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

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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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## FORM 10-Q

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

For the quarterly period ended June 30, 2017

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 001-37504

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## Provident Bancorp, Inc.

(Exact name of registrant as specified in its charter)

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Massachusetts

(State or other jurisdiction of  
incorporation or organization)

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45-3231576

(I.R.S. Employer  
Identification Number)

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5 Market Street, Amesbury, Massachusetts

(Address of Principal Executive Offices)

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01913

Zip Code

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(978) 834-8555

(Registrant's telephone number)

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N/A

(Former name, former address, and former fiscal year if changed since last report)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 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 requirements for the past 90 days.

YES  NO

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

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

Large accelerated filer   
Non-accelerated filer (Do not check if a smaller reporting company)

Accelerated filer   
  
Smaller reporting company   
Emerging growth company

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

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

As of August 8, 2017, there were 9,633,288 shares of the Registrant's common stock, no par value per share, outstanding.

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**Provident Bancorp, Inc.**  
**Form 10-Q**

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**Part I. Financial Information**

## Item 1. Financial Statements

PROVIDENT BANCORP, INC.  
CONSOLIDATED BALANCE SHEETS

<i>(Dollars in thousands)</i>	At June 30, 2017 <i>(unaudited)</i>	At December 31, 2016
<b>Assets</b>		
Cash and due from banks	\$ 10,535	\$ 7,939
Interest-bearing demand deposits with other banks	1,243	2,637
Money market mutual funds	158	129
Cash and cash equivalents	11,936	10,705
Investments in available-for-sale securities (at fair value)	123,143	117,867
Federal Home Loan Bank stock, at cost	3,008	2,787
Loans, net	702,085	624,425
Bank owned life insurance	19,694	19,395
Premises and equipment, net	14,457	11,587
Accrued interest receivable	2,532	2,320
Deferred tax asset, net	4,240	4,913
Other assets	2,047	1,544
<b>Total assets</b>	<b>\$ 883,142</b>	<b>\$ 795,543</b>
<b>Liabilities and Equity</b>		
Deposits:		
Noninterest-bearing	\$ 170,136	\$ 158,075
Interest-bearing	531,214	469,907
Total deposits	701,350	627,982
Federal Home Loan Bank advances	60,075	49,858
Other liabilities	7,715	8,554
Total liabilities	769,140	686,394
Shareholders' equity:		
Preferred stock; authorized 50,000 shares: no shares issued and outstanding	-	-
Common stock, no par value: 30,000,000 shares authorized; 9,652,448 shares issued, 9,633,288 shares outstanding at June 30, 2017 and 9,652,448 issued and outstanding at December 31, 2016	-	-
Additional paid-in capital	43,976	43,393
Retained earnings	69,632	66,229
Accumulated other comprehensive income	3,753	2,622
Unearned compensation - ESOP	(2,976)	(3,095)
Treasury stock: 19,160 shares at June 30, 2017	(383)	-
Total shareholders' equity	114,002	109,149
<b>Total liabilities and shareholders' equity</b>	<b>\$ 883,142</b>	<b>\$ 795,543</b>

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

PROVIDENT BANCORP, INC.  
CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
<i>(Dollars in thousands, except per share data)</i>				
<b>Interest and dividend income:</b>				
Interest and fees on loans	\$ 7,911	\$ 6,159	\$ 15,144	\$ 12,250
Interest and dividends on securities	902	861	1,775	1,742
Interest on interest-bearing deposits	3	6	9	14
Total interest and dividend income	<u>8,816</u>	<u>7,026</u>	<u>16,928</u>	<u>14,006</u>
<b>Interest expense:</b>				
Interest on deposits	678	529	1,248	1,084
Interest on Federal Home Loan Bank advances	201	152	411	294
Total interest expense	<u>879</u>	<u>681</u>	<u>1,659</u>	<u>1,378</u>
<b>Net interest and dividend income</b>	<u>7,937</u>	<u>6,345</u>	<u>15,269</u>	<u>12,628</u>
<b>Provision for loan losses</b>	<u>892</u>	<u>210</u>	<u>1,455</u>	<u>321</u>
<b>Net interest and dividend income after provision for loan losses</b>	<u>7,045</u>	<u>6,135</u>	<u>13,814</u>	<u>12,307</u>
<b>Noninterest income:</b>				
Customer service fees on deposit accounts	346	292	684	597
Service charges and fees - other	481	448	983	866
Gain on sale of securities, net	58	17	540	37
Other income	185	210	364	402
Total noninterest income	<u>1,070</u>	<u>967</u>	<u>2,571</u>	<u>1,902</u>
<b>Noninterest expense:</b>				
Salaries and employee benefits	3,727	3,159	7,403	6,281
Occupancy expense	450	417	921	782
Equipment expense	157	164	307	309
FDIC assessment	73	96	141	190
Data processing	176	165	366	328
Marketing expense	100	51	150	108
Professional fees	215	313	429	578
Other	977	715	1,779	1,428
Total noninterest expense	<u>5,875</u>	<u>5,080</u>	<u>11,496</u>	<u>10,004</u>
<b>Income before income tax expense</b>	<u>2,240</u>	<u>2,022</u>	<u>4,889</u>	<u>4,205</u>
<b>Income tax expense</b>	<u>639</u>	<u>659</u>	<u>1,486</u>	<u>1,355</u>
<b>Net income</b>	<u>\$ 1,601</u>	<u>\$ 1,363</u>	<u>\$ 3,403</u>	<u>\$ 2,850</u>
<b>Income per share:</b>				
Basic	\$ 0.17	0.15	0.37	0.31
Diluted	\$ 0.17	0.15	0.37	0.31
<b>Weighted Average Shares:</b>				
Basic	9,193,836	9,173,317	9,193,206	9,170,340
Diluted	9,198,286	9,173,317	9,193,206	9,170,340

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

PROVIDENT BANCORP, INC.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

<i>(In thousands)</i>	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
<b>Net income</b>	\$ 1,601	\$ 1,363	\$ 3,403	\$ 2,850
Other comprehensive income:				
Change in net unrealized holding gains	1,605	1,028	2,344	1,871
Reclassification adjustment for realized gains in net income	(58)	(17)	(540)	(37)
Net change in unrealized gain	1,547	1,011	1,804	1,834
Income tax effect	(577)	(348)	(673)	(666)
Net of tax amount	970	663	1,131	1,168
Change in net unrealized holding gains on securities transferred from held-to-maturity to available-for-sale	-	2,239	-	2,239
Income tax effect	-	(894)	-	(894)
Net of tax amount	-	1,345	-	1,345
Other comprehensive income	970	2,008	1,131	2,513
<b>Total comprehensive income</b>	<u>\$ 2,571</u>	<u>\$ 3,371</u>	<u>\$ 4,534</u>	<u>\$ 5,363</u>

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

PROVIDENT BANCORP, INC.  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(Unaudited)

<i>(In thousands, except share data)</i>	<u>Shares of Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Unearned Compensation ESOP</u>	<u>Treasury Stock</u>	<u>Total</u>
<b>Balance, December 31, 2016</b>	9,652,448	\$ 43,393	\$ 66,229	\$ 2,622	\$ (3,095)	\$ -	\$ 109,149
Net income	-	-	3,403	-	-	-	3,403
Net change in other comprehensive income	-	-	-	1,131	-	-	1,131
Stock-based compensation expense	-	460	-	-	-	-	460
Treasury stock acquired	(19,160)	-	-	-	-	(383)	(383)
ESOP shares earned	-	123	-	-	119	-	242
<b>Balance, June 30, 2017</b>	<u>9,633,288</u>	<u>\$ 43,976</u>	<u>\$ 69,632</u>	<u>\$ 3,753</u>	<u>\$ (2,976)</u>	<u>\$ (383)</u>	<u>\$ 114,002</u>
<b>Balance, December 31, 2015</b>	9,498,722	\$ 43,159	\$ 59,890	\$ 1,690	\$ (3,333)	\$ -	\$ 101,406
Net income	-	-	2,850	-	-	-	2,850
Net change in other comprehensive income	-	-	-	2,513	-	-	2,513
ESOP shares earned	-	43	-	-	119	-	162
<b>Balance, June 30, 2016</b>	<u>9,498,722</u>	<u>\$ 43,202</u>	<u>\$ 62,740</u>	<u>\$ 4,203</u>	<u>\$ (3,214)</u>	<u>\$ -</u>	<u>\$ 106,931</u>

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

PROVIDENT BANCORP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

<i>(In thousands)</i>	Six Months Ended June 30,	
	2017	2016
<b>Cash flows from operating activities:</b>		
Net income	\$ 3,403	\$ 2,850
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of securities premiums, net of accretion	398	413
ESOP expense	242	162
Gain on sale of securities, net	(540)	(37)
Change in deferred loan fees, net	66	(27)
Provision for loan losses	1,455	321
Depreciation and amortization	420	419
(Increase) decrease in accrued interest receivable	(212)	68
Increase in taxes receivable	(448)	(127)
Share-based compensation expense	460	-
Increase in cash surrender value of life insurance	(299)	(312)
Increase in other assets	(55)	-
Decrease in other liabilities	(839)	(115)
Net cash provided by operating activities	4,051	3,615
<b>Cash flows from investing activities:</b>		
Purchases of available-for-sale securities	(12,490)	(369)
Proceeds from sales of available-for-sale securities	1,621	400
Proceeds from pay downs, maturities and calls of available-for-sale securities	7,539	5,968
Proceeds from pay downs, maturities and calls of held-to-maturity securities	-	220
(Purchase) redemption of Federal Home Loan Bank stock	(221)	943
Loan originations and purchases, net of paydowns	(79,181)	(25,265)
Recoveries of loans previously charged off	-	23
Additions to premises and equipment	(3,290)	(689)
Net cash used in investing activities	(86,022)	(18,769)

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



PROVIDENT BANCORP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

(Unaudited)

<i>(In thousands)</i>	Six Months Ended June 30,	
	2017	2016
<b>Cash flows from financing activities:</b>		
Net increase in demand deposits, NOW and savings accounts	37,481	48,635
Net increase (decrease) in time deposits	35,887	(18,541)
Proceeds from advances from Federal Home Loan Bank	7,000	11,500
Net change in Federal Home Loan Bank short-term advances	3,217	(29,976)
Purchase of treasury stock	(383)	-
Net cash provided by financing activities	83,202	11,618
Net increase (decrease) in cash and cash equivalents	1,231	(3,536)
Cash and cash equivalents at beginning of period	10,705	20,464
<b>Cash and cash equivalents at end of period</b>	<b>\$ 11,936</b>	<b>\$ 16,928</b>
<b>Supplemental disclosures:</b>		
Interest paid	\$ 1,621	\$ 1,375
Income taxes paid	1,934	1,482
Held-to-maturity securities transferred to available-for-sale	-	44,240

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

PROVIDENT BANCORP, INC.  
Notes to Consolidated Financial Statements

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(Unaudited)

**(1) Basis of Presentation**

The accompanying unaudited financial statements of Provident Bancorp, Inc., a Massachusetts corporation (the “Company”), were prepared in accordance with the instructions for Form 10-Q and with Regulation S-X and do not include information or footnotes necessary for a complete presentation of the financial condition, results of operations, and cash flows in conformity with U.S. generally accepted accounting principles (“GAAP”). However, in the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial statements have been included. The results of operations for the three- and six-month periods ended June 30, 2017 are not necessarily indicative of the results that may be expected for future periods, including the entire fiscal year. Certain amounts in 2016 have been reclassified to be consistent with 2017 consolidated financial statement presentation, and had no effect on the net income reported in the consolidated statement of income. These financial statements should be read in conjunction with the annual financial statements and notes thereto included in the annual report on Form 10-K the Company filed with the Securities and Exchange Commission on March 16, 2017.

The consolidated financial statements include the accounts of Provident Bancorp, Inc., its wholly owned subsidiary, The Provident Bank (the “Bank”), and the Bank’s wholly owned subsidiaries, Provident Security Corporation and 5 Market Street Security Corporation. Provident Security Corporation and 5 Market Street Security Corporation were established to buy, sell, and hold investments for their own account. All significant inter-company balances and transactions have been eliminated in consolidation.

**(2) Corporate Structure**

On July 15, 2015, the Company issued 4,274,425 shares of common stock to the public at \$10.00 per share, including 357,152 shares purchased by The Provident Bank Employee Stock Ownership Plan. In addition, the Company issued 5,034,323 shares to Provident Bancorp, the Company’s mutual holding company (the “MHC”), and 189,974 shares to The Provident Community Charitable Organization, Inc., a charitable foundation that was formed in connection with the stock offering and is dedicated to supporting charitable organizations operating in the Bank’s local community.

Expenses incurred related to the offering were \$1.5 million, and were recorded against offering proceeds.

Upon the completion of the stock offering, a special “liquidation account” was established for the benefit of certain depositors of the Bank in an amount equal to the percentage ownership interest in the equity of the Company to be held by persons other than the MHC as of the date of the latest balance sheet contained in the prospectus utilized in connection with the offering. The Company is not permitted to pay dividends on its capital stock if the Company’s shareholders’ equity would be reduced below the amount of the liquidation account. The liquidation account is reduced annually to the extent that eligible account holders have reduced their qualifying deposits. Subsequent increases will not restore an eligible account holder’s interest in the liquidation account.

### **(3) Recent Accounting Pronouncements**

In May 2014, the FASB issued *ASU (Accounting Standards Update) No. 2014-09 – Revenue from Contracts with Customers (Topic 606)*. The ASU establishes a single comprehensive model for an entity to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled, and will supersede nearly all existing revenue recognition guidance, to clarify and converge revenue recognition principles under US GAAP and International Financial Reporting Standards (IFRS). The update outlines five steps to recognizing revenue: (i) identify the contracts with the customer; (ii) identify the separate performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the separate performance obligations; (v) recognize revenue when each performance obligation is satisfied. The update requires more comprehensive disclosures, relating to quantitative and qualitative information for amounts, timing, the nature and uncertainty of revenue, and cash flows arising from contracts with customers, which will mainly impact construction and high-tech industries. The most significant potential impact to banking entities relates to less prescriptive derecognition requirements on the sale of other real estate owned (OREO) property. In August 2015, the Financial Accounting Standards Board (FASB) issued *ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*. The amendments in ASU 2015-14 defer the effective date of ASU 2014-09 for all entities by one year. Accordingly, the amendments are effective for annual and interim periods beginning after December 15, 2017. Early adoption was permitted for annual and interim reporting periods beginning after December 15, 2016. An entity may elect either a full retrospective or a modified retrospective application. The Company did not elect to early adopt this ASU. The Company does not expect the application of this guidance will have a material impact on the Company's financial statements.

In January 2016, the FASB issued *ASU No. 2016-01, Financial Instruments – Overall (Subtopic 825-10): “Recognition and Measurement of Financial Assets and Financial Liabilities.”* The ASU has been issued to improve the recognition and measurement of financial instruments by requiring 1) equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; 2) separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; 3) the use of the exit price notion when measuring fair value of financial instruments for disclosure purposes; and 4) separate presentation by the reporting organization in other comprehensive income for the portion of the total change in the fair value of a liability resulting from the change in the instrument-specific credit risk (also referred to as “own credit”) when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. The standard is effective for the Company beginning on January 1, 2018. The Company holds a portfolio of marketable equity securities; depending on the size and composition of the portfolio at the adoption date, the impact of the ASU could be material to the Company's consolidated financial statements.

In February 2016, the FASB issued *ASU 2016-02, Leases (Topic 842)*. The amendments in this update require lessees to recognize, on the balance sheet, assets and liabilities for the rights and obligations created by leases. Accounting by lessors will remain largely unchanged. The guidance will be effective for the Company on January 1, 2019, with early adoption permitted. Adoption will require a modified retrospective transition where the lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented. The Company does not expect the application of this guidance will have a material impact on the Company's financial statements.

In March 2016, the FASB issued *ASU 2016-09, Compensation Stock – Compensation (Topic 718): “Improvements to Employee Share Based Payment Accounting.”* This ASU changes how companies account for certain aspects of share based payments to employees. Entities will be required to recognize the income tax effects of awards in the statement of income when the awards vest or are settled, the guidance on employers' accounting for an employee's use of shares to satisfy the employer's statutory income tax withholding obligation and for forfeitures is changing and the update requires companies to present excess tax benefits as an operating activity on the statement of cash flows rather than as a financing activity. The amendments in this update were effective for the Company on January 1, 2017. The adoption of this ASU did not have a material impact on the Company's financial statements.

In June 2016, the FASB issued *ASU No. 2016-13, Financial Instruments—Credit Losses (Topic 326): “Measurement of Credit Losses on Financial Instruments.”* The ASU changes the impairment model for most financial assets and certain other instruments. For trade and other receivables, held-to-maturity debt securities, loans and other instruments, entities will be required to use a new forward-looking “expected loss” model that will replace today’s “incurred loss” model and can result in the earlier recognition of credit losses. For available-for-sale debt securities with unrealized losses, entities will measure credit losses in a manner similar to current practice, except that the losses will be recognized as an allowance. The amendments in this update will be effective for the Company on January 1, 2020. Early adoption is permitted as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Management is currently evaluating the impact of its pending adoption of this guidance on the Company’s financial statements.

In August 2016, the FASB issued *ASU No. 2016-15, Statement of Cash Flows (Topic 230): “Classification of Certain Cash Receipts and Cash Payments.”* This ASU changes how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230, Statement of Cash Flows, and other Topics. The amendments address the classification of the following eight items in the statement of cash flows; debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, distributions received from equity method investees, beneficial interests in securitization transactions and separately identifiable cash flows and application of the Predominance Principle. The amendments in this update are effective for the Company on January 1, 2018. The Company does not expect the application of this guidance will have a material impact on the Company’s financial statements.

In November 2016, the FASB issued *ASU No. 2016-18, Statement of Cash Flows (Topic 230): “Restricted Cash.”* This ASU provide guidance on the presentation of restricted cash or restricted cash equivalents in the statement of cash flows. The amendments in this Update require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments in this Update are effective for the Company on January 1, 2018. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The Company does not expect the application of this guidance will have a material impact on the Company’s financial statements.

In March 2017, the FASB issued *ASU No. 2017-08, Receivables – Nonrefundable Fees and Other Costs (subtopic 310-20): “Premium Amortization on Purchased Callable Debt Securities.”* This ASU shortens the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The amendments will be effective for the Company on January 1, 2019. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The Company does not expect the application of this guidance will have a material impact on the Company’s financial statements.

**(4) Investment Securities**

The following summarizes the amortized cost of investment securities classified as available-for-sale and their approximate fair values at June 30, 2017 and December 31, 2016:

<i>(In thousands)</i>	<b>Amortized Cost Basis</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
<b>June 30, 2017</b>				
State and municipal	\$ 57,101	\$ 2,084	\$ 8	\$ 59,177
Corporate debt	1,000	8	-	1,008
Asset-backed securities	8,275	47	17	8,305
Government mortgage-backed securities	36,827	461	168	37,120
Trust preferred securities	1,356	-	136	1,220
Marketable equity securities	12,734	4,019	282	16,471
	<u>117,293</u>	<u>6,619</u>	<u>611</u>	<u>123,301</u>
Money market mutual funds included in cash and cash equivalents	(158)	-	-	(158)
Total available-for-sale securities	<u>\$ 117,135</u>	<u>\$ 6,619</u>	<u>\$ 611</u>	<u>\$ 123,143</u>
<b>December 31, 2016</b>				
State and municipal	\$ 49,367	\$ 1,281	\$ 68	\$ 50,580
Corporate debt	1,000	31	-	1,031
Asset-backed securities	8,747	-	69	8,678
Government mortgage-backed securities	41,818	435	339	41,914
Trust preferred securities	1,368	-	400	968
Marketable equity securities	11,492	3,551	218	14,825
	<u>113,792</u>	<u>5,298</u>	<u>1,094</u>	<u>117,996</u>
Money market mutual funds included in cash and cash equivalents	(129)	-	-	(129)
Total available-for-sale securities	<u>\$ 113,663</u>	<u>\$ 5,298</u>	<u>\$ 1,094</u>	<u>\$ 117,867</u>

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The scheduled maturities of debt securities were as follows at June 30, 2017:

<i>(In thousands)</i>	<u>Available-for-Sale</u>	
	<u>Amortized</u>	<u>Fair</u>
	<u>Cost</u>	<u>Value</u>
Due within one year	\$ 1,106	\$ 1,117
Due after one year through five years	2,628	2,684
Due after five years through ten years	8,974	9,316
Due after ten years	46,749	48,288
Government mortgage-backed securities	36,827	37,120
Asset-backed securities	8,275	8,305
	<u>\$ 104,559</u>	<u>\$ 106,830</u>

The aggregate fair value and unrealized losses of securities that have been in a continuous unrealized loss position for less than twelve months and for twelve months or more are as follows at June 30, 2017 and December 31, 2016:

<i>(In thousands)</i>	<u>Less than 12 Months</u>		<u>12 Months or Longer</u>		<u>Total</u>	
	<u>Fair</u>	<u>Unrealized</u>	<u>Fair</u>	<u>Unrealized</u>	<u>Fair</u>	<u>Unrealized</u>
	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>	<u>Value</u>	<u>Losses</u>

**June 30, 2017**

Temporarily impaired securities:

State and municipal	\$ 628	\$ 6	\$ 161	\$ 2	\$ 789	\$ 8
Asset-backed securities	1,215	11	562	6	1,777	17
Government mortgage-backed securities	13,081	90	3,097	78	16,178	168
Trust preferred securities	15	29	1,205	107	1,220	136
Marketable equity securities	1,564	170	592	112	2,156	282
Total temporarily impaired securities	<u>\$ 16,503</u>	<u>\$ 306</u>	<u>\$ 5,617</u>	<u>\$ 305</u>	<u>\$ 22,120</u>	<u>\$ 611</u>

**December 31, 2016**

Temporarily impaired securities:

State and municipal	\$ 6,413	\$ 63	\$ 160	\$ 5	\$ 6,573	\$ 68
Asset-backed securities	8,104	60	574	9	8,678	69
Government mortgage-backed securities	20,868	247	2,770	92	23,638	339
Trust preferred securities	26	18	942	382	968	400
Marketable equity securities	1,942	104	768	114	2,710	218
Total temporarily impaired securities	<u>\$ 37,353</u>	<u>\$ 492</u>	<u>\$ 5,214</u>	<u>\$ 602</u>	<u>\$ 42,567</u>	<u>\$ 1,094</u>

*Government mortgage-backed securities, state and municipal securities and asset-backed securities:* Management believes that no individual unrealized loss at June 30, 2017 represents an other-than-temporarily impairment (OTTI) because the decline in fair value of these securities is primarily attributable to changes in interest rates and not credit quality, and because the Company has the intent and ability to hold these investments until market price recovery or maturity.

**Marketable equity securities:** Management continuously monitors equity securities for impairment by reviewing the financial condition of the issuer, company-specific events, industry developments, and general economic conditions. Management reviews corporate financial reports, credit agency reports and other publicly available information. Based on these reviews, none of these securities are considered to be other-than-temporarily impaired.

**Trust preferred securities:** Management monitors its pooled-trust preferred securities for possible other-than-temporary impairment on a quarterly basis. This review includes an analysis of collateral reports, cash flows, stress default levels and financial ratios of the underlying issuers. Management utilizes a third party to compile this data and perform other-than-temporary impairment cash flow testing. Critical assumptions that go into the other-than-temporary impairment cash flow testing are prepayment speeds, default rates of the underlying issuers and discount margins. The result of the third-party other-than-temporary impairment cash flow testing indicated no other-than-temporary impairment as of June 30, 2017.

#### **(5) Loans**

A summary of loans is as follows:

<i>(Dollars in thousands)</i>	At June 30, 2017		At December 31, 2016	
	Amount	Percent	Amount	Percent
Commercial real estate	\$ 348,148	48.86%	\$ 336,102	53.07%
Commercial	216,225	30.35%	166,157	26.23%
Residential real estate	73,046	10.25%	76,850	12.13%
Construction and land development	63,183	8.87%	48,161	7.60%
Consumer	11,928	1.67%	6,172	0.97%
	<u>712,530</u>	<u>100.00%</u>	<u>633,442</u>	<u>100.00%</u>
Allowance for loan losses	(9,952)		(8,590)	
Deferred loan fees, net	(493)		(427)	
Net loans	<u>\$ 702,085</u>		<u>\$ 624,425</u>	

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The following tables set forth information regarding the activity in the allowance for loan losses by portfolio segment for the three and six months ended June 30, 2017 and 2016:

<i>(In thousands)</i>	<b>For the three months ended June 30,</b>						
	<b>Commercial Real Estate</b>	<b>Commercial</b>	<b>Residential Real Estate</b>	<b>Construction and Land Development</b>	<b>Consumer</b>	<b>Unallocated</b>	<b>Total</b>
<b>Allowance for loan losses:</b>							
<b>Balance at March 31, 2017</b>	\$ 4,513	\$ 2,780	\$ 320	\$ 1,041	\$ 375	\$ 110	\$ 9,139
Charge-offs	-	(61)	-	-	(18)	-	(79)
Recoveries	-	-	-	-	-	-	-
Provision (benefit)	127	562	(2)	100	115	(10)	892
<b>Balance at June 30, 2017</b>	<u>\$ 4,640</u>	<u>\$ 3,281</u>	<u>\$ 318</u>	<u>\$ 1,141</u>	<u>\$ 472</u>	<u>\$ 100</u>	<u>\$ 9,952</u>
<b>Balance at March 31, 2016</b>	\$ 4,030	\$ 2,084	\$ 384	\$ 1,184	\$ 111	\$ 227	\$ 8,020
Charge-offs	-	-	-	-	(8)	-	(8)
Recoveries	-	-	-	-	9	-	9
Provision (benefit)	(29)	213	(20)	102	(10)	(46)	210
<b>Balance at June 30, 2016</b>	<u>\$ 4,001</u>	<u>\$ 2,297</u>	<u>\$ 364</u>	<u>\$ 1,286</u>	<u>\$ 102</u>	<u>\$ 181</u>	<u>\$ 8,231</u>

<i>(In thousands)</i>	<b>For the six months ended June 30,</b>						
	<b>Commercial Real Estate</b>	<b>Commercial</b>	<b>Residential Real Estate</b>	<b>Construction and Land Development</b>	<b>Consumer</b>	<b>Unallocated</b>	<b>Total</b>
<b>Allowance for loan losses:</b>							
<b>Balance at December 31, 2016</b>	\$ 4,503	\$ 2,513	\$ 328	\$ 882	\$ 279	\$ 85	\$ 8,590
Charge-offs	(6)	(61)	-	-	(26)	-	(93)
Recoveries	-	-	-	-	-	-	-
Provision (benefit)	143	829	(10)	259	219	15	1,455
<b>Balance at June 30, 2017</b>	<u>\$ 4,640</u>	<u>\$ 3,281</u>	<u>\$ 318</u>	<u>\$ 1,141</u>	<u>\$ 472</u>	<u>\$ 100</u>	<u>\$ 9,952</u>
<b>Balance at December 31, 2015</b>	\$ 3,827	\$ 2,138	\$ 412	\$ 1,236	\$ 119	\$ 173	\$ 7,905
Charge-offs	-	-	-	-	(18)	-	(18)
Recoveries	-	1	12	-	10	-	23
Provision (benefit)	174	158	(60)	50	(9)	8	321
<b>Balance at June 30, 2016</b>	<u>\$ 4,001</u>	<u>\$ 2,297</u>	<u>\$ 364</u>	<u>\$ 1,286</u>	<u>\$ 102</u>	<u>\$ 181</u>	<u>\$ 8,231</u>



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The following table sets forth information regarding the allowance for loan losses and related loan balances by segment at June 30, 2017 and December 31, 2016:

<i>(In thousands)</i>	<b>Commercial Real Estate</b>	<b>Commercial</b>	<b>Residential Real Estate</b>	<b>Construction and Land Development</b>	<b>Consumer</b>	<b>Unallocated</b>	<b>Total</b>
<b>June 30, 2017</b>							
Allowance for loan losses:							
Ending balance:							
Individually evaluated for impairment	\$ -	\$ 27	\$ -	\$ -	\$ -	\$ -	\$ 27
Ending balance:							
Collectively evaluated for impairment	4,640	3,254	318	1,141	472	100	9,925
Total allowance for loan losses ending balance	<u>\$ 4,640</u>	<u>\$ 3,281</u>	<u>\$ 318</u>	<u>\$ 1,141</u>	<u>\$ 472</u>	<u>\$ 100</u>	<u>\$ 9,952</u>
Loans:							
Ending balance:							
Individually evaluated for impairment	\$ 4,248	\$ 1,801	\$ 412	\$ -	\$ -	\$ -	\$ 6,461
Ending balance:							
Collectively evaluated for impairment	343,900	214,424	72,634	63,183	11,928	-	706,069
Total loans ending balance	<u>\$ 348,148</u>	<u>\$ 216,225</u>	<u>\$ 73,046</u>	<u>\$ 63,183</u>	<u>\$ 11,928</u>	<u>\$ -</u>	<u>\$ 712,530</u>
<b>December 31, 2016</b>							
Allowance for loan losses:							
Ending balance:							
Individually evaluated for impairment	\$ -	\$ 46	\$ -	\$ -	\$ -	\$ -	\$ 46
Ending balance:							
Collectively evaluated for impairment	4,503	2,467	328	882	279	85	8,544
Total allowance for loan losses ending balance	<u>\$ 4,503</u>	<u>\$ 2,513</u>	<u>\$ 328</u>	<u>\$ 882</u>	<u>\$ 279</u>	<u>\$ 85</u>	<u>\$ 8,590</u>
Loans:							
Ending balance:							
Individually evaluated for impairment	\$ 1,956	\$ 1,660	\$ 422	\$ -	\$ -	\$ -	\$ 4,038
Ending balance:							
Collectively evaluated for impairment	334,146	164,497	76,428	48,161	6,172	-	629,404
Total loans ending balance	<u>\$ 336,102</u>	<u>\$ 166,157</u>	<u>\$ 76,850</u>	<u>\$ 48,161</u>	<u>\$ 6,172</u>	<u>\$ -</u>	<u>\$ 633,442</u>

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The following tables set forth information regarding non-accrual loans and loan delinquencies by portfolio segment at June 30, 2017 and December 31, 2016:

<i>(In thousands)</i>	<u>30 - 59 Days</u>	<u>60 - 89 Days</u>	<u>90 Days or More Past Due</u>	<u>Total Past Due</u>	<u>Total Current</u>	<u>Total Loans</u>	<u>90 Days or More Past Due and Accruing</u>	<u>Non-accrual Loans</u>
<b>June 30, 2017</b>								
Commercial real estate	\$ -	\$ -	\$ -	\$ -	\$ 348,148	\$ 348,148	\$ -	\$ 2,667
Commercial	69	-	-	69	216,156	216,225	-	903
Residential real estate	-	333	155	488	72,558	73,046	-	663
Construction and land development	-	-	-	-	63,183	63,183	-	-
Consumer	4	1	1	6	11,922	11,928	-	1
<b>Total</b>	<u>\$ 73</u>	<u>\$ 334</u>	<u>\$ 156</u>	<u>\$ 563</u>	<u>\$ 711,967</u>	<u>\$ 712,530</u>	<u>\$ -</u>	<u>\$ 4,234</u>
<b>December 31, 2016</b>								
Commercial real estate	\$ -	\$ -	\$ 346	\$ 346	\$ 335,756	\$ 336,102	\$ -	\$ 346
Commercial	29	-	-	29	166,128	166,157	-	933
Residential real estate	-	-	-	-	76,850	76,850	-	303
Construction and land development	-	-	-	-	48,161	48,161	-	-
Consumer	-	-	-	-	6,172	6,172	-	-
<b>Total</b>	<u>\$ 29</u>	<u>\$ -</u>	<u>\$ 346</u>	<u>\$ 375</u>	<u>\$ 633,067</u>	<u>\$ 633,442</u>	<u>\$ -</u>	<u>\$ 1,582</u>

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Information about the Company's impaired loans by portfolio segment was as follows at and for the period ended June 30, 2017 and at and for the year ended December 31, 2016:

<i>(In thousands)</i>	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
<b>June 30, 2017</b>					
With no related allowance recorded:					
Commercial real estate	\$ 4,248	\$ 4,248	\$ -	\$ 2,484	\$ 33
Commercial	966	966	-	922	29
Residential real estate	412	412	-	417	10
Construction and land development	-	-	-	-	-
Consumer	-	-	-	-	-
Total impaired with no related allowance	<u>5,626</u>	<u>5,626</u>	<u>-</u>	<u>3,823</u>	<u>72</u>
With an allowance recorded:					
Commercial real estate	-	-	-	-	-
Commercial	835	835	27	847	-
Residential real estate	-	-	-	-	-
Construction and land development	-	-	-	-	-
Consumer	-	-	-	-	-
Total impaired with an allowance recorded	<u>835</u>	<u>835</u>	<u>27</u>	<u>847</u>	<u>-</u>
<b>Total</b>					
Commercial real estate	4,248	4,248	-	2,484	33
Commercial	1,801	1,801	27	1,769	29
Residential real estate	412	412	-	417	10
Construction and land development	-	-	-	-	-
Consumer	-	-	-	-	-
Total impaired loans	<u>\$ 6,461</u>	<u>\$ 6,461</u>	<u>\$ 27</u>	<u>\$ 4,670</u>	<u>\$ 72</u>
<b>December 31, 2016</b>					
With no related allowance recorded:					
Commercial real estate	\$ 1,956	\$ 1,956	\$ -	\$ 2,744	\$ 188
Commercial	799	799	-	794	42
Residential real estate	422	422	-	429	20
Construction and land development	-	-	-	-	-
Consumer	-	-	-	-	-
Total impaired with no related allowance	<u>3,177</u>	<u>3,177</u>	<u>-</u>	<u>3,967</u>	<u>250</u>
With an allowance recorded:					
Commercial real estate	-	-	-	-	-
Commercial	861	861	46	886	-
Residential real estate	-	-	-	-	-
Construction and land development	-	-	-	-	-
Consumer	-	-	-	-	-
Total impaired with an allowance recorded	<u>861</u>	<u>861</u>	<u>46</u>	<u>886</u>	<u>-</u>
<b>Total</b>					
Commercial real estate	1,956	1,956	-	2,744	188
Commercial	1,660	1,660	46	1,680	42
Residential real estate	422	422	-	429	20
Construction and land development	-	-	-	-	-
Consumer	-	-	-	-	-
Total impaired loans	<u>\$ 4,038</u>	<u>\$ 4,038</u>	<u>\$ 46</u>	<u>\$ 4,853</u>	<u>\$ 250</u>

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The following summarizes troubled debt restructurings entered into during the six months ended June 30, 2017:

<i>(Dollars in thousands)</i>	<u>Number of Contracts</u>	<u>Pre- Modification Outstanding Recorded Investment</u>	<u>Post- Modification Outstanding Recorded Investment</u>
<b>June 30, 2017</b>			
Troubled debt restructurings:			
Commercial	1	\$ 249	\$ 249
	<u>1</u>	<u>\$ 249</u>	<u>\$ 249</u>

In 2017, the Company approved one troubled debt restructure totaling \$249,000, with no specific reserve required based on an analysis of the borrower's collateral coverage. The term of this commercial loan was extended to a three-year term.

The following tables present the Company's loans by risk rating and portfolio segment at June 30, 2017 and December 31, 2016:

<i>(In thousands)</i>	<u>Commercial Real Estate</u>	<u>Commercial</u>	<u>Residential Real Estate</u>	<u>Construction and Land Development</u>	<u>Consumer</u>	<u>Total</u>
<b>June 30, 2017</b>						
Grade:						
Pass	\$ 333,362	\$ 206,018	\$ -	\$ 63,183	\$ -	\$ 602,563
Special mention	3,338	2,404	-	-	-	5,742
Substandard	11,448	7,803	698	-	-	19,949
Not formally rated	-	-	72,348	-	11,928	84,276
Total	<u>\$ 348,148</u>	<u>\$ 216,225</u>	<u>\$ 73,046</u>	<u>\$ 63,183</u>	<u>\$ 11,928</u>	<u>\$ 712,530</u>
<b>December 31, 2016</b>						
Grade:						
Pass	\$ 319,712	\$ 157,306	\$ -	\$ 48,161	\$ -	\$ 525,179
Special mention	4,471	1,668	-	-	-	6,139
Substandard	11,919	7,183	729	-	-	19,831
Not formally rated	-	-	76,121	-	6,172	82,293
Total	<u>\$ 336,102</u>	<u>\$ 166,157</u>	<u>\$ 76,850</u>	<u>\$ 48,161</u>	<u>\$ 6,172</u>	<u>\$ 633,442</u>

**Credit Quality Information**

The Company utilizes a seven grade internal loan risk rating system for commercial real estate, construction and land development, and commercial loans as follows:

**Loans rated 1-3:** Loans in these categories are considered “pass” rated loans with low to average risk.

**Loans rated 4:** Loans in this category are considered “special mention.” These loans are starting to show signs of potential weakness and are being closely monitored by management.

**Loans rated 5:** Loans in this category are considered “substandard.” Generally, a loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligors and/or the collateral pledged. There is a distinct possibility that the Company will sustain some loss if the weakness is not corrected.

**Loans rated 6:** Loans in this category are considered “doubtful.” Loans classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable.

**Loans rated 7:** Loans in this category are considered uncollectible loss and of such little value that their continuance as loans is not warranted.

On an annual basis, or more often if needed, the Company formally reviews the ratings on all commercial real estate, construction and land development, and commercial loans.

For residential real estate and consumer loans, the Company initially assesses credit quality based upon the borrower’s ability to pay and rates such loans as pass. Subsequent risk rating downgrades are based upon the borrower’s payment activity. All other residential and consumer loans are not formally rated.

**(6) Federal Home Loan Bank Advances**

Borrowings from the Federal Home Loan Bank (the “FHLB”) are secured by a blanket lien on qualified collateral, consisting primarily of loans with first mortgages secured by one to four family properties, certain commercial loans and other qualified assets.

Maturities of advances from the FHLB as of June 30, 2017 are summarized as follows:

*(In thousands)*

2017	\$	33,275
2018		12,000
2019		4,919
2020		6,381
Thereafter		3,500
Total	\$	<u>60,075</u>

## **(7) Fair Value Measurements**

The Company reports certain assets at fair value in accordance with GAAP, which defines fair value and establishes a framework for measuring fair value in accordance with generally accepted accounting principles. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The guidance establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair values:

### **Basis of Fair Value Measurements**

- Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2 - Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability;
- Level 3 - Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

### **Fair Values of Financial Instruments Measured on a Recurring Basis**

The Company's investments in U.S. Government and federal agency, state and municipal, corporate debt, asset-backed and government mortgage-backed securities available-for-sale are generally classified within Level 2 of the fair value hierarchy. For these investments, the Company obtains fair value measurements from independent pricing services. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, trading levels, market consensus prepayment speeds, credit information and the instrument's terms and conditions.

The Company classifies its investments in trust preferred securities as Level 3 securities. Level 3 is for positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used. Subsequent to inception, management only changes Level 3 inputs and assumptions when corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalization and other transactions across the capital structure, offerings in the equity or debt markets, and changes in financial ratios or cash flows.

The Company classified its investments in marketable equity securities as Level 1 securities. Such securities are classified as Level 1 securities because fair values are obtained through quoted market prices for identical securities in active exchange markets.

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The following summarizes financial instruments measured at fair value on a recurring basis at June 30, 2017 and December 31, 2016:

<i>(In thousands)</i>	<b>Fair Value Measurements at Reporting Date Using</b>			
	<b>Total</b>	<b>Quoted Prices in Active Markets for Identical Assets Level 1</b>	<b>Significant Other Observable Inputs Level 2</b>	<b>Significant Unobservable Inputs Level 3</b>
<b>June 30, 2017</b>				
State and municipal	\$ 59,177	\$ -	\$ 59,177	\$ -
Corporate debt	1,008	-	1,008	-
Asset-backed securities	8,305	-	8,305	-
Mortgage-backed securities	37,120	-	37,120	-
Trust preferred securities	1,220	-	-	1,220
Marketable equity securities	16,313	16,313	-	-
Totals	<u>\$ 123,143</u>	<u>\$ 16,313</u>	<u>\$ 105,610</u>	<u>\$ 1,220</u>
<b>December 31, 2016</b>				
State and municipal	\$ 50,580	\$ -	\$ 50,580	\$ -
Corporate debt	1,031	-	1,031	-
Asset-backed securities	8,678	-	8,678	-
Mortgage-backed securities	41,914	-	41,914	-
Trust preferred securities	968	-	-	968
Marketable equity securities	14,696	14,696	-	-
Totals	<u>\$ 117,867</u>	<u>\$ 14,696</u>	<u>\$ 102,203</u>	<u>\$ 968</u>

The following is a summary of activity for Level 3 financial instruments measured at fair value on a recurring basis for the six-month periods ended June 30, 2017 and 2016.

<i>(In thousands)</i>	<b>Available-for-Sale Securities</b>
<b>Balance beginning January 1, 2017</b>	\$ 968
Total gains or (losses) (realized/unrealized)	
Included in earnings	-
Included in other comprehensive income	264
Paydowns	(12)
<b>Ending balance, June 30, 2017</b>	<u>\$ 1,220</u>
<b>Balance beginning January 1, 2016</b>	\$ 1,116
Total gains or (losses) (realized/unrealized)	
Included in earnings	-
Included in other comprehensive income	(183)
Paydowns	-
<b>Ending balance, June 30, 2016</b>	<u>\$ 933</u>

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The Company's impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from the collateral. Collateral values are estimated using Level 2 inputs based upon appraisals of similar properties obtained from a third party. However, the Company generally discounts appraisals to arrive at fair value, therefore classifies such loans as Level 3 because the discounts are a significant input that is not observable.

The following summarizes financial instruments measured at fair value on a nonrecurring basis at June 30, 2017 and December 31, 2016:

<i>(In thousands)</i>	<b>Fair Value Measurements at Reporting Date Using:</b>			
	<b>Total</b>	<b>Quoted Prices in Active Markets for Identical Assets Level 1</b>	<b>Significant Other Observable Inputs Level 2</b>	<b>Significant Unobservable Inputs Level 3</b>
<b>June 30, 2017</b>				
Impaired loan	\$ 808	\$ -	\$ -	\$ 808
<b>December 31, 2016</b>				
Impaired loan	\$ 815	\$ -	\$ -	\$ 815

The following is a summary of the valuation methodology and unobservable inputs for Level 3 assets measured at fair value on a nonrecurring basis at June 30, 2017 and December 31, 2016:

<i>(In thousands)</i>	<b>Fair Value</b>	<b>Valuation Technique</b>	<b>Unobservable Input</b>
<b>June 30, 2017</b>			
Impaired loan	\$ 808	Business valuation	Comparable company valuations
<b>December 31, 2016</b>			
Impaired loan	\$ 815	Business valuation	Comparable company valuations



**(8) Fair Value of Financial Instruments**

GAAP requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value. Certain financial instruments and all nonfinancial instruments are excluded from the disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The carrying amounts and estimated fair values of the Company's financial instruments, all of which are held or issued for purposes other than trading, are as follows at June 30, 2017 and December 31, 2016:

<i>(In thousands)</i>	<u>Carrying Amount</u>	<u>Fair Value</u>			<u>Total</u>
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	
<b>June 30, 2017</b>					
Financial assets:					
Cash and cash equivalents	\$ 11,936	\$ 11,936	\$ -	\$ -	\$ 11,936
Available-for-sale securities	123,143	16,313	105,610	1,220	123,143
Federal Home Loan Bank of Boston stock	3,008	3,008	-	-	3,008
Loans, net	702,085	-	-	711,119	711,119
Accrued interest receivable	2,532	-	2,532	-	2,532
Financial liabilities:					
Deposits	701,350	-	-	701,224	701,224
Federal Home Loan Bank advances	60,075	-	60,033	-	60,033
<b>December 31, 2016</b>					
Financial assets:					
Cash and cash equivalents	\$ 10,705	\$ 10,705	\$ -	\$ -	\$ 10,705
Available-for-sale securities	117,867	14,696	102,203	968	117,867
Federal Home Loan Bank of Boston stock	2,787	2,787	-	-	2,787
Loans, net	624,425	-	-	632,278	632,278
Accrued interest receivable	2,320	-	2,320	-	2,320
Financial liabilities:					
Deposits	627,982	-	-	628,060	628,060
Federal Home Loan Bank advances	49,858	-	49,901	-	49,901

**(9) Regulatory Capital**

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

Effective January 1, 2015 (with a phase-in period of two to four years for certain components), the Bank became subject to capital regulations adopted by the FDIC, which implement the Basel III regulatory capital reforms and the changes required by the Dodd-Frank Act. The new regulations require a new Common Equity Tier 1 ("CET1") capital ratio of 4.5%, a minimum Tier 1 capital to risk-weighted assets ratio of 6.0%, a minimum total capital to risk-weighted assets ratio of 8.0% and a minimum Tier 1 leverage ratio of 4.0%. CET1 generally consists of common stock and retained earnings, subject to applicable adjustments and deductions. Under new prompt corrective action regulations, in order to be considered "well capitalized," the Bank must maintain a CET1 capital ratio of 6.5% and a Tier 1 ratio of 8.0%, a total risk based capital ratio of 10% and a Tier 1 leverage ratio of 5.0%. In addition, the regulations establish a capital conservation buffer above the required capital ratios that started phasing in on January 1, 2016 at 0.625% of risk-weighted assets and increases each year by 0.625% until it is fully phased in at 2.5% effective January 1, 2019. Beginning January 1, 2016, failure to maintain the capital conservation buffer limits the ability of the Bank and the Company to pay dividends, repurchases shares or pay discretionary bonuses.

As of June 30, 2017 and December 31, 2016, the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action.

The Bank’s actual capital amounts and ratios are presented in the following table.

<i>(dollars in thousands)</i>	Actual		For Capital Adequacy Purposes				To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio		
<b>June 30, 2017</b>								
Total Capital (to Risk Weighted Assets)	\$ 113,105	14.8%	\$ 61,258	≥ 8.0%	\$ 76,572	≥ 10.0%		
Tier 1 Capital (to Risk Weighted Assets)	101,847	13.3	45,943	≥ 6.0	61,258	≥ 8.0		
Common Equity Tier 1 Capital (to Risk Weighted Assets)	101,847	13.3	34,457	≥ 4.5	49,772	≥ 6.5		
Tier 1 Capital (to Average Assets)	101,847	12.0	33,819	≥ 4.0	42,273	≥ 5.0		
<b>December 31, 2016</b>								
Total Capital (to Risk Weighted Assets)	\$ 107,731	15.9%	\$ 54,272	≥ 8.0%	\$ 67,840	≥ 10.0%		
Tier 1 Capital (to Risk Weighted Assets)	97,750	14.4	40,704	≥ 6.0	54,272	≥ 8.0		
Common Equity Tier 1 Capital (to Risk Weighted Assets)	97,750	14.4	30,528	≥ 4.5	44,096	≥ 6.5		
Tier 1 Capital (to Average Assets)	97,750	12.6	31,058	≥ 4.0	38,822	≥ 5.0		

The Company may use capital management tools such as cash dividends and common share repurchases. Massachusetts regulations restrict repurchases for the first three years following the stock offering except where compelling and valid business reasons are established to the satisfaction of the Massachusetts Commissioner of Banks, and except to fund stock benefit plans. The Company is also subject to the Federal Reserve Board’s notice provisions for stock repurchases. In January 2017, the Company received a non-objection from the Federal Reserve Bank to adopt a stock repurchase program for up to 6.6% of its common stock. As of June 30, 2017, the Company had repurchased 19,160 shares of its stock at an average price of \$19.94 per share, or 3.1% of the 625,015 shares authorized for repurchase under the Company’s repurchase program.

**(10) Employee Stock Ownership Plan**

The Bank maintains an Employee Stock Ownership Plan (“ESOP”) to provide eligible employees the opportunity to own Company stock. This plan is a tax-qualified retirement plan for the benefit of Bank employees. Contributions are allocated to eligible participants on the basis of compensation, subject to federal tax limits. The number of shares committed to be released per year through 2029 is 23,810.

The Company contributed funds to a subsidiary to loan to the ESOP to purchase 357,152 shares of the Company’s common stock at a price of \$10.00 per share. The loan is payable annually over 15 years at a rate per annum equal to the Prime Rate as of December 31 (3.75% at December 31, 2016). Loan payments are principally funded by cash contributions from the Bank.

	June 30, 2017	December 31, 2016
Allocated	47,620	23,810
Committed to be allocated	11,905	23,810
Unallocated	297,627	309,532
Total	357,152	357,152

The fair value of unallocated shares was approximately \$6.7 million at June 30, 2017.

Total compensation expense recognized in connection with the ESOP for the three months ended June 30, 2017 and June 30, 2016 was \$128,000 and \$84,000, respectively. Total compensation expense recognized for the six months ended June 30, 2017 and June 30, 2016 was \$242,000 and \$162,000, respectively.

**(11) Earnings Per Common Share**

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Unallocated ESOP shares, treasury stock and unvested restricted stock is not deemed outstanding for earnings per share calculation.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
<i>(Dollars in thousands)</i>				
Net Income attributable to common shareholders	\$ 1,601	\$ 1,363	\$ 3,403	\$ 2,850
Average number of common shares outstanding	9,652,448	9,498,722	9,652,448	9,498,722
Less:				
average unallocated ESOP shares	(301,483)	(325,405)	(303,855)	(328,382)
average unvested restricted stock	(140,916)	-	(144,738)	-
average treasury stock acquired	(16,213)	-	(10,649)	-
Average number of common shares outstanding to calculate basic earnings per common share	9,193,836	9,173,317	9,193,206	9,170,340
Effect of dilutive unvested restricted stock and stock option awards	4,450	-	-	-
Average number of common shares outstanding to calculate diluted earnings per common share	9,198,286	9,173,317	9,193,206	9,170,340
Earnings per common share:				
Basic	\$ 0.17	\$ 0.15	\$ 0.37	\$ 0.31
Diluted	\$ 0.17	\$ 0.15	\$ 0.37	\$ 0.31

**(12) Share-Based Compensation**

Under the Provident Bancorp, Inc. 2016 Equity Incentive Plan (the "Equity Plan"), the Company may grant options, restricted stock, restricted units or performance awards to its directors, officers and employees. Both incentive stock options and non-qualified stock options may be granted under the Equity Plan, with the total shares reserved for options equaling 446,440. The exercise price of each option equals the market price of the Company's stock on the date of grant and the term of each option is generally ten years. The total number of shares reserved for restricted stock or restricted units is 178,575. Options and other awards vest ratably over five years.

Expense related to options and restricted stock granted to directors is recognized in other within non-interest expense.

Stock Options

The fair value of each option is estimated on the date of the grant using the Black-Scholes option-pricing model with the following assumptions:

- Volatility is based on peer group volatility because the Company does not have a sufficient trading history.
- Expected life represents the period of time that the option is expected to be outstanding, taking into account the contractual term, and the vesting period.
- The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for a period equivalent to the expected life of the option.

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A summary of the status of the Company's stock option grants for the six months ended June 30, 2017, is presented in the table below:

	<b>Stock Option Awards</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term (years)</b>	<b>Aggregate Intrinsic Value</b>
Balance at December 31, 2016	384,268	\$ 17.40		
Granted	-	-		
Balance at June 30, 2017	<u>384,268</u>	<u>\$ 17.40</u>	<u>9.39</u>	<u>\$ 1,364,151</u>
Outstanding and expected to vest at June 30, 2017	<u>384,268</u>	<u>\$ 17.40</u>	<u>9.39</u>	<u>\$ 1,364,151</u>
Exercisable at June 30, 2017	-	-	-	-
Unrecognized compensation cost	<u>\$ 1,691,000</u>			
Weighted average remaining recognition period (years)	<u>4.39</u>			

For the three and six months ended June 30, 2017, total expense for the stock options was \$96,000 and \$193,000, respectively. There was no stock-based compensation expense for the three and six months ended June 30, 2016.

### Restricted Stock

Shares issued upon vesting of restricted stock may be either authorized but unissued shares or reacquired shares held by the Company. Any shares not issued because vesting requirements are not met will again be available for issuance under the Equity Plan. The fair market value of shares awarded, based on the market prices at the date of grant, is recorded as unearned compensation and amortized over the applicable vesting period.

The following table presents the activity in restricted stock awards under the Equity Plan for the six months June 30, 2017:

	<b>Outstanding Restricted Stock Awards</b>	<b>Weighted Average Grant Price</b>
Restricted stock awards at December 31, 2016	153,726	\$ 17.40
Granted	-	-
Restricted stock awards at June 30, 2017	<u>153,726</u>	<u>\$ 17.40</u>
Unrecognized compensation cost	<u>\$ 2,342,000</u>	
Weighted average remaining recognition period (years)	<u>4.39</u>	

For the three and six months ended June 30, 2017, total expense for the restricted stock awards was \$133,000 and \$267,000, respectively. There was no stock-based compensation expense for the three and six months ended June 30, 2016.

## **Item 2. Management's Discussion of Financial Condition and Results of Operations**

Management's discussion and analysis of financial condition and results of operations at June 30, 2017 and December 31, 2016 and for the three and six months ended June 30, 2017 and 2016 is intended to assist in understanding our financial condition and results of operations. Operating results for the three- and six- month period ended June 30, 2017 may not be indicative of results for all of 2017 or any other period. The information contained in this section should be read in conjunction with the Unaudited Consolidated Financial Statements and the notes thereto, appearing in Part 1, Item 1 of this report.

## Forward-Looking Statements

This document may contain certain forward-looking statements, such as statements of the Company's or the Bank's plans, objectives, expectations, estimates and intentions. Forward-looking statements may be identified by the use of words such as "expects," "subject," "believes," "will," "intends," "will be," "would" or similar expressions. Readers should not place undue reliance on any forward-looking statements, which reflect management's analysis of factors only as of the date of which they are given. These statements are subject to change based on various important factors (some of which are beyond the Company's or the Bank's control) and actual results may differ materially. These factors include general economic conditions, including trends and levels of interest rates; the ability of our borrowers to repay their loans; the ability of the Company or the Bank to effectively manage its growth; real estate values in the market area; loan demand; competition; changes in accounting policies; changes in laws and regulations; our success in introducing new products or entering new markets; our ability to retain key employees; failures or breaches of our IT systems; and results of regulatory examinations, among other factors. The foregoing list of important factors is not exclusive. Readers should carefully review the factors described in other documents the Company files from time to time with the Securities and Exchange Commission, including Current Reports on Form 8-K.

Except as required by applicable law and regulation, the Company does not undertake — and specifically disclaims any obligation — to update any forward-looking statements after the date of this quarterly report.

## Critical Accounting Policies

Critical accounting estimates are necessary in the application of certain accounting policies and procedures and are particularly susceptible to significant change. Critical accounting policies are defined as those involving significant judgments and assumptions by management that could have a material impact on the carrying value of certain assets or on income under different assumptions or conditions. Management believes that the most critical accounting policies, which involve the most complex or subjective decisions or assessments, are as follows:

***Allowance for Loan Losses.*** The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the un-collectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

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

The Company classifies a loan as impaired when, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, we do not separately identify individual consumer and residential loans for impairment disclosures.

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by the following loan segments: residential real estate, commercial real estate, construction and land development, commercial and consumer. Management uses a rolling average of historical losses based on a time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels/trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff; and national and local economic trends and conditions. There were no changes in our policies or methodology pertaining to the general component of the allowance for loan losses during the six months ended June 30, 2017 or during the twelve months ended December 31, 2016.

The qualitative factors are determined based on the various risk characteristics of each loan segment. Risk characteristics relevant to each portfolio segment are as follows:

*Residential real estate:* We generally do not originate loans with a loan-to-value ratio greater than 80% and do not grant subprime loans. Loans with loan to value ratios greater than 80% require the purchase of private mortgage insurance. All loans in this segment are collateralized by owner-occupied residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this segment.

*Commercial real estate:* Loans in this segment are primarily income-producing properties throughout Massachusetts and New Hampshire. The underlying cash flows generated by the properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates, which in turn, will have an effect on the credit quality in this segment. Management periodically obtains rent rolls and continually monitors the cash flows of these loans.

*Construction and land development:* Loans in this segment primarily include speculative and pre-sold real estate development loans for which payment is derived from sale of the property and a conversion of the construction loans to permanent loans for which payment is then derived from cash flows of the property. Credit risk is affected by cost overruns, time to sell at an adequate price, and market conditions.

*Commercial:* Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer spending, will have an effect on the credit quality in this segment.

*Consumer:* Loans in this segment are generally unsecured and repayment is dependent on the credit quality of the individual borrower.

The allocated component relates to loans that are classified as impaired. Impairment is measured on a loan by loan basis for commercial, commercial real estate and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows (or collateral value) of the impaired loan is lower than the carrying value of that loan.

We periodically may agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring. All troubled debt restructurings are initially classified as impaired.

An unallocated component can be maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general reserves in the portfolio.

**Stock-based Compensation Plans.** The Company measures and recognizes compensation cost relating to stock-based payment transactions based on the grant-date fair value of the equity instruments issued. Stock-based compensation is recognized over the period the employee is required to provide services for the award. The Company uses the Black-Scholes option-pricing model to determine the fair value of stock options granted. The determination of fair value involves a number of significant estimates, which require a number of assumptions to determine the model inputs. The fair value of restricted stock is recorded based on the grant date value of the equity instrument issued.

**Income Taxes.** The Company recognizes income taxes under the asset and liability method. Under this method, deferred tax assets and liabilities are established for the temporary differences between the accounting basis and the tax basis of our assets and liabilities at enacted tax rates expected to be in effect when the amounts related to such temporary differences are realized or settled. A tax valuation allowance is established, as needed, to reduce net deferred tax assets to the amount expected to be realized.

The Company examines its significant income tax positions quarterly to determine whether a tax benefit is more likely than not to be sustained upon examination by tax authorities.

### Balance Sheet Analysis

**Assets.** Total assets were \$883.1 million at June 30, 2017, an increase of \$87.6 million, or 11.0%, from \$795.5 million at December 31, 2016. The increase resulted primarily from increases in net loans of \$77.7 million, investments in available-for-sale securities of \$5.3 million and premises and equipment of \$2.9 million.

**Cash and Cash Equivalents.** Cash and cash equivalents increased \$1.2 million, or 11.5%, to \$11.9 million at June 30, 2017 from \$10.7 million at December 31, 2016. The increase in cash and cash equivalents resulted from an increase in deposits.

**Loans.** At June 30, 2017, net loans were \$702.1 million, or 79.5% of total assets, compared to \$624.4 million, or 78.5% of total assets, at December 31, 2016. An increase in commercial loans of \$50.1 million, or 30.1%, an increase in construction and land development loans of \$15.0 million, or 31.2%, an increase in commercial real estate loans of \$12.0 million, or 3.6%, and an increase in consumer loans of \$5.8 million, or 93.3%, were partially offset by a decrease in residential real estate loans of \$3.8 million, or 4.9%, reflecting our continued focus on commercial lending. Our significant increase in total loans is due mainly to organic loan growth.

The following table sets forth the composition of our loan portfolio by type of loan at the dates indicated.

	At June 30, 2017		At December 31, 2016	
	Amount	Percent	Amount	Percent
Commercial real estate	\$ 348,148	48.86%	\$ 336,102	53.07%
Commercial	216,225	30.35%	166,157	26.23%
Residential real estate	73,046	10.25%	76,850	12.13%
Construction and land development	63,183	8.87%	48,161	7.60%
Consumer	11,928	1.67%	6,172	0.97%
	712,530	100.00%	633,442	100.00%
Allowance for loan losses	(9,952)		(8,590)	
Deferred loan fees, net	(493)		(427)	
Net loans	\$ 702,085		\$ 624,425	



**Securities.** Our available-for-sale securities portfolio increased \$5.3 million, or 4.5%, to \$123.1 million at June 30, 2017 from \$117.9 million at December 31, 2016 as we purchased state and municipal securities in the beginning of 2017 to replace investment securities that matured during 2016. The cash flows generated by principal paydowns and maturities were used to fund loan growth throughout 2016.

**Premises and Equipment.** Premises and equipment increased \$2.9 million to \$14.5 million at June 30, 2017 from \$11.6 million as of December 31, 2016. The increase was primarily due to the purchase of a building in Portsmouth, New Hampshire that is intended to provide space for future additional employees as we grow.

**Deposits.** Total deposits increased \$73.4 million, or 11.7%, to \$701.4 million at June 30, 2017 from \$628.0 million at December 31, 2016. The increase was primarily due to an increase in time deposits of \$35.9 million, an increase in money market accounts of \$19.8 million, and an increase in NOW accounts of \$11.7 million. Increases in time deposits were primarily due to increases in brokered certificates of deposit of \$28.4 million and an increase of \$9.8 million in QwickRate certificates of deposit, where we gather certificates of deposit nationwide by posting online rates we will pay on these deposits.

**Borrowings.** Borrowings at both June 30, 2017 and December 31, 2016 consisted entirely of Federal Home Loan Bank advances. Borrowings increased \$10.2 million, or 20.5%, to \$60.1 million at June 30, 2017 from \$49.9 million at December 31, 2016. The increase was primarily due to funding loan growth.

**Shareholders' Equity.** Total shareholders' equity increased \$4.9 million, or 4.4%, to \$114.0 million at June 30, 2017, from \$109.1 million at December 31, 2016. The increase was primarily due to year-to-date net income of \$3.4 million; increases of \$1.1 million in year-to-date accumulated other comprehensive income, reflecting an increase in the fair value of available-for-sale securities; and a \$460,000 increase in additional paid-in capital related to stock based compensation; partially offset by repurchases of common stock totaling \$383,000. Book value per share increased to \$11.83 at June 30, 2017 from \$11.31 at December 31, 2016.

**Asset Quality.**

The following table sets forth information regarding our non-performing assets at the dates indicated.

<i>(Dollars in thousands)</i>	At June 30, 2017	At December 31, 2016
Non-accrual loans:		
Real estate:		
Commercial	\$ 2,667	\$ 346
Residential	663	303
Construction and land development	-	-
Commercial	903	933
Consumer	1	-
Total non-accrual loans	<u>4,234</u>	<u>1,582</u>
Accruing loans past due 90 days or more	-	-
Real estate owned	-	-
Total non-performing assets	<u>\$ 4,234</u>	<u>\$ 1,582</u>
Total loans (1)	\$ 712,037	\$ 633,015
Total assets	\$ 883,142	\$ 795,543
Total non-performing loans to total loans (1)	0.59%	0.25%
Total non-performing assets to total assets	0.48%	0.20%

(1) Loans are presented before the allowance for loan losses but include deferred fees/costs

The increase in non-performing assets at June 30, 2017 compared to December 31, 2016 was primarily due to a downgrade to substandard of a \$2.7 million commercial real estate loan. Although we have continued to receive payments due under the terms of the loan, we placed the loan on non-accrual status during the quarter ended June 30, 2017 due to the financial performance of the borrower.

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**Allowance for Loan Losses.** The allowance for loan losses is maintained at levels considered adequate by management to provide for probable loan losses inherent in the loan portfolio as of the consolidated balance sheet reporting dates. The allowance for loan losses is based on management's assessment of various factors affecting the loan portfolio, including portfolio size and composition, amount of and trend regarding delinquent and non-accrual loans, national and local business conditions, loss experience and an overall evaluation of the quality of the underlying collateral.

The following table sets forth activity in our allowance for loan losses for the periods indicated:

<i>(Dollars in thousands)</i>	<b>Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>
Allowance at beginning of period	\$ 8,590	\$ 7,905
Provision for loan losses	1,455	321
Charge offs:		
Real estate:		
Commercial	6	-
Residential	-	-
Construction and land development	-	-
Commercial	61	-
Consumer	26	18
Total charge-offs	<u>93</u>	<u>18</u>
Recoveries:		
Real estate:		
Commercial	-	-
Residential	-	12
Construction and land development	-	-
Commercial	-	1
Consumer	-	10
Total recoveries	<u>-</u>	<u>23</u>
Net charge-offs (recoveries)	<u>93</u>	<u>(5)</u>
Allowance at end of period	<u>\$ 9,952</u>	<u>\$ 8,231</u>
Non-performing loans at end of period	\$ 4,234	\$ 1,369
Total loans outstanding at end of period (1)	712,037	588,108
Average loans outstanding during the period (1)	661,815	567,235
Allowance to non-performing loans	235.05%	601.24%
Allowance to total loans outstanding at end of period	1.40%	1.40%
Net charge-offs (recoveries) to average loans outstanding during the during the period (annualized)	0.03%	(0.00%)

(1) Loans are presented before the allowance for loan losses but include deferred fees/costs

## Results of Operations for the Three Months Ended June 30, 2017 and 2016

**General.** Net income increased \$238,000 to \$1.6 million for the three months ended June 30, 2017 from \$1.4 million for the three months ended June 30, 2016. The increase was related to an increase of \$1.6 million in net interest and dividend income and a \$103,000 increase in noninterest income, partially offset by an increase in provision for loan losses of \$682,000 and an increase in noninterest expense of \$795,000.

**Interest and Dividend Income.** Interest and dividend income, which includes Federal Home Loan Bank stock dividends, increased \$1.8 million, or 25.5%, to \$8.8 million for the three months ended June 30, 2017 from \$7.0 million for the three months ended June 30, 2016. This was primarily attributable to an increase in interest and fees on loans, which increased \$1.8 million, or 28.4%, to \$7.9 million for the three months ended June 30, 2017 from \$6.2 million for the three months ended June 30, 2016.

The increase in interest income on loans was due to an increase in the average balance of loans of \$107.7 million, or 18.9%, to \$677.3 million for the three months ended June 30, 2017 from \$569.6 million for the three months ended June 30, 2016. Yield on loans also increased 35 basis points to 4.67% for the three months ended June 30, 2017 due to our continued focus on higher-yielding commercial lending.

**Interest Expense.** Interest expense increased \$198,000, or 29.1%, to \$879,000 for the three months ended June 30, 2017 from \$681,000 for the three months ended June 30, 2016, caused by an increase in interest expense on deposits and on borrowings. Interest expense on deposits increased \$149,000, or 28.2%, to \$678,000 for the three months ended June 30, 2017 from \$529,000 for the three months ended June 30, 2016, as the average rate paid on interest-bearing deposits increased five basis points to 0.53% for the three months ended June 30, 2017 from 0.48% for the three months ended June 30, 2016. The increase in the average rate was primarily the result of increases in the average rate paid on money market accounts and certificates of deposit. The average rate paid on money market accounts and certificates of deposit increased due to rises in the rate environment. The average balance of interest-bearing deposits increased \$72.3 million, or 16.4%, to \$511.8 million for the three months ended June 30, 2017 from \$439.5 million for the three months ended June 30, 2016. The increase resulted primarily from an increase in the average balance of money market accounts, which increased \$46.5 million, or 42.6%, and an increase in the average balance of certificates of deposit, which increased \$14.1 million, or 12.2%.

Interest expense on borrowings increased \$49,000, or 32.2%, to \$201,000 for the three months ended June 30, 2017 from \$152,000 for the three months ended June 30, 2016. The interest expense on borrowings increased due to the increase in average outstanding balances of \$18.6 million, or 53.4% to \$53.5 million for the three months ended June 30, 2017. The increase in the average outstanding balance was partially offset by a 24 basis point decrease in the cost of borrowing to 1.50% for the three months ended June 30, 2017. The average balance in borrowings increased during the three months ended June 30, 2017 to aid in funding the loan growth.

**Net Interest and Dividend Income.** Net interest and dividend income increased \$1.6 million, or 25.1%, to \$7.9 million for the three months ended June 30, 2017 from \$6.3 million for the three months ended June 30, 2016. The increase was due to both higher balances of earning assets, earning liabilities and expanding margins. Our net interest rate spread increased 32 basis points to 3.75% for the three months ended June 30, 2017 from 3.43% for the three months ended June 30, 2016. Our net interest margin increased 32 basis points to 3.94% for the three months ended June 30, 2017 from 3.62% for the three months ended June 30, 2016. The average yield we earned on interest-earning assets increased 38 basis points to 4.38% and the average rate paid on interest-bearing liabilities increased five basis points to 0.62%.

**Provision for Loan Losses.** The provision for loan losses was \$892,000 for the three months ended June 30, 2017 compared to \$210,000 for the three months ended June 30, 2016. The provision recorded resulted in an allowance for loan losses of \$10.0 million, or 1.40% of total loans at June 30, 2017, compared to \$8.6 million, or 1.36% of total loans, at December 31, 2016 and \$8.2 million, or 1.40% of total loans, at June 30, 2016. The provision for the three months ended June 30, 2017 resulted primarily from an increase in the loan portfolio as we apply historical loss ratios to newly originated loans, which, absent other factors, results in an increase in the allowance for loan losses as the loan portfolio increases.

**Noninterest Income.** Noninterest income increased \$103,000, or 10.7%, to \$1.1 million for the three months ended June 30, 2017 from \$967,000 for the three months ended June 30, 2016. The increase was primarily caused by an increase in the gain on sales of securities and an increase in income from service fees. Gains on sales of securities increased \$41,000, or 241.2%, to \$58,000 for the three months ended June 30, 2017 from \$17,000 for the three months ended June 30, 2016. Income from service fees increased \$54,000, or 18.5%, to \$346,000 for the three months ended June 30, 2017 from \$292,000 for the three months ended June 30, 2016. Service fees increased due to an increase in deposits.

**Noninterest Expense.** Noninterest expense increased \$795,000, or 15.6%, to \$5.9 million for the three months ended June 30, 2017 from \$5.1 million for the three months ended June 30, 2016. The largest increases were related to the salaries and employee benefits expense, marketing expense, and other expense. The increase in salary and employee benefits of \$568,000, or 18.0%, to \$3.7 million for the three months ended June 30, 2017 from \$3.2 million for the three months ended June 30, 2016 was primarily related to an increased employee base and stock-based compensation expense compared to no stock based compensation expense in the prior year. The marketing expense increased \$49,000, or 96.1%, to \$100,000 for the three months ended June 30, 2017 from \$51,000 for the three months ended June 30, 2016. The primary reason the marketing expense increased was due to strategic target marketing within the Company's footprint. The increase in other expense of \$262,000, or 36.6%, to \$977,000 for the three months ended June 30, 2017 from \$715,000 for the three months ended June 30, 2016 was primarily related to an increase in software expense and the directors' stock-based compensation. The noninterest expense increases were partially offset by decreases in professional fees and the FDIC assessment expense. The decrease in professional fees of \$98,000, or 31.3%, to \$215,000 for the three months ended June 30, 2017 from \$313,000 for the three months ended June 30, 2016 was due to one-time services incurred in 2016. The decrease in the FDIC assessment expense was \$23,000, or 24.0%, to \$73,000 for the three months ended June 30, 2017 from \$96,000 for the three months ended June 30, 2016. The decrease was related to a change in the FDIC reserve calculation.

**Income Tax Provision.** We recorded a provision for income taxes of \$639,000 for the three months ended June 30, 2017, reflecting an effective tax rate of 28.5%, compared to a provision of \$659,000 for the three months ended June 30, 2016, reflecting an effective tax rate of 32.6%. The changes in the income tax provision were primarily due to the purchase of tax credits in 2017. Our effective tax rates are below statutory federal and state rates due primarily to tax-exempt income related to investments in bank owned life insurance and municipal securities.

**Average Balance Sheet and Related Yields and Rates**

The following tables set forth the average balance sheets, annualized average yields and costs, and certain other information for the periods indicated. No tax-equivalent yield adjustments have been made, as the amount of tax free interest-earning assets is immaterial. All average balances are daily average balances. Non-accrual loans were included in the computation of average balances. The yields set forth below include the effect of deferred fees, discounts, and premiums that are amortized or accreted to interest income or interest expense.

	For the Three Months Ended June 30,					
	2017			2016		
	Average Balance	Interest Earned/ Paid	Yield/ Rate	Average Balance	Interest Earned/ Paid	Yield/ Rate
<i>(Dollars in thousands)</i>						
<b>Assets:</b>						
Interest-earning assets:						
Loans	\$ 677,321	\$ 7,911	4.67%	\$ 569,648	\$ 6,159	4.32%
Interest-earning deposits	1,623	3	0.74%	6,327	6	0.38%
Investment securities	124,185	867	2.79%	123,316	834	2.71%
Federal Home Loan Bank stock	2,791	35	5.02%	2,465	27	4.38%
Total interest-earning assets	805,920	8,816	4.38%	701,756	7,026	4.00%
Non-interest earning assets	43,245			39,884		
Total assets	\$ 849,165			\$ 741,640		
Interest-bearing liabilities:						
Savings accounts	\$ 114,111	50	0.18%	\$ 105,986	42	0.16%
Money market accounts	155,657	151	0.39%	109,193	71	0.26%
NOW accounts	112,072	167	0.60%	108,466	166	0.61%
Certificates of deposit	129,935	310	0.95%	115,847	250	0.86%
Total interest-bearing deposits	511,775	678	0.53%	439,492	529	0.48%
Federal Home Loan Bank advances	53,501	201	1.50%	34,884	152	1.74%
Total interest-bearing liabilities	565,276	879	0.62%	474,376	681	0.57%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	163,297			155,408		
Other noninterest-bearing liabilities	7,792			6,955		
Total liabilities	736,365			636,739		
Total equity	112,800			104,901		
Total liabilities and equity	\$ 849,165			\$ 741,640		
Net interest income		\$ 7,937			\$ 6,345	
Interest rate spread (1)			3.75%			3.43%
Net interest-earning assets (2)	\$ 240,644			\$ 227,380		
Net interest margin (3)			3.94%			3.62%
Average interest-earning assets to interest-bearing liabilities	142.57%			147.93%		

- (1) Net interest rate spread represents the difference between the weighted average yield on interest-bearing assets and the weighted average rate of interest-bearing liabilities.
- (2) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.
- (3) Net interest margin represents net interest income divided by average total interest-earning assets

**Rate/Volume Analysis**

The following table sets forth the effects of changing rates and volumes on our net interest income. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effect attributable to changes in volume (changes in volume multiplied by prior rate). The total column represents the sum of the prior columns. For purposes of this table, changes attributable to changes in both rate and volume that cannot be segregated have been allocated proportionately based on the changes due to rate and the changes due to volume.

	<b>For the Three Months Ended June 30, 2017</b>		
	<b>Compared to the Three Months Ended June 30, 2016</b>		<b>Total</b>
	<b>Increase (Decrease) Due to</b>		
<b>Rate</b>	<b>Volume</b>		
<i>(In thousands)</i>			
<b>Interest-earning assets:</b>			
Loans	\$ 522	\$ 1,230	\$ 1,752
Interest-earning deposits	3	(6)	(3)
Investment securities	27	6	33
Federal Home Loan Bank stock	4	4	8
<b>Total interest-earning assets</b>	<b>556</b>	<b>1,234</b>	<b>1,790</b>
<b>Interest-bearing liabilities:</b>			
Savings accounts	5	3	8
Money Market accounts	43	37	80
Now accounts	(4)	5	1
Certificates of deposit	28	32	60
<b>Total interest-bearing deposits</b>	<b>71</b>	<b>78</b>	<b>149</b>
Federal Home Loan Bank advances	(23)	72	49
<b>Total interest-bearing liabilities</b>	<b>48</b>	<b>150</b>	<b>198</b>
<b>Change in net interest income</b>	<b>\$ 508</b>	<b>\$ 1,084</b>	<b>\$ 1,592</b>

## Results of Operations for the Six Months Ended June 30, 2017 and 2016

**General.** Net income increased \$553,000 to \$3.4 million for the six months ended June 30, 2017 from \$2.9 million for the six months ended June 30, 2016. The increase was related to an increase of \$2.6 million in net interest income and a \$669,000 increase in noninterest income, partially offset by an increase in provision for loan losses of \$1.1 million and an increase in noninterest expense of \$1.5 million.

**Interest and Dividend Income.** Interest and dividend income, which includes Federal Home Loan Bank stock dividends, increased \$2.9 million, or 20.9%, to \$16.9 million for the six months ended June 30, 2017 from \$14.0 million for the six months ended June 30, 2016. This was primarily attributable to an increase in interest and fees on loans, which increased \$2.9 million, or 23.6%, to \$15.1 million for the six months ended June 30, 2017 from \$12.3 million for the six months ended June 30, 2016.

The increase in interest income on loans was due to an increase in the average balance of loans of \$94.6 million, or 16.7%, to \$661.8 million for the six months ended June 30, 2017 from \$567.2 million for the six months ended June 30, 2016. Yield on loans also increased 26 basis points to 4.58% for the six months ended June 30, 2017 due to our continued focus on higher-yielding commercial lending.

**Interest Expense.** Interest expense increased \$281,000, or 20.4%, to \$1.7 million for the six months ended June 30, 2017 from \$1.4 million for the six months ended June 30, 2016, caused by an increase in interest expense on deposits and on borrowings. Interest expense on deposits increased \$164,000, or 15.1%, to \$1.2 million for the six months ended June 30, 2017 from \$1.1 million for the six months ended June 30, 2016, as the average rate paid on interest-bearing deposits increased one basis point to 0.50% for the six months ended June 30, 2017 from 0.49% for the six months ended June 30, 2016. The increase in the average rate was primarily the result of increases in the average rate paid on money market accounts. The average rate paid on money market accounts increased due to rises in the rate environment. The average balance of interest-bearing deposits increased \$54.9 million, or 12.4%, to \$498.6 million for the six months ended June 30, 2017 from \$443.7 million for the six months ended June 30, 2016. The increase resulted primarily from an increase in the average balance of money market accounts, which increased \$44.0 million, or 40.5%, and an increase in the average balance of savings accounts, which increased \$9.7 million, or 9.1%.

Interest expense on borrowings increased \$117,000, or 39.8%, to \$411,000 for the six months ended June 30, 2017 from \$294,000 for the six months ended June 30, 2016. The interest expense on borrowings increased due to the increase in average outstanding balances of \$22.7 million, or 65.0% to \$57.5 million for the six months ended June 30, 2017. The increase in the average outstanding balance was partially offset by the cost decrease of 26 basis points to 1.43% for the six months ended June 30, 2017 due to restructuring borrowings at a lower interest rate. The average balance in borrowings increased during the six months ended June 30, 2017 to aid in funding the loan growth.

**Net Interest and Dividend Income.** Net interest and dividend income increased \$2.6 million, or 20.9%, to \$15.3 million for the six months ended June 30, 2017 from \$12.6 million for the six months ended June 30, 2016. The increase was due to both higher balances of earning assets and expanding margins. Our net interest rate spread increased 27 basis points to 3.69% for the six months ended June 30, 2017 from 3.42% for the six months ended June 30, 2016. Our net interest margin increased 26 basis points to 3.86% for the six months ended June 30, 2017 from 3.60% for the six months ended June 30, 2016. The average yield we earned on interest-earning assets increased 28 basis points to 4.28% and the average rate paid on interest-bearing liabilities increased two basis points to 0.60%.

**Provision for Loan Losses.** The provision for loan losses was \$1.5 million for the six months ended June 30, 2017 compared to \$321,000 for the six months ended June 30, 2016. The provision recorded resulted in an allowance for loan losses of \$10.0 million, or 1.40% of total loans at June 30, 2017, compared to \$8.6 million, or 1.36% of total loans, at December 31, 2016 and \$8.2 million, or 1.40% of total loans, at June 30, 2016. The provision for the six months ended June 30, 2017 resulted primarily from an increase in the loan portfolio as we apply historical loss ratios to newly originated loans, which, absent other factors, results in an increase in the allowance for loan losses as the loan portfolio increases.



**Noninterest Income.** Noninterest income increased \$669,000, or 35.2%, to \$2.6 million for the six months ended June 30, 2017 from \$1.9 million for the six months ended June 30, 2016. The increase was primarily caused by an increase in the gain on sales of marketable equity securities and an increase in income from service fees. Gains on sales of securities increased \$503,000 to \$540,000 for the six months ended June 30, 2017 from \$37,000 for the six months ended June 30, 2016. Income from service fees increased \$87,000, or 14.6%, to \$684,000 for the six months ended June 30, 2017 from \$597,000 for the six months ended June 30, 2016.

**Noninterest Expense.** Noninterest expense increased \$1.5 million, or 14.9%, to \$11.5 million for the six months ended June 30, 2017 from \$10.0 million for the six months ended June 30, 2016. The largest increases were related to the salaries and employee benefits expense, marketing expense, occupancy expense and other expense. The increase in salary and employee benefits of \$1.1 million, or 17.9%, to \$7.4 million for the six months ended June 30, 2017 from \$6.3 million for the six months ended June 30, 2016 was primarily related to an increased employee base and an increase in stock-based compensation expense in 2017 compared to 2016. The marketing expense increased \$42,000, or 38.9%, to \$150,000 for the six months ended June 30, 2017 from \$108,000 for the six months ended June 30, 2016. The primary reason the marketing expense increased was due to strategic target marketing within the Company's footprint. Occupancy expense increased \$139,000, or 17.8%, to \$921,000 for the six months ended June 30, 2017 from \$782,000 for the six months ended June 30, 2016. The primary reason occupancy expense increased was maintenance expenses related to the purchase of the Portsmouth, New Hampshire building. The increase in other expense of \$351,000, or 24.6%, to \$1.8 million for the six months ended June 30, 2017 from \$1.4 million for the six months ended June 30, 2016 was primarily related to increase in software expense and the directors' stock-based compensation. The noninterest expense increases were partially offset by decreases in professional fees and the FDIC assessment expense. The decrease in professional fees of \$149,000, or 25.8%, to \$429,000 for the six months ended June 30, 2017 from \$578,000 for the six months ended June 30, 2016 was due to one-time services incurred in 2016. The decrease in the FDIC assessment expense was \$49,000, or 25.8%, to \$141,000 for the six months ended June 30, 2017 from \$190,000 for the six months ended June 30, 2016. The decrease was related to a change in the FDIC reserve calculation.

**Income Tax Provision.** We recorded a provision for income taxes of \$1.5 million for the six months ended June 30, 2017, reflecting an effective tax rate of 30.4%, compared to a provision of \$1.4 million for the six months ended June 30, 2016, reflecting an effective tax rate of 32.2%. The changes in the income tax provision were primarily due to the purchase of tax credits in 2017. Our effective tax rates are below statutory federal and state rates due primarily to tax-exempt income related to investments in bank owned life insurance and municipal securities.

### Average Balance Sheet and Related Yields and Rates

The following tables set forth the average balance sheets, annualized average yields and costs, and certain other information for the periods indicated. No tax-equivalent yield adjustments have been made, as the amount of tax free interest-earning assets is immaterial. All average balances are daily average balances. Non-accrual loans were included in the computation of average balances. The yields set forth below include the effect of deferred fees, discounts, and premiums that are amortized or accreted to interest income or interest expense.

	For the Six Months Ended June 30,					
	2017			2016		
(dollars in thousands)	Average Balance	Interest Earned/ Paid	Yield/ Rate	Average Balance	Interest Earned/ Paid	Yield/ Rate
<b>Assets:</b>						
Interest-earning assets:						
Loans	\$ 661,815	\$ 15,144	4.58%	\$ 567,235	\$ 12,250	4.32%
Interest-earning deposits	2,649	9	0.68%	6,954	14	0.40%
Investment securities	122,752	1,714	2.79%	124,056	1,697	2.74%
Federal Home Loan Bank stock	3,149	61	3.87%	2,727	45	3.30%
Total interest-earning assets	790,365	16,928	4.28%	700,972	14,006	4.00%
Non-interest earning assets	45,760			39,569		
Total assets	\$ 836,125			\$ 740,541		
Interest-bearing liabilities:						
Savings accounts	\$ 116,192	109	0.19%	\$ 106,525	85	0.16%
Money market accounts	152,618	277	0.36%	108,613	142	0.26%
NOW accounts	113,294	334	0.59%	109,504	319	0.58%
Certificates of deposit	116,485	528	0.91%	119,052	538	0.90%
Total interest-bearing deposits	498,589	1,248	0.50%	443,694	1,084	0.49%
Federal Home Loan Bank advances	57,527	411	1.43%	34,864	294	1.69%
Total interest-bearing liabilities	556,116	1,659	0.60%	478,558	1,378	0.58%
Noninterest-bearing liabilities:						
Noninterest-bearing deposits	157,442			151,502		
Other noninterest-bearing liabilities	7,961			6,840		
Total liabilities	721,519			636,900		
Total equity	114,606			103,641		
Total liabilities and equity	\$ 836,125			\$ 740,541		
Net interest income		\$ 15,269			\$ 12,628	
Interest rate spread (1)			3.69%			3.42%
Net interest-earning assets (2)	\$ 234,249			\$ 222,414		
Net interest margin (3)			3.86%			3.60%
Average interest-earning assets to interest-bearing liabilities	142.12%			146.48%		

- (1) Net interest rate spread represents the difference between the weighted average yield on interest-bearing assets and the weighted average rate of interest-bearing liabilities.
- (2) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.
- (3) Net interest margin represents net interest income divided by average total interest-earning assets

**Rate/Volume Analysis**

The following table sets forth the effects of changing rates and volumes on our net interest income. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effect attributable to changes in volume (changes in volume multiplied by prior rate). The total column represents the sum of the prior columns. For purposes of this table, changes attributable to changes in both rate and volume that cannot be segregated have been allocated proportionately based on the changes due to rate and the changes due to volume.

	<b>For the Six Months Ended June 30, 2017 Compared to the Six Months Ended June 30, 2016</b>		
	<b>Increase (Decrease) Due to</b>		<b>Total</b>
	<b>Rate</b>	<b>Volume</b>	<b>Increase (Decrease)</b>
<i>(in thousands)</i>			
<b>Interest-earning assets:</b>			
Loans	\$ 762	\$ 2,132	\$ 2,894
Interest-earning deposits	6	(11)	(5)
Investment securities	35	(18)	17
Federal Home Loan Bank stock	8	8	16
<b>Total interest-earning assets</b>	<b>811</b>	<b>2,111</b>	<b>2,922</b>
<b>Interest-bearing liabilities:</b>			
Savings accounts	16	8	24
Money Market accounts	66	69	135
Now accounts	4	11	15
Certificates of deposit	2	(12)	(10)
<b>Total interest-bearing deposits</b>	<b>88</b>	<b>76</b>	<b>164</b>
Federal Home Loan Bank advances	(50)	167	117
<b>Total interest-bearing liabilities</b>	<b>38</b>	<b>243</b>	<b>281</b>
<b>Change in net interest income</b>	<b>\$ 773</b>	<b>\$ 1,868</b>	<b>\$ 2,641</b>

## **Liquidity and Capital Resources**

Liquidity is the ability to meet current and future financial obligations of a short-term nature. Our primary sources of funds consist of deposit inflows, loan repayments and maturities, and sales of securities. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition.

We regularly review the need to adjust our investments in liquid assets based upon our assessment of: (1) expected loan demand, (2) expected deposit flows, (3) yields available on interest-earning deposits and securities, and (4) the objectives of our asset/liability management program. Excess liquid assets are invested generally in interest-earning deposits and short- and intermediate-term securities.

Our most liquid assets are cash and cash equivalents. The levels of these assets are dependent on our operating, financing, lending and investing activities during any given period. At June 30, 2017, cash and cash equivalents totaled \$11.9 million. Securities classified as available-for-sale, which provide additional sources of liquidity, totaled \$123.1 million at June 30, 2017.

At June 30, 2017, we had the ability to borrow a total of \$184.2 million from the Federal Home Loan Bank of Boston. On that date, we had \$60.1 million in advances outstanding. At June 30, 2017, we also had an available line of credit with the Federal Reserve Bank of Boston's borrower-in-custody program of \$176.2 million, none of which was outstanding as of that date.

We have no material commitments or demands that are likely to affect our liquidity other than set forth below. In the event loan demand were to increase faster than expected, or any unforeseen demand or commitment were to occur, we could access our borrowing capacity with the Federal Home Loan Bank of Boston or obtain additional funds through brokered certificates of deposit.

At June 30, 2017 and December 31, 2016, we had \$4.6 million and \$25.4 million in loan commitments outstanding, respectively. In addition to commitments to originate loans, at June 30, 2017 and December 31, 2016, we had \$158.9 million and \$202.0 million in unadvanced funds to borrowers, respectively. We also had \$3.5 million and \$5.2 million in outstanding letters of credit at June 30, 2017 and December 31, 2016, respectively.

Certificates of deposit due within one year of June 30, 2017 totaled \$97.1 million, or 13.8% of total deposits. If these deposits do not remain with us, we will be required to seek other sources of funds, including other certificates of deposit and Federal Home Loan Bank of Boston advances. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit at June 30, 2017. We believe, however, based on past experience that a significant portion of our certificates of deposit will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

Our primary investing activities are the origination of loans and the purchase of securities. During the six months ended June 30, 2017, we originated \$135.2 million of loans, all of which were intended to be held in our portfolio. We also purchased \$11.3 million in loans and \$12.5 million in securities. During the six months ended June 30, 2016, we originated \$89.8 million of loans, all of which were intended to be held in our portfolio, and we did not purchase any loans. We also purchased \$369,000 in securities during the six months ended June 30, 2016.

Financing activities consist primarily of activity in deposit accounts and Federal Home Loan Bank advances. We experienced net increases in total deposits of \$73.4 million and \$30.1 million for the six months ended June 30, 2017 and 2016, respectively. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by us and our local competitors and other factors. We generally manage the pricing of our deposits to be competitive. Federal Home Loan Bank advances increased \$27.2 million and \$9.5 million during the three months ended June 30, 2017 and 2016, respectively.

The Provident Bank is subject to various regulatory capital requirements administered by the Massachusetts Commissioner of Banks and the Federal Deposit Insurance Corporation. At June 30, 2017, The Provident Bank exceeded all applicable regulatory capital requirements, and was considered “well capitalized” under regulatory guidelines. See Note 9 of the Notes to the Unaudited Consolidated Financial Statements for additional information.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Not applicable, as the Company is a smaller reporting company.

**Item 4. Controls and Procedures**

An evaluation was performed under the supervision and with the participation of the Company’s management, including the President and Chief Executive Officer and the Executive Vice President and Chief Financial Officer, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended) as of June 30, 2017. Based on that evaluation, the Company’s management, including the President and Chief Executive Officer and the Executive Vice President and Chief Financial Officer, concluded that the Company’s disclosure controls and procedures were effective.

During the quarter ended June 30, 2017, there have been no changes in the Company’s internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

**Part II – Other Information**

**Item 1. Legal Proceedings**

The Company is subject to various legal actions arising in the normal course of business. In the opinion of management, the resolution of these legal actions is not expected to have a material adverse effect on the Company’s financial condition or results of operations.

**Item 1A. Risk Factors**

Not applicable, as the Company is a smaller reporting company.

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

- (a) Not applicable.
- (b) Not applicable.
- (c) The Company's repurchases of common stock for the three months ended June 30, 2017 were as follows:

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1)</b>
April 1, 2017 through April 30, 2017	-	\$ -	-	613,555
May 1, 2017 through May 31, 2017	6,500	\$ 20.73	6,500	607,055
June 1, 2017 through June 30, 2017	1,200	\$ 20.81	1,200	605,855
Total	7,700	\$ 20.74	7,700	

(1) On January 26, 2017, the Company announced a repurchase program under which it would repurchase up to 6.6% of the then-outstanding shares of the Company's common stock (625,015 shares) from time to time, depending on market conditions. The repurchase program would continue until it is completed or terminated by the Company's Board of Directors.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

- 3.1 Amended and Restated Articles of Organization of Provident Bancorp, Inc. (1)
- 3.2 By-Laws of Provident Bancorp, Inc. (1)
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101 The following financial statements from the Provident Bancorp, Inc. Quarterly Report on Form 10-Q for the quarter ended June 30, 2017, formatted in Extensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Income; (iii) Consolidated Statements of Comprehensive Income; (iv) Consolidated Statements of Changes in Shareholders' Equity; (v) Consolidated Statements of Cash Flows; and (vi) Notes to Unaudited Consolidated Financial Statements.

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(1) Incorporated by reference to the Company's Registration Statement on Form S-1 (file no. 333-202716), initially filed with the Securities and Exchange Commission on March 13, 2015.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**PROVIDENT BANCORP, INC.**

Date: August 11, 2017

/s/ David P. Mansfield  
David P. Mansfield  
President and Chief Executive Officer

Date: August 11, 2017

/s/ Carol L. Houle  
Carol L. Houle  
Executive Vice President and Chief Financial Officer

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## **Section 2: EX-31.1 (EXHIBIT 31.1)**

### **Exhibit 31.1**

#### **Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, David P. Mansfield, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Provident Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 11, 2017

/s/ David P. Mansfield  
David P. Mansfield  
President and Chief Executive Officer

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## Section 3: EX-31.2 (EXHIBIT 31.2)

### Exhibit 31.2

#### Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Carol L. Houle, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Provident Bancorp, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 11, 2017

/s/ Carol L. Houle

Carol L. Houle

Executive Vice President and Chief Financial Officer

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## Section 4: EX-32 (EXHIBIT 32)

### Exhibit 32

#### Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

David P. Mansfield, President and Chief Executive Officer of Provident Bancorp, Inc. (the "Company"), and Carol L. Houle, Executive Vice President and Chief Financial Officer of the Company, each certify in his or her capacity as an officer of the Company that they have reviewed the quarterly report on Form 10-Q for the quarter ended June 30, 2017 (the "Report") and that to the best of their knowledge:

1. the Report fully complies with the requirements of Sections 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 11, 2017

/s/ David P. Mansfield

David P. Mansfield

President and Chief Executive Officer

Date: August 11, 2017

/s/ Carol L. Houle

Carol L. Houle

Executive Vice President and Chief Financial Officer



A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

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