The major employers are Fareway Stores, Inc., Iowa National Guard, Union Pacific Railroad, Boone County Hospital and Communication Data Services. Boone Bank provides lending services to the agriculture, commercial and real estate markets.

State Bank is located in Nevada, Iowa with a population of 6,798. Nevada is the county seat of Story County. The major employers are Print Graphics, General Financial Supply, Mid-American Manufacturing, Mid-States Millwright & Builders, Inc., Burke Corporation and Almaco. State Bank provides various types of loans with a major agricultural presence.

Reliance Bank is headquartered in Story City, Iowa with a population of 3,431. The major employers in the Story City area are Bethany Manor, American Packaging, M.H. Eby, Inc. and Record Printing. The Bank also maintains an office in Garner, Iowa with a population of 3,075. Garner is the county seat of Hancock County. The major employers in the Garner area are Iowa Mold & Tooling and Stellar Industries. All locations are in major agricultural areas and the Bank has a strong presence in this type of lending.

United Bank is located in Marshalltown, Iowa with a population of 27,620. The major employers are Iowa Veterans Home, Marshalltown School District, JBS Swift & Co., Emerson Process Management/Fisher Division, Lennox Industries and UnityPoint Health. Marshalltown is the county seat of Marshall County. Loan services include primarily commercial and consumer types of credit including operating lines, equipment loans, automobile financing and real estate loans.

Competition

The geographic market area served by the Banks is highly competitive with respect to both loans and deposits. The Banks compete principally with other commercial banks, savings and loan associations, credit unions, mortgage companies, finance divisions of auto and farm equipment companies, agricultural suppliers and other financial service providers. Some of these competitors are local, while others are statewide or nationwide. The major commercial bank competitors include Great Western Bank, U.S. Bank National Association and Wells Fargo Bank, each of which maintains an office or offices within the Banks' primary central Iowa trade areas. Among the advantages such larger banks have are their ability to finance extensive advertising campaigns and to allocate their investment assets to geographic regions of higher yield and demand. These larger banking organizations have much higher legal lending limits than the Banks and thus are better able to finance large regional, national and global commercial customers.

In order to compete with the other financial institutions in their primary trade areas, the Banks use, to the fullest extent possible, the flexibility which is accorded by independent status. This includes an emphasis on specialized services, local promotional activity and personal contacts by the Banks' officers, directors and employees. In particular, the Banks compete for deposits principally by offering depositors a wide variety of deposit programs, convenient office locations, hours and other services. The Banks compete for loans primarily by offering competitive interest rates, experienced local lending personnel and quality products and services.

As of December 31, 2017, there were 50 FDIC insured institutions having approximately 107 locations within Boone, Hancock, Marshall, Polk and Story County, Iowa where the Banks' offices are located. First National, State Bank and Reliance Bank together have the largest percentage of deposits in Story County.

The Banks also compete with the financial markets for funds. Yields on corporate and government debt securities and commercial paper affect the ability of commercial banks to attract and hold deposits. Commercial banks also compete for funds with equity, money market, and insurance products offered by brokerage and insurance companies. This competitive trend will likely continue in the future.

The Company anticipates bank competition will continue to change materially over the next several years as more financial institutions, including the major regional and national banks, continue to consolidate. Credit unions, which are not subject to income taxes, have a significant competitive advantage and provide additional competition in the Company's local markets.

Supervision and Regulation

The following discussion refers to certain statutes and regulations affecting the banking industry in general. These references provide brief summaries and therefore do not purport to be complete and are qualified in their entirety by reference to those statutes and regulations. In addition, due to the numerous statutes and regulations that apply to and regulate the banking industry, many are not referenced below.

Dodd-Frank Wall Street Reform and Consumer Protection Act of *2010 (“the Dodd-Frank Act”).* In response to the last national and international economic recession and to strengthen supervision of financial institutions and systemically important nonbank financial institutions, Congress and the U.S. government have taken a variety of actions, including the enactment of the Dodd-Frank Act on July 21, 2010. The Dodd-Frank Act represents the most comprehensive change to banking laws since the Great Depression of the 1930s and mandates changes in several key areas: regulation and compliance (both with respect to financial institutions and systemically important nonbank financial companies), securities regulation, executive compensation, regulation of derivatives, corporate governance, transactions with affiliates, deposit insurance assessments and consumer protection. While the changes in the law required by the Dodd-Frank Act have most significantly affected larger institutions, even relatively small institutions such as the Company have been affected.

Pursuant to the Dodd-Frank Act, the Banks are subject to regulations promulgated by the consumer protection bureau housed within the Federal Reserve, known as the Bureau of Consumer Financial Protection (the “Bureau” or “BCFP”). The Bureau promulgates rules and orders with respect to consumer financial products and services and has substantial power to define the rights of consumers and responsibilities of lending institutions, such as the Banks. The Bureau will not, however, examine or supervise the Banks for compliance with such regulations; rather, enforcement authority will remain with the Banks’ primary federal regulator although the Banks may be required to submit reports or other materials to the Bureau upon its request.

The Company and the Banks are subject to extensive federal and state regulation and supervision. Regulation and supervision of financial institutions is primarily intended to protect depositors and the FDIC rather than shareholders of the Company. The laws and regulations affecting banks and bank holding companies have changed significantly over recent years. There is reason to expect that similar changes will continue in the future. Any change in applicable laws, regulations or regulatory policies may have a material effect on the business, operations and prospects of the Company. The Company is unable to predict the nature or the extent of the effects on its business and earnings that any fiscal or monetary policies or new federal or state legislation may have in the future.

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The Company

The Company is a bank holding company by virtue of its ownership of the Banks, and is registered as such with the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The Company is subject to regulation under the Bank Holding Company Act of 1956, as amended (the "BHCA"), which subjects the Company and the Banks to supervision and examination by the Federal Reserve. Under the BHCA, the Company files with the Federal Reserve annual reports of its operations and such additional information as the Federal Reserve may require.

Source of Strength to the Banks. The Federal Reserve takes the position that a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, it is the Federal Reserve's position that in serving as a source of strength to its subsidiary banks, bank holding companies should use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity. It should also maintain the financial flexibility and capital raising capacity to obtain additional resources for providing assistance to its subsidiary banks. A bank holding company's failure to meet its obligation, or to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve to be an unsafe and unsound banking practice, or a violation of the Federal Reserve's regulations, or both.

Federal Reserve Approval. Bank holding companies must obtain the approval of the Federal Reserve before they: (i) acquire direct or indirect ownership or control of any voting stock of any bank if, after such acquisition, they would own or control, directly or indirectly, more than 5% of the voting stock of such bank; (ii) merge or consolidate with another bank holding company; or (iii) acquire substantially all of the assets of any additional banks.

Non-Banking Activities. With certain exceptions, the BHCA also prohibits bank holding companies from acquiring direct or indirect ownership or control of voting stock in any company other than a bank or a bank holding company unless the Federal Reserve finds the company's business to be incidental to the business of banking. When making this determination, the Federal Reserve in part considers whether allowing a bank holding company to engage in those activities would offer advantages to the public that would outweigh possible adverse effects. A bank holding company may engage in permissible non-banking activities on a de novo basis, if the holding company meets certain criteria and notifies the Federal Reserve within ten (10) business days after the activity has commenced.

Financial Holding Company. Under the Financial Services Modernization Act, eligible bank holding companies may elect (with the approval of the Federal Reserve) to become a "financial holding company." Financial holding companies are permitted to engage in certain financial activities through affiliates that had previously been prohibited activities for bank holding companies. Such financial activities include securities and insurance underwriting and merchant banking. At this time, the Company has not elected to become a financial holding company, but may choose to do so at some time in the future.

Control Transactions. The Change in Bank Control Act of 1978, as amended, requires a person or group of persons acquiring "control" of a bank holding company to provide the Federal Reserve with at least 60 days prior written notice of the proposed acquisition. Following receipt of this notice, the Federal Reserve has 60 days to issue a notice disapproving the proposed acquisition, but the Federal Reserve may extend this time period for up to another 30 days. An acquisition may be completed before the disapproval period expires if the Federal Reserve issues written notice of its intent not to disapprove the action. Under a rebuttable presumption established by the Federal Reserve, the acquisition of 10% or more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended, would constitute the acquisition of control. In addition, any "company" would be required to obtain the approval of the Federal Reserve under the BHCA before acquiring 25% (or 5% if the "company" is a bank holding company) or more of the outstanding shares of the Company, or otherwise obtain control over the Company.

Affiliate Transactions. The Company and the Banks are deemed affiliates within the meaning of the Federal Reserve Act, and transactions between affiliates are subject to certain restrictions. Generally, the Federal Reserve Act: (i) limits the extent to which the financial institution or its subsidiaries may engage in "covered transactions" with an affiliate; and (ii) requires all transactions with an affiliate, whether or not "covered transactions," to be on terms substantially the same, or at least as favorable to the institution or subsidiary, as those provided to a non-affiliate. The term "covered transaction" includes the making of loans, purchase of assets, issuance of a guarantee and similar transactions.

State Law on Acquisitions. Iowa law permits bank holding companies to make acquisitions throughout the state. However, Iowa currently has a deposit concentration limit of 15% on the amount of deposits in the state that any one banking organization can control and continue to acquire banks or bank deposits (by acquisitions), which applies to all depository institutions doing business in Iowa.

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Banking Subsidiaries

Applicable federal and state statutes and regulations governing a bank's operations relate, among other matters, to capital adequacy requirements, required reserves against deposits, investments, loans, legal lending limits, certain interest rates payable, mergers and consolidations, borrowings, issuance of securities, payment of dividends, establishment of branches and dealings with affiliated persons.

First National and United Bank are national banks subject to primary federal regulation and supervision by the Office of Comptroller of the Currency (“OCC”). The FDIC, as an insurer of the deposits to the maximum extent permitted by law, also has some limited regulatory authority over First National and United Bank. State Bank, Boone Bank and Reliance Bank are state banks subject to regulation and supervision by the Iowa Division of Banking. The three state Banks are also subject to regulation and examination by the FDIC, which insures their respective deposits to the maximum extent permitted by law. The federal laws that apply to the Banks regulate, among other things, the scope of their business, their investments, their reserves against deposits, the timing of the availability of deposited funds and the nature and amount of and collateral for loans. The laws and regulations governing the Banks generally have been promulgated to protect depositors and the deposit insurance fund of the FDIC and not to protect stockholders of such institutions or their holding companies.

The OCC and FDIC each have authority to prohibit banks under their supervision from engaging in what it considers to be an unsafe and unsound practice in conducting their business. The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") requires federal banking regulators to adopt regulations or guidelines in a number of areas to ensure bank safety and soundness, including internal controls, credit underwriting, asset growth, management compensation, ratios of classified assets to capital and earnings. FDICIA also contains provisions which are intended to change independent auditing requirements, restrict the activities of state-chartered insured banks, amend various consumer banking laws, limit the ability of "undercapitalized banks" to borrow from the Federal Reserve's discount window, require regulators to perform periodic on-site bank examinations and set standards for real estate lending.

Borrowing Limitations. Each of the Banks is subject to limitations on the aggregate amount of loans that it can make to any one borrower, including related entities. Subject to numerous exceptions based on the type of loans and collateral, applicable statutes and regulations generally limit loans to one borrower of 15% of total equity and reserves. Each of the Banks is in compliance with applicable loans to one borrower requirements.

FDIC Insurance. The deposit insurance coverage limit is $250,000 per depositor, per insured depository institution for each account ownership category. The FDIC has adopted a risk-based insurance assessment system under which depository institutions contribute funds to the FDIC insurance fund based on their risk classification. The FDIC may terminate the deposit insurance of any insured depository institution if it determines after an administrative hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law.

Capital Adequacy Requirements. The Federal Reserve, the FDIC and the OCC (collectively, the "Agencies") have adopted risk-based capital guidelines for banks and bank holding companies that are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies and account for off-balance sheet items. Failure to achieve and maintain adequate capital levels may give rise to supervisory action through the issuance of a capital directive to ensure the maintenance of required capital levels. Each of the Banks is in compliance with applicable risk-based capital level requirements as of December 31, 2017.

Basel III Capital Requirements. In July, 2013, the Agencies, approved final rules (the “Basel III Capital Rules”) establishing a new comprehensive capital framework for U.S. banking organizations. The Basel III Capital Rules generally implement the Basel Committee on Banking Supervision’s (the “Basel Committee”) December 2010 final capital framework referred to as “Basel III” for strengthening international capital standards. The Basel III Capital Rules revise the definitions and the components of regulatory capital, as well as address other issues affecting the numerator in banking institutions’ regulatory capital ratios. The Basel III Capital Rules also address asset risk weights and other matters affecting the denominator in banking institutions’ regulatory capital ratios and replace the existing general risk-weighting approach, which was derived from the Basel Committee’s 1988 “Basel I” capital accords, with a more risk-sensitive approach based, in part, on the “standardized approach” in the Basel Committee’s 2004 “Basel II” capital accords. In addition, the Basel III Capital Rules implement certain provisions of the Dodd-Frank Act, including the requirements of Section 939A to remove references to credit ratings from the federal agencies’ rules. The Basel III Capital Rules were effective for the Company and Banks on January 1, 2015, subject to phase-in periods for certain of their components and other provisions.

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Among other matters, the Basel III Capital Rules: (i) introduce a new capital measure called “Common Equity Tier 1” (“CET1”) and related regulatory capital ratio of CET1 to risk-weighted assets; (ii) specify that Tier 1 capital consists of CET1 and “Additional Tier 1 capital” instruments meeting certain revised requirements; (iii) mandate that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital; and (iv) expand the scope of the deductions from and adjustments to capital as compared to existing regulations. Under the Basel III Capital Rules, for most banking organizations, the most common form of Additional Tier 1 capital is non-cumulative perpetual preferred stock and the most common form of Tier 2 capital is subordinated notes and a portion of the allowance for loan and lease losses, in each case, subject to the Basel III Capital Rules’ specific requirements.

Pursuant to the Basel III Capital Rules, the Company and Banks are subject to new regulatory capital adequacy requirements promulgated by the Federal Reserve and the OCC. Failure by the Company or Bank to meet minimum capital requirements could result in certain mandatory and discretionary actions by the regulators that could have a material adverse effect on the Company’s consolidated financial statements. Under the capital requirements and the regulatory framework for prompt corrective action, the Company and Banks must meet specific capital guidelines that involve quantitative measures of the Company and Banks’ assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company’s and Banks’ capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weightings and other factors.

The Basel III Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such items, in the aggregate, exceed 15% of CET1. See Note 15 to the “Notes to Consolidated Financial Statements,” which is included in Part II, Item 8 “Financial Statements and Supplementary Data” of this Annual Report on Form 10-K.

Pursuant to the Basel III Capital Rules, the effects of certain accumulated other comprehensive income or loss (“AOCI”) items are not excluded; however, the Company and Banks, made a one-time permanent election to continue to exclude these items. This election was made concurrently with the first filing of certain of the Company and Banks’ periodic regulatory reports in the beginning of 2015 in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of their securities portfolio. The Basel III Capital Rules also preclude certain hybrid securities, such as trust preferred securities issued prior to May 19, 2010, from inclusion in Tier 1 capital, subject to grandfathering in the case of companies, such as us, that had less than $15 billion in total consolidated assets as of December 31, 2009.

Implementation of the deductions and other adjustments to CET1 began on January 1, 2015, and will be phased in over a four-year period (beginning at 40% on January 1, 2015, and an additional 20% per year thereafter). The implementation of the capital conservation buffer began on January 1, 2016, at the 0.625% level and increases by 0.625% on each subsequent January 1, until it reaches 2.5% on January 1, 2019.

With respect to the Banks, the Basel III Capital Rules revise the Prompt Corrective Action (“PCA”) regulations adopted pursuant to Section 38 of the Federal Deposit Insurance Act, by: (i) introducing a CET1 ratio requirement at each PCA category (other than critically undercapitalized), with the required CET1 ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each category, with the minimum Tier 1 capital ratio for well-capitalized status being 8%; and (iii) eliminating the provision that provides that a bank with a composite supervisory rating of 1 may have a 3% leverage ratio and still be adequately capitalized. The Basel III Capital Rules do not change the total risk-based capital requirement for any PCA category.

The Basel III Capital Rules prescribe a standardized approach for risk weightings for a large and risk-sensitive number of categories, depending on the nature of the assets, generally ranging from 0% for U.S. Government and agency securities, to 600% for certain equity exposures, and resulting in high-risk weights for a variety of asset classes.

Should the Company or Banks not meet the requirements of the Basel III Capital Rules, the Company and Banks would be subject to adverse regulatory action by their regulators, which action could result in material adverse consequences for the Company, Banks, and Company shareholders.

As of December 31, 2017, the Banks exceeded all of their regulatory capital requirements and were designated as “well-capitalized” under federal guidelines. See Note 15 to the “Notes to Consolidated Financial Statements,” which is included in Part II, Item 8 “Financial Statements and Supplementary Data” of this Annual Report on Form 10-K.

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Prompt Corrective Action. Regulations adopted by the Agencies impose even more stringent capital requirements under prompt corrective action. The FDIC and other Agencies must take certain "prompt corrective action" when a bank fails to meet capital requirements. The regulations establish and define five capital levels: (i) "well-capitalized," (ii) "adequately capitalized," (iii) "undercapitalized," (iv) "significantly undercapitalized" and (v) "critically undercapitalized." Increasingly severe restrictions are imposed on the payment of dividends and management fees, asset growth and other aspects of the operations of institutions that fall below the category of being "adequately capitalized." Undercapitalized institutions are required to develop and implement capital plans acceptable to the appropriate federal regulatory agency. Such plans must require that any company that controls the undercapitalized institution must provide certain guarantees that the institution will comply with the plan until it is adequately capitalized. As of December 31, 2017, each of the Banks was categorized as “well capitalized” under regulatory prompt corrective action provisions.

Restrictions on Dividends. The dividends paid to the Company by the Banks are the major source of Company cash flow. Various federal and state statutory provisions limit the amount of dividends banking subsidiaries are permitted to pay to their holding companies without regulatory approval. Federal Reserve policy further limits the circumstances under which bank holding companies may declare dividends. For example, a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition. In addition, the Federal Reserve and the FDIC have issued policy statements which provide that insured banks and bank holding companies should generally pay dividends only out of current operating earnings. Federal and state banking regulators may also restrict the payment of dividends by order.

First National Bank and United Bank, as national banks, generally may pay dividends, without obtaining the express approval of the OCC, in an amount up to its retained net profits for the preceding two calendar years plus retained net profits up to the date of any dividend declaration in the current calendar year. Retained net profits as defined by the OCC, consists of net income less dividends declared during the period. Boone Bank, Reliance Bank and State Bank are also restricted under Iowa law to paying dividends only out of their undivided profits. Additionally, the payment of dividends by the Banks is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and the Banks generally are prohibited from paying any dividends if, following payment thereof, the Bank would be undercapitalized.

Reserves Against Deposits

The Federal Reserve requires all depository institutions to maintain reserves against their transaction accounts (primarily checking accounts) and non-personal time deposits. Generally, reserves of 3% must be maintained against total transaction accounts of $115,100,000 or less (subject to an exemption not in excess of the first $15,500,000 of transaction accounts). A reserve of $2,988,000 plus 10% of amounts in excess of $115,100,000 must be maintained in the event total transaction accounts exceed $115,100,000. The balances maintained to meet the reserve requirements imposed by the Federal Reserve may be used to satisfy applicable liquidity requirements. Because required reserves must be maintained in the form of vault cash or a noninterest bearing account at a Federal Reserve Bank, the effect of this reserve requirement is to reduce the earning assets of the Banks.

Regulatory Enforcement Authority

The enforcement powers available to federal and state banking regulators are substantial and include, among other things, the ability to assess civil monetary penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties. In general, enforcement actions must be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions, or inactions, may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities. Applicable law also requires public disclosure of final enforcement actions by the federal banking agencies.

National Monetary Policies

In addition to being affected by general economic conditions, the earnings and growth of the Banks are affected by the regulatory authorities' policies, including the Federal Reserve. An important function of the Federal Reserve is to regulate the money supply, credit conditions and interest rates. Among the instruments used to implement these objectives are open market operations in U.S. Government securities, changes in reserve requirements against bank deposits and the Federal Reserve Discount Rate, which is the interest rate charged member banks to borrow from the Federal Reserve Bank. These instruments are used in varying combinations to influence overall growth and distribution of credit, bank loans, investments and deposits, and their use may also affect interest rates charged on loans or paid on deposits.

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The monetary policies of the Federal Reserve have had a material impact on the operating results of commercial banks in the past and are expected to have a similar impact in the future. The U.S. Congress established three key objectives for monetary policy in the Federal Reserve Act: maximizing employment, stabilizing prices, and moderating long-term interest rates. The first two objectives are sometimes referred to as the Federal Reserve's dual mandate. Its duties have expanded over the years, and as of 2009 so include supervising and regulating banks, maintaining the stability of the financial system and providing financial services to depository institutions, the U.S. government, and foreign official institutions. The Federal Reserve conducts research into the economy and releases numerous publications. Also important in terms of effect on banks are controls on interest rates paid by banks on deposits and types of deposits that may be offered by banks. The Federal Open Market Committee ("FOMC"), a committee within the Federal Reserve System, is charged under the United States of America ("USA") law with overseeing the nation's open market operations (i.e., the Federal Reserve Banks buying and selling of USA government securities). This Federal Reserve committee makes key decisions about interest rates and the growth of the USA money supply. The FOMC is the principal organization of USA national monetary policy. The Committee sets monetary policy by specifying the short-term objective for the Federal Reserve Bank's open market operations, which is usually a target level for the federal funds rate (the rate that commercial banks charge between themselves for overnight loans).

Availability of Information on Company Website

The Company files periodic reports with the Securities and Exchange Commission ("SEC"), including annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K. The Company makes available on or through its website free of charge all periodic reports filed by the Company with the SEC, including any amendments to such reports, as soon as reasonably practicable after such reports have been electronically filed with the SEC. The address of the Company's website on the Internet is: www.amesnational.com.

The Company will provide a paper copy of these reports free of charge upon written or telephonic request directed to John P. Nelson, CFO, 405 5th Street, Ames, Iowa 50010 or (515) 232-6251 or by email request at info@amesnational.com. The information found on the Company's website is not part of this or any other report the Company files with the SEC.

Executive Officers of Company and Banks

The following table sets forth summary information about the executive officers of the Company and certain executive officers of the Banks. Unless otherwise indicated, each executive officer has served in his current position for the past five years with the exception of John P. Nelson. Mr. Nelson was appointed chief operating officer and executive vice president on November 9, 2016.

Name	Age	Position with the Company or Bank and Principal Occupation and Employment During the Past Five Years
Scott T. Bauer	55	President and Director of First National.
Kevin G. Deardorff	63	Vice President & Technology Director of the Company.
Curtis A. Hoff	55	President and Director of United Bank.
Stephen C. McGill	63	President and Director of State Bank.
John P. Nelson	51	Chief Financial Officer, Executive Vice President, Chief Operating Officer, Secretary, Treasurer and Director of the Company. Director and Chairman of Reliance Bank.
Thomas H. Pohlman	67	Chief Executive Officer, President and Director of the Company. Director and Chairman of First National, State Bank, Boone Bank and United Bank.
Jeffrey K. Putzier	56	President and Director of Boone Bank.
Richard J. Schreier	50	President and Director of Reliance Bank.

ITEM 1A. RISK FACTORS

Set forth below is a description of risk factors related to the Company’s business, provided to enable investors to assess, and be appropriately apprised of, certain risks and uncertainties the Company faces in conducting its business. An investor should carefully consider the risks described below and elsewhere in this Report, which could materially and adversely affect the Company’s business, results of operations or financial condition. The risks and uncertainties discussed below are also applicable to forward-looking statements contained in this Report and in other reports filed by the Company with the Securities and Exchange Commission. Given these risks and uncertainties, investors are cautioned not to place undue reliance on forward-looking statements.

Changes in general business, economic and political conditions may adversely affect the Company's business.

Our earnings and financial condition are affected by general business, economic and political conditions. For example, a depressed economic environment increases the likelihood of lower employment levels and recession, which could adversely affect our earnings and financial condition. General business and economic conditions that could affect us include short-term and long-term interest rates, inflation, fluctuations in both debt and equity capital markets and the strength of the national and local economies in which we operate. Political conditions can also affect our earnings through the introduction of new regulatory schemes and changes in tax laws.

Our financial performance generally, and in particular the ability of customers to pay interest on and repay principal of outstanding loans and the value of collateral securing those loans, as well as demand for loans and other products and services we offer, is highly dependent upon the business environment not only in the markets where we operate but also in the state of Iowa generally and in the United States as a whole. A favorable business environment is generally characterized by, among other factors: economic growth; efficient capital markets; low inflation; low unemployment; high business and investor confidence; and strong business earnings. Unfavorable or uncertain economic and market conditions can be caused by: declines in economic growth, business activity, or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; increases in inflation or interest rates; high unemployment; natural disasters; or a combination of these or other factors.

Economic conditions in our market, the state of Iowa, and the United States have generally improved during the last several years. There can be no assurance, however, that this improvement will continue or occur at a meaningful rate. In particular, Company management is seeing weakness in the Iowa agricultural economy as a result of the current low grain prices; however, favorable yields in 2017 are generally providing break even cash flows for most of the Company's agricultural borrowers. Stagnant or declining economic conditions could materially and adversely affect our results of operations and financial condition.

Fair values of investments in the Company's securities portfolio may adversely change.

As of December 31, 2017, the fair value of our securities portfolio was approximately $498.3 million. Factors beyond our control can significantly influence the fair value of securities in our portfolio and can cause potential adverse changes to the fair value of those securities. These factors include, but are not limited to, changes in interest rates, an unfavorable change in the liquidity of an investment, rating agency downgrades of the securities, reinvestment risk, liquidity risk, defaults by the issuer or individual mortgagors with respect to the underlying securities, and instability in the credit markets. Any of the foregoing factors could cause us to recognize an other than temporary impairment (OTTI) in future periods and result in realized losses that negatively impact earnings. The success of any investment activity is affected by general economic conditions. Unexpected volatility or illiquidity in the markets in which we hold securities could reduce our liquidity and stockholders' equity. To mitigate these risks, we have access to lines of credit that provide additional liquidity, if needed.

Our investment securities are analyzed quarterly to determine whether, in the opinion of management, any of the securities have OTTI. To the extent that any portion of the unrealized losses in our portfolio of investment securities is determined to have OTTI and is credit loss related, we will recognize a charge to our earnings in the quarter during which such determination is made, and our earnings and capital ratios will be adversely impacted. Generally, a fixed income security is determined to have OTTI when it appears unlikely that we will receive all of the principal and interest due in accordance with the original terms of the investment. In addition to credit losses, losses are recognized for a security having an unrealized loss if we have the intent to sell the security or if it is more likely than not that we will be required to sell the security before collection of the principal amount.

Our business depends on our ability to successfully manage credit risk.

The operation of our business requires us to manage credit risk. As a lender, we are exposed to the risk that our borrowers will be unable to repay their loans according to their terms, and that the collateral securing repayment of their loans, if any, may not be sufficient to ensure repayment. In addition, there are risks inherent in making any loan, including risks with respect to the period of time over which the loan may be repaid, risks relating to proper loan underwriting, risks resulting from changes in economic and industry conditions and risks inherent in dealing with individual borrowers. In order to successfully manage credit risk, we must, among other things, maintain disciplined and prudent underwriting standards and ensure that our bankers follow those standards. The weakening of these standards for any reason, such as an attempt to attract higher yielding loans, a lack of discipline or diligence by our employees in underwriting and monitoring loans, our inability to adequately adapt policies and procedures to changes in economic or any other conditions affecting borrowers may negatively impact the quality of our loan portfolio, result in loan defaults, foreclosures and additional charge-offs and necessitate that we significantly increase our allowance for loan and lease losses. As a result, our inability to successfully manage credit risk could have a material adverse effect on our business, financial condition or results of operations.

The commercial real estate loan portfolio is a significant part of the Company’s business.

Commercial real estate loans were a significant portion of our total loan portfolio as of December 31, 2017. The market value of real estate securing these loans can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. Adverse developments affecting real estate values in one or more of our markets could increase the credit risk associated with our loan portfolio. Additionally, real estate lending typically involves higher loan principal amounts, and the repayment of the loans generally is dependent, in large part, on sufficient income from the properties securing the loans to cover operating expenses and debt service. Economic events or governmental regulations outside of the control of the borrower or lender could negatively impact the future cash flow and market values of the affected properties.

If the loans that are collateralized by real estate become troubled and the value of the real estate has been significantly impaired, then we may not be able to recover the full contractual amount of principal and interest that was anticipated at the time of originating the loan, which could cause an increase in charge-offs, resulting in the need to increase our provision for loan losses and adversely affecting our operating results and financial condition.

If the Company’s actual loan losses exceed the allowance for loan losses or increase significantly, the Company’s net income will decrease.

We maintain an allowance for loan losses at a level believed to be adequate to absorb estimated losses inherent in the existing loan portfolio. The level of the allowance reflects management’s continuing evaluation of industry concentrations; specific credit risks; credit loss experience; current loan portfolio quality; present economic, political and regulatory conditions; and unidentified losses inherent in the current loan portfolio.

Determination of the allowance is inherently subjective as it requires significant estimates and management’s judgment of credit risks and future trends, all of which may undergo material changes. Continuing deterioration in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in the allowance for loan losses. In addition, bank regulatory agencies periodically review our allowance and may require an increase in the provision for loan losses or the recognition of additional loan charge-offs, based on judgments different from those of management. Also, if charge-offs in future periods exceed the allowance for loan losses or increase significantly; we will need additional provisions to increase the allowance. Any increases in provisions will result in a decrease in net income and capital and may have a material adverse effect on our financial condition and results of operations.

Changes in interest rates could adversely affect the Company’s results of operations and financial condition.

Short-term federal funds interest rates have risen 0.75% in 2017, while longer term rates (10-20 years) are relatively unchanged in 2017. This increase in short-term rates has negatively impacted the Company's net interest margin as interest expense increases more quickly than interest income. Our earning assets (primarily our loan and investment portfolio) have longer maturities than our interest bearing liabilities (primarily our deposits and other borrowings). Therefore, in a rising interest rate environment, interest expense will increase more quickly than interest income, as the interest bearing liabilities reprice more quickly than earning assets, placing downward pressure on the net interest margin. A reduction in the net interest margin could negatively affect our results of operations, including earnings. In response to this challenge, we model quarterly the changes in income that would result from various changes in interest rates. Management believes our earning assets have the appropriate maturity and repricing characteristics to optimize earnings and interest rate risk positions.

The Company may have difficulty continuing to grow, and even if we do grow, our growth may strain our resources and limit our ability to expand operations successfully.

Our future profitability will depend in part on our continued ability to grow in both loans and deposits; however, we may not be able to sustain our historical growth rate or be able to grow at all. In addition, our future success will depend on competitive factors and on the ability of our senior management to continue to maintain an appropriate system of internal controls and procedures and manage a growing number of customer relationships. We may not be able to implement changes or improvements to these internal controls and procedures in an efficient or timely manner and may discover deficiencies in existing systems and controls. Consequently, continued growth, if achieved, may place a strain on our operational infrastructure, which could have a material adverse effect on our financial condition and results of operations.

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We may not be able to attract and retain key personnel and other skilled employees.

Our success depends, in large part, on the skills of our management team and our ability to retain, recruit and motivate key officers and employees. Our senior management team has significant industry experience, and their knowledge and relationships would be difficult to replace. Leadership changes will occur from time to time, and we cannot predict whether significant resignations will occur or whether we will be able to recruit additional qualified personnel. Competition for senior executives and skilled personnel in the financial services and banking industry is intense, which means the cost of hiring, incentivizing and retaining skilled personnel may continue to increase. We need to continue to attract and retain key personnel and to recruit qualified individuals to succeed existing key personnel to ensure the continued growth and successful operation of our business. In addition, as a provider of commercial and agricultural banking services, we must attract and retain qualified banking personnel to continue to grow our business, and competition for such personnel can be intense. Our ability to effectively compete for senior executives and other qualified personnel by offering competitive compensation and benefit arrangements may be restricted by applicable banking laws and regulations. The loss of the services of any senior executive or other key personnel, or the inability to recruit and retain qualified personnel in the future, could have a material adverse effect on our business, financial condition or results of operations. In addition, to attract and retain personnel with appropriate skills and knowledge to support our business, we may offer a variety of benefits, which could reduce our earnings or have a material adverse effect on our business, financial condition or results of operations.

The Company is subject to certain operational risks, including, but not limited to, data processing system failures, errors, data security breaches and customer or employee fraud.

There have been a number of publicized cases involving errors, fraud or other misconduct by employees of financial services firms in recent years. Misconduct by our employees could include hiding unauthorized activities from us, improper or unauthorized activities on behalf of our customers or improper use of confidential information. Employee fraud, errors and employee and customer misconduct could subject us to financial losses or regulatory sanctions and seriously harm our reputation. It is not always possible to prevent employee errors and misconduct, and the precautions we take to prevent and detect this activity may not be effective in all cases. Employee errors could also subject us to civil claims for negligence.

Although we maintain a system of internal controls and procedures designed to reduce the risk of loss from employee or customer fraud or misconduct and employee errors as well as insurance coverage to mitigate against some operational risks, including data processing system failures and errors and customer or employee fraud; these internal controls may fail to prevent or detect such an occurrence, or such an occurrence may not be insured or exceed applicable insurance limits.

In addition, there have also been a number of cases where financial institutions have been the victim of fraud related to unauthorized wire and automated clearinghouse transactions. The facts and circumstances of each case vary but generally involve criminals posing as customers (i.e., stealing bank customers' identities) to transfer funds out of the institution quickly in an effort to place the funds beyond recovery prior to detection. Although we have policies and procedures in place to verify the authenticity of our customers and prevent identity theft, we can provide no assurances that these policies and procedures will prevent all fraudulent transfers. In addition, although we have safeguards in place, it is possible that our computer systems could be infiltrated by hackers or other intruders resulting in loss, destruction or misuse of our data or confidential information about our customers. We can provide no assurances that these safeguards will prevent all unauthorized infiltrations or breaches. Identity theft, successful unauthorized intrusions and similar unauthorized conduct could result in reputational damage and financial losses to the Company.

An impairment charge of goodwill or other intangibles could have a material adverse impact on the Company's results of operations and financial condition.

Because the Company has grown in part through acquisitions, goodwill and intangible assets are included in the consolidated assets. Goodwill and intangible assets were $7.9 million as of December 31, 2017. Under generally accepted accounting principles ("GAAP"), we are required to test the carrying value of goodwill and intangible assets at least annually or sooner if events occur that indicate impairment could exist. These events or circumstances could include a significant change in the business climate, including a sustained decline in a reporting unit's fair value, legal and regulatory factors, operating performance indicators, competition and other factors. GAAP requires us to assign and then test goodwill at the reporting unit level. If over a sustained period of time we experience a decrease in our stock price and market capitalization, which may serve as an estimate of the fair value of our reporting unit, this may be an indication of impairment. If the fair value of our reporting unit is less than its net book value, we may be required to record goodwill impairment charges in the future. In addition, if the revenue and cash flows generated from any of our other intangible assets is not sufficient to support its net book value, we may be required to record an impairment charge. The amount of any impairment charge could be significant and could have a material adverse impact on our financial condition and results of operations for the period in which the charge is taken.

Loans to agricultural-related borrowers are subject to factors beyond the Company's control, including fluctuations in commodity and livestock prices and other risks, which could negatively impact the Company's loan portfolio.

A significant portion of our loan portfolio consists of loans to borrowers who are directly or indirectly affected by the health of the Iowa agricultural economy. During 2016 and 2017, the agricultural economy has experienced historically low commodity and livestock prices which have placed downward pressure on cash flow and profits from agricultural activities. An extended period of low commodity and/or livestock prices, together with other risks to which our agricultural borrowers are subject, including poor weather conditions, higher input costs and changes in governmental support programs, could result in reduced cash flows and profit margins, negatively affecting these borrowers and making it more difficult for them to repay their loan obligations to us. A general decline in the agricultural economy could also negatively affect us by reducing the value of agricultural real estate which secures some of our agricultural loans, creating the potential for greater losses if these borrowers are unable to repay their loans and we are forced to rely on this collateral. Moreover, a general decline in the agricultural economy could also negatively impact some of our commercial borrowers whose businesses are directly or indirectly dependent on the health of the agricultural economy. All of these risks, which are beyond our control, could produce losses in our loan portfolio and adversely affect our financial condition or results of operations.

Changes in accounting policies or accounting standards, or changes in how accounting standards are interpreted or applied, could materially affect how the Company reports our results of operations and financial condition.

Our accounting policies are fundamental to determining and understanding our results of operation and financial condition. Some of these policies require use of estimates and assumptions that may affect the value of our assets or liabilities and financial results. Any changes in our accounting policies could materially affect our financial statements. From time to time, the Financial Accounting Standards Board (the "FASB") and the SEC change the financial accounting and reporting standards that govern the preparation of our financial statements. In addition, accounting standard setters and those who interpret the accounting standards (such as the FASB, the SEC, banking regulators and our outside auditors) may change positions on how these standards should be applied. Changes in financial accounting and reporting standards and changes in current interpretations may be beyond our control, can be difficult to predict and could materially affect how we report our results of operations and financial condition. We may be required to apply a new or revised standard retroactively or apply an existing standard differently and retroactively, which may result in the Company being required to restate prior period financial statements in material amounts. In particular, the FASB issued a new rule requiring companies to estimate current expected credit losses. The rule, which is a major change for banking organizations, becomes effective for the Company on January 1, 2020. The new standard is likely to result in more timely recognition of credit losses than under the previous incurred loss model, and the Company is evaluating the extent to which the new rule will affect its results of operations.

The inability to maintain adequate liquidity may adversely affect the Company's business.

Maintaining adequate liquidity is essential to the banking business. An inability to raise funds through deposits, borrowing, sale of securities or other sources could have a substantial negative impact on our liquidity. Access to funding sources in amounts necessary to finance our activities or with terms that are acceptable to us could be impaired by factors that affect us specifically or the financial services industry or economy in general. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity as a result of a downturn in the markets or adverse regulatory action taken against us. Our ability to borrow could be impaired by factors such as a disruption in the financial markets or negative views and expectations of the prospects for the financial services industry in light of the challenges facing the industry.

We maintain liquidity primarily through customer deposits and other short-term funding sources, including advances from the Federal Home Loan Bank (FHLB), Federal Reserve Bank (FRB) overnight borrowings and purchased federal funds. If economic conditions change so that we do not have access to short-term credit, or our depositors withdraw a substantial amount of their funds for other uses, we might experience liquidity issues. Our efforts to monitor and manage liquidity risk may not be successful or sufficient to deal with dramatic or unanticipated reductions in our liquidity. In such events, our cost of funds may increase, thereby reducing our net interest income, or we may need to sell a portion of our investment portfolio, which, depending upon market conditions, could result in us realizing losses on such sales. Either of these situations could have a material adverse impact on our results of operation and financial condition.

The Company's operations are concentrated in Iowa.

Our operations are concentrated primarily in central and north central Iowa. As a result of this geographic concentration, our results of operations may correlate to the economic conditions in this area. Any deterioration in economic conditions in central or north central Iowa, particularly in the industries on which the area depends (including agriculture which, in turn, is dependent upon commodity prices, weather conditions and government support programs), may adversely affect the quality of our loan portfolio and the demand for our products and services, and accordingly, our financial condition and results of operations.

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The Company faces competition from larger financial institutions.

The banking and financial services business in our market area continues to be a competitive field and is becoming more competitive as a result of:

- changes in regulations;
- changes in technology and product delivery systems; and
- the accelerating pace of consolidation among financial services providers.

It may be difficult for us to compete effectively in the market, and our results of operations could be adversely affected by the nature or pace of change in competition. We compete for loans, deposits and customers with various bank and non-bank financial services providers, many of which are much larger in total assets and capitalization, have greater access to capital markets and offer a broader array of financial services. Our strategic planning efforts continue to focus on capitalizing on our strengths in local markets while working to identify opportunities for improvement to gain competitive advantages.

Damage to our reputation could adversely affect our business.

Our business depends upon earning and maintaining the trust and confidence of our customers, investors, and employees. Damage to our reputation could cause significant harm to our business. Harm to our reputation could arise from numerous sources, including employee misconduct, compliance failures, litigation, breach of information security, or governmental investigations, among other things. In addition, a failure to deliver appropriate standards of service, or a failure or perceived failure to treat customers and clients fairly could result in customer dissatisfaction, litigation, breach of information security, and heightened regulatory scrutiny, all of which could lead to lost revenue, higher operating costs and harm to our reputation. Adverse publicity about us, whether or not true, may also result in harm to our business. Should any events or circumstances that could undermine our reputation occur, there can be no assurance that the additional costs and expenses that we may incur in addressing such issues would not adversely affect our financial condition and results of operations.

Risk related to the Company's stock.

The trading volume in our common stock on the Nasdaq Capital Market is relatively limited compared to those of companies with larger capitalization listed on the NASDAQ Capital Market, the NASDAQ Global Markets, the New York Stock Exchange or other consolidated reporting systems or stock exchanges. A change in the supply or demand for our common stock, or other events affecting our business, may have a more significant impact on the price of our stock than would be the case for more actively traded companies.

Changes in technology could be costly.

The financial services industry is continually undergoing technological changes with frequent introductions of new technology-driven products and services. In addition to improving customer services, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend, in part, on our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements and there is a risk we could become less competitive if we are unable to take advantage of these improvements due to the cost limitations or otherwise.

A breach of information security, compliance breach, or error by one of the Company's agents or vendors could negatively affect the Company's reputation and business.

We depend on data processing, communication and information exchange on a variety of computing platforms and networks and over the Internet. A cyber-attack on our systems could result in the theft, loss or destruction of our information or the theft or improper use of confidential information about our customers, any of which could harm our reputation. We cannot be certain all of our systems are entirely free from vulnerability to attack, despite safeguards which have been installed. We also outsource certain key aspects of our data processing and communication to certain third-party providers. While we have selected these third-party providers carefully, we cannot control their actions or their degree of compliance with their own systems of internal control. If information security is breached, or one of our service providers or vendors breaches compliance procedures, information could be lost or misappropriated, resulting in financial loss or costs to us or damage to our customers or others. If information security is breached either on our systems or those of our vendors, our financial condition, results of operations, reputation and future prospects could be adversely affected.

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Our accounting policies and methods may require management to make estimates about matters that are inherently uncertain.

Our accounting policies and methods are fundamental to how we record and report our financial condition and results of operations. Our management must exercise judgment in selecting and applying many of these accounting policies and methods in order to ensure they comply with GAAP and reflect management's judgment as to the most appropriate manner in which to record and report our financial condition and results of operations. In some cases, management must select the accounting policy or method to apply from two or more alternatives, any of which might be reasonable under the circumstances. The application of that chosen accounting policy or method might result in us reporting different amounts than would have been reported under a different alternative. If management's estimates or assumptions are incorrect, we may experience a material loss.

We have identified three accounting policies as being "critical" to the presentation of our financial condition and results of operations because they require management to make particularly subjective and complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. These critical accounting policies relate to (1) the fair value and possible impairment losses on investment securities available for sale, (2) the allowance for loan losses, and (3) impairment of goodwill. Because of the inherent uncertainty of the estimates required to apply these policies, no assurance can be given that application of alternative policies or methods might not result in the reporting of different amounts of the fair value of securities available for sale, the allowance for loan losses, goodwill valuation and, accordingly, net income.

From time to time, the FASB and the SEC change the financial accounting and reporting standards or the interpretation of those standards that govern the preparation of our external financial statements. These changes are beyond our control, can be difficult to predict and could materially impact how we report our financial condition and results of operations.

Changes in these standards are continuously occurring, and given the current economic and regulatory environment, more significant changes may occur. The implementation of such changes could have a material adverse effect on our financial condition and results of operations.

Current and future government regulations may increase the Company's costs of doing business.

Current and future legislation and the policies established by federal and state regulatory authorities will affect our operations. We are subject to extensive supervision of, and examination by, federal and state regulatory authorities which may limit our growth and the return to our shareholders by restricting certain activities, such as:

the payment of dividends to our shareholders;
the payment of dividends to the Company by the Banks;
possible mergers with or acquisitions of or by other institutions;
investment policies;
loans and interest rates on loans;
interest rates paid on deposits;
expansion of branch offices; and/or
the possibility to provide or expand securities or trust services.

On July 21, 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank Act represented a comprehensive overhaul of the financial services industry within the United States and, among many other things, established the federal BCFP and required the BCFP and other federal agencies to implement many significant rules and regulations. Compliance with the law and regulations has resulted in additional costs, and not all the rules and regulations have been finalized.

We cannot predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that any changes may have on future business and earnings prospects. The cost of compliance with future regulatory requirements may adversely affect our net income.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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ITEM 2. PROPERTIES

The Company's office is housed in the main office of First National located at 405 5th Street, Ames, Iowa and occupies approximately 4,200 square feet. There is a lease agreement between the Company and First National. The main office owned by First National, consists of approximately 45,000 square feet. In addition to its main office, First National conducts its business through six full-service offices, the West Ames office, North Grand office, Ankeny office, West Glen office, Valley Junction office and Johnston office. The West Ames office is located in Ames, Iowa and consists of approximately 1,800 square feet. The North Grand office is located in Ames, Iowa and consists of approximately 3,700 square feet. The office in Ankeny, Iowa occupies approximately 14,000 square feet, of which approximately 3,000 square feet is leased to four tenants for business purposes. The West Glenn office is located in West Des Moines, Iowa and occupies approximately 12,500 square feet and is leased from the Company. The West Glen office leases approximately 2,000 square feet to one tenant. The Valley Junction office is located in West Des Moines, Iowa and consists of approximately 2,600 square feet. The Johnston office is leased and consists of 3,800 square feet. All of the properties owned by the Company and First National are free of any mortgages.

State Bank conducts its business from its main office located at 1025 Sixth Street, Nevada, Iowa. This property is owned by State Bank free of any mortgage.

Boone Bank conducts its business from its main office located at 716 Eighth Street, Boone, Iowa and from one additional full-service office also located in Boone, Iowa. All properties are owned by Boone Bank free of any mortgage.

Reliance Bank conducts its business from its main office located at 606 Broad Street, Story City, Iowa. Approximately 12,400 square feet of the Story City office is leased to twelve individual tenants and two commercial tenants. Reliance also has a full service office located in Garner, Iowa. All properties are owned by Reliance Bank free of any mortgage.

United Bank conducts its business from its main office located at 2101 South Center Street, Marshalltown, Iowa and from a full-service office also located in Marshalltown, Iowa. All properties are owned by United Bank free of any mortgage.

ITEM 3. LEGAL PROCEEDINGS

The Banks are from time-to-time parties to various legal actions arising in the normal course of business. The Company believes that there is no threatened or pending proceeding against the Company or the Banks, which, if determined adversely, would have a material adverse effect on the business or financial condition of the Company or the Banks.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

On February 28, 2018, the Company had approximately 333 shareholders of record and approximately 1,606 additional beneficial owners whose shares were held in nominee titles through brokerage or other accounts. The Company's common stock is traded on the NASDAQ Capital Market under the symbol "ATLO". Trading in the Company's common stock is, however, relatively limited. The closing price of the Company's common stock was $26.55 on February 28, 2018.

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Based on information provided to and gathered by the Company on an informal basis, the Company believes that the high and low sales price for the common stock on a per share basis during the last two years is as follows:

2017			**2016**		
	Market Price			Market Price	
Quarter	High	Low	Quarter	High	Low
1st	$37.45	$28.50	1st	$25.20	$22.54
2nd	$32.00	$29.45	2nd	$27.02	$24.00
3rd	$31.15	$26.60	3rd	$28.86	$25.78
4th	$31.90	$27.55	4th	$35.30	$26.60

The Company declared aggregate annual cash dividends in 2017 and 2016 of approximately $8,194,000 and $7,821,000, respectively, or $0.88 per share in 2017 and $0.84 per share in 2016. In February 2018, the Company declared a quarterly cash dividend of approximately $2,142,000 or $0.23 per share and a one-time special cash dividend of $0.25 per share.

Quarterly dividends declared during the last two years were as follows:

	2017	**2016**
Quarter	Cash dividends declared per share	Cash dividends declared per share
1st	$ 0.22	$ 0.21
2nd	$ 0.22	$ 0.21
3rd	$ 0.22	$ 0.21
4th	$ 0.22	$ 0.21

The decision to declare cash dividends in the future and the amount thereof rests within the discretion of the Board of Directors of the Company and will be subject to, among other things, the future earnings, capital requirements and financial condition of the Company and certain regulatory restrictions imposed on the payment of dividends by the Banks. Such restrictions are discussed in greater detail in Management’s Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources and in Note 15 (Regulatory Matters) to the Company’s financial statements included herein.

The Company does not maintain or sponsor any equity compensation plans covering its executives or employees of the Company or the Banks.

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The following performance graph provides information regarding cumulative, five-year total return on an indexed basis of the Company's common stock as compared with the NASDAQ Composite Index, the SNL Midwest OTC_BB and Pink Banks ("Midwest OTC Bank Index") and the SNL Bank NASDAQ Index ("NASDAQ Bank Index") prepared by SNL Financial L.C. of Charlottesville, Virginia (www.snl.com). The Midwest OTC Bank Index reflects the performance of 116 bank holding companies operating principally in the Midwest as selected by SNL Financial. The NASDAQ Bank Index is comprised of 264 bank and bank holding companies listed on the NASDAQ market and operating throughout the United States. The indexes assume the investment of $100 on December 31, 2012, in the Company's common stock, the NASDAQ Composite Index, Midwest OTC Bank Index and the NASDAQ Bank Index with all dividends reinvested. The Company's stock price performance shown in the following graph is not indicative of future stock price performance.

		Period Ending				
Index	**12/31/12**	**12/31/13**	**12/31/14**	**12/31/15**	**12/31/16**	**12/31/17**
Ames National Corporation	100.00	105.24	125.73	121.47	170.37	147.89
NASDAQ Composite Index	100.00	140.12	160.78	171.97	187.22	242.71
NASDAQ Bank Index	100.00	143.73	148.86	160.70	222.81	234.58
Midwest OTC Bank Index	100.00	121.31	138.93	157.38	180.74	215.16

In November, 2017, the Board of Directors approved a Stock Repurchase Plan which provided for the repurchase of up to 100,000 shares of the Company's common stock. This Stock Repurchase Plan replaced the previous Stock Repurchase Plan (approved in November, 2016) that expired in November, 2017. The Company did not purchase any shares in 2017 or 2016 under either of the Stock Repurchase Plans that were in effect during 2017 or 2016.

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The following table provides information with respect to purchases made by or on behalf of the Company or any "affiliated purchaser" (as defined in rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of the Company's common stock during the three months ended December 31, 2017.

Period			Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Maximum Number of Shares that May Yet Be Purchased Under The Plan
October 1, 2017	to	October 31, 2017 (1)	-	$ -	-	100,000
November 1, 2017	to	November 30, 2017 (1) and (2)	-	$ -	-	100,000
December 1, 2017	to	December 31, 2017 (2)	-	$ -	-	100,000
Total			-		-	

(1) The Stock Repurchase Plan adopted in November, 2016 expired in November, 2017 and no shares remain available for purchase under this plan as a result of the expiration. No purchases were made under this plan during October or November, 2017.

(2) A successor Stock Repurchase Plan was approved and became effective on November 8, 2017 and authorized the purchase of up to 100,000 shares. This plan is scheduled to expire on November 13, 2018. No purchases were made under this plan during November or December, 2017.

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ITEM 6. SELECTED FINANCIAL DATA

The following financial data of the Company for the five years ended December 31, 2013 through 2017 is derived from the Company's historical audited financial statements and related footnotes. The information set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operation" and the consolidated financial statements and related notes contained elsewhere in this Annual Report.

	Years Ended December 31,				
(dollars in thousands, except per share amounts)	**2017**	**2016**	**2015**	**2014**	**2013**
STATEMENT OF INCOME DATA					
Interest income	$45,794	$44,046	$43,150	$40,964	$38,434
Interest expense	5,581	4,135	4,185	4,547	5,075
Net interest income	40,213	39,911	38,965	36,417	33,359
Provision for loan losses	1,520	524	1,099	429	786
Net interest income after provision for loan losses	38,693	39,387	37,866	35,988	32,573
Noninterest income	7,993	8,088	8,267	9,252	7,718
Noninterest expense	25,405	24,935	25,312	24,373	21,679
Income before provision for income tax	21,281	22,540	20,821	20,867	18,612
Provision for income tax	7,584	6,805	5,806	5,616	4,658
Net income	$13,697	$15,735	$15,015	$15,251	$13,954
DIVIDENDS AND EARNINGS PER SHARE DATA					
Cash dividends declared	$8,194	$7,821	$7,449	$6,704	$5,959
Cash dividends declared per share	$0.88	$0.84	$0.80	$0.72	$0.64
Basic and diluted earnings per share	$1.47	$1.69	$1.61	$1.64	$1.50
Weighted average shares outstanding	9,310,913	9,310,913	9,310,913	9,310,913	9,310,913
BALANCE SHEET DATA					
Total assets	$1,375,060	$1,366,453	$1,326,747	$1,301,031	$1,233,084
Net loans	771,550	752,182	701,328	658,441	564,502
Deposits	1,134,391	1,109,409	1,074,193	1,052,123	1,011,803
Stockholders' equity	170,753	165,105	161,250	154,674	142,106
Equity to assets ratio	12.42 %	12.08 %	12.15 %	11.89 %	11.52 %

	Years Ended December 31, 2017	2016	2015	2014	2013
FIVE YEAR FINANCIAL PERFORMANCE					
Net income	$13,697	$15,735	$15,015	$15,251	$13,954
Average assets	1,368,680	1,330,906	1,325,321	1,263,382	1,225,617
Average stockholders' equity	170,762	167,750	159,047	151,211	142,997
Return on assets (net income divided by average assets)	1.00 %	1.18 %	1.13 %	1.21 %	1.14 %
Return on equity (net income divided by average equity)	8.02 %	9.38 %	9.44 %	10.09 %	9.76 %
Net interest margin (net interest income divided by average earning assets) *	3.25 %	3.36 %	3.33 %	3.31 %	3.18 %
Efficiency ratio (noninterest expense divided by noninterest income plus net interest income)	52.70 %	51.95 %	53.59 %	53.37 %	52.78 %
Dividend payout ratio (dividends per share divided by net income per share)	59.86 %	49.70 %	49.69 %	43.90 %	42.67 %
Dividend yield (dividends per share divided by closing year-end market price)	3.16 %	2.55 %	3.29 %	2.78 %	2.86 %
Equity to assets ratio (average equity divided by average assets)	12.48 %	12.60 %	12.00 %	11.97 %	11.67 %

* See page 30 for further discussion of this Non-GAAP financial measure.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

The following discussion is provided for the consolidated operations of the Company and its Banks. The purpose of this discussion is to focus on significant factors affecting the Company's financial condition and results of operations.

The Company does not engage in any material business activities apart from its ownership of the Banks. Products and services offered by the Banks are for commercial and consumer purposes, including loans, deposits and wealth management services. Some Banks also offer investment services through a third-party broker-dealer. The Company employs 14 individuals to assist with financial reporting, human resources, marketing, audit, compliance, technology systems, training and the coordination of management activities, in addition to 206 full-time equivalent individuals employed by the Banks.

The Company's primary competitive strategy is to utilize seasoned and competent Bank management and local decision-making authority to provide customers with prompt response times and flexibility in the products and services offered. This strategy is viewed as providing an opportunity to increase revenues through the creation of a competitive advantage over other financial institutions. The Company also strives to remain operationally efficient to improve profitability while enabling the Banks to offer more competitive loan and deposit rates.

The principal sources of Company revenues and cash flows are: (i) interest and fees earned on loans made or held by the Company and Banks; (ii) interest on investments, primarily on bonds, held by the Banks; (iii) fees on wealth management services; (iv) service charges on deposit accounts maintained at the Banks; (v) merchant and card fees; (vi) gain on the sale of loans held for sale; and (vii) securities gains. The Company's principal expenses are: (i) interest expense on deposit accounts and other borrowings; (ii) salaries and employee benefits; (iii) data processing costs primarily associated with maintaining the Banks' loan and deposit functions; (iv) occupancy expenses for maintaining the Banks' facilities; (v) professional fees; and (vi) business development. The largest component contributing to the Company's net income is net interest income, which is the difference between interest earned on earning assets (primarily loans and investments) and interest paid on interest bearing liabilities (primarily deposit accounts and other borrowings). One of management's principal functions is to manage the spread between interest earned on earning assets and interest paid on interest bearing liabilities in an effort to maximize net interest income while maintaining an appropriate level of interest rate risk.

The Company reported net income of $13,697,000 for the year ended December 31, 2017 compared to $15,735,000 and $15,015,000 reported for the years ended December 31, 2016 and 2015, respectively. This represents a decrease in net income of 12.9% when comparing 2017 with 2016 and an increase in net income of 4.8% when comparing 2016 with 2015. The decline in earnings in 2017 from 2016 is primarily the result of an increased provision for loan losses, elevated deposit interest expense and higher income tax expense, offset in part by improved loan interest income. The increase in net income in 2016 from 2015 was primarily the result of increased loan interest income, lower provision for loan losses and lower other real estate owned expenses, offset in part by decreased security interest income, decreased securities gains and increased salaries and benefits expense. Earnings per share for 2017 were $1.47 compared to $1.69 in 2016 and $1.61 in 2015. All five Banks demonstrated profitable operations during 2017, 2016 and 2015.

The Company's return on average equity for 2017 was 8.02% compared to 9.38% and 9.44% in 2016 and 2015, respectively, and the return on average assets for 2017 was 1.00% compared to 1.18% in 2016 and 1.13% in 2015. The decrease in return on average equity and return on average assets when comparing 2017 to 2016 was primarily a result of lower net income. The decrease in return on average equity when comparing 2016 to 2015 was primarily a result of increased average equity, more than offsetting the increase in net income. The increase in return on average assets when comparing 2016 to 2015 was primarily a result of increased net income.

The following discussion will provide a summary review of important items relating to:

Challenges
Key Performance Indicators
Industry Results
Critical Accounting Policies
Income Statement Review
Balance Sheet Review
Asset Quality Review and Credit Risk Management
Liquidity and Capital Resources
Interest Rate Risk
Inflation
Forward-Looking Statements and Business Risks
Non-GAAP Financial Measures

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Challenges

Management has identified certain events or circumstances that have the potential to negatively impact the Company's financial condition and results of operations in the future and is attempting to position the Company to best respond to those challenges.

If interest rates increase significantly over a relatively short period of time due to improving national employment levels or higher inflationary numbers, the interest rate environment may present a challenge to the Company. Increases in interest rates may negatively impact the Company's net interest margin if interest expense increases more quickly than interest income, thus placing downward pressure on net interest income. The Company's earning assets (primarily its loan and investment portfolio) have longer maturities than its interest bearing liabilities (primarily deposits and other borrowings); therefore, in a rising interest rate environment, interest expense will tend to increase more quickly than interest income as the interest bearing liabilities reprice more quickly than earning assets, resulting in a reduction in net interest income. In response to this challenge, the Banks model quarterly the changes in income that would result from various changes in interest rates. Management believes Bank earning assets have the appropriate maturity and repricing characteristics to optimize earnings and the Banks' interest rate risk positions.

If market interest rates in the three to five year term remain at low levels as compared to the short term interest rates, the interest rate environment may present a challenge to the Company. The Company's earning assets (typically priced at market interest rates in the three to five year range) will reprice at lower interest rates, but the deposits will not reprice at significantly lower interest rates, therefore the net interest income may decrease. Management believes Bank earning assets have the appropriate maturity and repricing characteristics to optimize earnings and the Banks' interest rate risk positions.

The agricultural community is subject to commodity price fluctuations. Extended periods of low commodity prices, higher input costs or poor weather conditions could result in reduced profit margins, reducing demand for goods and services provided by agriculture-related businesses, which, in turn, could affect other businesses in the Company's market area. Any combination of these factors could produce losses within the Company's agricultural loan portfolio and in the commercial loan portfolio with respect to borrowers whose businesses are directly or indirectly impacted by the health of the agricultural economy.

Key Performance Indicators

Certain key performance indicators for the Company and the industry are presented in the following chart. The industry figures are compiled by the Federal Deposit Insurance Corporation (FDIC) and are derived from 5,670 commercial banks and savings institutions insured by the FDIC. Management reviews these indicators on a quarterly basis for purposes of comparing the Company's performance from quarter to quarter against the industry as a whole.

Selected Indicators for the Company and the Industry

	Years Ended December 31,					
	2017		**2016**		**2015**	
	Company	Industry	Company	Industry	Company	Industry
Return on assets	1.00 %	0.97 %	1.18 %	1.04 %	1.13 %	1.04 %
Return on equity	8.02 %	8.64 %	9.38 %	9.32 %	9.44 %	9.31 %
Net interest margin	3.25 %	3.25 %	3.36 %	3.13 %	3.33 %	3.07 %
Efficiency ratio	52.70 %	57.94 %	51.95 %	58.28 %	53.59 %	59.91 %
Capital ratio	12.48 %	9.62 %	12.60 %	9.48 %	12.00 %	9.59 %

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Key performance indicators include:

Return on Assets

This ratio is calculated by dividing net income by average assets. It is used to measure how effectively the assets of the Company are being utilized in generating income. The Company's return on assets ratio is higher than that of the industry, primarily as a result of the Company's noninterest expense relative to the industry.

Return on Equity

This ratio is calculated by dividing net income by average equity. It is used to measure the net income or return the Company generated for the shareholders' equity investment in the Company. The Company's return on equity ratio is lower than the industry primarily as a result of the Company's higher capital ratio.

Net Interest Margin

This ratio is calculated by dividing net interest income by average earning assets. Earning assets consist primarily of loans and investments that earn interest. This ratio is used to measure how well the Company is able to maintain interest rates on earning assets above those of interest-bearing liabilities, which is the interest expense paid on deposit accounts and other borrowings. The Company's net interest margin is the same as the industry.

Efficiency Ratio

This ratio is calculated by dividing noninterest expense by net interest income and noninterest income. The ratio is a measure of the Company's ability to manage noninterest expenses. The Company's efficiency ratio is lower than the industry average, primarily as a result of the Company's lower noninterest expense.

Capital Ratio

The capital ratio is calculated by dividing average total equity capital by average total assets. It measures the level of average assets that are funded by shareholders' equity. Given an equal level of risk in the financial condition of two companies, the higher the capital ratio, generally the more financially sound the company. The Company's capital ratio is significantly higher than the industry average.

Industry Results

The FDIC Quarterly Banking Profile reported the following results for the fourth quarter of 2017

Quarterly Net Income Is 40.9% Lower Than a Year Ago Largely Due to One-Time Changes From the New Tax Law

In the fourth quarter, 5,670 insured institutions reported quarterly net income of $25.5 billion, down $17.7 billion (40.9%) from a year ago. Higher income taxes, reflecting one-time income tax effects enacted from the new tax law, coupled with higher noninterest expense and loan-loss provisions, lowered quarterly net income. Excluding one-time income tax effects, estimated quarterly net income would have been $42.2 billion, down 2.3percent.

Full-Year 2017 Net Income Declines 3.5% Due to One-Time Tax Changes

Net income for full-year 2017 totaled $164.8 billion a decline of $6 billion (3.5%) compared to 2016.The decline in full-year net income was due to higher income taxes (up $21.6 billion, or 28.4%), which reflects one-time changes from the new tax law, combined with higher noninterest expense (up $19.5 billion, or 4.6%) and higher loan-loss provisions (up$3 billion, or 6.2%). Net operating revenue (the sum of net interest income and total noninterest income)increased by $39.5 billion from 2016, as net interest income rose by $37.7 billion (8.2%) and noninterest income grew by $1.8 billion (0.7%). The average net interest margin (NIM) increased to 3.25% from 3.13% in 2016. Without the one-time tax charges in the fourth quarter, estimated full-year 2017 net income would have been $183.1 billion, an increase of 7.2% from 2016.

Net Interest Income Rises 8.5% From Fourth Quarter 2016

Net operating revenue of $192.2 billion, was $10 billion (5.5%) higher than fourth quarter 2016. Net interest income grew by $10.2 billion (8.5%), while noninterest income fell by $202.4million (0.3%).More than four out of five banks (86.4%) reported higher net interest income from a year ago, as interest-bearing assets increased (up 4.4%) and the average NIM increased to 3.31% from 3.16% a year ago. This is the highest quarterly NIM for the industry since fourth quarter 2012. More than two out of three banks (70%) reported higher net interest margins than a year earlier.

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Provisions Increase 8.9% From a Year Ago

Loan-loss provisions totaled $13.6 billion in the fourth quarter, an increase of $1.1 billion (8.9%) from a year ago. More than one in three (38.9%) institutions reported higher loan-loss provisions than in fourth quarter 2016. Fourth quarter loan-loss provisions totaled 7.1% of net operating revenue, up from 6.8% a year ago. This estimate of net income applies the average quarterly tax rate between fourth quarter 2011 and third quarter 2017 to income before taxes and discontinued operations. 3This estimate of net income applies the average annual tax rate between 2011 and 2016 to income before taxes and discontinued operations.

Noninterest Expense Increases From a Year Ago

Noninterest expense for the banking industry was $9.4 billion (8.6%)higher than fourth quarter 2016, led by an increase in “other” noninterest expense(up $6.3 billion, or 14.1%).Other noninterest expense includes, but is not limited to, information technology costs, legal fees, consulting services, and audit fees. Salary and employee benefits rose by $3.2 billion (6.3%) from a year ago. Full-time equivalent employees at FDIC-insured institutions rose by 1.1% from a year ago, while industry assets increased by 3.8%. Average assets per employee rose to $8.4 million from $8.2 million in fourth quarter 2016.

Net Charge-Off Rate Increases Slightly

Banks charged off $13.2 billion in uncollectable loans during the quarter, an increase of $1 billion (8.6%) from a year ago. This marks a ninth consecutive quarter that net charge-offs increased. Less than half (45.3%) of all banks reported an annual increase in their quarterly net charge-offs. The increase in net charge-offs was led by credit card balances, which grew by $1.1 billion(15.7%).Net charge-offs declined for commercial and industrial loans (down $210.3 million, 8.6%), home equity loans (down $178.1 million, or 68.6%),and residential mortgage loans (down $68.3million, or 36.4%).The average net charge-off rate rose from 0.52% in fourth quarter 2016 to 0.55%.

Noncurrent Loan Rate Remains Stable

After declining for the past six consecutive quarters, noncurrent balances (90 days or more past due or in nonaccrual status) for total loans and leases increased by $1.5 billion (1.3%) during the fourth quarter. The increase in noncurrent balances was led by residential mortgages (up 2.8 billion, or 5.2%) and credit cards (up $1.2 billion, or 11.5%), and was partially offset by a decline in noncurrent commercial and industrial loans (down $1.7 billion, or 8.5%). Despite the overall dollar increase, the average noncurrent loan rate remained unchanged at 1.20% from the previous quarter.

Loan-Loss Reserves Increase From the Previous Quarter

Banks continued to increase their loan-loss reserves (up $236.2 million, or 0.2%) during the quarter, as loan-loss provisions of $13.6 billion exceeded net charge-offs of $13.2 billion. Banks that itemize their reserves(banks with assets greater than $1 billion) reported higher reserves for credit card losses (up $1.9 billion, or 5.2%) from the previous quarter, and lower reserves for residential real estate losses(down $827.2 million, or 5.4%) and commercial and industrial loan losses (down $723.5 million, or 2.2%)during the quarter. The coverage ratio (loan-loss reserves to noncurrent loan balances) declined slightly to 106.3%, but has been above 100% for the past three quarters.

Equity Capital Rises Modestly

Total equity capital increased by $3.6 billion (0.2%) in fourth quarter 2017. Declared dividends of $30.1 billion exceeded the quarterly net income of $25.5 billion during the quarter, reducing retained earnings by $4.6 billion. Accumulated other comprehensive income declined by $8.5 billion in the quarter, which was led by a decline in the market value of available-for-sale securities. The equity-to-asset ratio declined to 11.22% from 11.31% in third quarter 2017, but remained above the year-ago ratio of 11.10%. At year-end 2017, 99.4% of all insured institutions, which account for 99.97% of total industry assets, met or exceeded the requirements for the highest regulatory capital category, as defined for Prompt Corrective Action purposes.

Total Loan and Lease Balances Increase $164.1 Billion During the Fourth Quarter

Total loan and lease balances increased by $164.1 billion (1.7%) from third quarter 2017, as balances in all major loan categories increased. Credit card balances increased by $69.6 billion (8.8%) from the previous quarter, commercial and industrial loans grew by $24.5 billion (1.2%), and residential mortgage loans rose by $21.7 billion (1.1%).Unused loan commitments were $108.9 billion (1.5%) higher than the previous quarter, led by higher unused credit card lines (up $57.7 billion, or 1.6%). Over the past 12 months, loan and lease balances increased by $416.1 billion (4.5%), exceeding last quarter's annual growth rate of 3.5%.The 12-monthincrease in loan and lease balances was led by commercial and industrial loans (up $78.4 billion, or 4.1%), residential mortgage loans (up $68.7 million, or 3.4%), nonfarm nonresidential loans (up $67.1 billion, or 5.1%),and credit card balances (up $65.2 billion, or 8.2%). Home equity lines of credit continued with the year-over-year decline (down $23 billion, or 5.3%). Unused loan commitments increased 4.4% from a year ago, the largest annual growth rate since third quarter 2016.

Deposits Grew 1.4% From the Previous Quarter

Total deposits increased by $179.8 billion (1.4%) in the fourth quarter. Balances in domestic interest-bearing accounts rose by $153.7 billion (1.8%), and balances in noninterest-bearing accounts grew by $7.8 billion (0.2%). Domestic deposits in accounts larger than $250,000 increased by $159.6 billion (2.5%) from third quarter 2017. Nondeposit liabilities declined by $8.9 billion (0.4%), as other liabilities were down $29.3 billion (7.3%).

"Problem Bank List" Falls Below 100

The FDIC's Problem Bank List declined from 104 to 95 at year-end 2017, the lowest number of problem banks since first quarter 2008. Total assets of problem banks were down from $16 billion in the third quarter to $13.9 billion. During the quarter, merger transactions absorbed 64 institutions, two institutions failed, and one new charter was added. For full-year 2017, five new charters were added, 230 institutions were absorbed by mergers, and eight institutions failed.

Critical Accounting Policies

The discussion contained in this Item 7 and other disclosures included within this Annual Report are based on the Company's audited consolidated financial statements which appear in Item 8 of this Annual Report. These statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The financial information contained in these statements is, for the most part, based on the financial effects of transactions and events that have already occurred. However, the preparation of these statements requires management to make certain estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses.

The Company's significant accounting policies are described in the "Notes to Consolidated Financial Statements" accompanying the Company's audited financial statements. Based on its consideration of accounting policies that involve the most complex and subjective estimates and judgments, management has identified the allowance for loan losses, the assessment of other-than-temporary impairment for investment securities and the assessment of goodwill to be the Company's most critical accounting policies.

Allowance for Loan Losses

The allowance for loan losses is established through a provision for loan losses that is treated as an expense and charged against earnings. Loans are charged against the allowance for loan losses when management believes that collectability of the principal is unlikely. The Company has policies and procedures for evaluating the overall credit quality of its loan portfolio, including timely identification of potential problem loans. On a quarterly basis, management reviews the appropriate level for the allowance for loan losses, incorporating a variety of risk considerations, both quantitative and qualitative. Quantitative factors include the Company's historical loss experience, delinquency and charge-off trends, collateral values, known information about individual loans and other factors. Qualitative factors include various considerations regarding the general economic environment in the Company's market area. To the extent actual results differ from forecasts and management's judgment, the allowance for loan losses may be greater or lesser than future charge-offs. Due to potential changes in conditions, it is at least reasonably possible that change in estimates will occur in the near term and that such changes could be material to the amounts reported in the Company's financial statements.

For further discussion concerning the allowance for loan losses and the process of establishing specific reserves, see the section of this Annual Report entitled "Asset Quality Review and Credit Risk Management" and "Analysis of the Allowance for Loan Losses".

Fair Value and Other-Than-Temporary Impairment of Investment Securities

The Company's securities available-for-sale portfolio is carried at fair value with "fair value" being defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability is not adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact, and (iv) willing to transact.

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Declines in the fair value of available-for-sale securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the intent to sell the investment securities and the more likely than not requirement that the Company will be required to sell the investment securities prior to recovery (2) the length of time and the extent to which the fair value has been less than cost and (3) the financial condition and near-term prospects of the issuer. Due to potential changes in conditions, it is at least reasonably possible that change in management's assessment of other-than-temporary impairment will occur in the near term and that such changes could be material to the amounts reported in the Company's financial statements.

Goodwill

Goodwill arose in connection with acquisitions in 2014 and 2012. Goodwill is tested annually for impairment or more often if conditions indicate a possible impairment. For the purposes of goodwill impairment testing, determination of the fair value of a reporting unit involves the use of significant estimates and assumptions. Impairment would arise if the fair value of a reporting unit is less than its carrying value. At December 31, 2017, Company's management has completed the goodwill impairment analysis and determined goodwill was not impaired. Actual future test results may differ from the present evaluation of impairment due to changes in the conditions used in the current evaluation.

Non-GAAP Financial Measures

This report contains references to financial measures that are not defined in GAAP. Such non-GAAP financial measures include the Company's presentation of net interest income and net interest margin on a fully taxable equivalent (FTE) basis. Management believes these non-GAAP financial measures are widely used in the financial institutions industry and provide useful information to both management and investors to analyze and evaluate the Company's financial performance. Limitations associated with non-GAAP financial measures include the risks that persons might disagree as to the appropriateness of items included in these measures and that different companies might calculate these measures differently. These non-GAAP disclosures should not be considered an alternative to the Company's GAAP results. The following table reconciles the non-GAAP financial measures of net interest income and net interest margin on an FTE basis to GAAP. *(dollars in thousands)*

	2017	2016	2015
Reconciliation of net interest income and annualized net interest margin on an FTE basis to GAAP:			
Net interest income (GAAP)	$40,213	$39,911	$38,965
Tax-equivalent adjustment [1]	2,700	2,929	3,123
Net interest income on an FTE basis (non-GAAP)	42,913	42,840	42,088

Average interest-earning assets	$1,319,362	$1,276,543	$1,264,537
Net interest margin on an FTE basis (non-GAAP)	3.25 %	3.36 %	3.33 %

(1) Computed on a tax-equivalent basis using an incremental federal income tax rate of 35 percent, adjusted to reflect the effect of the nondeductible interest expense associated with owning tax-exempt securities and loans.

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Income Statement Review

The following highlights a comparative discussion of the major components of net income and their impact for the last three years.

Average Balances and Interest Rates

The following two tables are used to calculate the Company's net interest margin. The first table includes the Company's average assets and the related income to determine the average yield on earning assets. The second table includes the average liabilities and related expense to determine the average rate paid on interest bearing liabilities. The net interest margin is equal to the interest income less the interest expense divided by average earning assets. Refer to the net interest income discussion following the tables for additional detail. *(dollars in thousands)*

ASSETS

	2017			**2016**			**2015**		
	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
Interest-earning assets									
Loans (1)									
Commercial	$75,997	$3,477	4.58 %	$91,009	$4,039	4.44 %	$98,546	$4,446	4.51 %
Agricultural	68,382	3,599	5.26 %	74,205	3,625	4.89 %	75,706	3,568	4.71 %
Real estate	616,821	26,427	4.28 %	541,953	23,956	4.42 %	488,827	22,039	4.51 %
Consumer and other	10,968	545	4.97 %	19,671	738	3.75 %	18,745	728	3.89 %
Total loans (including fees)	772,168	34,048	4.41 %	726,838	32,358	4.45 %	681,824	30,781	4.51 %
Investment securities									
Taxable	272,293	6,219	2.28 %	260,618	5,853	2.25 %	275,105	6,179	2.25 %
Tax-exempt (2)	237,938	7,716	3.24 %	252,864	8,369	3.31 %	264,028	8,931	3.38 %
Total investment securities	510,231	13,935	2.73 %	513,482	14,222	2.77 %	539,133	15,110	2.80 %
Interest bearing deposits and federal funds sold	36,963	512	1.39 %	36,223	395	1.09 %	43,580	382	0.88 %

Total interest-earning assets	1,319,362	$48,495	3.68 %	1,276,543	$46,975	3.68 %	1,264,537	$46,273	3.66 %
Noninterest-earning assets									
Cash and due from banks	21,702			20,844			21,052		
Premises and equipment, net	15,766			16,583			16,404		
Other, less allowance for loan losses	11,850			16,936			23,328		
Total noninterest-earning assets	49,318			54,363			60,784		
TOTAL ASSETS	$1,368,680			$1,330,906			$1,325,321		

(1) Average loan balance includes nonaccrual loans, if any. Interest income collected on nonaccrual loans has been included.

(2) Tax-exempt income has been adjusted to a tax-equivalent basis using an incremental tax rate of 35%.

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Average Balances and Interest Rates (continued)

LIABILITIES AND STOCKHOLDERS' EQUITY

	2017			2016			2015		
	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate	Average balance	Revenue/ expense	Yield/ rate
Interest-bearing liabilities									
Deposits									
Savings, NOW accounts and money markets	$717,875	$2,547	0.35 %	$669,754	$1,340	0.20 %	$652,063	$1,143	0.18 %
Time deposits > $100,000	83,059	921	1.11 %	86,400	797	0.92 %	90,574	809	0.89 %
Time deposits < $100,000	114,469	972	0.85 %	124,894	937	0.75 %	138,387	1,067	0.77 %
Total deposits	915,403	4,440	0.49 %	881,048	3,074	0.35 %	881,024	3,019	0.34 %
Other borrowed funds	73,049	1,142	1.56 %	82,582	1,061	1.28 %	86,381	1,166	1.35 %
Total interest-bearing liabilities	988,452	5,582	0.56 %	963,630	4,135	0.43 %	967,405	4,185	0.43 %
Noninterest-bearing liabilities									
Demand deposits	202,120			191,899			192,112		
Other liabilities	7,346			7,627			6,757		
Stockholders' equity	170,762			167,750			159,047		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$1,368,680			$1,330,906			$1,325,321		
Net interest income		$42,913	3.25 %		$42,840	3.36 %		$42,088	3.33 %

Spread Analysis

Interest income/average assets	$48,495	3.54 %	$46,975	3.53 %	$46,273	3.49 %
Interest expense/average assets	5,582	0.41 %	4,135	0.31 %	4,185	0.32 %
Net interest income/average assets	42,913	3.14 %	42,840	3.22 %	42,088	3.18 %

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Rate and Volume Analysis

The rate and volume analysis is used to determine how much of the change in interest income or expense is the result of a change in volume or a change in interest rate. For example, real estate loan interest income increased $2,471,000 in 2017 compared to 2016. Increased volume of real estate loans increased interest income in 2017 by $3,245,000 and lower interest rates decreased interest income in 2017 by $774,000. *(dollars in thousands)*

The following table sets forth, on a tax-equivalent basis, a summary of the changes in net interest income resulting from changes in volume and rates.

	2017 Compared to 2016			**2016 Compared to 2015**		
	Volume	Rate	Total (1)	Volume	Rate	Total (1)
Interest income						
Loans						
Commercial	$(686)	$124	$(562)	$(338)	$(69)	$(407)
Agricultural	(293)	267	(26)	(74)	131	57
Real estate	3,245	(774)	2,471	2,362	(445)	1,917
Consumer and other	(387)	194	(193)	36	(26)	10
Total loans (including fees)	1,879	(189)	1,690	1,986	(409)	1,577
Investment securities						
Taxable	282	84	366	(326)	(0)	(326)
Tax-exempt	(481)	(172)	(653)	(377)	(185)	(562)
Total investment securities	(199)	(88)	(287)	(703)	(185)	(888)
Interest bearing deposits and federal funds sold	8	109	117	(71)	84	13
Total interest-earning assets	1,688	(168)	1,520	1,212	(510)	702
Interest-bearing liabilities						
Deposits						
Savings, NOW accounts and money markets	105	1,102	1,207	39	158	197
Time deposits > $100,000	(32)	156	124	(37)	25	(12)
Time deposits < $100,000	(83)	118	35	(103)	(27)	(130)
Total deposits	(10)	1,376	1,366	(101)	156	55
Other borrowed funds	(132)	213	81	(48)	(57)	(105)

Total interest-bearing liabilities	(142)	1,589	1,447	(149)	99	(50)
Net interest income-earning assets	$1,830	$(1,757)	$73	$1,361	$(609)	$752

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

Net Interest Income

The Company’s largest contributing component to net income is net interest income, which is the difference between interest earned on earning assets and interest paid on interest bearing liabilities. The volume of and yields earned on earning assets and the volume of and the rates paid on interest bearing liabilities determine net interest income. Refer to the tables preceding this paragraph for additional detail. Interest earned and interest paid is also affected by general economic conditions, particularly changes in market interest rates, by government policies and the action of regulatory authorities. Net interest income divided by average earning assets is referred to as net interest margin. For the years December 31, 2017, 2016 and 2015, the Company's net interest margin was 3.25%, 3.36% and 3.33%, respectively, computed on a FTE basis.

Net interest income during 2017, 2016 and 2015 totaled $40,213,000, $39,911,000 and $38,965,000, respectively, representing a 0.8% increase in 2017 compared to 2016 and a 2.4% increase in 2016 from 2015. Net interest income increased in 2017 as compared to 2016 due primarily to increases in the average balance of real estate loans. Net interest income increased in 2016 as compared to 2015 due primarily to increases in the average balance of real estate loans.

The high level of competition in the local markets will continue to put downward pressure on the net interest margin of the Company. Currently, the Company's primary market in Ames, Iowa, has ten banks, six credit unions and several other financial investment companies. Multiple banks are also located in the Company's other market areas in central and north central Iowa creating similarly competitive environments.

Provision for Loan Losses

The provision for loan losses reflects management's judgment of the expense to be recognized in order to maintain an adequate allowance for loan losses. The Company's provision for loan losses for the year ended December 31, 2017 was $1,520,000 compared to $524,000 for the previous year. The provision for loan losses in 2017 was necessary to maintain an adequate allowance for loan loss on the increasing outstanding loan portfolio, as well as funding net charge offs of $706,000. Credit quality indicators, such as classified assets, past due or impaired loans, have remained steady since 2015. The Company's provision for loan losses for the year ended December 31, 2016 was $524,000 compared to $1,099,000 for the year ended December 31, 2015. The provision for loan losses in 2016 and 2015 were necessary to maintain an adequate allowance for loan loss on the outstanding loan portfolio, as net charge offs were not significant. The increase in the allowance for loan losses in 2016 was provided due to growth in the Company's loan portfolios and, to a lesser extent to provide for a specific reserve on impaired loans. Credit quality indicators such as classified assets and impaired loans have improved since 2014; while past due loans have risen slightly but remain at a favorable level as compared to peer banks. There was no significant change in the allowance for loan loss on impaired loans. Refer to the "Asset Quality and Credit Risk Management" discussion for additional details with regard to loan loss provision expense.

Management believes the allowance for loan losses is adequate to absorb probable losses in the current portfolio. This statement is based upon management's continuing evaluation of inherent risks in the current loan portfolio, current levels of classified assets and general economic factors. The Company will continue to monitor the allowance and make future adjustments to the allowance as conditions dictate. Due to potential changes in conditions, it is at least reasonably possible that change in estimates will occur in the near term and that such changes could be material to the amounts reported in the Company's financial statements.

Noninterest Income and Expense

Total noninterest income is comprised primarily of fee-based revenues from wealth management and trust services, bank-related service charges on deposit activities, net securities gains, merchant and card fees related to electronic processing of merchant and cash transactions and gain on the sale of loans held for sale.

Noninterest income during the years ended 2017, 2016 and 2015 totaled $7,993,000, $8,088,000 and $8,267,000, respectively. The decrease in noninterest income in 2017 compared to 2016 is primarily due to lower gains on the sale of loans, offset in part by higher wealth management income. The decrease in the gain on the sale of loans is primarily due to a slowdown in the refinance of home loans held for sale resulting in lower revenue. The increase in wealth management income is primarily due to increases in assets under management due to a brokerage business acquisition in 2016. The lower noninterest income in 2016 as compared to 2015 related primarily to the lower security gains, offset in part by an increase in wealth management income. The increase in wealth management income is primarily due to increases in assets under management. Excluding securities gains, noninterest income decreased 2.3% in 2017 as compared to 2016. Excluding securities gains and gain on disposal of premises and equipment in 2016 and 2015, noninterest income increased 3.5% in 2016 as compared to 2015.

Noninterest expense for the Company consists of all operating expenses other than interest expense on deposits and other borrowed funds. Salaries and employee benefits are the largest component of the Company’s operating expenses and comprise 63%, 63% and 60% of noninterest expense in 2017, 2016 and 2015, respectively.

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Noninterest expense during the years ended 2017, 2016 and 2015 totaled $25,405,000, $24,935,000 and $25,312,000, respectively, representing a 1.9% increase in 2017 compared to a 1.5% decrease in 2016. The primary reason for the increase in 2017 was normal salary and benefit increases and lower real estate owned income, offset by lower FDIC insurance assessment. Other real estate owned income declined primarily due to gains recorded in 2016 with significantly lesser corresponding gains in 2017. FDIC assessments decreased due primarily to lower assessment rates in 2017 as compared to 2016. Salaries and employee benefits increased primarily due to normal salary increases and to a lesser extent normal increases in benefit costs. The primary reason for the decrease in 2016 was lower other real estate owned expenses and FDIC insurance assessments, offset in part by increases in salaries and employee benefits and data processing costs. Other real estate owned expense declined primarily due to impairment losses in 2016 of $28,000 as compared to losses of $615,000 in 2015. To a lesser extent other real estate owned expense decreased due to gains on the sale of other real estate owned of $219,000 in 2016 as compared to gains of $100,000 in 2015. FDIC insurance assessment decreased primarily due to lower assessment rates in 2016 as compared to 2015. Salaries and employee benefits increased primarily due to normal salary increases and to a lesser extent normal increases in benefit costs. Data processing costs increased in 2016 primarily due to normal increases in our existing data processing contracts. The percentage of noninterest expense to average assets was 1.86 % in 2017, compared to 1.87% and 1.91% during 2016 and 2015, respectively.

Provision for Income Taxes

The provision for income taxes for 2017, 2016 and 2015 was $7,585,000, $6,805,000 and $5,807,000, respectively. This amount represents an effective tax rate of 36%, 30% and 28% for 2017, 2016 and 2015, respectively. The Company's marginal federal income tax rate through December 31, 2017 was 35%. The difference between the Company's effective and marginal tax rate historically has been primarily related to investments made in tax exempt securities. However, the increase in the effective tax rate for 2017 is due primarily to the write down of $1,190,000 of the Company’s deferred income tax asset due to a decrease in the corporate federal income tax rates to 21% enacted in December 2017. The increase in the effective tax rate for 2016 compared to 2015 is due primarily to an increase in income before income taxes; tax-exempt interest income decreasing as a percent of income before income taxes; and the recording of a $226,000 valuation allowance to fully reserve the deferred income tax asset associated with a state alternative minimum tax credit carryforward in 2016.

Balance Sheet Review

The Company’s assets are comprised primarily of loans and investment securities. Average earning asset maturity or repricing dates are generally five years or less for the combined portfolios as the assets are funded for the most part by short term deposits with either immediate availability or less than one year average maturities. This exposes the Company to risk with regard to changes in interest rates that are more fully explained in Item 7A of this Annual Report “Quantitative and Qualitative Disclosures about Market Risk”.

Total assets increased to $1,375,060,000 in 2017 compared to $1,366,453,000 in 2016, a 0.6% increase. The increase in assets was due primarily to an increase in the loan portfolio and the Company's interest bearing deposits in other financial institutions, which was funded primarily by a decrease in securities and an increase in deposits.

Loan Portfolio

Net loans as of December 31, 2017 totaled $771,550,000, an increase of 2.6% from the $752,182,000 as of December 31, 2016. Loan demand remained favorable in 2017 as most markets provided additional lending opportunities, in particular the Des Moines metro and Ames markets. This growth is primarily reflected in the commercial real estate loan portfolios. Loans are the primary contributor to the Company's revenues and cash flows. The average yield on loans was 168 basis points higher in both 2017 and 2016, in comparison to the average tax-equivalent investment portfolio yields.

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Types of Loans

The following table sets forth the composition of the Company's loan portfolio for the past five years ending at December 31, 2017. *(dollars in thousands)*

	2017	2016	2015	2014	2013
Real Estate					
Construction	$50,309	$61,042	$66,268	$36,016	$23,928
1-4 family residential	146,258	149,507	127,076	122,777	108,289
Commercial	350,626	315,702	251,889	257,054	206,112
Agricultural	81,790	73,032	62,530	57,449	53,834
Commercial	73,816	74,378	102,515	92,703	86,823
Agricultural	69,806	76,994	79,533	85,609	81,326
Consumer and other	10,345	12,130	21,599	15,763	12,795
Total loans	782,950	762,785	711,410	667,371	573,107
Deferred loan fees, net	(79)	(96)	(94)	(92)	(34)
Total loans net of deferred fees	$782,871	$762,689	$711,316	$667,279	$573,073

The Company's loan portfolio consists of real estate, commercial, agricultural and consumer loans. As of December 31, 2017, gross loans totaled approximately $783 million, which equals approximately 69.0% of total deposits and 56.9% of total assets. The Company’s peer group (consisting of 332 bank holding companies with total assets of $1 to $3 billion) loan to deposit ratio as of September 30, 2017 was a much higher 87%. The primary factor relating to the lower loan to deposit ratio for the Company compared to peer group averages is a more conservative underwriting philosophy and competitive markets for borrowers, based upon a comparison of net charge offs. As of December 31, 2017, the majority of the loans were originated directly by the Banks to borrowers within the Banks’ principal market areas. There are no foreign loans outstanding during the years presented.

Real estate loans include various types of loans for which the Banks hold real property as collateral and consist of loans primarily on commercial properties and single family residences. Real estate loans typically have fixed rates for up to five years, with the Company’s loan policy permitting a maximum fixed rate maturity of up to 15 years. The majority of construction loan volume is given to contractors to construct 1-4 family residence and commercial buildings and these loans generally have maturities of up to 12 months. The Banks also originate residential real estate loans for sale to the secondary market for a fee.

Commercial loans consist primarily of loans to businesses for various purposes, including revolving lines to finance current operations, floor-plans, inventory and accounts receivable; capital expenditure loans to finance equipment and other fixed assets; and letters of credit. These loans generally have short maturities, have either adjustable or fixed rates and are unsecured or secured by inventory, accounts receivable, equipment and/or real estate.

Agricultural loans play an important part in the Banks' loan portfolios. Iowa is a major agricultural state and is a national leader in both grain and livestock production. The Banks play a significant role in their communities in financing operating, livestock and real estate activities for area producers.

Consumer loans include loans extended to individuals for household, family and other personal expenditures not secured by real estate. The majority of the Banks' consumer lending is for vehicles, consolidation of personal debts, household appliances and improvements.

The interest rates charged on loans vary with the degree of risk and the amount and maturity of the loan. Competitive pressures, market interest rates, the availability of funds and government regulation further influence the rate charged on a loan. The Banks follow a loan policy, which has been approved by both the board of directors of the Company and the Banks, and is overseen by both Company and Bank management. These policies establish lending limits, review and grading criteria and other guidelines such as loan administration and allowance for loan losses. Loans are approved by the Banks' board of directors and/or designated officers in accordance with respective guidelines and underwriting policies of the Company. Credit limits generally vary according to the type of loan and the individual loan officer's experience. Loans to any one borrower are limited by applicable state and federal banking laws.

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Maturities and Sensitivities of Loans to Changes in Interest Rates as of December 31, 2017

The contractual maturities of the Company's loan portfolio are as shown below. Actual maturities may differ from contractual maturities because individual borrowers may have the right to prepay loans with or without prepayment penalties. *(dollars in thousands)*

	Within one year	After one year but within five years	After five years	Total
Real Estate				
Construction	$28,749	$19,852	$1,708	$50,309
1-4 family residential	24,873	55,409	65,976	146,258
Commercial	24,003	271,022	55,601	350,626
Agricultural	11,382	25,857	44,551	81,790
Commercial	41,556	27,010		