Board of Governors of the Federal Reserve System

Annual Report of Holding Companies—FR Y-6

Report at the close of business as of the end of fiscal year

This Report is required by law: Section 5(c)(1)(A) of the Bank Holding Company Act (12 U.S.C. § 1844(c)(1)(A)); sections 8(a) and 13(a) of the International Banking Act (12 U.S.C. §§ 3106(a) and 3108(a)); sections 11(a)(1), 25, and 25A of the Federal Reserve Act (12 U.S.C. §§ 248(a)(1), 602, and 611a); and sections 113, 165, 312, 618, and 809 of the Dodd-Frank Act (12 U.S.C. §§ 5361, 5365, 5412, 1850a(c)(1), and 5468(b)(1)). Return to the appropriate Federal Reserve Bank the original and the number of copies specified.

This report form is to be filed by all top-tier bank holding companies, top-tier savings and loan holding companies, and U.S. intermediate holding companies organized under U.S. law, and by any foreign banking organization that does not meet the requirements of and is not treated as a qualifying foreign banking organization under Section 211.23 of Regulation K (12 C.F.R. § 211.23). (See page one of the general instructions for more detail of who must file.) The Federal Reserve may not conduct or sponsor, and an organization (or a person) is not required to respond to, an information collection unless it displays a currently valid OMB control number.

NOTE: The *Annual Report of Holding Companies* must be signed by one director of the top-tier holding company. This individual should also be a senior official of the top-tier holding company. In the event that the top-tier holding company does not have an individual who is a senior official and is also a director, the chairman of the board must sign the report. If the holding company is an ESOP/ESOT formed as a corporation or is an LLC, see the General Instructions for the authorized individual who must sign the report.

I, Charolette Vermillion
Name of the Holding Company Director and Official

Vice Chairperson & Interim CEO
Title of the Holding Company Director and Official

attest that the *Annual Report of Holding Companies* (including the supporting attachments) for this report date has been prepared in conformance with the instructions issued by the Federal Reserve System and are true and correct to the best of my knowledge and belief.

With respect to information regarding individuals contained in this report, the Reporter certifies that it has the authority to provide this information to the Federal Reserve. The Reporter also certifies that it has the authority, on behalf of each individual, to consent or object to public release of information regarding that individual. The Federal Reserve may assume, in the absence of a request for confidential treatment submitted in accordance with the Board's "Rules Regarding Availability of Information," 12 C.F.R. Part 261, that the Reporter and individual consent to public release of all details in the report concerning that individual.

Charolette Vermillion, Vice-Chairman
Signature of Holding Company Director and Official

March 25, 2020
Date of Signature

For holding companies not registered with the SEC–
Indicate status of Annual Report to Shareholders:
- [x] is included with the FR Y-6 report
- [ ] will be sent under separate cover
- [ ] is not prepared

For Federal Reserve Bank Use Only

RSSD ID ____________
C.I. ____________

Date of Report (top-tier holding company's fiscal year-end):
December 31, 2019
Month / Day / Year

N/A
Reporter's Legal Entity Identifier (LEI) (20-Character LEI Code)

Reporter's Name, Street, and Mailing Address

Commonwealth Holdings, L.L.C.
Legal Title of Holding Company

PO Box 357
(Mailing Address of the Holding Company) Street / P.O. Box

City	State	Zip Code
Burlington	KY	41005

2221 Beil Street Burlington, KY 41005
Physical Location (if different from mailing address)

Person to whom questions about this report should be directed:

Name	Title
Craig Liechty	CFO

859-334-4211
Area Code / Phone Number / Extension

859-586-9240
Area Code / FAX Number

c.liechty@ourheritage.bank
E-mail Address

N/A
Address (URL) for the Holding Company's web page

Is confidential treatment requested for any portion of this report submission? (0=No, 1=Yes) 0

In accordance with the General Instructions for this report (check only one),

1. a letter justifying this request is being provided along with the report ☐
2. a letter justifying this request has been provided separately ... ☐

NOTE: Information for which confidential treatment is being requested must be provided separately and labeled as "confidential."

Public reporting burden for this information collection is estimated to vary from 1.3 to 101 hours per response, with an average of 5.50 hours per response, including time to gather and maintain data in the required form and to review instructions and complete the information collection. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551, and to the Office of Management and Budget, Paperwork Reduction Project (7100-0297), Washington, DC 20503.

For Use By Tiered Holding Companies

Top-tiered holding companies must list the names, mailing address, and physical locations of each of their subsidiary holding companies below.

Heritage Bancorp, Inc.
Legal Ti le of Subsidiary Holding Company

PO Box 357
(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

Burlington	KY	41005
City	State	Zip Code

1818 Florence Pike Burlington, KY 41005
Physical Location (if different from mailing address)

Legal Ti le of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

Legal Ti le of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

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(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

ANNUAL REPORT OF BANK HOLDING COMPANIES-FR Y-6
COMMONWEALTH HOLDINGS LLC
BURLINGTON, KY
FISCAL YEAR ENDING DECEMBER 31, 2019

Report Item 1:

Annual reports – not prepared in normal course of business for Commonwealth Holdings, LLC
Annual Reports – Heritage Bancorp, Inc.- financial statements enclosed

Report Item 2a: Organizational Chart

(LEI Code Not Applicable Unless Noted)

Commonwealth Holdings, LLC
Burlington, Kentucky
Incorporated in Kentucky

Heritage Bancorp, Inc.
Burlington, Kentucky
Incorporated in Kentucky
33% Owned

Heritage Bank, Inc.
Erlanger, Kentucky
Incorporated in Kentucky
Wholly-Owned 100%

Heritage Investcorp, Inc.
Burlington, Kentucky
Incorporated in Kentucky
Wholly-Owned 100%

Report Item 2b: Domestic Branch Listing: emailed to Structure.CLEV@clev.feb.org

Report Item 3(1): Shareholders currently owning greater than or equal to 5% outstanding shares of Commonwealth Holdings, LLC.

<u>Arnold E. Caddell Family Trust</u>
Burlington, Kentucky
USA
# of Common Shares- 129,986
% of Common Shares – 100%

Report Item 3 (1) Shareholders currently owning greater than or equal to 5% outstanding shares of Heritage Bancorp, Inc.

<u>Commonwealth Holdings, LLC</u>
Burlington, Kentucky
USA
# of Common Shares – 127,721
% of Common Shares – 33%

<u>CAC Properties LLC</u>
Burlington, KY
USA
# of Common Shares – 20,655
% of Common Shares – 5%

<u>Caddell Holding Trust</u>
Burlington, Kentucky
USA
# of Common Shares – 27,400
% of Common Shares - 7%

<u>Robert J. and Jeanette Lightner</u>
Jeanette Lightner – 125 Shares
Robert J. Lightner – 73,760 Shares
Union, Kentucky
USA
# of Common Shares - 73,885
% of Common Shares – 19%

Report Item 3 (2) Shareholders currently owning greater than or equal to 5% outstanding shares of Commonwealth Holdings, L.C.C. not listed in 3 (1).
N/A.

Report Item 3 (2) Shareholders currently owning greater than or equal to 5% outstanding shares of Heritage Bancorp, Inc. not listed in 3 (1).
N/A.

Report Item 4: Commonwealth Holdings, LLC

1. Christopher Caddell
   Florence, Kentucky
   USA

2. N/A

3. (a) CEO & Chairman of the Board
   (b) CEO & Chairman, Heritage Bancorp, Inc.
   CEO & Chairman, Heritage Bank, Inc.
   (c) ACES Properties LLC, Manager
   CAC Properties, LLC, Manager

4. (a) 100%
   (b) Heritage Bancorp, Inc. 33%
   (c) 40% of ACES Properties, LLC
   45% of CAC Properties, LLC

Report Item 4: Heritage Bancorp, Inc.

1. Christopher Caddell
   Florence, Kentucky
   USA

2. N/A

3. (a) CEO & Chairman of the Board
   (b) CEO & Chairman, Heritage Bancorp, Inc.
   CEO & Chairman, Heritage Bank, Inc.
   (c) ACES Properties LLC, Manager
   CAC Properties, LLC, Manager

4. (a) 33%
   (b) N/A
   (c) 40% of ACES Properties, LLC
   45% of CAC Properties, LLC

1. <u>Gary C. Griesser</u>
   Burlington, Kentucky
   USA

2. Motivational Speaker

3. (a) Director
   (b) Director, Heritage Bank, Inc.
   (c) Griesser Music and Motivation, Owner

4. (a) 1%
   (b) N/A
   (c) 100% of Griesser Music and Motivation

1. <u>W Lee Scheben</u>
   Union, Kentucky
   USA

2. N/A

3. (a) President
   (b) President, Heritage Bank Inc
   (c) Grandview Rd, LLC, Manager
   Marshall Rd, LLC, Manager
   Mills Rd, LLC, Member
   Nicholson Development, LLC, Member
   Pond Creek, LLC, Member

Scheben Group, LLC, Member
Scheben Group 2, LLC, Member
Scheben Group 3, LLC, Member
Scheben Group 4, LLC, Member
Scheben Group 5, LLC, Member
Independence Station, LLC, Member

4. (a) N/A
(b) N/A
(c) 25% of Grandview Rd, LLC, Manager
25% of Marshall Rd, LLC, Manager
25% of Mills Rd, LLC, Member
25% of Nicholson Development, LLC, Member
25% of Pond Creek, LLC, Member
25% of Scheben Group, LLC, Member
28% of Scheben Group 2, LLC, Member
28% of Scheben Group 3, LLC, Member
28% of Scheben Group 4, LLC, Member
28% of Scheben Group 5, LLC, Member
25% of Independence Station, LLC, Member

1. Larry S. Burcham
Burlington, Kentucky
USA

2. Real Estate Broker/Auctioneer/Appraiser

3. (a) Director
(b) Director, Heritage Bank, Inc.
(c) Clore & Burcham, Inc., President

4. (a) 1%
(b) N/A
(c) 100% Clore & Burcham, Inc., President

1. Verne Epperson
Florence, Kentucky
USA

2. Retired

3. (a) Director
(b) Director, Heritage Bank, Inc.
(c) N/A

4. (a) 3%

(b) N/A
(c) N/A

1. Robert J. Lightner
Union, Kentucky
USA

2. Insurance

3. (a) Director
(b) Director, Heritage Bank, Inc.
(c) C.M.I., President & Chief Executive Officer
CMI P&C, Inc.
Potter's Ranch, Founder/Chairman
R.J.L. Properties, Owner
PV Marine & Powersport, President
AWE, Owner & Co-Founder
LFL Partnership, General Manager
H & L Enterprises, Owner & Co-Founder

4. (a) 19%
(b) N/A
(a) 100% C.M.I.
100% CMI P&C, Inc.
100% Potter's Ranch
100% R.J.L. Properties
100% PV Marine & Powersport
100% AWE
1% LFL Partnership
75% H & L Enterprises

1. Gary Wilmhoff
Florence, Kentucky
USA

2. Retail

3. (a) Director
(b) Director, Heritage Bank, Inc.
(c) Wilmhoff Development, Partner

4. (a) 1%
(b) N/A
(c) 50% Wilmhoff Development

1. <u>Dan Catalano</u>
   Florence, KY
   USA

2. Manufacturing

3. (a) Director
   (b) Director, Heritage Bank, Inc.
   (c) President and Director, Zotefoams, Inc.
       Director, Zotefoams Midwest, LLC.
       Executive Team, Zotefoams PLC.

4. (a) N/A
   (b) N/A
   (c) N/A

1. <u>Charolette Vermillion</u>
   Florence, KY
   USA

2. N/A

3. (a) Vice Chairperson & Interim CEO
   (b) Vice Chairperson & Interim CEO, Heritage Bank, Inc.
   (c) N/A

4. (a) N/A
   (b) N/A
   (c) N/A

1. <u>Craig Liechty</u>
   Burlington, KY
   USA

2. N/A

3. (a) Chief Financial Officer
   (b) Chief Financial Officer, Heritage Bank, Inc.
   (c) The Liechty Family Agency, LLC, Member

4. (a) N/A
   (b) N/A
   (c) 100% of The Liechty Family Agency, LLC

1. <u>Kevin Mooney</u>
   Warsaw, KY
   USA

2. N/A

3. (a) Chief Operating Officer
   (b) Chief Operating Officer, Heritage Bank, Inc.
   (c) N/A

4. (a) N/A
   (b) N/A
   (c) N/A

Results: A list of branches for your depository institution: HERITAGE BANK, INC. (ID_RSSD: 1469677).
This depository institution is held by COMMONWEALTH HOLDINGS, L.L.C. (2332536) of BURLINGTON, KY.
The data are as of 12/31/2019. Data reflects information that was received and processed through 01/03/2020.

Reconciliation and Verification Steps

1. In the **Data Action** column of each branch row, enter one or more of the actions specified below
2. If required, enter the date in the **Effective Date** column

Actions

OK: If the branch information is correct, enter 'OK' in the **Data Action** column.
Change: If the branch information is incorrect or incomplete, revise the data, enter 'Change' in the **Data Action** column and the date when this information first became valid in the **Effective Date** column.
Close: If a branch listed was sold or closed, enter 'Close' in the **Data Action** column and the sale or closure date in the **Effective Date** column.
Delete: If a branch listed was never owned by this depository institution, enter 'Delete' in the **Data Action** column.
Add: If a reportable branch is missing, insert a row, add the branch data, and enter 'Add' in the **Data Action** column and the opening or acquisition date in the **Effective Date** column.

If printing this list, you may need to adjust your page setup in MS Excel. Try using landscape orientation, page scaling, and/or legal sized paper.

Submission Procedure

When you are finished, send a saved copy to your FRB contact. See the detailed instructions on this site for more information.
If you are e-mailing this to your FRB contact, put your institution name, city and state in the subject line of the e-mail.

Note:
To satisfy the **FR Y-10 reporting requirements**, you must also submit FR Y-10 Domestic Branch Schedules for each branch with a **Data Action** of Change, Close, Delete, or Add.
The FR Y-10 report may be submitted in a hardcopy format or via the FR Y-10 Online application - https://y10online.federalreserve.gov.

* FDIC UNINUM, Office Number, and ID_RSSD columns are for reference only. Verification of these values is not required.

Data Action	Effective Date	Branch Service Type	Branch ID_RSSD*	Popular Name	Street Address	City	State	Zip Code	County	Country	FDIC UNINUM*	Office Number*	Head Office	Head Office ID_RSSD*	Comments
ok		Full Service (Head Office)	1469677	HERITAGE BANK, INC.	456 COMMONWEALTH AVENUE	ERLANGER	KY	41018	KENTON	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
ok		Full Service	4004154	ALEXANDRIA OFFICE BRANCH	7953 ALEXANDRIA PIKE	ALEXANDRIA	KY	41001	CAMPBELL	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
ok		Full Service	3675548	BURLINGTON BRANCH	1818 FLORENCE PIKE	BURLINGTON	KY	41005	BOONE	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
ok		Full Service	799014	BUTLER OFFICE	10499 US 27 NORTH	BUTLER	KY	41006	PENDLETON	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
ok		Full Service	4559195	LATONIA OFFICE	3600 DECOURSEY AVENUE	COVINGTON	KY	41015	KENTON	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
ok		Full Service	3379613	CRESCENT SPRINGS BRANCH	612 BUTTERMILK PIKE	CRESCENT SPRINGS	KY	41017	KENTON	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
ok		Full Service	4115498	DRY RIDGE OFFICE	48 BROADWAY	DRY RIDGE	KY	41035	GRANT	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
ok		Full Service	3839733	FALMOUTH BRANCH	1057 RIDGEWAY AVENUE	FALMOUTH	KY	41040	PENDLETON	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
ok		Full Service	2102878	FLORENCE BRANCH	7434 U.S. 42	FLORENCE	KY	41042	BOONE	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
ok		Full Service	2500205	FORT WRIGHT BRANCH	1911 DIXIE HIGHWAY	FORT WRIGHT	KY	41011	KENTON	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
ok		Full Service	2949251	HEBORN BRANCH	2101 MEDICAL ARTS DR.	HEBRON	KY	41048	BOONE	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
ok		Full Service	2851710	INDEPENDENCE OFFICE	2040 DECLARATION DRIVE	INDEPENDENCE	KY	41051	KENTON	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
ok		Full Service	3675575	COLD SPRING BRANCH	4929 ALEXANDRIA PIKE	NEWPORT	KY	41076	CAMPBELL	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
ok		Full Service	4662385	NEWPORT OFFICE	647 MONMOUTH STREET	NEWPORT	KY	41071	CAMPBELL	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
ok		Full Service	2483504	UNION BRANCH	8751 U.S. 42	UNION	KY	41091	BOONE	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
ok		Full Service	3716414	WALTON BRANCH	235 MARY GRUBBS HIGHWAY	WALTON	KY	41094	BOONE	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
Closed	9/14/2018	Service Center	132219	WALTON SOUTH BRANCH	13447 DIXIE HIGHWAY	WALTON	KY	41094	KENTON	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
ok		Full Service	5283189	WILLIAMSTOWN BRANCH	229 SOUTH MAIN STREET	WILLIAMSTOWN	KY	41097	GRANT	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
ok		Full Service	5206357	MASON BRANCH	6310 TYLERSVILLE ROAD	MASON	OH	45040	WARREN	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	
ok	9/19/2019	Full Service	5426780	MONTGOMERY BRANCH	9749 MONTGOMERY ROAR	BLUE ASH	OH	56353	HAMILTON	UNITED STATES	Not Required	Not Required	HERITAGE BANK, INC.	1469677	

Heritage BANK

Statement of Management's Responsibilities

The management of Heritage Bancorp, Inc. (the "Company") is responsible for preparing the Company's annual financial statements in accordance with generally accepted accounting principles; for establishing and maintaining an adequate internal control structure and procedures for financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the 2019 FR Y-9SP (Parent Company Only Financial Statements for Small Holding Companies) and the 2019 Quarterly Call Reports (FFEIC - Consolidated Reports of Condition and Income for a Bank With Domestic Offices Only); and for complying with the Federal laws and regulations pertaining to insider loans and the Federal and, if applicable, State laws and regulations pertaining to dividend restrictions. The following subsidiary institutions of the Company that are subject to Part 363 are included in this statement of management's responsibilities: Heritage Bank, Inc.

Management's Assessment of Compliance with Designated Laws and Regulations

The management of Heritage Bancorp, Inc. (the "Company") has assessed the Company's compliance with the Federal laws and regulations pertaining to insider loans and the Federal and, if applicable, State laws and regulations pertaining to dividend restrictions during the fiscal year that ended on December 31, 2019. Based upon its assessment, management has concluded that the Company complied with the Federal laws and regulations pertaining to insider loans and the Federal and, if applicable, State laws and regulations pertaining to dividend restrictions during the fiscal year that ended on December 31, 2019. The following subsidiary institutions of the Company that are subject to Part 363 are included in this assessment of compliance with these designated laws and regulations: Heritage Bank, Inc.

Heritage Bancorp, Inc.

Charolette Vermillion

Charolette Vermillion, Vice Chairperson & Interim Chief Executive Officer
Date: March 25, 2020

Craig Liechty, Chief Financial Officer
Date: March 25, 2020

CLARK SCHAEFER HACKETT
CPAS & ADVISORS

One East Fourth Street, Suite 1200, Cincinnati, Ohio 45202
P. 513.241.3111 | F. 513.241.1212 | cshco.com

March 4, 2020

To the Board of Directors
Heritage Bancorp, Inc. and Subsidiary

We have audited the consolidated financial statements of Heritage Bancorp, Inc. and Subsidiary for the year ended December 31, 2019, and have issued our report thereon dated March 4, 2020. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated November 19, 2019. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Matters

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by Heritage Bancorp, Inc. and Subsidiary are described in Note 1 to the consolidated financial statements. As described in Note 1, the Institution changed accounting policies related to Revenue Recognition by adopting FASB Accounting Standards Update No. 606 *Revenue from Contracts with Customers* in 2019. There were no changes to revenue recognition as a result of the adoption of this standard. We noted no transactions entered into by the Institution during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the consolidated financial statements in the proper period.

Accounting estimates are an integral part of the consolidated financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the consolidated financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate affecting the consolidated financial statements was:

> Management's estimate of the allowance for loan loss is based on management's evaluation of the collectability for the loan portfolio, credit concentrations, trends in historical loss experience, specific impaired loans and economic conditions. We evaluated the key factors and assumptions used to develop the allowance for loan losses in determining that it is reasonable in relation to the consolidated financial statements taken as a whole.

The consolidated financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. There are no uncorrected misstatements at December 31, 2019.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the consolidated financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated March 4, 2020.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Institution's consolidated financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Institution's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

This information is intended solely for the use of the Board of Directors and management of Heritage Bancorp, Inc. and Subsidiary and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

Clark, Schaefer, Hackett & Co.

Heritage Bancorp, Inc. and Subsidiary

Consolidated Financial Statements

December 31, 2019 and 2018

(with Independent Auditors' Report)

TABLE OF CONTENTS

One East Fourth Street, Suite 1200, Cincinnati, Ohio 45202
P. 513.241.3111 | F. 513.241.1212 | cshco.com

INDEPENDENT AUDITORS' REPORT

To the Stockholders and
Board of Directors
Heritage Bancorp, Inc.
Burlington, Kentucky

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Heritage Bancorp, Inc., and Subsidiary which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Heritage Bancorp, Inc., and Subsidiary as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Clark, Schaefer, Hackett & Co.

Cincinnati, Ohio
March 4, 2020

Assets

	2019	2018
	(in thousands)	
Cash and cash equivalents:		
Cash and due from banks	$ 87,862	91,232
Federal funds sold	25,143	22,481
	113,005	113,713
Certificates of deposit	1,650	1,650
Investment securities, available for sale at fair value	149,500	130,373
Investment securities, held to maturity at amortized cost	2,416	2,299
Loans, net	667,385	613,517
Interest receivable	2,827	2,390
Other real estate owned	363	1,303
Federal Home Loan Bank stock	3,025	2,388
Bank premises and equipment, net	15,717	14,936
Core deposit intangible, net	19	47
Bank owned life insurance	17,444	13,290
Other assets	1,585	691
Deferred income taxes	1,013	1,693
	$ 975,949	898,290

See accompanying notes to the consolidated financial statements.

Liabilities and Stockholders' Equity

	2019	2018
	(in thousands)	
Deposits:		
Noninterest bearing	$ 210,297	182,029
Interest bearing	643,023	604,705
	853,320	786,734
Securities sold under repurchase agreements	23,931	20,624
Advances from Federal Home Loan Bank	5,457	9,025
Dividends payable	1,278	1,194
Interest payable	1,289	769
Other liabilities	3,780	3,490
	889,055	821,836
Stockholders' equity:		
Common stock; 1,000,000 shares authorized; 388,235 shares issued; 381,477 and 385,030 shares outstanding in 2019 and 2018, respectively	1,941	1,941
Treasury stock, at cost, 6,758 shares in 2019 and 3,205 shares in 2018	(1,093)	(398)
Additional paid-in capital	7,543	7,543
Retained earnings	76,564	68,552
Accumulated other comprehensive loss:		
Unrealized gain (loss) on securities available for sale, net of of income taxes of $(681) in 2019 and $315 in 2018	1,939	(1,184)
	86,894	76,454
	$ 975,949	898,290

See accompanying notes to the consolidated financial statements.

Heritage Bancorp, Inc. and Subsidiary
Consolidated Statements of Income
Years Ended December 31, 2019 and 2018

		2019	2018
Interest income:		(in thousands)	
Loans receivable, including fees	$	34,988	30,729
Investment securities:			
U.S. Government agencies		2,152	1,849
Obligations of states and political subdivisions		1,233	1,072
Federal funds sold and interest bearing due from bank		1,391	930
Dividend income-FHLB and other		300	320
Total interest income		40,064	34,900
Interest expense:			
Deposits		7,380	4,707
Fed funds purchased		1	23
FHLB advances		143	307
Repurchase agreements		201	160
Total interest expense		7,725	5,197
Net interest income		32,339	29,703
Provision for loan losses		820	1,012
Net interest income after provision for loan losses		31,519	28,691
Noninterest income:			
Service charges and fees		1,358	1,335
ATM/Interchange fees		1,013	817
Net realized loss on sale of securities		(293)	(25)
Bank owned life insurance		1,149	275
Other		1,821	1,293
		5,048	3,695
Noninterest expense:			
Salaries and employee benefits		15,933	13,615
Occupancy		2,533	2,453
Consulting fees		680	465
Taxes other than payroll, property and income		1,067	918
Advertising		702	436
Data processing		1,218	1,217
FDIC Insurance		253	486
Other		3,556	3,280
		25,942	22,870
Income before income taxes		10,625	9,516
Provision for income taxes		1,335	1,779
Net income	$	9,290	7,737
Basic earnings per share	$	24.14	20.09

See accompanying notes to the consolidated financial statements.

		2019	2018
		(in thousands)	
Net income	$	9,290	7,737
Other comprehensive income (loss):			
Unrealized gain (loss) on available for sale securities arising during the period, net of tax of $1,058 and ($241) in 2019 and 2018, respectively		2,892	(947)
Reclassification adjustment for unrealized loss recognized during current period, net of tax benefit of $62 in 2019 and $5 in 2018		231	20
Other comprehensive income (loss)		3,123	(927)
Comprehensive income	$	12,413	6,810

See accompanying notes to the consolidated financial statements.

	Common Stock		Treasury Stock		Additional Paid-In	Retained	Accumulated Other Comprehensive	Total Stockholders'
	Shares	Par Value	Shares	Value	Capital	Earnings	Income (Loss)	Equity
	(in thousands except common and treasury stock information and per share information)							
Balance at December 31, 2017	388,235	$ 1,941	3,205	$ (398)	7,543	62,009	(257)	70,838
Net income for the year	-	-	-	-	-	7,737	-	7,737
Other comprehensive income, net of tax:								
Unrealized loss on available for sale securities arising during the period, net of reclassification adjustment	-	-	-	-	-	-	(927)	(927)
Dividends - $3.10 per share	-	-	-	-	-	(1,194)	-	(1,194)
Balance at December 31, 2018	388,235	1,941	3,205	(398)	7,543	68,552	(1,184)	76,454
Net income for the year	-	-	-	-	-	9,290	-	9,290
Treasury shares purchased during the year	-	-	3,553	(695)	-	-	-	(695)
Other comprehensive income, net of tax:								
Unrealized loss on available for sale securities arising during the period, net of reclassification adjustment	-	-	-	-	-	-	3,123	3,123
Dividends - $3.35 per share	-	-	-	-	-	(1,278)	-	(1,278)
Balance at December 31, 2019	388,235	$ 1,941	6,758	$ (1,093)	7,543	76,564	1,939	86,894

See accompanying notes to the consolidated financial statements.

	2019	2018
	(in thousands)	
Operating activities:		
Net income	$ 9,290	7,737
Adjustments to reconcile net income to net cash provided by operating activities:		
Investment securities amortization, net	948	938
Provision for loan losses	820	1,012
Net realized losses on sale of securities available for sale	293	25
Gain on sale of other real estate owned	(250)	(204)
Write-downs of other real estate owned	-	16
Depreciation	578	543
Amortization	523	255
Earnings on bank-owned life insurance	(1,149)	(275)
Deferred income taxes	(316)	(284)
Effects of change in operating assets and liabilities:		
Accrued interest receivable	(437)	(78)
Other assets	(523)	390
Accrued interest payable	520	230
Other liabilities	290	809
Net cash provided by operating activities	10,587	11,114
Investing activities:		
Purchases of securities available for sale	(50,990)	(22,545)
Purchases of securities held to maturity	(612)	(1,880)
Proceeds from sales of securities available for sale	16,545	2,996
Proceeds from maturities and prepayments of securities available for sale	18,196	15,055
Purchase of Federal Home Loan Bank Stock	(637)	-
Purchases of certificates of deposit	-	(1,405)
Net increase in loans	(55,168)	(74,756)
Purchases of Bank Owned Life Insurance policies	(5,000)	-
Death benefit proceeds from Bank Owned Life Insurance policies	1,624	-
Proceeds from sales of other real estate owned	1,670	1,525
Purchases of premises and equipment	(1,359)	(1,080)
Net cash used in investing activities	(75,731)	(82,090)
Financing activities:		
Increase in deposits	66,586	132,077
Increase in securities sold under repurchase agreements	3,307	2,481
Repayments to Federal Home Loan Bank	(3,568)	(5,787)
Treasury stock purchases	(695)	-
Cash dividends paid	(1,194)	(1,020)
Net cash provided by financing activities	64,436	127,751
Increase (decrease) in cash and cash equivalents	(708)	56,775
Cash and cash equivalents - beginning of year	113,713	56,938
Cash and cash equivalents - end of year	$ 113,005	113,713
Supplemental disclosures:		
Interest paid	$ 7,205	4,967
Income taxes paid	$ 975	1,150
Real estate acquired through or in lieu of loan foreclosure	$ 480	1,751
Dividends declared but unpaid	$ 1,278	1,194

See accompanying notes to the consolidated financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The following sets forth the significant accounting policies that Heritage Bancorp, Inc. (Company) and its wholly owned subsidiary, Heritage Bank (Bank), follow in preparing and presenting its financial statements.

Nature of operations and organization
The Company is a bank holding company subject to regulation by the Federal Reserve. The principal activity of the Company is the ownership and management of the Bank. The Bank operates under a State bank charter and provides full banking services. As a State Chartered bank, the Bank is subject to regulation by the Kentucky Department of Financial Institutions and the Federal Deposit Insurance Corporation.

The Bank generates commercial, mortgage and consumer loans and receives deposits from customers located primarily in the Kentucky counties of Boone, Kenton, Campbell, Pendleton and Grant County and surrounding area and Warren and Hamilton Counties in Ohio and surrounding area. The Bank's loans are generally secured by specific items of collateral including real property, consumer assets and business assets. The Bank directly owns Heritage Investcorp, Inc., a non-bank subsidiary. Heritage Investcorp, Inc. primarily manages the Bank's general market municipal investment securities portfolio.

Estimates
The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Principles of consolidation
The consolidated financial statements include the accounts of the Company, the Bank and its subsidiary after elimination of all material intercompany transactions and accounts. Certain prior period amounts have been reclassified to conform to the current year's presentation.

Investment securities
Investment securities are classified upon acquisition into one of three categories: held to maturity, available for sale, or trading.

Investment securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Investment securities are classified as available for sale when they might be sold before maturity for any reason, including liquidity needs, changes in market interest rates, or asset-liability management strategies. Investment securities available for sale are carried at fair value, with unrealized holding gains and losses reported separately in stockholders' equity, net of applicable taxes. Investment securities are classified as trading when held for short-term periods in anticipation of market gains, and are carried at fair value. At December 31, 2019 and 2018 all of the Bank's investment securities were classified as held to maturity or available for sale.

Amortization of premiums and accretion of discounts are recorded as interest income from securities. Realized gains and losses are recorded as net security gains (losses). Realized gains (losses) on securities available for sale are included in other operating income and, when applicable, are reported as a reclassification adjustment, net of taxes, in other comprehensive income. Gains and losses on sales of securities are determined on the specific-identification method.

Declines in the fair value of individual held to maturity and available for sale securities below their cost that are other-than-temporary, generally result in write-downs of the individual securities to their fair value. The related write-downs are included in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. During the years ended December 31, 2019 and 2018, the Bank recognized no impairment losses on investment securities for declines in value deemed by management to be other-than-temporary.

Investment tax credits are accounted for using the flow-through method, which results in a direct reduction of federal income taxes for the year in which the credits arise. For the years ended December 31, 2019 and 2018, the direct reduction of income taxes payable was approximately $416,000 and $311,000, respectively.

Loans

Loans are carried at the principal amount outstanding adjusted for allowance for loan losses and charge offs. Interest income is accrued on the principal balances of loans. The accrual of interest is discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection. Loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued, but not collected, for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Past due status is based on contractual terms.

Allowance for loan losses

The allowance for loan losses is maintained at a level adequate to absorb probable loan losses. Management determines the adequacy of the allowance based on continuing review and evaluation of the loan portfolio and its judgment as to the impact of economic conditions on the portfolio. The evaluation by management includes consideration of past loss experience, changes in the composition of the portfolio, the current condition and amount of loans outstanding, and the probability of collecting all amounts due. Loans deemed uncollectible are charged to the allowance. Provisions for loan losses and recoveries on loans previously charged off are added to the allowance.

The allowance consists of specific and general components. The specific component relates to loans that are impaired in accordance with generally accepted accounting principles. Impaired loans are measured by the present value of expected future cash flows, or the fair value of the collateral of the loan, if collateral dependent. For such loans that are considered to be impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. Management believes that as of December 31, 2019, the allowance for loan losses is adequate based on information currently available. A worsening or protracted economic decline in the areas in which the Bank operates would increase the likelihood of additional losses due to credit and market risks and could create the need for additional loss reserves.

Various regulatory agencies, as an integral part of their examination process, periodically review the adequacy of the Bank's allowance for loan losses. Such agencies may require the Bank to make additional provisions to the allowance based upon their judgments about information available to them at the time of their examinations. Management believes that as of December 31, 2019, the allowance for loan losses is adequate to absorb inherent losses on existing loans that may become uncollectible.

Premises and equipment
Bank premises and equipment are carried at cost, net of accumulated depreciation. Depreciation is computed using the straight-line method based principally on the estimated useful lives of the assets. Buildings and improvements are depreciated over useful lives ranging from 10 to 40 years. Furniture, fixtures and equipment are depreciated over useful lives ranging from 3 to 10 years. Maintenance and repairs are expensed as incurred while major additions and improvements are capitalized. Gains and losses on dispositions are included in current operations.

Federal Home Loan Bank (FHLB) stock
The Bank is required to invest in FHLB stock in order to maintain access to the Federal Home Loan Bank system. The required investment in the common stock is based on a predetermined formula established by the FHLB.

Other real estate owned
Foreclosed real estate is carried at the lower of cost or fair value less estimated selling costs. When foreclosed real estate is acquired, any required adjustment is charged to the allowance for loan losses. All subsequent activity is included in current operations.

Bank owned life insurance
The Bank has purchased life insurance policies on certain key executives. Bank-owned life insurance is recorded at its cash surrender value, or the amount that can be realized.

Per share information
Earnings per share are calculated in accordance with generally accepted accounting principles. Basic earnings per common share are presented on the face of the consolidated income statement and are computed using the weighted average number of shares of common stock outstanding during the year.

Income tax
The provision for income taxes in the consolidated statement of income includes deferred income tax provisions or benefits for all significant temporary differences in recognizing income and expenses for financial reporting and income tax purposes. The Company files consolidated income tax returns with its subsidiary.

The Company evaluates uncertain tax positions based on a more likely than not threshold that a tax position will be sustained upon examination. The Company did not have any uncertain tax positions at December 31, 2019 or 2018. The Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for tax years ended on or before December 31, 2016. The Company's policy with regard to interest and penalties is to recognize interest through interest expense and penalties through other expense. There were no interest or penalties paid in 2019 or 2018. In evaluating the Company's tax provisions and accruals, future taxable income, and the reversal of temporary differences, interpretations and tax planning strategies are considered. The Company believes their estimates are appropriate based on current facts and circumstances.

Advertising costs
Advertising costs are expensed as incurred.

Cash and cash equivalents
For the purposes of the statement of cash flows, cash and cash equivalents consist of cash, due from banks, Federal funds sold, and interest deposits in other financial institutions with original maturities of 3 months or less.

The Company maintains its cash in bank deposit accounts, which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts and management believes it is not exposed to any significant credit risk on cash and cash equivalents.

Subsequent events
The Company evaluates events and transactions occurring subsequent to the date of the consolidated financial statements for matters requiring recognition or disclosure in the consolidated financial statements. The accompanying consolidated financial statements consider events through March 4, 2020, the date on which the financial statements were available to be issued.

Adoption of a new accounting standard
On January 1, 2019, the Company adopted ASU 2014-09 *Revenue from Contracts with Customers* and all subsequent amendments to the ASU (collectively, "ASC 606"), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as OREO. The majority of the Company's revenues come from interest income and other sources, including loans, leases, securities and derivatives, that are outside the scope of ASC 606. The Company's services that fall within the scope of ASC 606 are presented within noninterest income and are recognized as revenue as the Company satisfies its performance obligation to the customer. Services within the scope of ASC 606 include service charges on deposits and the sale of other real estate owned. Refer to Note 8

Revenue from Contracts with Customers for further discussion on the Company's accounting policies for revenue sources within the scope of ASC 606.

The Company adopted ASC 606 using the modified retrospective method applied to all contracts not completed as of January 1, 2019. Results for reporting periods beginning after January 1, 2019 are presented under ASC 606 while prior period amounts continue to be reported in accordance with legacy GAAP. The adoption of ASC 606 did not result in a change to the accounting for any of the in-scope revenue streams; as such, no cumulative effect adjustment was recorded.

Effects of recent pronouncements
In June 2016, the FASB issued ASU 2016-13, Financial Instruments-Credit Losses: Measurement of Credit Losses on Financial Instruments ("ASU 2016-13"), which changes the impairment model for most financial assets. This ASU is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The underlying premise of the ASU is that financial assets measured at amortized cost should be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The allowance for credit losses should reflect management's current estimate of credit losses that are expected to occur over the remaining life of a financial asset. The income statement will be affected for the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2022, and early adoption is permitted for annual and interim periods beginning after December 15, 2018. With certain exceptions, transition to the new requirements will be through a cumulative effect adjustment to opening retained earnings as of the beginning of the first reporting period in which the guidance is adopted. We expect to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective, but cannot yet determine the magnitude of any such one-time adjustment or the overall impact of the new guidance on the Company's consolidated financial statements.

2. INVESTMENT SECURITIES:

Amortized cost and fair value of investment securities, by category, at December 31, 2019 and 2018 are as follows:

	2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
Available for sale:				
Municipal bonds	$ 48,658	1,659	-	50,317
Mortgage-backed securities	78,401	1,043	102	79,342
SBA pools	19,702	135	114	19,723
Equity securities	118	-	-	118
	$ 146,879	2,837	216	149,500
Held to maturity:				
Low income housing tax credits	$ 2,416	-	-	2,416
	$ 2,416	-	-	2,416

	2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
Available for sale:				
Federal agencies	$ 999	-	37	962
Municipal bonds	43,323	341	556	43,108
Mortgage-backed securities	66,219	204	1,082	65,341
SBA pools	21,223	19	387	20,855
Equity securities	107	-	-	107
	$ 131,871	564	2,062	130,373
Held to maturity:				
Low income housing tax credits	$ 2,299	-	-	2,299
	$ 2,299	-	-	2,299

The Company has future commitments to fund low income housing investments of the following as of December 31, 2019 (in thousands):

2020	$ 1,937
2021	2,773
2022	374
2023	296
2024	265
Thereafter	718
	$ 6,363

Contractual maturities of debt securities available for sale at December 31, 2019 are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(in thousands)	
Within one year	$ 407	410
One to five years	5,989	6,051
Five to ten years	6,512	6,610
After ten years	35,750	37,246
Mortgage-backed securities	98,103	99,065
	$ 146,761	149,382

The investment securities held to maturity fully mature on various dates ranging from 2022 through 2036.

Securities with a carrying value of $91.9 million and $95.8 million were pledged at December 31, 2019 and 2018, respectively, to secure certain deposits and for other purposes as permitted or required by law.

Proceeds from sales of securities available for sale were $16.5 million and $3.0 million during 2019 and 2018, respectively. Gross gains of $2,000 were realized in 2019 for sales and calls of investment securities. There were no gains realized in 2018 for sales and calls of investment securities. Gross losses of $295,000 and $25,000 were realized in 2019 and 2018, respectively, for sales of investment securities.

The table below shows gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2019 and 2018.

	December 31, 2019					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
Municipal bonds	$ -	-	-	-	-	-
Mortgage-backed securities	12,558	22	9,212	80	21,770	102
SBA pools	-	-	10,128	114	10,128	114
Total temporarily impaired securities	$ 12,558	22	19,340	194	31,898	216
Number of investments	7		35		42	

	December 31, 2018					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(in thousands)					
Federal agencies	$ -	-	962	37	962	37
Municipal bonds	8,854	142	13,893	414	22,747	556
Mortgage-backed securities	8,898	50	37,012	1,032	45,910	1,082
SBA pools	5,060	61	12,517	326	17,577	387
Total temporarily impaired securities	$ 22,812	253	64,384	1,809	87,196	2,062
Number of investments	33		94		127	

Management has the ability and intent not to sell these securities for the foreseeable future and the decline in market value is due to changes in market interest rates. The fair values are expected to recover as securities approach maturity dates.

3. FINANCING RECEIVABLES:

Loans receivable consist of the following at December 31, 2019 and 2018:

	2019	2018
	(in thousands)	
1-4 Family	$ 163,596	179,930
Commercial Real Estate	334,443	282,700
Construction	73,138	65,182
Commercial	99,157	87,885
Consumer	5,774	6,029
	$ 676,108	621,726
Less: Allowance for loan losses	(8,723)	(8,209)
	$ 667,385	613,517

The risk characteristics applicable to each segment of the loan portfolio are described as follows:

Residential real estate loans are secured by 1-4 family residences and are generally owner-occupied. The Bank generally establishes a maximum loan-to-value ratio and requires private mortgage insurance if that ratio is exceeded. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market area, such as unemployment levels. Repayment can also be impacted by changes in property values of residential properties. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

Commercial real estate loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves larger loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The characteristics of properties securing the Bank’s commercial real estate portfolio are diverse, but with geographic location almost entirely in the Bank’s market area. Management monitors and evaluates commercial real estate loans based on cash flow, collateral, geography and risk grade criteria.

Construction loans are underwritten utilizing feasibility studies, independent reviews and financial analysis of the developers and property owners. Construction loans are generally based on estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Bank until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

Commercial loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets, such as accounts receivable or inventory, and may include a personal guarantee. Short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrowers to collect amounts due from its customers.

Consumer loans consist of two segments - automobile loans and home equity loans. Automobile loans are generally secured by the automobile being financed or other personal assets. Home equity loans are typically secured by a subordinate interest in 1-4 family residences. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market area, such as unemployment levels, and secondarily on the collateral securing the loan. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

Allowance for Loan Losses and Recorded Investment in Financing Receivables
December 31, 2019

		1-4 Family	Commercial Real Estate	Construction	Commercial	Consumer	Total
				(in thousands)			
Allowance for loan losses:							
Beginning balance	$	1,433	4,573	1,306	815	82	8,209
Provision		174	(53)	209	440	50	820
Charge-offs		(71)	(42)	(141)	(47)	(79)	(380)
Recoveries		23	15	-	7	29	74
Ending balance	$	1,559	4,493	1,374	1,215	82	8,723
Ending balance: Individually evaluated for impairment	$	469	1,137	817	615	-	3,038
Ending balance: Collectively evaluated for impairment	$	1,090	3,356	557	600	82	5,685
Loans receivable:							
Ending balance	$	163,596	334,443	73,138	99,157	5,774	676,108
Ending balance: Individually evaluated for impairment	$	2,646	8,747	1,266	1,215	217	14,091
Ending balance: Collectively evaluated for impairment	$	160,950	325,696	71,872	97,942	5,557	662,017

Allowance for Loan Losses and Recorded Investment in Financing Receivables
December 31, 2018

	1-4 Family	Commercial Real Estate	Construction	Commercial	Consumer	Total
			(in thousands)			
Allowance for loan losses:						
Beginning balance	$ 1,298	3,844	1,216	1,143	105	7,606
Provision	77	1,235	105	(454)	49	1,012
Charge-offs	(103)	(506)	(15)	(15)	(102)	(741)
Recoveries	161	-	-	141	30	332
Ending balance	$ 1,433	4,573	1,306	815	82	8,209
Ending balance: Individually evaluated for impairment	$ 296	1,435	958	437	-	3,126
Ending balance: Collectively evaluated for impairment	$ 1,137	3,138	348	378	82	5,083
Loans receivable:						
Ending balance	$ 179,930	282,700	65,182	87,885	6,029	621,726
Ending balance: Individually evaluated for impairment	$ 3,184	10,128	1,998	1,454	229	16,993
Ending balance: Collectively evaluated for impairment	$ 176,746	272,572	63,184	86,431	5,800	604,733

The Bank assigns credit risk grades to evaluated loans using grading standards employed by regulatory agencies. Loans judged to carry lower-risk attributes are assigned a “1 or 2” grade, with a minimal likelihood of loss. Loans judged to carry higher-risk attributes are referred to as “3” and are further disaggregated, with increasing expectations for loss recognition, as “4,” “5,” “6,” and “7.” The Corporation’s Loan Committee assigns the credit risk grades to loans and reports to the board on a monthly basis the “classified asset” report. Each level is defined as follows:

1. Highest. A cash secured or well-structured credit relationship with an established borrower. Customer could be rated investment grade by an investment-rating agency or should meet similar quality standards.

2. Quality. A strong and well-structured credit. The loan may not be as seasoned or as high quality as a 1-rated credit, but it has sufficient credit strength so as not to represent a concern to management. The loan is supported by unaudited financial statements containing strong balance sheets with consecutive years of profits.

3. Average. Loans with standard underwriting conditions, changing collateral values or any changing conditions which require periodic monitoring. The loan is typically secured with collateral possessing loan to value or collateral coverage adequate to protect the Bank from loss.

4. Acceptable. Loans exhibit some weaknesses but with offsetting features or other support readily available. The loan warrants close attention without evidence of repayment being in jeopardy. The key distinction of an Acceptable classification is that the credit characteristics are those of a “3” rated credit that is performing normally, with an additional identified level of risk. The “4” credit is considered a non-criticized pass loan that needs a proper level of management supervision.

5. Special Mention. Loans or borrowing relationships that require a significant amount of management attention. Adverse industry conditions, deteriorating financial conditions, management problems, or other similar weaknesses may be evident. Ability to meet current payment schedules may be questionable, even though interest and principal are still being paid as agree.

6. Substandard. Loans possessing weaknesses that jeopardize the ultimate collection of total outstandings. The weaknesses require close supervision by Bank management. Loss may not be evident; however, the loan is inadequately protected by current financial or collateral pledged.

7. Non-accrual. A loan is generally placed on non-accrual status if (1) the loan becomes 90 days or more past due at any time, or (2) payment in full on both principal and interest cannot reasonably be expected. Payments received on a non-accrual account are applied to principal until qualifying for return to accrual status.

8. Doubtful. Loans or portions of loans with one or more weaknesses, which, on the basis of currently existing facts, conditions, and values, make ultimate collection of all principal highly questionable. The possibility of loss is high.

9. Loss.

Credit Risk Profile by Internally Assigned Grade
December 31, 2019

	1-4 Family	Commercial Real Estate	Construction	Commercial	Consumer	Total
			(in thousands)			
Grade:						
1 or 2	$ 6,918	21,211	397	11,127	802	40,455
3	100,651	182,454	7,976	50,369	1,573	343,023
4	50,126	121,500	62,249	31,735	3,352	268,962
5	3,750	6,672	1,894	5,150	39	17,505
6	976	2,444	622	770	-	4,812
7	1,175	162	-	6	8	1,351
Total	$ 163,596	334,443	73,138	99,157	5,774	676,108

The following table summarizes loans by delinquency, nonaccrual status and impaired loans:

	30-89 Days Past Due	Over 90 Days Past Due	Total Past Due	Current	Nonaccrual	Total Loans	Recorded Investment 90 Days and Accruing
				(in thousands)			
Real Estate:							
1-4 Family	$ 898	859	1,757	161,839	1,175	163,596	15
Commercial Real Estate	392	-	392	334,051	162	334,443	-
Construction	724	96	820	72,318	-	73,138	96
Commercial	340	-	340	98,817	6	99,157	-
Consumer	11	8	19	5,755	8	5,774	-
Total	2,365	963	3,328	672,780	1,351	676,108	111

Credit Risk Profile by Internally Assigned Grade
December 31, 2018

	1-4 Family	Commercial Real Estate	Construction	Commercial	Consumer	Total
			(in thousands)			
Grade:						
1 or 2	$ 11,211	19,307	1,770	8,505	789	41,582
3	97,195	169,758	14,199	49,280	3,229	333,661
4	63,520	83,875	46,484	25,409	1,927	221,215
5	5,346	6,008	1,496	3,219	74	16,143
6	878	2,983	574	1,454	-	5,889
7	1,780	769	659	18	10	3,236
Total	$ 179,930	282,700	65,182	87,885	6,029	621,726

The following table summarizes loans by delinquency, nonaccrual status and impaired loans:

	30-89 Days Past Due	Over 90 Days Past Due	Total Past Due	Current	Nonaccrual	Total Loans	Recorded Investment 90 Days and Accruing
				(in thousands)			
Real Estate:							
1-4 Family	$ 1,456	1,461	2,917	177,013	1,779	179,930	83
Commercial Real Estate	602	95	697	282,003	770	282,700	-
Construction	-	659	659	64,523	659	65,182	-
Commercial	48	15	63	87,822	18	87,885	-
Consumer	440	6	446	5,583	10	6,029	1
Total	2,546	2,236	4,782	616,944	3,236	621,726	84

Impaired Loans
As of December 31, 2019

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
			(in thousands)		
Loans with no related allowance recorded:					
1-4 Family	$ 988	1,162	-	1,419	63
Commercial Real Estate	1,633	3,298	-	1,921	96
Construction	14	14	-	302	2
Commercial	10	10	-	12	-
Consumer	217	217	-	223	11
Total	$ 2,862	4,701	-	3,877	172
Loans with an allowance recorded:					
1-4 Family	$ 1,658	1,728	469	1,497	77
Commercial Real Estate	7,114	7,416	1,137	7,517	404
Construction	1,252	1,252	817	1,330	-
Commercial	1,205	1,233	615	1,323	67
Consumer	-	-	-	-	-
Total	$ 11,229	11,629	3,038	11,667	548
Total:					
1-4 Family	$ 2,646	2,890	469	2,916	140
Commercial Real Estate	8,747	10,714	1,137	9,438	500
Construction	1,266	1,266	817	1,632	2
Commercial	1,215	1,243	615	1,335	67
Consumer	217	217	-	223	11
Total	$ 14,091	16,330	3,038	15,544	720

Impaired Loans
As of December 31, 2018

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
			(in thousands)		
Loans with no related allowance recorded:					
1-4 Family	$ 1,849	2,299	-	1,824	91
Commercial Real Estate	2,208	3,854	-	2,276	96
Construction	590	605	-	1,785	8
Commercial	14	14	-	68	-
Consumer	229	229	-	235	8
Total	$ 4,890	7,001	-	6,188	203
Loans with an allowance recorded:					
1-4 Family	$ 1,335	1,466	296	1,431	70
Commercial Real Estate	7,920	8,348	1,435	9,600	513
Construction	1,408	1,408	958	1,748	-
Commercial	1,440	1,454	437	1,710	120
Consumer	-	-	-	23	-
Total	$ 12,103	12,676	3,126	14,512	703
Total:					
1-4 Family	$ 3,184	3,765	296	3,255	161
Commercial Real Estate	10,128	12,202	1,435	11,876	609
Construction	1,998	2,013	958	3,533	8
Commercial	1,454	1,468	437	1,778	120
Consumer	229	229	-	258	8
Total	$ 16,993	19,677	3,126	20,700	906

Troubled Debt Restructurings

At December 31, 2019 and 2018, the Bank had $10.9 million and $11.8 million in TDRs, respectively.

If a borrower is experiencing financial difficulty, the Bank may consider, in certain circumstances, modifying the terms of their loan in a troubled debt restructuring (TDR) to maximize collection of amounts due. Within each of the Bank's loan classes, TDRs typically involved either a reduction of the stated interest rate of the loan or an extension of the loan's maturity date(s) with a stated rate lower than the current market rate for a new loan with similar risk. Modifying the terms of loans may result in an increase or decrease to the ALLL depending upon the terms modified, the method used to measure the ALLL for a loan prior to modification, and whether any charge-offs were recorded on the loan before or at the time of modification. The ten new troubled debt restructurings that occurred during the year ended December 31, 2019 had a combination of interest rate concessions, maturity date extensions, payment term modifications and collateral modifications. The two new troubled debt restructurings that occurred during the year ended December 31, 2018 had a combination of interest rate concessions and maturity date extensions.

The following tables present loans by class modified as troubled debt restructurings that occurred during the years ended December 31, 2019 and 2018:

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Effect on ALLL upon modification
		(Dollars in thousands)		
December 31, 2019				
Troubled Debt Restructurings				
Real Estate:				
1-4 Family	2	$134	134	-
Commercial Real Estate	3	854	854	-
Construction	-	-	-	-
Commercial	5	267	267	-
Consumer	-	-	-	-
		$1,255	1,255	-

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Effect on ALLL upon modification
		(Dollars in thousands)		
December 31, 2018				
Troubled Debt Restructurings				
Real Estate:				
1-4 Family	2	$123	128	-
Commercial Real Estate	-	-	-	-
Construction	-	-	-	-
Commercial	-	-	-	-
Consumer	-	-	-	-
		$123	128	-

The Bank considers TDRs that become 90 days or more past due under the modified terms as subsequently defaulted. The following table presents loans by class modified as troubled debt restructurings for which there were subsequent defaults within 12 months following the modification during the years ended December 31, 2019 and 2018:

	Number of Contracts	Recorded Investment
Troubled Debt Restructurings that Subsequently Defaulted:		(Dollars in thousands)
December 31, 2019		
None	-	-
December 31, 2018		
1-4 Family	3	$ 401

The provision for loan losses charged to expense includes the evaluation of impaired loans under generally accepted accounting principles. A loan is considered to be impaired when based upon current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan. Impairment is primarily measured based on the fair value of the loan's collateral. Impairment losses are included in the provision for credit losses. This treatment does not apply to large groups of smaller balance homogeneous loans that are collectively evaluated for impairment, except for those loans restructured under a troubled debt restructuring. There are no outstanding commitments on any impaired loans as of December 31, 2019.

The Bank acquired loans pursuant to the acquisition of Commonwealth Trust Bancorp, Inc. in April 2012. The Bank reviewed the loan portfolio at acquisition to determine whether there was evidence of deterioration of credit quality since origination and if it was probable that it will be unable to collect all amounts due according to the loan's contractual terms. The Bank determined there were no loans acquired with deteriorated credit quality. The Bank recorded a yield discount representing the excess of the loan's cash flows expected to be collected over the amount paid. This discount is accreted into interest income over the remaining life of the loan (accretable yield).

The following table depicts the accretable yield at the beginning and end of 2018:

	2018 (in thousands)
Balance at the beginning of the year	$ 166
Accretion into interest income	(166)
Balance at the end of the year	$ -

Loans made in the ordinary course of business to various officers and directors, entities in which these individuals are officers or stockholders, and other related parties aggregated approximately $88,000 and $132,000 as of December 31, 2019 and 2018, respectively. Such loans were made at rates and terms comparable to those given to other customers of the Bank. During 2019, repayments totaled $44,000. There were no loan originations to related parties in 2019.

Residential loans being serviced by the Bank for the benefit of others totaled $1,215,000 and $4,526,000 for the years ending December 31, 2019 and 2018, respectively. Commercial mortgage loan participations sold and serviced by the Bank for the benefit of others totaled $8,224,000 and $6,925,000 for the years ending December 31, 2019 and 2018, respectively.

4. PREMISES AND EQUIPMENT:

Bank premises and equipment at December 31, 2019 and 2018 were as follows:

	2019	2018
	(in thousands)	
Land	$ 4,955	4,675
Buildings	14,155	12,872
Equipment	3,918	3,492
Construction in progress	49	679
	23,077	21,718
Less accumulated depreciation	7,360	6,782
	$ 15,717	14,936

Depreciation expense for 2019 and 2018 was approximately $578,000 and $543,000, respectively.

5. DEPOSITS:

	2019	2018
	(in thousands)	
Demand deposits	$ 513,920	482,861
Savings deposits	138,173	134,523
Certificates and other time deposits of $250,000 or more	30,654	20,121
Other certificates and time deposits	170,573	149,229
	$ 853,320	786,734

A summary of time deposit accounts by maturity at December 31, 2019 is as follows:

	(in thousands)
2020	$ 163,284
2021	17,210
2022	10,103
2023	5,906
2024	4,724
	$ 201,227

The Bank held related party deposits of approximately $4.2 million and $6.6 million at December 31, 2019 and 2018, respectively.

The aggregate amount of overdraft deposits reclassified as loan balances was approximately $112,000 and $75,000 at December 31, 2019 and 2018, respectively.

As part of management's asset liability management strategy, the Bank will sell public funds deposits through the Promontory ICS managed products from time to time. As of December 31, 2019, the Bank had $52.2 million in the ICS one-way sell product. There were no one-way sells at December 31, 2018.

6. ADVANCES FROM FEDERAL HOME LOAN BANK:

The Bank owns stock of the Federal Home Loan Bank (FHLB) of Cincinnati, Ohio. This stock allows the Bank to borrow long-term advances from the FHLB which the Bank uses to fund long-term fixed rate mortgages. The FHLB advances are secured by the Bank's first-mortgage loan portfolio, including 1-4 family and commercial loan portfolios, obligations of the United States of America and the Bank's FHLB stock.

At December 31, 2019 and 2018, $5.5 million and $9.0 million, respectively, represented the balance due on the advances from the FHLB. The advances require interest only payments and mature on remaining terms of less than one year to five years with interest rates ranging from 1.73% to 2.98%. Scheduled principal payments due on advances during the five subsequent years to December 31, 2019 are as follows:

	(in thousands)
2020	$ 3,703
2021	234
2022	231
2023	608
2024	681
	$ 5,457

7. OTHER BORROWED FUNDS AND LINES OF CREDIT:

Securities sold under agreements to repurchase mature within one day from the transaction date.

Information concerning securities sold under agreements to repurchase is summarized as follows:

	2019	2018
	(in thousands)	
Average balance during the year	$16,761	13,806
Average interest rate during the year	1.20%	1.16%
Maximum month-end balance during the year	$23,931	20,624

Obligations of U.S. Government Agencies underlying the agreements at year-end:		
Carrying value	$23,931	20,624
Fair value	24,602	21,082

The Bank has available federal funds purchased lines with two financial institutions: $12.0 million with First Tennessee and $15.0 million with Zions Bank. There were no borrowings on either line at December 31, 2019 and 2018. The Bank also has an arrangement with the Bankers Bank of Kentucky (BBK) that allows it to borrow an amount not to exceed 50% of the Bank's individual unimpaired capital and surplus or $10.0 million. There were no draws against this line at December 31, 2019 and 2018.

8. REVENUE RECOGNITION:

On January 1, 2019, the Company adopted ASU No. 2014-09 *"Revenue from Contracts with Customers" (Topic 606)* and all subsequent ASUs that modified Topic 606. As stated in Note 1 *Significant Accounting Policies*, the implementation of the new standard did not have a material impact on the measurement or recognition of revenue.

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

The following presents noninterest income, segregated by revenue streams in-scope and out-of scope of Topic 606, for the years ended December 31, 2019 and 2018:

	2019	2018
	(in thousands)	
In scope of Topic 606:		
Service charges and fees	$1,358	1,335
ATM/Interchange fees	1,013	817
Other	880	695
Noninterest income (in-scope of Topic 606)	3,251	2,847
Noninterest income (out-of-scope of Topic 606)	1,797	848
Total noninterest income	$5,048	3,695

Service charges and fees

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

ATM/Interchange fees
Fees, exchange, and other service charges are primarily comprised of debit and credit card income, ATM fees and other service charges. Debit and credit card income is primarily comprised of interchange fees earned whenever the Company's debit and credit cards are processed through card payment networks such as Mastercard. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. The Company's performance obligation for fees, exchange, and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month.

Other
Other noninterest income consists of other recurring revenue streams such as check order fees, wire transfer fees, safety deposit box rental fees, item processing fees and other miscellaneous revenue streams. Check order income mainly represents fees charged to customers for checks. Wire transfer fees represent revenue from processing wire transfers. Safe deposit box rental fees are charged to the customer on an annual basis and recognized upon receipt of payment. The Company determined that since rentals and renewals occur fairly consistently over time, revenue is recognized on a basis consistent with the duration of the performance obligation. Item processing fee income represents fees charged to other financial institutions for processing their transactions. Payment is typically received in the following month. Also included in other is gain on sale of other real estate owned (OREO). The Company records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the same time of an executed deed. When this occurs, the OREO asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer.

9. INCOME TAX:

	2019	2018
	(in thousands)	
Income tax expense (benefit):		
Current	$ 1,651	2,063
Deferred	(316)	(284)
	$ 1,335	1,779

The tax effects of the temporary differences that created deferred tax assets and liabilities at December 31, 2019 and 2018 were as follows:

	2019	2018
	(in thousands)	
Deferred tax assets:		
Allowance for loan losses	$ 2,175	1,724
Deferred compensation	292	279
Core deposit intangible	40	32
Net unrealized loss on securities available for sale	-	315
Total deferred tax assets	2,507	2,350
Deferred tax liabilities:		
Depreciation	(510)	(401)
Unrealized gain on securities available for sale	(681)	-
FHLB stock dividends	(303)	(256)
Total deferred tax liabilities	(1,494)	(657)
Net deferred tax assets	$ 1,013	1,693

The provision for federal income taxes differs from the amount computed by applying the statutory rate to income before income taxes in the years ended December 31, 2019 and 2018, as indicated in the following analysis:

	2019		2018	
	(in thousands)		(in thousands)	
Tax based on statutory rate	$ 2,231	21.0%	1,998	21.0%
Effect of tax-exempt income	(518)	(4.9)	(314)	(3.3)
Tax credits	79	0.8	(54)	(0.6)
Deferred tax impact of change in state tax rate effective January 1, 2021	(315)	(3.0)	-	-
Other	(142)	(1.3)	149	1.6
	$ 1,335	12.6%	1,779	18.7%

Income tax expense for 2019 includes an upward adjustment of net deferred tax assets in the amount of $315,000, recorded as a result of the enactment of Kentucky House Bills 354 and 458 during 2019. The Bills changed the tax structure from a bank franchise tax to having a state corporate income tax for all financial institutions. Beginning January 1, 2021, the Company will be subject to this new tax structure.

10. COMMITMENTS AND CONTINGENCIES:

In the normal course of business there are outstanding commitments and contingent liabilities, such as commitments to extend credit and standby letters of credit, which are not included in the accompanying financial statements. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual or notional amount of those instruments. The Bank uses the same credit policies in making such commitments as they do for instruments that are included in the consolidated balance sheet.

Financial instruments whose contract amount represents credit risk as of December 31, 2019 and 2018 were as follows:

	2019	2018
	(in thousands)	
Commitments to extend credit	$181,056	153,838
Standby letters of credit	7,189	7,259

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, is based on management's credit evaluation. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The Company and its subsidiary are also subject to claims and lawsuits which arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the consolidated financial position of the Company.

11. REGULATORY MATTERS:

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

At December 31, 2019, management believes it meets all capital adequacy requirements to which it is subject. The most recent notification from the regulatory agencies, dated October 15, 2018, categorized the Company and Bank as well capitalized under the regulatory framework for prompt corrective action. There have been no conditions or events since that notification that management believes have changed this categorization.

Generally, the Bank's payment of dividends is limited, without regulatory approval, to net earnings for the current calendar year, plus the two preceding calendar years, less dividends paid over the comparable time period.

The Company's and Bank's actual and required capital amounts and ratios for 2019 and 2018 are as follows:

	December 31, 2019					
	Actual		Minimum Required For Capital Adequacy Purposes		Minimum Required To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(in thousands)			
Common equity tier 1 risk-based capital						
Heritage Bancorp, Inc.	$84,955	10.78%	35,453	4.50%	N/A	N/A
Heritage Bank	84,502	10.74	35,397	4.50	45,010	6.50%
Tier 1 risk-based capital						
Heritage Bancorp, Inc.	84,955	10.78	47,271	6.00	N/A	N/A
Heritage Bank	84,502	10.74	47,196	6.00	62,928	8.00%
Total risk-based capital						
Heritage Bancorp, Inc.	93,678	11.89	63,028	8.00	N/A	N/A
Heritage Bank	92,408	11.75	62,928	8.00	69,246	10.00%
Tier 1 leverage						
Heritage Bancorp, Inc.	84,955	8.68	39,164	4.00	N/A	N/A
Heritage Bank	84,502	8.64	39,114	4.00	48,893	5.00%

	December 31, 2018					
	Actual		Minimum Required For Capital Adequacy Purposes		Minimum Required To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(in thousands)			
Common equity tier 1 risk-based capital						
Heritage Bancorp, Inc.	$77,638	11.19%	31,224	4.50%	N/A	N/A
Heritage Bank	77,156	11.14	31,161	4.50	45,010	6.50%
Tier 1 risk-based capital						
Heritage Bancorp, Inc.	77,638	11.19	41,632	6.00	N/A	N/A
Heritage Bank	77,156	11.14	41,548	6.00	55,397	8.00%
Total risk-based capital						
Heritage Bancorp, Inc.	85,847	12.37	55,510	8.00	N/A	N/A
Heritage Bank	84,407	12.19	55,397	8.00	69,246	10.00%
Tier 1 leverage						
Heritage Bancorp, Inc.	77,638	8.83	35,170	4.00	N/A	N/A
Heritage Bank	77,156	8.79	35,114	4.00	43,892	5.00%

12. PROFIT SHARING PLAN:

The Bank has a defined contribution 401(k) Plan covering substantially all of the Bank's employees. Employees may contribute a percentage of compensation up to the maximum allowed by law. Company contributions are at the discretion of the Board of Directors and are allocated among eligible participants in the proportion of their salaries to the total salaries of all participants. The Company contributed $644,000 and $496,000 to the plan in 2019 and 2018, respectively.

13. COMPREHENSIVE INCOME RECLASSIFICATION ADJUSTMENT:

The following information discloses the reclassification adjustments for each component of accumulated other comprehensive income, including the income statement line items affected as of December 31, 2019 and 2018:

Accumulated Other Comprehensive Income Components	Reclassification Amount (in thousands)	Affected Line Item in the Consolidated Statements of Income
December 31, 2019:		
Unrealized losses on available for sale securities	(293)	Net realized loss on sale of securities
	62	Provision for income taxes
Total reclassifications	$ (231)	
December 31, 2018:		
Unrealized losses on available for sale securities	(25)	Net realized loss on sale of securities
	5	Provision for income taxes
Total reclassifications	$ (20)	

14. FAIR VALUES OF FINANCIAL INSTRUMENTS:

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Following is a description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Investment securities
Fair value on available for sale securities were based upon a market approach. Securities which are fixed income instruments that are not quoted on an exchange, but are traded in active markets, are valued using prices obtained from our custodian, which used third party data service providers and are classified as Level 2 inputs. Available for sale securities include U.S. agency securities, municipal bonds and mortgage-backed agency securities.

Impaired loans
A loan is considered to be impaired when it is probable the Company will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. Individually identified impaired loans are measured based on the present value of expected payments using the loan's original effective rate as the discount rate, the loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. If the recorded investment in the impaired loan exceeds the measure of fair value, a valuation allowance may be established as a component of the allowance for loan losses. Impaired loans are classified within Level 2 of the hierarchy.

Other real estate owned
Real estate acquired through foreclosure assets are adjusted to fair value upon transfer of the loans to foreclosed assets. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price, the Bank records the foreclosed asset as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Bank records as Level 3.

Fair value measurements for certain assets and liabilities measured at fair value on a recurring basis (in thousands):

	Total carrying value in balance sheet	Quoted market prices in an active market (Level 1)	Internal models with significant observable market parameters (Level 2)	Internal models with significant unobservable market parameters (Level 3)
December 31, 2019:				
Municipal bonds	$ 50,317	-	50,317	-
Mortgage-backed securities	79,342	-	79,342	-
SBA pools	19,723	-	19,723	-
Other	118	-	118	-
December 31, 2018:				
Federal agencies	$ 962	-	962	-
Municipal bonds	43,108	-	43,108	-
Mortgage-backed securities	65,341	-	65,341	-
SBA pools	20,855	-	20,855	-
Other	107	-	107	-

Fair value measurements for certain assets and liabilities measured at fair value on a nonrecurring basis (in thousands):

	Total carrying value in balance sheet	Quoted market prices in an active market (Level 1)	Internal models with significant observable market parameters (Level 2)	Internal models with significant unobservable market parameters (Level 3)
	(in thousands)			
December 31, 2019:				
Collateral dependent impaired loans	$ 8,191	-	8,191	-
Other real estate owned	363	-	363	-
December 31, 2018:				
Collateral dependent impaired loans	$8,977	-	8,977	-
Other real estate owned	1,303	-	1,303	-

15. CONDENSED FINANCIAL INFORMATION (PARENT COMPANY ONLY):
Presented below is condensed financial information comprising the financial position, results of operations and cash flows of the Parent Company only:

Condensed Balance Sheets

	December 31,	
	2019	2018
Assets:	(in thousands)	
Cash	$ 43	28
Investment in subsidiary	86,459	76,019
Loans, net	435	450
Dividends receivable from subsidiary	1,278	1,194
Total assets	$ 88,215	77,691
Liabilities:		
Dividends payable	$ 1,278	1,194
Accrued taxes	43	43
Total liabilities	1,321	1,237
Stockholders' equity:		
Capital stock; 1,000,000 shares authorized; 388,235 shares issued; 381,477 and 385,030 shares outstanding in 2019 and 2018, respectively	1,941	1,941
Treasury Stock, at cost; 6,758 shares in 2019 and 3,205 shares in 2018	(1,093)	(398)
Additional paid-in capital	7,543	7,543
Retained earnings	76,564	68,552
Accumulated other comprehensive loss	1,939	(1,184)
Total stockholders' equity	86,894	76,454
Total liabilities and stockholders' equity	$ 88,215	77,691

Condensed Statements of Income

	December 31, 2019	December 31, 2018
	(in thousands except per share data)	
Income		
Earnings from subsidiary	$ 1,973	1,194
Expenses		
Other	-	41
Income before equity in undistributed income of bank subsidiary	1,973	1,153
Equity in undistributed income of bank subsidiary	7,317	6,584
Net income	$ 9,290	7,737
Basic earnings per share:	$ 24.14	$ 20.09

Condensed Statements of Cash Flows

	December 31, 2019	December 31, 2018
	(in thousands)	
Operating activities		
Net income	$ 9,290	7,737
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	-	58
Equity in undistributed earnings of subsidiary	(7,401)	(6,758)
Effects of change in operating liabilities:		
Accrued income taxes	-	(16)
Payable to subsidiary	-	(6)
Net cash provided by operating activities	1,889	1,015
Investing activities		
Net decrease in loans	15	-
Net cash provided by investing activities	15	-
Financing activities		
Treasury stock repurchases	(695)	-
Cash dividends paid	(1,194)	(1,020)
Net cash used in financing activities	(1,889)	(1,020)
Net change in cash	15	(5)
Cash - beginning of year	28	33
Cash - end of year	$ 43	28

Non-cash: Payments of $52,000 received on loans in 2018 were treated as capital infusions to the Bank subsidiary.

16. BONUS COMPENSATION PLAN:

Effective January 1, 2007 the Company established the Heritage Bank Bonus Compensation Plan (the "Plan") for certain key officers and employees. The Plan awards incentive units to its participants on four anniversary dates beginning January 1, 2007 and ending January 1, 2010. There were additional units awarded with an anniversary date of January 1, 2014, January 1, 2015 and January 1, 2016. Units are redeemable in cash after each calendar year and are valued by comparing the growth of the Company's equity from the award date through the most recently completed calendar year. Effective January 1, 2019 the Heritage Bank Bonus Compensation plan was terminated and new Deferred Compensation plans were established for key officers and employees. The average discount rate used to determine the present value of future obligations was 5.50%. The plans are nonqualified and unfunded. The total accrued liability for the deferred compensation plans at December 31, 2019 and 2018 was approximately $875,000 and $1,055,000, respectively. The Bank recognized approximately $607,000 and $280,000 in compensation expense related to the Plans for the years ending December 31, 2019 and 2018, respectively. In addition, the Bank made payouts of $787,000 and $196,000 for the years ending December 31, 2019 and 2018, respectively.