MBT FINANCIAL CORP
Form 10-Q
May 10, 2016

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

**Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934** For the quarterly period ended March 31, 2016

Or

**Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

Commission File Number: 000-30973

**MBT FINANCIAL CORP.**

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Michigan** | **38-3516922** |
| (State or other jurisdiction of<br>incorporation or organization) | (I.R.S. Employer<br>Identification No.) |

**102 E. Front Street**

**Monroe, Michigan 48161**

(Address of principal executive offices)

(Zip Code)

**(734) 241-3431**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

| | |
|---|---|
| Large accelerated filer | Accelerated Filer |
| Non-accelerated filer | Smaller reporting company |

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

As of May 10, 2016, there were 22,915,136 shares of the Company's Common Stock outstanding**.**

**Part I Financial Information**

**Item 1. Financial Statements**

**MBT FINANCIAL CORP.**

CONSOLIDATED BALANCE SHEETS

| Dollars in thousands | March 31, 2016 (Unaudited) | December 31, 2015 |
|---|---|---|
| **ASSETS** | | |
| Cash and Cash Equivalents | | |
| Cash and due from banks | | |
| Non-interest bearing | $ 11,845 | $ 14,996 |
| Interest bearing | 91,615 | 70,054 |
| Total cash and cash equivalents | 103,460 | 85,050 |
| | | |
| Securities - Held to Maturity | 42,816 | 41,282 |
| Securities - Available for Sale | 470,798 | 496,859 |
| Federal Home Loan Bank stock - at cost | 4,148 | 4,148 |
| | | |
| Loans held for sale | 646 | 1,477 |
| | | |
| Loans | 617,967 | 617,308 |
| Allowance for Loan Losses | (10,537 ) | (10,896 ) |
| Loans - Net | 607,430 | 606,412 |
| | | |
| Accrued interest receivable and other assets | 22,008 | 23,365 |
| Other Real Estate Owned | 1,587 | 2,383 |
| Bank Owned Life Insurance | 53,448 | 53,093 |
| Premises and Equipment - Net | 27,790 | 28,244 |
| Total assets | $ 1,334,131 | $ 1,342,313 |
| | | |
| **LIABILITIES** | | |
| Deposits: | | |
| Non-interest bearing | $ 259,140 | $ 253,795 |
| Interest-bearing | 903,593 | 911,598 |
| Total deposits | 1,162,733 | 1,165,393 |
| | | |
| Repurchase agreements | 15,000 | 15,000 |
| Interest payable and other liabilities | 13,974 | 14,579 |
| Total liabilities | 1,191,707 | 1,194,972 |

| | | |
|---|---|---|
| **STOCKHOLDERS' EQUITY** | | |
| Common stock (no par value; 50,000,000 shares authorized, 22,902,198 and 22,790,707 shares issued and outstanding) | **23,561** | **23,492** |
| Retained earnings | **117,082** | **126,214** |
| Unearned compensation | **(10)** | **(13)** |
| Accumulated other comprehensive income (loss) | **1,791** | **(2,352)** |
| Total stockholders' equity | **142,424** | **147,341** |
| Total liabilities and stockholders' equity | **$ 1,334,131** | **$ 1,342,313** |

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

**MBT FINANCIAL CORP.**

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME - UNAUDITED

| Dollars in thousands, except per share data | Three Months Ended March 31, 2016 | 2015 |
|---|---|---|
| **Interest Income** | | |
| Interest and fees on loans | **$7,035** | **$7,432** |
| Interest on investment securities- | | |
| Tax-exempt | **305** | **275** |
| Taxable | **2,526** | **2,428** |
| Interest on balances due from banks | **117** | **26** |
| Total interest income | **9,983** | **10,161** |
| **Interest Expense** | | |
| Interest on deposits | **517** | **645** |
| Interest on borrowed funds | **176** | **174** |
| Total interest expense | **693** | **819** |
| **Net Interest Income** | **9,290** | **9,342** |
| **Provision For (Recovery Of) Loan Losses** | **(300 )** | **(800 )** |
| **Net Interest Income After Provision For Loan Losses** | **9,590** | **10,142** |
| **Other Income** | | |
| Income from wealth management services | **1,097** | **1,222** |
| Service charges and other fees | **1,008** | **894** |
| Debit card income | **674** | **564** |
| Net gain on sales of securities available for sale | **320** | **236** |
| Net loss on sales of Other Real Estate Owned | **(56 )** | **(263 )** |
| Origination fees on mortgage loans sold | **130** | **129** |
| Bank owned life insurance income | **355** | **271** |
| Other | **586** | **572** |
| Total other income | **4,114** | **3,625** |
| **Other Expenses** | | |
| Salaries and employee benefits | **5,618** | **5,874** |
| Occupancy expense | **701** | **820** |
| Equipment expense | **684** | **734** |
| Marketing expense | **259** | **246** |
| Professional fees | **652** | **576** |
| EFT/ATM Expense | **309** | **90** |

| | | |
|---|---|---|
| Other Real Estate Owned expenses | **64** | **126** |
| FDIC Deposit Insurance Assessment | **169** | **414** |
| Bonding and other insurance expense | **122** | **230** |
| Telephone expense | **126** | **95** |
| Other | **779** | **614** |
| Total other expenses | **9,483** | **9,819** |
| | | |
| **Income Before Income Taxes** | **4,221** | **3,948** |
| **Income Tax Expense** | **1,224** | **1,171** |
| **Net Income** | **$2,997** | **$2,777** |
| | | |
| **Other Comprehensive Income - Net of Tax** | | |
| Unrealized gains on securities | **4,327** | **2,941** |
| Reclassification adjustment for gains included in net income | **(211 )** | **(156 )** |
| Postretirement benefit liability | **27** | **27** |
| **Total Other Comprehensive Income - Net of Tax** | **4,143** | **2,812** |
| | | |
| **Comprehensive Income** | **$7,140** | **$5,589** |
| | | |
| **Basic Earnings Per Common Share** | **$0.13** | **$0.12** |
| | | |
| **Diluted Earnings Per Common Share** | **$0.13** | **$0.12** |
| | | |
| **Common Stock Dividends Declared Per Share** | **$0.53** | **$-** |

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

**MBT FINANCIAL CORP.**

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY - UNAUDITED

| Dollars in thousands | **Common Stock** | **Retained Earnings** | **Unearned Compensation** | **Accumulated Other** Comprehensive **Income (Loss)** | **Total** |
|---|---|---|---|---|---|
| **Balance - January 1, 2016** | $ 23,492 | $ 126,214 | $ (13 ) | $ (2,352 ) | $ 147,341 |
| Issuance of Common Stock | | | | | |
| SOSARs exercised (95,856 shares) | 73 | - | - | - | 73 |
| Other stock issued (15,635 shares) | 124 | - | - | - | 124 |
| Equity Compensation | (128 ) | - | 3 | - | (125 ) |
| Dividends declared ($0.53 per share) | - | (12,129 ) | - | . | (12,129 ) |
| Net income | - | 2,997 | - | - | 2,997 |
| Other comprehensive income - net of tax | - | - | - | 4,143 | 4,143 |
| **Balance - March 31, 2016** | $ 23,561 | $ 117,082 | $ (10 ) | $ 1,791 | $ 142,424 |

| Dollars in thousands | **Common Stock** | **Retained Earnings** | **Unearned Compensation** | **Accumulated Other** Comprehensive Income (Loss) | **Total** |
|---|---|---|---|---|---|
| **Balance - January 1, 2015** | $ 23,037 | $ 114,132 | $ - | $ (2,633 ) | $ 134,536 |
| Issuance of Common Stock | | | | | |
| SOSARs exercised (7,856 shares) | - | - | - | - | - |
| Other stock issued (4,714 shares) | 26 | - | - | - | 26 |
| Equity Compensation | 57 | - | - | - | 57 |
| Net income | - | 2,777 | - | - | 2,777 |

| | | | | | |
|---|---|---|---|---|---|
| Other comprehensive income - net of tax | - | - | - | 2,812 | 2,812 |
| **Balance - March 31, 2015** | $ 23,120 | $ 116,909 | $ - | $ 179 | $ 140,208 |

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**MBT FINANCIAL CORP.**

CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED

| Dollars in thousands | Three Months Ended March 31, 2016 | 2015 |
|---|---|---|
| **Cash Flows from Operating Activities** | | |
| Net Income | $2,997 | $2,777 |
| Adjustments to reconcile net income to net cash from operating activities | | |
| Recovery of loan losses | (300) | (800) |
| Depreciation | 395 | 398 |
| Decrease in net deferred taxes | 1,224 | 1,155 |
| Net amortization of investment premium and discount | 290 | 282 |
| Writedowns of Other Real Estate Owned | 68 | 312 |
| Net decrease in interest payable and other liabilities | (565) | (737) |
| Net (increase) decrease in interest receivable and other assets | (1,764) | 443 |
| Equity based compensation expense | (52) | 58 |
| Net gain on sale/settlement of securities | (320) | (236) |
| Increase in cash surrender value of life insurance | (355) | (271) |
| Net cash provided by operating activities | $1,618 | $3,381 |
| **Cash Flows from Investing Activities** | | |
| Proceeds from maturities and redemptions of investment securities held to maturity | $1,793 | $686 |
| Proceeds from maturities and redemptions of investment securities available for sale | 57,157 | 47,011 |
| Proceeds from sales of investment securities available for sale | - | 8,430 |
| Net (increase) decrease in loans | 63 | (7,807) |
| Proceeds from sales of other real estate owned | 770 | 562 |
| Proceeds from sales of other assets | 149 | 65 |
| Purchase of investment securities held to maturity | (3,350) | (4,439) |
| Purchase of investment securities available for sale | (24,807) | (71,629) |
| Purchase of bank premises and equipment | (318) | (352) |
| Net cash provided by (used for) investing activities | $31,457 | $(27,473) |
| **Cash Flows from Financing Activities** | | |
| Net increase (decrease) in deposits | $(2,660) | $23,501 |
| Proceeds from issuance of common stock | 124 | 26 |
| Dividends paid | (12,129) | - |
| Net cash provided by (used for) financing activities | $(14,665) | $23,527 |
| **Net Increase (Decrease) in Cash and Cash Equivalents** | $18,410 | $(565) |
| **Cash and Cash Equivalents at Beginning of Period** | 85,050 | 52,122 |
| **Cash and Cash Equivalents at End of Period** | $103,460 | $51,557 |

| | | |
|---|---|---|
| **Supplemental Cash Flow Information** | | |
| Cash paid for interest | **$687** | **$823** |
| Cash paid for federal income taxes | **$-** | **$15** |
| | | |
| **Supplemental Schedule of Non Cash Investing Activities** | | |
| Transfer of loans to other real estate owned | **$29** | **$40** |
| Transfer of loans to other assets | **$21** | **$45** |

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

**MBT FINANCIAL CORP.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES

The unaudited consolidated financial statements include the accounts of MBT Financial Corp. (the “Company”) and its subsidiary, Monroe Bank & Trust (the “Bank”). The Bank includes the accounts of its wholly owned subsidiary, MB&T Financial Services, Inc. The Bank operates fourteen branches in Monroe County, Michigan, six branches in Wayne County, Michigan, and one loan and wealth management office in each Wayne County and Lenawee County. The Bank’s primary source of revenue is from providing loans to customers, who are predominantly small and middle-market businesses and middle-income individuals. The Company’s sole business segment is community banking.

The accounting and reporting policies of the Bank conform to practice within the banking industry and are in accordance with accounting principles generally accepted in the United States. Preparation of 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant changes in the near term are the determination of the allowance for loan losses, the valuation of other real estate owned, and the fair value of investment securities.

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, such information reflects all adjustments (consisting of normal recurring adjustments), which are, in the opinion of Management, necessary for fair statement of results for the interim periods.

The significant accounting policies are as follows:

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its subsidiary. All material intercompany transactions and balances have been eliminated.

COMPREHENSIVE INCOME

Accounting principles generally require that revenue, expenses, gains, and losses be included in net income. Certain changes in assets and liabilities, however, such as unrealized gains and losses on securities available for sale and amounts recognized related to postretirement benefit plans (gains and losses, prior service costs, and transition assets or obligations), are reported as a direct adjustment to the equity section of the balance sheet. Such items, along with net income, are components of comprehensive income.

BUSINESS SEGMENTS

While the Company's chief decision makers monitor the revenue streams of various products and services, operations are managed and financial performance is evaluated on a company wide basis. Accordingly, all of the Company’s operations are considered by management to be aggregated in one reportable segment.

FAIR VALUE

The Company measures or monitors many of its assets and liabilities on a fair value basis. Fair value is used on a recurring basis for assets and liabilities that are elected to be accounted for under The Fair Value Option as well as for certain assets and liabilities in which fair value is the primary basis of accounting. Examples of these include derivative instruments and available for sale securities. Additionally, fair value is used on a non-recurring basis to evaluate assets or liabilities for impairment or for disclosure purposes. Examples of these non-recurring uses of fair value include certain loans held for sale accounted for on a lower of cost or market basis. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Depending on the nature of the asset or liability, the Company uses various valuation techniques and assumptions when estimating fair value.

When determining the fair value measurements for assets and liabilities required or permitted to be recorded at and/or marked to fair value, the Company considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset or liability. When possible, the Company looks to active and observable markets to price identical assets or liabilities. When identical assets and liabilities are not traded in active markets, the Company looks to market observable data for similar assets or liabilities. Nevertheless, certain assets and liabilities are not actively traded in observable markets and the Company must use alternative valuation techniques to derive a fair value measurement.

ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2014-09 (ASU 2014-09), "Revenue from Contracts with Customers (Topic 606)". ASU 2014-09 adopts a standardized approach for revenue recognition and was a joint effort with the International Accounting Standards Board (IASB). The new revenue recognition standard is based on a core principle of recognizing revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 does not apply to financial instruments. ASU 2014-09 is effective for public entities for reporting periods beginning after December 15, 2016 (therefore, for the year ending December 31, 2017 for the Corporation). Early implementation is not allowed for public companies. Management is currently assessing the impact to the Corporation's consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities". The amendments in ASU 2016-01 supersede the guidance to classify equity securities with readily determinable fair values into different categories (that is, trading or available-for-sale) and require equity securities (including other ownership interests, such as partnerships, unincorporated joint ventures, and limited liability companies) to be measured at fair value with changes in the fair value recognized through net income. The amendments allow equity investments that do not have readily determinable fair values to be re-measured at fair value either upon the occurrence of an observable price change or upon identification of an impairment. The amendments also require enhanced disclosures about those investments. The amendments improve financial reporting by providing relevant information about an entity's equity investments and reducing the number of items that are recognized in other comprehensive income. For public business entities, the amendments in this update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The amendments should be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The adoption of this guidance is not expected to have a material effect on the Company's financial position or results of operations.

In February 2016, the Financial Accounting Standards Board issued ASU 2016-02, "Leases", which will supersede the current lease requirements in ASC 840. The ASU requires lessees to recognize a right of use asset and related lease liability for all leases, with a limited exception for short-term leases.  Leases will be classified as either finance or operating, with the classification affecting the pattern of expense recognition in the statement of operations. Currently, leases are classified as either capital or operating, with only capital leases recognized on the balance sheet. The reporting of lease related expenses in the statements of operations and cash flows will be generally consistent with the current guidance. The new lease footnote guidance will be effective for the Company's year ending December

31, 2019 and will be applied using a modified retrospective transition method to the beginning of the earliest period presented.  The effect of applying the new lease guidance on the financial statements as not yet been determined, however the new lease standard is not expected to have a significant effect on the Company’s financial statements.

2. EARNINGS PER SHARE

The calculations of earnings per common share are as follows:

| | For the three months ended March 31, | |
|---|---|---|
| | 2016 | 2015 |
| **Basic** | | |
| Net income | $2,997,000 | $2,777,000 |
| Average common shares outstanding | 22,854,556 | 22,721,845 |
| Earnings per common share - basic | $0.13 | $0.12 |
| | | |
| **Diluted** | | |
| Net income | $2,997,000 | $2,777,000 |
| Average common shares outstanding | 22,854,556 | 22,721,845 |
| Equity compensation | 160,401 | 184,489 |
| Average common shares outstanding - diluted | 23,014,957 | 22,906,334 |
| Earnings per common share - diluted | $0.13 | $0.12 |

3. STOCK BASED COMPENSATION

*Stock Only Stock Appreciation Rights (SOSARs)* - On February 25, 2016, 106,000 Stock Only Stock Appreciation Rights (SOSARs) were awarded to certain officers in accordance with the MBT 2008 Stock Incentive Plan that was approved by shareholders on May 1, 2008 and amended by shareholders on May 7, 2015. The SOSARs have a term of ten years and vest in three equal annual installments beginning on December 31, 2016. The fair value of $3.08 for the SOSARs was estimated at the date of the grant, using the Black-Scholes option pricing model, with the following assumptions: expected option lives of 7 years, expected volatility of 41.21%, a risk free interest rate of 1.47% and dividend yield of 1.50%. The fair value of the Company's common stock was $8.26 on the grant date.

SOSARs granted under the plan are structured as fixed grants with the base price equal to the market value of the underlying stock on the date of the grant.

The following table summarizes the SOSARs that have been granted:

| | SOSARs | Weighted Average |
|---|---|---|

| | | Base Price |
|---|---|---|
| SOSARs Outstanding, January 1, 2016 | 609,275 | $ 4.02 |
| Granted | 106,000 | 8.26 |
| Exercised | (174,227) | 2.60 |
| Forfeited | - | - |
| Expired | - | - |
| SOSARs Outstanding, March 31, 2016 | 541,048 | $ 5.31 |
| SOSARs Exercisable, March 31, 2016 | 316,829 | $ 4.36 |

The exercise of a SOSAR results in the issuance of a number of shares of common stock of the Company based on the appreciation of the market price of the stock over the base price of the SOSAR. The market value of the Company's common stock on March 31, 2016 was $8.05. The value of the exercisable SOSARs that are in-the-money as of March 31, 2016 was $1,200,000, and exercise of those SOSARs on that date would have resulted in the issuance of 149,118 shares of common stock. The plan allows participants to elect to withhold shares from the exercise of SOSARs to cover their tax liability. This may affect the number of shares issued and the value of the common stock account on the balance sheet and the statement of changes in equity.

*Restricted Stock Unit Awards* – On February 25, 2016, 35,000 performance restricted stock units were awarded to certain key executive officers in accordance with the MBT 2008 Stock Incentive Plan that was approved by shareholders on May 1, 2008 and amended by shareholders on May 7, 2015. Each Restricted Stock Unit (RSU) is equivalent to one share of MBT Financial Corp. common stock. Stock will be issued to the participants following a two year performance period that ends on December 31, 2017 if the defined performance targets are achieved. Earned RSUs vest on December 15, 2018 and as of March 31, 2016 none of the RSUs were vested.

*Restricted Stock Awards* – On February 25, 2016, 6,000 restricted shares were awarded to certain non-executive members of the board of directors in accordance with the MBT 2008 Stock Incentive Plan that was approved by shareholders on May 1, 2008 and amended by shareholders on May 7, 2015. The restricted shares vest on December 31, 2016. The expense for the restricted stock is based on the grant date value of $8.26 and is recognized over the vesting period. The unrecognized cost related to the non-vested restricted stock awards was $50,000 as of March 31, 2016.

The total expense for equity based compensation was $114,000 in the first quarter of 2016 and $83,000 in the first quarter of 2015.

4. LOANS

The Bank makes commercial, consumer, and mortgage loans primarily to customers in Monroe County, Michigan, southern and western Wayne County, Michigan, Lenawee County, Michigan, and surrounding areas. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent on the automotive, manufacturing, and real estate development economic sectors.

Loans consist of the following (000s omitted):

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Residential real estate loans | $218,305 | $213,989 |
| Commercial and Construction real estate loans | 259,149 | 259,139 |
| Agriculture and agricultural real estate loans | 19,344 | 19,243 |
| Commercial and industrial loans | 82,881 | 84,438 |

| | | |
|---|---|---|
| Loans to individuals for household, family, and other personal expenditures | 38,288 | 40,499 |
| Total loans, gross | $617,967 | $617,308 |
| Less: Allowance for loan losses | 10,537 | 10,896 |
| Net Loans | $607,430 | $606,412 |

Loans are placed in a nonaccrual status when, in the opinion of Management, the collection of additional interest is doubtful. All loan relationships over $250,000 that are classified by Management as nonperforming as well as selected performing accounts and all renegotiated loans are reviewed for impairment each quarter. Allowances for loans determined to be impaired are included in the allowance for loan losses. All cash received on nonaccrual loans is applied to the principal balance. Nonperforming assets consist of nonaccrual loans, loans 90 days or more past due, restructured loans, nonaccrual investment securities, other real estate owned, and other repossessed assets. Other real estate owned includes real estate that has been acquired in full or partial satisfaction of loan obligations or upon foreclosure and real estate that the bank has purchased but no longer intends to use for bank premises.

The following table summarizes nonperforming assets (000s omitted):

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Nonaccrual loans | $ 8,079 | $ 8,633 |
| Loans 90 days past due and accruing | 17 | 4 |
| Restructured loans | 17,828 | 18,910 |
| Total nonperforming loans | $ 25,924 | $ 27,547 |
| | | |
| Other real estate owned | 1,587 | 2,383 |
| Other assets | 21 | - |
| Total nonperforming assets | $ 27,532 | $ 29,930 |
| | | |
| Nonperforming assets to total assets | 2.06 % | 2.23 % |
| Allowance for loan losses to nonperforming loans | 40.65 % | 39.55 % |

5. ALLOWANCE FOR LOAN LOSSES

The Company separates its loan portfolio into segments to perform the calculation and analysis of the allowance for loan losses. The six segments analyzed are Agriculture and Agricultural Real Estate, Commercial, Commercial Real Estate, Construction Real Estate, Residential Real Estate, and Consumer and Other. The Agriculture and Agricultural Real Estate segment includes all loans to finance agricultural production and all loans secured by agricultural real estate. This segment does not include loans to finance agriculture that are secured by residential real estate, which are included in the Residential Real Estate segment. The Commercial segment includes loans to finance commercial and industrial businesses that are not secured by real estate. The Commercial Real Estate segment includes loans secured by non-farm, non-residential real estate. The Construction Real Estate segment includes loans to finance construction and land development. This includes residential and commercial construction and land development. The Residential Real Estate segment includes all loans, other than construction loans, that are secured by single family and multi family residential real estate properties. The Consumer and Other segment includes all loans not included in any other segment. These are primarily loans to consumers for household, family, and other personal expenditures, such as autos, boats, and recreational vehicles.

Activity in the allowance for loan losses during the three months ended March 31, 2016 was as follows (000s omitted):

| | Agriculture and Agricultural Real Estate | Commercial | Commercial Real Estate | Construction Real Estate | Residential Real Estate | Consumer and Other | Total |
|---|---|---|---|---|---|---|---|
| **Allowance for loan losses: For the three months ended March 31, 2016** | | | | | | | |
| Beginning Balance | $ 389 | $ 2,279 | $ 4,350 | $ 420 | $ 2,235 | $ 1,223 | $ 10,896 |
| Charge-offs | - | - | (56 ) | - | (91 ) | (62 ) | (209 ) |
| Recoveries | - | 33 | 23 | 13 | 58 | 23 | 150 |
| Provision | 98 | (715 ) | 701 | 42 | (282 ) | (144 ) | (300 ) |
| Ending balance | $ 487 | $ 1,597 | $ 5,018 | $ 475 | $ 1,920 | $ 1,040 | $ 10,537 |
| **Allowance for loan losses as of March 31, 2016** | | | | | | | |
| Ending balance individually evaluated for impairment | $ 241 | $ 525 | $ 763 | $ 269 | $ 387 | $ 209 | $ 2,394 |
| Ending balance collectively evaluated for impairment | 246 | 1,072 | 4,255 | 206 | 1,533 | 831 | 8,143 |
| Ending balance | $ 487 | $ 1,597 | $ 5,018 | $ 475 | $ 1,920 | $ 1,040 | $ 10,537 |
| **Loans as of March 31, 2016** | | | | | | | |
| Ending balance individually evaluated for impairment | $ 695 | $ 895 | $ 11,898 | $ 1,796 | $ 7,510 | $ 450 | $ 23,244 |
| Ending balance collectively evaluated for impairment | 18,649 | 81,986 | 230,917 | 14,538 | 210,795 | 37,838 | 594,723 |
| Ending balance | $ 19,344 | $ 82,881 | $ 242,815 | $ 16,334 | $ 218,305 | $ 38,288 | $ 617,967 |

Activity in the allowance for loan losses during the three months ended March 31, 2015 was as follows (000s omitted):

| | Agriculture and Agricultural | Commercial | Commercial Real Estate | Construction Real Estate | Residential Real Estate | Consumer and Other | Total |
|---|---|---|---|---|---|---|---|

| | Real Estate | | | | | | |
|---|---|---|---|---|---|---|---|
| **Allowance for loan losses: For the three months ended March 31, 2015** | | | | | | | |
| Beginning Balance | $ 216 | $ 1,361 | $ 6,179 | $ 803 | $ 3,226 | $ 1,423 | $ 13,208 |
| Charge-offs | - | (106) | - | - | (196) | (20) | (322) |
| Recoveries | 7 | 74 | 161 | 609 | 223 | 31 | 1,105 |
| Provision | 32 | 51 | (662) | (602) | (180) | 561 | (800) |
| Ending balance | $ 255 | $ 1,380 | $ 5,678 | $ 810 | $ 3,073 | $ 1,995 | $ 13,191 |
| **Allowance for loan losses as of March 31, 2015** | | | | | | | |
| Ending balance individually evaluated for impairment | $ 34 | $ 449 | $ 1,296 | $ 671 | $ 580 | $ 212 | $ 3,242 |
| Ending balance collectively evaluated for impairment | 221 | 931 | 4,382 | 139 | 2,493 | 1,783 | 9,949 |
| Ending balance | $ 255 | $ 1,380 | $ 5,678 | $ 810 | $ 3,073 | $ 1,995 | $ 13,191 |
| **Loans as of March 31, 2015** | | | | | | | |
| Ending balance individually evaluated for impairment | $ 917 | $ 1,255 | $ 18,248 | $ 1,969 | $ 11,480 | $ 523 | $ 34,392 |
| Ending balance collectively evaluated for impairment | 16,189 | 72,816 | 232,479 | 10,815 | 209,849 | 42,183 | 584,331 |
| Ending balance | $ 17,106 | $ 74,071 | $ 250,727 | $ 12,784 | $ 221,329 | $ 42,706 | $ 618,723 |

Each period the provision for loan losses in the income statement results from the combination of an estimate by Management of loan losses that occurred during the current period and the ongoing adjustment of prior estimates of losses occurring in prior periods.

The provision for loan losses increases the allowance for loan losses, a valuation account which appears on the consolidated balance sheets. As the specific customer and amount of a loan loss is confirmed by gathering additional information, taking collateral in full or partial settlement of the loan, bankruptcy of the borrower, etc., the loan is charged off, reducing the allowance for loan losses. If, subsequent to a charge off, the Bank is able to collect additional amounts from the customer or sell collateral worth more than earlier estimated, a recovery is recorded.

To serve as a basis for making this provision, the Bank maintains an extensive credit risk monitoring process that considers several factors including: current economic conditions affecting the Bank's customers, the payment performance of individual loans and pools of homogeneous loans, portfolio seasoning, changes in collateral values, and detailed reviews of specific loan relationships.

The Company utilizes an internal loan grading system to assign a risk grade to all commercial loans, all renegotiated loans, and each commercial credit relationship. Grades 10 through 45 are considered "pass" credits and grades 50 through 65 are considered "watch" credits and are subject to greater scrutiny. Loans with grades 70 through 95 and considered "doubtful" or "loss" and have generally been charged off. A description of the general characteristics of each grade is as follows:

- Grades 10 and 15 – Excellent – Loans secured by marketable collateral, with adequate margin, or supported by strong financial statements, including substantial levels of tangible net worth. Probability of serious financial deterioration is unlikely. Possess a sound repayment source and a secondary source. This classification will also include individual loans backed by liquid personal assets, established history and unquestionable character. High liquidity, minimum risk, strong ratios, and low handling costs are common to these loans.
- Grades 20 and 25 – Above Average – Loans that exhibit less than average risk and clearly demonstrate debt service coverage that is consistently above average as well as a strong capital base. These loans may have some deficiency or vulnerability, but with offsetting features and are considered to be fully collectable.
- Grades 30 and 35 – Satisfactory – Loans that have an acceptable amount of risk but may exhibit vulnerability to deterioration if adverse circumstances are encountered. These loans should demonstrate adequate debt service coverage and adequate levels of capital support but warrant periodic monitoring to ensure that weaknesses do not materialize or advance.
- Grades 40 and 45 – Pass – Loans that are considered "pass credits" and typically demonstrate adequate debt service coverage. The level of risk is considered acceptable but these loans warrant ongoing monitoring to ensure that adverse trends or other credit deficiencies have not materialized or advanced. The level of risk is considered acceptable so long as the loan is given adequate and ongoing management supervision.
- Grades 50 and 55 – Watch – Loans that possess some credit deficiency or potential weakness that deserves close attention. The primary source of loan repayment is sufficient but may be considered inadequate by the Bank's standards.
- Grades 60 and 65 – Substandard – Loans that exhibit one or more of the following characteristics: (1) a defined credit weakness, financial deterioration is underway, and uncertainty about the likelihood that the loan will be paid from the primary source of repayment; (2) inadequately protected by the current net worth and paying capacity of the obligor; (3) reliance on secondary source of repayment such as collateral liquidation or guarantees; (4) distinct possibility the Bank will sustain loss if deficiencies are not corrected; (5) unusual courses of action are needed to maintain a high probability of repayment; (6) insufficient cash flow to repay principal but continuing to pay interest; (7) the Bank is subordinated or unsecured due to flaws in documentation; (8) loans are restructured or are on nonaccrual status due to concessions to the borrower when compared to normal loan terms; (9) the Bank is contemplating foreclosure or legal

action due to the apparent deterioration in the loan; or (10) there is deterioration in the market conditions and the borrower is highly vulnerable to these conditions.

- Grades 70 and 75 – Doubtful – Loans that exhibit one or more of the following characteristics: (1) loans with all the weaknesses of Substandard loans and collection or liquidation is not probable to result in payment in full; (2) the primary source of repayment is gone and there is considerable doubt as to the quality of the secondary source of repayment; or (3) the possibility of loss is high, but certain important pending factors may strengthen the loan and loss classification is deferred.
- Grades 80-95 - Loss – Loans are considered uncollectible and of such little value that continuing to carry them on the Bank's financial statements is not feasible.

The assessment of compensating factors may result in a rating plus or minus one grade from those listed above. These factors include, but are not limited to collateral, guarantors, environmental conditions, history, plan/projection reasonableness, quality of information, and payment delinquency.

The portfolio segments in each credit risk grade as of March 31, 2016 are as follows (000s omitted):

**Credit Quality Indicators as of March 31, 2016**

Credit Risk by Internally Assigned Grade

| | Agriculture and Agricultural Real Estate | Commercial | Commercial Real Estate | Construction Real Estate | Residential Real Estate | Consumer and Other | Total |
|---|---|---|---|---|---|---|---|
| Not Rated | $ 137 | $ 1,368 | $ 256 | $ 6,734 | $ 134,608 | $ 30,495 | $ 173,598 |
| 10 | - | 5,656 | - | - | 59 | - | 5,715 |
| 20 | 306 | 340 | 512 | - | - | 365 | 1,523 |
| 30 | 614 | 13,020 | 8,175 | - | 367 | - | 22,176 |
| 40 | 13,076 | 55,403 | 184,484 | 5,579 | 68,456 | 7,247 | 334,245 |
| 45 | 2,106 | 2,139 | 7,402 | 1,454 | 3,852 | - | 16,953 |
| 50 | 1,326 | 3,491 | 22,343 | 2,206 | 3,137 | 16 | 32,519 |
| 55 | 179 | 240 | 3,961 | - | 90 | - | 4,470 |
| 60 | 1,600 | 1,224 | 15,682 | 361 | 7,736 | 165 | 26,768 |
| 70 | - | - | - | - | - | - | - |
| 80 | - | - | - | - | - | - | - |
| 90 | - | - | - | - | - | - | - |
| Total | $ 19,344 | $ 82,881 | $ 242,815 | $ 16,334 | $ 218,305 | $ 38,288 | $ 617,967 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Performing | $ 18,650 | $ 81,844 | $ 229,496 | $ 14,447 | $ 209,924 | $ 37,682 | $ 592,043 |
| Nonperforming | 694 | 1,037 | 13,319 | 1,887 | 8,381 | 606 | 25,924 |
| Total | $ 19,344 | $ 82,881 | $ 242,815 | $ 16,334 | $ 218,305 | $ 38,288 | $ 617,967 |

The portfolio segments in each credit risk grade as of December 31, 2015 are as follows (000s omitted):

**Credit Quality Indicators as of December 31, 2015**

Credit Risk by Internally Assigned Grade

| | Agriculture and Agricultural Real Estate | Commercial | Commercial Real Estate | Construction Real Estate | Residential Real Estate | Consumer and Other | Total |
|---|---|---|---|---|---|---|---|
| Not Rated | $ 102 | $ 2,173 | $ 310 | $ 6,789 | $ 136,049 | $ 32,461 | $ 177,884 |
| 10 | - | 2,717 | - | - | 60 | - | 2,777 |
| 20 | 306 | 359 | 533 | - | - | 366 | 1,564 |
| 30 | 432 | 17,024 | 7,620 | - | 373 | - | 25,449 |
| 40 | 14,413 | 55,204 | 184,504 | 6,548 | 62,347 | 7,453 | 330,469 |
| 45 | 840 | 1,094 | 6,506 | 74 | 2,957 | - | 11,471 |
| 50 | 1,340 | 3,428 | 23,678 | 2,163 | 3,948 | 18 | 34,575 |
| 55 | 929 | - | 3,700 | - | - | - | 4,629 |
| 60 | 881 | 2,439 | 16,369 | 345 | 8,255 | 201 | 28,490 |
| 70 | - | - | - | - | - | - | - |
| 80 | - | - | - | - | - | - | - |
| 90 | - | - | - | - | - | - | - |
| Total | $ 19,243 | $ 84,438 | $ 243,220 | $ 15,919 | $ 213,989 | $ 40,499 | $ 617,308 |
| | | | | | | | |
| Performing | $ 18,362 | $ 83,372 | $ 228,624 | $ 14,104 | $ 205,430 | $ 39,869 | $ 589,761 |
| Nonperforming | 881 | 1,066 | 14,596 | 1,815 | 8,559 | 630 | 27,547 |
| Total | $ 19,243 | $ 84,438 | $ 243,220 | $ 15,919 | $ 213,989 | $ 40,499 | $ 617,308 |

Loans are considered past due when contractually required payment of interest or principal has not been received. The amount classified as past due is the entire principal balance outstanding of the loan, not just the amount of payments that are past due. The following is a summary of past due loans as of March 31, 2016 and December 31, 2015 (000s omitted):

| **March 31, 2016** | 30-59 Days Past Due | 60-89 Days Past Due | >90 Days Past Due | Total Past Due | Current | Total Loans | Recorded Investment >90 |
|---|---|---|---|---|---|---|---|

| | | | | | | | Days Past Due and Accruing |
|---|---|---|---|---|---|---|---|
| Agriculture and Agricultural Real Estate | $134 | $- | $141 | $275 | $19,069 | $19,344 | $ - |
| Commercial | 44 | 58 | 60 | 162 | 82,719 | 82,881 | 17 |
| Commercial Real Estate | 1,320 | 108 | 2,129 | 3,557 | 239,258 | 242,815 | - |
| Construction Real Estate | - | - | - | - | 16,334 | 16,334 | - |
| Residential Real Estate | 1,487 | 327 | 465 | 2,279 | 216,026 | 218,305 | - |
| Consumer and Other | 14 | 27 | 41 | 82 | 38,206 | 38,288 | - |
| Total | $2,999 | $520 | $2,836 | $6,355 | $611,612 | $617,967 | $ 17 |

| **December 31, 2015** | 30-59 Days Past Due | 60-89 Days Past Due | >90 Days Past Due | Total Past Due | Current | Total Loans | Recorded Investment >90 Days Past Due and Accruing |
|---|---|---|---|---|---|---|---|
| Agriculture and Agricultural Real Estate | $136 | $213 | $44 | $393 | $18,850 | $19,243 | $ - |
| Commercial | 10 | 75 | 76 | 161 | 84,277 | 84,438 | 4 |
| Commercial Real Estate | 2,194 | 230 | 2,123 | 4,547 | 238,673 | 243,220 | - |
| Construction Real Estate | - | - | - | - | 15,919 | 15,919 | - |
| Residential Real Estate | 2,252 | 227 | 464 | 2,943 | 211,046 | 213,989 | - |
| Consumer and Other | 130 | 81 | 52 | 263 | 40,236 | 40,499 | - |
| Total | $4,722 | $826 | $2,759 | $8,307 | $609,001 | $617,308 | $ 4 |

Loans are placed on non-accrual status when, in the opinion of Management, the collection of additional interest is doubtful. Loans are automatically placed on non-accrual status upon becoming ninety days past due, however, loans may be placed on non-accrual status regardless of whether or not they are past due. All cash received on non-accrual loans is applied to the principal balance. Loans are considered for return to accrual status on an individual basis when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The following is a summary of non-accrual loans as of March 31, 2016 and December 31, 2015 (000s omitted):

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Agriculture and Agricultural Real Estate | $444 | $ 565 |
| Commercial | 167 | 148 |
| Commercial Real Estate | 4,611 | 4,823 |
| Construction Real Estate | 130 | 46 |
| Residential Real Estate | 2,572 | 2,915 |
| Consumer and Other | 155 | 136 |
| Total | $8,079 | $ 8,633 |

For loans deemed to be impaired due to an expectation that all contractual payments will probably not be received, impairment is measured by comparing the Bank's recorded investment in the loan to the present value of expected cash flows discounted at the loan's effective interest rate, the fair value of the collateral, or the loan's observable market price.

The following is a summary of impaired loans as of March 31, 2016 and 2015 (000s omitted):

| **March 31, 2016** | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment for the Three Months Ended | Interest Income Recognized in the Three Months Ended |
|---|---|---|---|---|---|

| | | | | | |
|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | |
| Agriculture and Agricultural Real Estate | $ - | $ - | $ - | $ - | $ - |
| Commercial | 156 | 206 | - | 163 | 3 |
| Commercial Real Estate | 6,679 | 7,206 | - | 7,017 | 66 |
| Construction Real Estate | 195 | 227 | - | 214 | 3 |
| Residential Real Estate | 4,238 | 4,484 | - | 4,447 | 55 |
| Consumer and Other | 16 | 16 | - | 17 | - |
| | | | | | |
| With an allowance recorded: | | | | | |
| Agriculture and Agricultural Real Estate | 695 | 702 | 241 | 825 | 4 |
| Commercial | 739 | 758 | 525 | 789 | 8 |
| Commercial Real Estate | 5,219 | 5,496 | 763 | 5,410 | 53 |
| Construction Real Estate | 1,601 | 1,600 | 269 | 1,605 | 18 |
| Residential Real Estate | 3,272 | 3,400 | 387 | 3,392 | 34 |
| Consumer and Other | 434 | 434 | 209 | 438 | 5 |
| | | | | | |
| Total: | | | | | |
| Agriculture and Agricultural Real Estate | $ 695 | $ 702 | $ 241 | $ 825 | $ 4 |
| Commercial | 895 | 964 | 525 | 952 | 11 |
| Commercial Real Estate | 11,898 | 12,702 | 763 | 12,427 | 119 |
| Construction Real Estate | 1,796 | 1,827 | 269 | 1,819 | 21 |
| Residential Real Estate | 7,510 | 7,884 | 387 | 7,839 | 89 |
| Consumer and Other | 450 | 450 | 209 | 455 | 5 |

| | Recorded Investment as of December 31, 2015 | Unpaid Principal Balance as of December 31, 2015 | Related Allowance as of December 31, 2015 | Average Recorded Investment for the Three Months Ended March 31, 2015 | Interest Income Recognized in the Three Months Ended March 31, 2015 |
|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | |
| Agriculture and Agricultural Real Estate | $ - | $ - | $ - | $ 255 | $ 3 |
| Commercial | 63 | 113 | - | 413 | 5 |
| Commercial Real Estate | 7,701 | 8,107 | - | 8,365 | 76 |
| Construction Real Estate | 200 | 233 | - | 339 | 3 |
| Residential Real Estate | 4,137 | 4,359 | - | 7,035 | 85 |
| Consumer and Other | 26 | 26 | - | 37 | 1 |
| With an allowance recorded: | | | | | |
| Agriculture and Agricultural Real Estate | 882 | 885 | 240 | 662 | 9 |
| Commercial | 895 | 916 | 672 | 936 | 11 |
| Commercial Real Estate | 5,697 | 6,183 | 634 | 11,903 | 124 |
| Construction Real Estate | 1,609 | 1,609 | 277 | 1,833 | 21 |
| Residential Real Estate | 3,206 | 3,310 | 506 | 5,055 | 57 |
| Consumer and Other | 470 | 468 | 223 | 491 | 5 |
| Total: | | | | | |
| Agriculture and Agricultural Real Estate | $ 882 | $ 885 | $ 240 | $ 917 | $ 12 |
| Commercial | 958 | 1,029 | 672 | 1,349 | 16 |
| Commercial Real Estate | 13,398 | 14,290 | 634 | 20,268 | 200 |
| Construction Real Estate | 1,809 | 1,842 | 277 | 2,172 | 24 |
| Residential Real Estate | 7,343 | 7,669 | 506 | 12,090 | 142 |
| Consumer and Other | 496 | 494 | 223 | 528 | 6 |

The Bank may agree to modify the terms of a loan in order to improve the Bank’s ability to collect amounts due. These modifications may include reduction of the interest rate, extension of the loan term, or in some cases, reduction of the principal balance. Modifications that are performed due to the debtor’s financial difficulties are considered Troubled Debt Restructurings (“TDRs”).

Loans that have been classified as TDRs during the three month period ended March 31, 2016 and March 31, 2015 are as follows (000s omitted from dollar amounts):

| | Three months ended March 31, 2016 | | | Three months ended March 31, 2015 | | |
|---|---|---|---|---|---|---|
| | Number of Contracts | Pre-Modification Recorded Principal Balance | Post-Modification Recorded Principal Balance | Number of Contracts | Pre-Modification Recorded Principal Balance | Post-Modification Recorded Principal Balance |
| Agriculture and Agricultural Real Estate | - | $ - | $ - | - | $ - | $ - |
| Commercial | - | - | - | - | - | - |
| Commercial Real Estate | - | - | - | 1 | 332 | 332 |
| Construction Real Estate | - | - | - | - | - | - |
| Residential Real Estate | 1 | 200 | 199 | - | - | - |
| Consumer and Other | - | - | - | - | - | - |
| Total | 1 | $ 200 | $ 199 | 1 | $ 332 | $ 332 |

The Bank considers TDRs that become past due under the modified terms as defaulted. There were no loans that became TDRs during the three month periods ended March 31, 2016 and March 31, 2015 that subsequently defaulted during the three month periods ended March 31, 2016 and March 31, 2015, respectively.

The Company has allocated $2,250,000 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings at March 31, 2016. In addition, there were no commitments to lend additional amounts to borrowers that are classified as troubled debt restructurings as of March 31, 2016 and March 31, 2015.

6. INVESTMENT SECURITIES

The following is a summary of the Bank's investment securities portfolio as of March 31, 2016 and December 31, 2015 (000s omitted):

| | **Held to Maturity** | | | |
|---|---|---|---|---|
| | **March 31, 2016** | | | |
| | **Amortized Cost** | **Gross Unrealized** Gains | **Gross Unrealized** Losses | **Estimated Market** Value |
| Obligations of States and Political Subdivisions | $42,316 | $ 1,501 | $ (105 ) | $ 43,712 |
| Corporate Debt Securities | 500 | 1 | - | 501 |
| | $42,816 | $ 1,502 | $ (105 ) | $ 44,213 |

| | **Available for Sale** | | | |
|---|---|---|---|---|
| | **March 31, 2016** | | | |
| | **Amortized Cost** | **Gross Unrealized** Gains | **Gross Unrealized** Losses | **Estimated Market** Value |
| Obligations of U.S. Government Agencies | $343,147 | $ 3,696 | $ (141 ) | $ 346,702 |
| Mortgage Backed Securities issued by U.S. Government Agencies | 99,549 | 586 | (568 ) | 99,567 |
| Obligations of States and Political Subdivisions | 17,160 | 293 | (19 ) | 17,434 |
| Corporate Debt Securities | 5,000 | - | (62 ) | 4,938 |
| Equity Securities | 2,044 | 113 | - | 2,157 |
| | $466,900 | $ 4,688 | $ (790 ) | $ 470,798 |

| | Held to Maturity | | | |
|---|---|---|---|---|
| | December 31, 2015 | | | |
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Market Value |
| Obligations of States and Political Subdivisions | $40,782 | $ 1,333 | $ (178 ) | $ 41,937 |
| Corporate Debt Securities | 500 | - | - | 500 |
| | $41,282 | $ 1,333 | $ (178 ) | $ 42,437 |

| | Available for Sale | | | |
|---|---|---|---|---|
| | December 31, 2015 | | | |
| | **Amortized Cost** | **Gross Unrealized** Gains | **Gross Unrealized** Losses | **Estimated Market** Value |
| Obligations of U.S. Government Agencies | $370,469 | $ 1,647 | $ (3,055 ) | $369,061 |
| Mortgage Backed Securities issued by U.S. Government Agencies | 104,472 | 107 | (1,327 ) | 103,252 |
| Obligations of States and Political Subdivisions | 17,212 | 305 | (48 ) | 17,469 |
| Corporate Debt Securities | 5,000 | - | (50 ) | 4,950 |
| Equity Securities | 2,044 | 83 | - | 2,127 |
| | $499,197 | $ 2,142 | $ (4,480 ) | $496,859 |

The amortized cost and estimated market values of securities by contractual maturity as of March 31, 2016 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.

| | Held to Maturity | | Available for Sale | |
|---|---|---|---|---|
| | **Amortized Cost** | **Estimated Market** Value | **Amortized Cost** | **Estimated Market** Value |
| Contractual maturity in | | | | |
| 1 year or less | $5,389 | $ 5,399 | $2,319 | $2,319 |
| After 1 year through five years | 26,744 | 27,242 | 216,430 | 218,412 |
| After 5 years through 10 years | 8,672 | 9,380 | 143,183 | 144,847 |
| After 10 years | 2,011 | 2,192 | 3,375 | 3,496 |
| Total | 42,816 | 44,213 | 365,307 | 369,074 |
| Mortgage Backed Securities | - | - | 99,549 | 99,567 |
| Securities with no stated maturity | - | - | 2,044 | 2,157 |
| Total | $42,816 | $ 44,213 | $466,900 | $470,798 |

The investment securities portfolio is evaluated for impairment throughout the year. Impairment is recorded against individual securities, unless the decrease in fair value is attributable to interest rates or the lack of an active market, and Management determines that the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before a recovery of their amortized costs bases, which may be maturity. The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses (in thousands), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at March 31, 2016 and December 31, 2015.

**March 31, 2016**

| | Less than 12 months | | 12 months or longer | | Total | |
|---|---|---|---|---|---|---|
| | Aggregate Fair Value | Gross Unrealized Losses | Aggregate Fair Value | Gross Unrealized Losses | Aggregate Fair Value | Gross Unrealized Losses |
| Obligations of United States Government Agencies | $32,965 | $ 132 | $6,748 | $ 9 | $39,713 | $ 141 |
| Mortgage Backed Securities issued by U.S. Government Agencies | 26,519 | 196 | 33,047 | 372 | 59,566 | 568 |
| Obligations of States and Political Subdivisions | 6,066 | 101 | 4,304 | 23 | 10,370 | 124 |
| Corporate Debt Securities | 4,938 | 62 | - | - | 4,938 | 62 |
| | $70,488 | $ 491 | $44,099 | $ 404 | $114,587 | $ 895 |

**December 31, 2015**

| | Less than 12 months | | 12 months or longer | | Total | |
|---|---|---|---|---|---|---|
| | Aggregate Fair Value | Gross Unrealized Losses | Aggregate Fair Value | Gross Unrealized Losses | Aggregate Fair Value | Gross Unrealized Losses |
| Obligations of United States Government Agencies | $170,178 | $ 2,367 | $53,497 | $ 688 | $223,675 | $ 3,055 |
| Mortgage Backed Securities issued by U.S. Government Agencies | 57,949 | 633 | 31,118 | 694 | 89,067 | 1,327 |
| Obligations of States and Political Subdivisions | 10,830 | 165 | 5,324 | 61 | 16,154 | 226 |
| Corporate Debt Securities | 4,950 | 50 | - | - | 4,950 | 50 |
| | $243,907 | $ 3,215 | $89,939 | $ 1,443 | $333,846 | $ 4,658 |

The amount of investment securities issued by government agencies, states, and political subdivisions with unrealized losses and the amount of unrealized losses on those investment securities are primarily the result of market interest rates and not the result of the credit quality of the issuers of the securities. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other than temporarily impaired at March 31, 2016. As of March 31, 2016 and December 31, 2015, there were 78 and 146 securities in an unrealized loss position, respectively.

7. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value, as defined in ASC Topic 820, is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability is not adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for market activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Fair value is used on a recurring basis for Available for Sale Securities. Additionally, fair value is used on a non-recurring basis to evaluate assets or liabilities for impairment or for disclosure purposes. Examples of these non-recurring uses of fair value include certain loans held for sale accounted for on a lower of cost or market basis. Depending on the nature of the asset or liability, the Company uses various valuation techniques and assumptions when estimating fair value.

The Company applied the following fair value hierarchy:

Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets. The Company’s mutual fund investments where quoted prices are available in an active market generally are classified within Level 1 of the fair value hierarchy.

Level 2 – Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. The Company’s borrowed funds and investments in U.S. government agency securities, government sponsored mortgage backed securities, corporate debt securities, and obligations of states and political subdivisions are generally classified in Level 2 of the fair value hierarchy. Fair values for these instruments are estimated using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement. Private equity investments and certain municipal debt obligations are classified within Level 3 of the fair value hierarchy. Fair values are initially valued based on transaction price and are adjusted to reflect exit values.

The following tables present information about the Company’s financial assets and liabilities measured at fair value on a recurring basis at March 31, 2016 and December 31, 2015, and the valuation techniques used by the Company to determine those fair values.

| March 31, 2016 | Carrying Value | Level 1 | Level 2 | Level 3 | Total Estimated Fair Value |
|---|---|---|---|---|---|
| Financial Assets: | | | | | |
| Cash and due from banks | $103,460 | $103,460 | $- | $- | $103,460 |
| Securities - Held to Maturity | | | | | |
| Obligations of States and Political Subdivisions | 42,316 | - | 3,798 | 39,914 | 43,712 |
| Corporate Debt Securities | 500 | - | 501 | - | 501 |
| | | | | | |
| Securities - Available for Sale | | | | | |
| Obligations of U.S. Government Agencies | 346,702 | - | 346,702 | - | 346,702 |
| MBS issued by U.S. Government Agencies | 99,567 | - | 99,567 | - | 99,567 |
| Obligations of States and Political Subdivisions | 17,434 | - | 17,434 | - | 17,434 |

| | | | | | |
|---|---|---|---|---|---|
| Corporate Debt Securities | 4,938 | - | 4,938 | - | 4,938 |
| Other Securities | 2,157 | 2,157 | - | - | 2,157 |
| | | | | | |
| Federal Home Loan Bank Stock | 4,148 | - | 4,148 | - | 4,148 |
| Loans Held for Sale | 646 | - | - | 660 | 660 |
| Loans, net | 607,430 | - | - | 614,498 | 614,498 |
| Accrued Interest Receivable | 4,725 | - | - | 4,725 | 4,725 |
| | | | | | |
| Financial Liabilities: | | | | | |
| Noninterest Bearing Deposits | 259,140 | 259,140 | - | - | 259,140 |
| Interest Bearings Deposits | 903,593 | - | 905,332 | - | 905,332 |
| Repurchase Agreements | 15,000 | - | 15,114 | - | 15,114 |
| Accrued Interest Payable | 115 | - | - | 115 | 115 |

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| December 31, 2015 | Carrying Value | Level 1 | Level 2 | Level 3 | Total Estimated Fair Value |
|---|---|---|---|---|---|
| Financial Assets: | | | | | |
| Cash and due from banks | $85,050 | $85,050 | $- | $- | $85,050 |
| Securities - Held to Maturity | | | | | |
| Obligations of States and Political Subdivisions | 40,782 | - | 3,805 | 38,132 | 41,937 |
| Corporate Debt Securities | 500 | - | 500 | - | 500 |
| | | | | | |
| Securities - Available for Sale | | | | | |
| Obligations of U.S. Government Agencies | 369,061 | - | 369,061 | - | 369,061 |
| MBS issued by U.S. Government Agencies | 103,252 | - | 103,252 | - | 103,252 |
| Obligations of States and Political Subdivisions | 17,469 | - | 17,469 | - | 17,469 |
| Corporate Debt Securities | 4,950 | - | 4,950 | - | 4,950 |
| Other Securities | 2,127 | 2,127 | - | - | 2,127 |
| | | | | | |
| Federal Home Loan Bank Stock | 4,148 | - | 4,148 | - | 4,148 |
| Loans Held for Sale | 1,477 | - | - | 1,508 | 1,508 |
| Loans, net | 606,412 | - | - | 613,397 | 613,397 |
| Accrued Interest Receivable | 4,170 | - | - | 4,170 | 4,170 |
| | | | | | |
| Financial Liabilities: | | | | | |
| Noninterest Bearing Deposits | 253,795 | 253,795 | - | - | 253,795 |
| Interest Bearings Deposits | 911,598 | - | 913,410 | - | 913,410 |
| Repurchase Agreements | 15,000 | - | 15,253 | - | 15,253 |
| Accrued Interest Payable | 108 | - | - | 108 | 108 |

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Company’s assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset.

The Company did not have any Level 3 assets measured at fair value on a recurring basis as of March 31, 2016 or December 31, 2015. The Company did not have any sales or purchases of Level 3 available for sale securities during the period.

Both observable and unobservable inputs may be used to determine the fair value of positions classified as Level 3 assets. As a result, the unrealized gains and losses for these assets presented in the tables above may include changes in fair value that were attributable to both observable and unobservable inputs.

The Company also has assets that under certain conditions are subject to measurement at fair value on a nonrecurring basis. These assets include loans and Other Real Estate Owned. The Company estimated the fair values of these assets using Level 3 inputs, specifically discounted cash flow projections.

Assets measured at fair value on a nonrecurring basis are as follows (000s omitted):

| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|
| Impaired loans | $ - | $ - | $ 20,850 |
| Other Real Estate Owned | $ - | $ - | $ 1,587 |

| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|
| Impaired loans | $ - | $ - | $ 22,334 |
| Other Real Estate Owned | $ - | $ - | $ 2,383 |

Impaired loans categorized as Level 3 assets consist of non-homogenous loans that are considered impaired. The Company estimates the fair value of the loans based on the present value of expected future cash flows using management's best estimate of key assumptions. These assumptions include future payment ability, timing of payment streams, and estimated realizable values of available collateral (typically based on outside appraisals). Other Real Estate Owned (OREO) consists of property received in full or partial satisfaction of a receivable. The Company utilizes independent appraisals to estimate the fair value of OREO properties.

## 8. FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated statements of condition.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for its other lending activities.

Financial instruments whose contractual amounts represent off-balance sheet credit risk were as follows (000s omitted):

| | Contractual Amount | |
|---|---|---|
| | March 31, 2016 | December 31, 2015 |
| Commitments to extend credit: | | |
| Unused portion of commercial lines of credit | $72,880 | $ 70,488 |
| Unused portion of credit card lines of credit | 4,412 | 4,396 |
| Unused portion of home equity lines of credit | 23,762 | 23,164 |
| Standby letters of credit and financial guarantees written | 1,555 | 1,555 |
| All other off-balance sheet commitments | - | - |

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. Most commercial lines of credit are secured by real estate mortgages or other collateral, and generally have fixed expiration dates or other termination clauses. Since the lines of credit may expire without being drawn upon, the total committed amounts do not necessarily represent future cash requirements. Credit card lines of credit have various established expiration dates, but are fundable on demand. Home equity lines of credit are secured by real estate mortgages, a majority of which have ten year expiration dates, but are fundable on demand. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of the collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on Management's credit evaluation of the counterparty.

Standby letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements and other business transactions.

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

Introduction

MBT Financial Corp. (the "Company") is a bank holding company with one commercial bank subsidiary, Monroe Bank & Trust (the "Bank"). The Bank operates 14 branch offices in Monroe County, Michigan and 6 branch offices in Wayne County, Michigan, and 1 loan and wealth management office in each Wayne County and Lenawee County, Michigan. The Bank closed 3 branch offices in Monroe County and 1 branch office in Wayne County in the first quarter of 2016. The Wayne County location where the retail branch was closed continues to serve as a loan and wealth management office.

The Bank's primary source of income is Net Interest Income (interest income on loans and investments less interest expense on deposits and borrowings), and its primary expense is the compensation of its employees. The discussion and analysis should be read in conjunction with the accompanying consolidated statements and footnotes.

Executive Overview

The Bank is operated as a community bank, primarily providing loan, deposit, and wealth management products and services to the people, businesses, and communities in its market area. In addition to our commitment to our mission of serving the needs of our local communities, we are focused on improving asset quality, increasing net interest income, and improving non-interest income and expenses.

The net profit of $2,997,000 for the quarter ended March 31, 2016 was an increase of $220,000 or 7.9% compared to the first quarter of 2015. The increase was the result of improvement in non-interest income and non-interest expense. These improvements exceeded the decreases in net interest income and the recovery of loan losses, resulting in increases in income before taxes and federal income tax expense. This quarter marked the nineteenth consecutive quarterly profit following significant losses caused by the severe economic downturn that impacted the regional and national economies beginning in 2006.

The national economic recovery is continuing slowly, and the recovery in southeast Michigan is relatively strong. Local unemployment rates continued to improve, with areas in our market better than the state and national averages. Commercial and residential development property values continue to improve, with some values reaching or exceeding their pre-recession levels. Our total classified assets, which include internal watch list loans, other real estate owned, and nonperforming and watch list investment securities, improved significantly during 2014 and 2015, and this trend of improvement is continuing into 2016. Classified assets went down $2.5 million, or 8.1% during the first quarter of 2016, and decreased $23.27 million or 45.0% compared to a year ago. The net charge offs for the quarter were only $59,000, or 0.04% of loans, annualized. This is a very good result, however, it is an increase compared to the first quarter of 2015 when we recorded a net recovery of $783,000 mainly due to a large recovery on one credit relationship. Due to improving loan quality metrics and lower charge offs, a reduction in our Allowance for Loan and Lease Losses (ALLL) was appropriate, and we recorded a $300,000 credit to the provision expense, reflecting an increase of $500,000 when compared to the negative provision of $800,000 recorded in the first quarter of 2015. The ALLL as a percent of loans decreased from 1.76% at the end of 2015 to 1.70%. We assess the adequacy of our ALLL each quarter, and adjust it as necessary by debiting or crediting the provision expense. The allowance includes $2.4 million of specific allocations on $23.2 million of loans evaluated for impairment and $8.1 million of general allocations on the remainder of the portfolio. The general allocation is based on the historical charge off experience of the previous 16 quarters. For the last several quarters, we have been replacing high charge off periods with low charge off periods in the calculation of our historical charge off rate, necessitating the negative provisions. If we continue to experience low charge off amounts like the $209,000 recorded this quarter, further negative provisions are likely to occur. However, significant growth in loans outstanding or deterioration of asset quality could require a provision expense.

Net Interest Income decreased $52,000, or 0.6% compared to the first quarter of 2015 even though the average earnings assets increased $50.9 million and the quarter was a day longer as the net interest margin decreased from 3.27% to 3.09%. The net interest margin decreased because the yield on earnings assets decreased more than the cost of interest bearing liabilities as interest rates remain at historically low levels. Non-interest income for the quarter increased $489,000, due to larger securities gains from bonds that were owned at discounts being called at par in the first quarter of 2016 than in the first quarter of 2015. Non-interest expenses decreased $336,000, as salaries, benefits, occupancy expenses, FDIC deposit insurance assessments, and insurance expenses decreased. These decreases were partially offset by increases in professional fees, ATM expenses, and other expenses that were related to some product changes and enhancements. We completed a branch efficiency initiative that began in the fourth quarter of 2015, which contributed to the decreases in salaries, benefits, and occupancy expenses.

## Critical Accounting Policies

The Company's Allowance for Loan Losses, Fair Value of Investment Securities, and Other Real Estate Owned are "critical accounting estimates" because they are estimates that are based on assumptions that are highly uncertain, and if different assumptions were used or if any of the assumptions used were to change, there could be a material impact on the presentation of the Company's financial condition. These assumptions include, but are not limited to, collateral values, the effect of economic conditions on the financial condition of the borrowers, the Company, and the issuers of investment securities, market interest rates, and projected earnings for the Company.

To determine the Allowance for Loan Losses, the Company estimates losses on all loans that are not classified as non accrual or renegotiated by applying historical loss rates, adjusted for current conditions, to those loans. In addition, all non accrual loan relationships over $250,000 that are classified by Management as nonperforming as well as selected performing accounts and all renegotiated loans are individually tested for impairment. Any amount of monetary impairment is included in the Allowance for Loan Losses.

To determine the fair value of investment securities, the Company utilizes quoted prices in active markets for identical assets, quoted prices for similar assets in active markets, or discounted cash flow calculations for investments where there is little, if any, market activity for the asset.

To determine the fair value of Other Real Estate Owned, the Company utilizes independent appraisals to estimate the fair value of the property.

Financial Condition

The regional economic recovery continued this quarter, with local unemployment and property values steadily improving since 2014. Management efforts are focused on improving asset quality, increasing net interest income, and improving non-interest income and expenses.

With respect to asset quality, our nonperforming assets (“NPAs”) decreased 8.0% during the quarter, from $29.9 million to $27.5 million, and total classified assets decreased 8.1% from $30.9 million to $28.4 million. Loan delinquencies decreased from 1.3% to 1.0% during the quarter. Over the last twelve months, NPAs decreased $12.5 million, or 31.2%, with nonperforming loans decreasing 26.2% from $35.1 million to $25.9 million, and Other Real Estate Owned (“OREO”) decreasing 67.1% from $4.9 million to $1.6 million. Total classified assets, which include internally classified watch list loans, other real estate, and watch list investment securities, decreased $23.2 million, or 45.0%. The Company’s Allowance for Loan and Lease Losses (“ALLL”) decreased $2.7 million over the last four quarters because of the improvement in the quality of the assets in the loan portfolio and a decrease in the historical loss rates. The ALLL is now 1.70% of loans, down from 2.13% at March 31, 2015. The ALLL is 40.65% of nonperforming loans (“NPLs”), compared to 39.55% at year end and 37.56% at March 31, 2015. In light of current economic conditions, we believe that this level of ALLL adequately estimates the potential losses in the loan portfolio.

Since December 31, 2015, total loans held for investment increased minimally as new loan activity was largely offset by payments received and other reductions in the period. Our pipeline of loans in process grew this quarter, and we expect new loan production to exceed run off, resulting in an increase in loans outstanding, in the next few quarters.

Since December 31, 2015, deposits decreased $2.7 million, other liabilities decreased $0.6 million and capital decreased $4.9 million, and as a result our total assets decreased $8.2 million, or 0.6%. The Company expects minimal deposit funding growth in the second quarter of 2016, as local municipalities that bank with us begin to distribute their property tax collections. The composition of deposits continues to change as customers move funds from maturing interest accounts to non interest bearing demand deposit accounts due to the low interest rate environment. The expected loan growth will be funded by reductions in our cash and investments. The decrease in total capital during the first quarter of 2016 was due to the payment of a special $0.50 per share dividend and the regular quarterly dividend of $0.03 per share. The total dividend payments of $12.1 million were offset by the profit of $3.0 million and the $4.1 million increase in the accumulated other comprehensive income (AOCI). AOCI increased mainly due to an increase in the value of our securities available for sale. Capital decreased at a higher rate than assets, causing the capital to assets ratio to decrease from 10.98% at December 31, 2015 to 10.68% at March 31, 2016.

Results of Operations – First Quarter 2016 vs. First Quarter 2015

Net Interest Income - A comparison of the income statements for the three months ended March 31, 2016 and 2015 shows a decrease of $52,000, or 0.6%, in Net Interest Income. Interest income on loans decreased $397,000 or 5.3% even though the average loans outstanding increased $4.0 million as the average yield on loans decreased from 4.89% to 4.56%. The loan yield decreased this quarter due to the continued low interest rates and a recovery of charged off interest in the first quarter of 2015, while average loans outstanding increased due to improving economic conditions and purchases of loan participations. The interest income on investments, fed funds sold, and interest bearing balances due from banks increased $219,000 even though the yield decreased from 1.97% to 1.95% because the average amount of investments, fed funds sold, and interest bearing balances due from banks increased $46.9 million and the quarter was a day longer this year. The Company continues to maintain a very high liquidity position by keeping a large amount of funds in low yielding short term investments and deposits in the Federal Reserve Bank. The interest expense on deposits decreased $128,000 or 19.8% even though the average deposits increased $39.7 million because the average cost of deposits decreased from 0.23% to 0.18%. The average cost of deposits decreased because maturing time deposits are either resetting at lower rates or customers are moving the funds to non interest bearing demand deposit accounts due to the low interest rate environment. The interest expense on borrowed funds increased $2,000 as the average amount of borrowed funds was unchanged at $15.0 million and the cost of borrowed funds was unchanged at 4.65%, but the quarter was one day longer.

Provision for Loan Losses - The Provision for Loan Losses increased $500,000 compared to the first quarter of 2015 as a $300,000 credit to provision expense was recorded in the first quarter of 2016, compared to the $800,000 credit to provision expense recorded in the first quarter of 2015. We charged off $209,000 of principal while recovering $150,000 of previously charged off loans in the first quarter of 2016, for a net charge off total of $59,000, or 0.04% of loans, annualized. Each quarter, the Company conducts a review and analysis of its ALLL to determine its adequacy. This analysis involves specific allocations for impaired credits and a general allocation for losses expected based on historical experience adjusted for current conditions. Due to an improvement in portfolio risk indicators and a decrease in the historical charge off percentages, the amount of ALLL required at the end of the first quarter of 2016 decreased from $10,896,000 at December 31, 2015 to $10,537,000. Along with the $59,000 net charge off, this required us to record a credit to the provision expense. The allowance includes $2.4 million of specific allocations and $8.1 million of general allocations. The general allocation is based on the historical charge off experience of the previous 16 quarters. For the last several quarters, we have been replacing high charge off periods with low charge off periods in the calculation of our historical charge off rate, necessitating the negative provisions. If we continue to experience low charge offs, further negative provisions are likely to occur. However, significant growth in loans outstanding or deterioration of asset quality could require a provision expense.

Other Income – Non interest income increased $489,000, or 13.5% compared to the first quarter of 2015. Excluding gains and losses on securities and other real estate owned activity, non-interest income increased $198,000, or 5.4%. Wealth management income decreased $125,000 or 10.2% as the market value of assets managed decreased. Service charges and other fees on deposit accounts increased $114,000, or 12.8% as we added new features and benefits to our primary checking account product and instituted a monthly service fee. Debit card income increased $110,000, or 19.5% due to increased activity. Gains on securities transactions increased $84,000 due to large gains in the first quarter of 2016 that were the result of the bonds purchased at discounts being called at par. Due to the low interest rates, issuers continue to call and refinance their debt, and we expect to record a larger gain in the second quarter of 2016. Losses from other real estate activity improved $207,000 due to smaller losses and write downs of the carrying values properties in the first quarter of 2016 compared to the first quarter of 2015.

Other Expenses – Total non-interest expenses decreased $336,000, or 3.4% compared to the first quarter of 2015. Salaries and Employee Benefits decreased $256,000, or 4.4%, as the number of full time equivalent employees decreased from 355 to 288 due to various efforts to reduce staffing in 2015, culminating in an efficiency initiative in the fourth quarter that resulted in the closing of 4 branch offices and the reduction of 43 staff positions. Occupancy expense decreased $119,000, or 14.5% due to lower utilities and maintenance costs, resulting from the efficiency initiative and the mild winter weather. Professional fees increased $76,000 or 13.2% due to increased consulting and legal expenses. Electronic Funds Transfer and Automated Teller Machine related expenses increased $219,000 due to increased debit card use, the reissuance of all of our debit cards with EMV chip cards in the first quarter of 2016, and an incentive payment received in the first quarter of 2015. FDIC insurance assessments decreased $245,000 and other insurance decreased $108,000 as the termination of our informal agreement with the FDIC and Michigan Department of Insurance and Financial Services in 2015 resulted in decreases in the rates. Other expense increased $165,000, primarily due to an accrual of $150,000 for estimated costs related to an incorrect filing of IRS 1099 forms.

As a result of the above activity, the Profit Before Income Taxes in the first quarter of 2016 was $4,221,000, an increase of $273,000 compared to the pre-tax profit of $3,948,000 in the first quarter of 2015. The Company recorded a federal income tax expense of $1,224,000 in the first quarter of 2016, reflecting an effective tax rate of 29.0%, compared to the tax expense of $1,171,000 in the first quarter of 2015, which reflected an effective rate of 29.7%. The decrease in the effective tax rate was the result of the increase in the percentage of operating income that was from municipal investments and bank owned life insurance. The Net profit for the first quarter of 2016 was $2,997,000, an increase of 7.9% compared to the net profit of $2,777,000 in the first quarter of 2015.

Cash Flows

Cash flows provided by operating activities decreased $1,763,000 compared to the first quarter of 2015 even though the net income was $220,000 higher due to the increase in interest receivable and other assets. Cash flows from investing activities increased by $58.9 million from $27.5 million used in the first quarter of 2015 to $31.5 million provided in the first quarter of 2016 as more cash was provided by investment security maturities and redemptions and less was invested in securities in the first quarter of 2016 than in the first quarter of 2015. In addition, $7.8 million less cash was used for loan growth as the loan portfolio grew in the first quarter of 2015 due to participation activity. The amount of cash used for financing activities in the first quarter of 2016 was $14.7 million, mainly due to the $12.1 million paid in dividends on the common stock. In the first quarter of 2015, $23.5 million of cash was provided by deposit growth. In the first quarter of 2015, the cash provided by operations and investing activities exceeded the use of cash for financing activities, resulting in an increase of $18.4 million in cash and cash equivalents during the quarter. In the first quarter of 2015, the use of cash for investing activities was slightly more than the cash provided by operations and financing activities, and the amount of cash and cash equivalents decreased by $565,000 during the period. We expect cash flows from redemptions of callable investment securities to remain high in the second quarter of 2016, but we plan to use that cash and the cash provided by operations to fund loan growth and investment security purchases, resulting in a reduction in our cash and cash equivalents by the end of the year.

Liquidity and Capital

The Company believes it has sufficient liquidity to fund its lending activity and allow for fluctuations in deposit levels. Internal sources of liquidity include the maturities of loans and securities in the ordinary course of business as well as our available for sale securities portfolio. External sources of liquidity include a line of credit with the Federal Home Loan Bank of Indianapolis, the Federal funds line that has been established with our correspondent bank, and Repurchase Agreements with money center banks that allow us to pledge securities as collateral for borrowings. As of March 31, 2016, the Bank was not utilizing any of its authorized limit of $255 million with the Federal Home Loan Bank of Indianapolis, or its $20 million overdraft line of credit with the Federal Home Loan Bank of Indianapolis, or its $25 million federal funds line with a correspondent bank. The Company periodically draws on its overdraft and fed funds lines to ensure that funding will be available if needed.

The Company’s Funds Management Policy includes guidelines for desired amounts of liquidity and capital. The Funds Management Policy also includes contingency plans for liquidity and capital that specify actions to take if liquidity and capital ratios fall below the levels contained in the policy. Throughout the first quarter of 2016 the Company was in compliance with its Funds Management Policy regarding liquidity and capital.

Total stockholders' equity of the Company was $142.4 million at March 31, 2016 and $147.3 million at December 31, 2015. Common stock increased $0.1 million due to the issuance of stock under compensation programs and for our Employee Stock Purchase Plan, retained earnings decreased $9.1 million as the year to date profit of $3.0 million was exceeded by the payment of $12.1 million in common stock dividends, and the Accumulated Other Comprehensive Income (AOCI) increased $4.1 million due to an increase in the value of our securities that are classified as Available For Sale. Total equity decreased $4.9 million while total assets decreased $8.2 million, so the ratio of equity to assets decreased from 10.98% at December 31, 2015 to 10.68% at March 31, 2016.

Federal bank regulatory agencies have set capital adequacy standards for Total Risk Based Capital, Tier 1 Risk Based Capital, and Leverage Capital. These standards require banks to maintain Leverage and Tier 1 ratios of at least 4% and a Total Capital ratio of at least 8% to be adequately capitalized. The regulatory agencies consider a bank to be well capitalized if its Total Risk Based Capital is at least 10% of Risk Weighted Assets, Tier 1 Capital is at least 8% of Risk Weighted Assets, and the Leverage Capital Ratio is at least 5%. The Basel III capital requirements that began to be phased in the first quarter of 2015 increased the well capitalized requirement for the Tier 1 Capital as a percent of Risk Weighted Assets from 6% to 8%. Basel III also implemented the new Common Equity Tier 1 Capital to Risk Weighted Assets ratio, with a minimum of 6.5% required to be considered well capitalized.

The following table summarizes the capital ratios of the Company and the Bank:

| | Actual | | Minimum to Qualify as Well Capitalized | |
|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio |
| **As of March 31, 2016:** | | | | |
| Total Capital to Risk-Weighted Assets | | | | |
| Consolidated | $145,379 | 18.74% | $77,557 | 10.0% |
| Monroe Bank & Trust | 143,643 | 18.54% | 77,477 | 10.0% |
| Tier 1 Capital to Risk-Weighted Assets | | | | |
| Consolidated | 135,594 | 17.48% | 62,045 | 8.0% |
| Monroe Bank & Trust | 133,870 | 17.28% | 61,982 | 8.0% |
| Common Equity Tier 1 Capital to Risk-Weighted Assets | | | | |
| Consolidated | 135,594 | 17.48% | 50,412 | 6.5% |
| Monroe Bank & Trust | 133,870 | 17.28% | 50,360 | 6.5% |
| Tier 1 Capital to Average Assets | | | | |
| Consolidated | 135,594 | 10.17% | 66,692 | 5.0% |
| Monroe Bank & Trust | 133,870 | 10.04% | 66,656 | 5.0% |

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| | Actual | | Minimum to Qualify as Well Capitalized | |
|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio |
| **As of December 31, 2015:** | | | | |
| Total Capital to Risk-Weighted Assets | | | | |
| Consolidated | $154,718 | 19.79 % | $78,163 | 10.0 % |
| Monroe Bank & Trust | 153,026 | 19.59 % | 78,107 | 10.0 % |
| Tier 1 Capital to Risk-Weighted Assets | | | | |
| Consolidated | 144,857 | 18.53 % | 62,531 | 8.0 % |
| Monroe Bank & Trust | 143,175 | 18.33 % | 62,485 | 8.0 % |
| Common Equity Tier 1 Capital to Risk-Weighted Assets | | | | |
| Consolidated | 144,857 | 18.53 % | 50,806 | 6.5 % |
| Monroe Bank & Trust | 143,175 | 18.33 % | 50,769 | 6.5 % |
| Tier 1 Capital to Average Assets | | | | |
| Consolidated | 144,857 | 11.04 % | 65,625 | 5.0 % |
| Monroe Bank & Trust | 143,175 | 10.91 % | 65,602 | 5.0 % |

Market risk for the Bank, as is typical for most banks, consists mainly of interest rate risk and market price risk. The Bank’s earnings and the economic value of its equity are exposed to interest rate risk and market price risk, and monitoring this risk is the responsibility of the Asset/Liability Management Committee (ALCO) of the Bank. The Bank’s market risk is monitored quarterly and it has not changed significantly since year-end 2015.

Forward-Looking Statements

Certain statements contained herein are not based on historical facts and are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements which are based on various assumptions (some of which are beyond the Company's control), may be identified by reference to a future period or periods, or by the use of forward-looking terminology, such as "may," "will," "believe," "expect," "estimate," "anticipate," "continue," or similar terms or variations on those terms, or the negative of these terms. Actual results could differ materially from those set forth in forward-looking statements, due to a variety of factors, including, but not limited to, those related to the economic environment, particularly in the market areas in which the Company operates, competitive products and pricing, fiscal and monetary policies of the U.S. Government, changes in government regulations affecting financial institutions, including regulatory fees and capital requirements, changes in prevailing interest rates, acquisitions and the integration of acquired businesses, credit risk management, asset/liability management, changes in the financial and securities markets, including changes with respect to the market value of our financial assets, the availability of and costs associated with sources of liquidity, and the ability of the Company to resolve or dispose of problem loans.

The Company does not undertake, and specifically disclaims any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

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

The Bank faces market risk to the extent that the fair values of its financial instruments are affected by changes in interest rates. The Bank does not face market risk due to changes in foreign currency exchange rates, commodity prices, or equity prices. The asset and liability management process of the Bank seeks to monitor and manage the amount of interest rate risk. This is accomplished by analyzing the differences in repricing opportunities for assets and liabilities, by simulating operating results under varying interest rate scenarios, and by estimating the change in the net present value of the Bank’s assets and liabilities due to interest rate changes.

Each quarter, the Asset and Liability Committee (ALCO), which includes the senior management of the Bank and a non executive member of the board of directors, estimates the effect of interest rate changes on the projected net interest income of the Bank. The sensitivity of the Bank’s net interest income to changes in interest rates is measured by using a computer based simulation model to estimate the impact on earnings of both gradual and sudden increases of 100, 200, 300, and 400 basis points and decreases of 100 and 200 basis points in the interest rates. The net interest income projections are compared to a base case projection, which assumes no changes in interest rates.

The Bank’s ALCO has established limits in the acceptable amount of interest rate risk, as measured by the change in the Bank’s projected net interest income, in its policy. Throughout the first quarter of 2016, the Bank’s interest rate risk has remained within its policy limits.

The ALCO also monitors interest rate risk by estimating the effect of changes in interest rates on the economic value of the Bank’s equity each quarter. The economic value of the Bank’s equity is first determined by subtracting the fair value of the Bank’s liabilities from the fair value of the Bank’s assets. The Bank estimates the interest rate risk by calculating the effect of market interest rate changes on that economic value of its equity. For this analysis, the Bank assumes immediate parallel shifts of plus 100, 200, 300, and 400 basis points and minus 100 and 200 basis points in interest rates. The discount rates used to determine the present values of the loans and deposits, as well as the prepayment rates for the loans, are based on Management’s expectations of the effect of the rate changes on the market for loans and deposits. In addition, each quarter, the Bank conducts additional analyses that utilize other rate scenarios, such as larger shifts in rates and changes in the shape of the yield curve, to assess the Bank’s exposure to interest rate risk in stress scenarios.

The Bank’s interest rate risk, as measured by the net interest income and economic value of equity simulations, has not changed significantly from December 31, 2015.

**Item 4. Controls and Procedures**

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of March 31, 2016, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of March 31, 2016, in alerting them in a timely manner to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings.

There was no change in the Company’s internal control over financial reporting that occurred during the Company’s fiscal quarter ended March 31, 2016, that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

**Part II Other Information**

**Item 1. Legal Proceedings**

MBT Financial Corp. and its subsidiaries are not a party to, nor is any of their property the subject of any material legal proceedings other than ordinary routine litigation incidental to their respective businesses, nor are any such proceedings known to be contemplated by governmental authorities.

**Item 1A. Risk Factors**

There have been no material changes in the risk factors disclosed by the Company in its Report on Form 10-K for the fiscal year ended December 31, 2015.

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

None.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

None.

**Item 5. Other Information**

No matters to be reported.

**Item 6. Exhibits**

| | |
|---|---|
| 3.1 | Articles of Incorporation of MBT Financial Corp. Previously filed as Exhibit 3.1 to MBT Financial Corp.'s Form 10-Q for its quarter ended June 30, 2011. |
| 3.2 | Amended and Restated Bylaws of MBT Financial Corp. Previously filed as Exhibit 3.2 to MBT Financial Corp.'s Form 10-Q for its quarter ended March 31, 2008. |
| 31.1 | Certification by Chief Executive Officer required by Securities and Exchange Commission Rule 13a-14. |
| 31.2 | Certification by Chief Financial Officer required by Securities and Exchange Commission Rule 13a-14. |
| 32.1 | Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as enacted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as enacted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

| | |
|---|---|
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

**Signatures**

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

| | |
|---|---|
| | MBT Financial Corp.<br>(Registrant) |
| May 10, 2016<br>Date | By: /s/ H. Douglas Chaffin<br>H. Douglas Chaffin<br>President &<br>Chief Executive Officer |
| May 10, 2016<br>Date | By: /s/ John L. Skibski<br>John L. Skibski<br>Executive Vice President and<br>Chief Financial Officer |

**Exhibit Index**

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