

CITY HOLDING CO
Form 10-Q
August 03, 2018
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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 June 30, 2018

OR

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

For The Transition Period From _____ To _____.

Commission File Number 0-11733

CITY HOLDING COMPANY

(Exact name of registrant as specified in its charter)

West Virginia

55-0619957

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

25 Gatewater Road

Charleston, West Virginia

25313

(Address of principal executive offices)

(Zip Code)

(304) 769-1100

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant has (1) 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.

YesNo

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).

YesNo

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 definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company []

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

Common stock, \$2.50 Par Value – 15,456,442 shares as of August 1, 2018.

FORWARD-LOOKING STATEMENTS

All statements other than statements of historical fact included in this Quarterly Report on Form 10-Q, including statements in Management's Discussion and Analysis of Financial Condition and Results of Operations are, or may be deemed to be, 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. Such information involves risks and uncertainties that could result in the Company's actual results differing materially from those projected in the forward-looking statements. Important factors that could cause actual results to differ materially from those discussed in such forward-looking statements include, but are not limited to, (1) the Company may incur additional loan loss provision due to negative credit quality trends in the future that may lead to a deterioration of asset quality; (2) the Company may incur increased charge-offs in the future; (3) the Company could have adverse legal actions of a material nature; (4) the Company may face competitive loss of customers; (5) the Company may be unable to manage its expense levels; (6) the Company may have difficulty retaining key employees; (7) changes in the interest rate environment may have results on the Company's operations materially different from those anticipated by the Company's market risk management functions; (8) changes in general economic conditions and increased competition could adversely affect the Company's operating results; (9) changes in regulations and government policies affecting bank holding companies and their subsidiaries, including changes in monetary policies, could negatively impact the Company's operating results; (10) the Company may experience difficulties growing loan and deposit balances; (11) deterioration in the financial condition of the U.S. banking system may impact the valuations of investments the Company has made in the securities of other financial institutions resulting in either actual losses or other than temporary impairments on such investments; (12) the effects of the Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and the regulations promulgated and to be promulgated thereunder, which may subject the Company and its subsidiaries to a variety of new and more stringent legal and regulatory requirements which adversely affect their respective businesses; (13) the impact of new minimum capital thresholds established as a part of the implementation of Basel III; (14) the businesses of City Holding Company, City National Bank of West Virginia, Poage Bankshares, Inc., Town Square Bank, Farmer's Deposit Bancorp, Inc. and Farmers Deposit Bank may not integrate successfully or such integration may take longer to accomplish than expected (15) the expected cost savings and any revenue synergies from the merger of City Holding Company, City National Bank of West Virginia, Poage Bankshares, Inc., Town Square Bank, Farmer's Deposit Bancorp, Inc. and Farmers Deposit Bank may not be fully realized within the expected time frames; (16) the disruption from the merger of City Holding Company, City National Bank of West Virginia, Poage Bankshares, Inc., Town Square Bank, Farmer's Deposit Bancorp, Inc. may make it more difficult to maintain relationships with clients, associates, or suppliers; and (17) other risk factors relating to the banking industry or the Company as detailed from time to time in the Company's reports filed with the Securities and Exchange Commission, including those risk factors included in the disclosures under the heading "Item 1A Risk Factors" of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017. Forward-looking statements made herein reflect management's expectations as of the date such statements are made. Such information is provided to assist stockholders and potential investors in understanding current and anticipated financial operations of the Company and is included pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances that arise after the date such statements are made.

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City Holding Company and Subsidiaries

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Part I - FINANCIAL INFORMATION

Item 1 - Financial Statements

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Consolidated Balance Sheets

City Holding Company and Subsidiaries

(in thousands)

	(Unaudited)	
	June 30, 2018	December 31, 2017
Assets		
Cash and due from banks	\$240,483	\$ 54,450
Interest-bearing deposits in depository institutions	25,041	28,058
Cash and Cash Equivalents	265,524	82,508
Investment securities available for sale, at fair value	552,603	550,389
Investment securities held-to-maturity, at amortized cost (approximate fair value at June 30, 2018 and December 31, 2017 - \$59,628 and \$65,646, respectively)	60,030	64,449
Other securities	28,920	14,147
Total Investment Securities	641,553	628,985
Gross loans	3,155,468	3,127,410
Allowance for loan losses	(16,876)	(18,836)
Net Loans	3,138,592	3,108,574
Bank owned life insurance	104,773	103,440
Premises and equipment, net	72,482	72,682
Accrued interest receivable	9,348	9,223
Net deferred tax asset	14,528	11,913
Goodwill and other intangible assets, net	78,342	78,595
Other assets	49,241	36,361
Total Assets	\$4,374,383	\$ 4,132,281
Liabilities		
Deposits:		
Noninterest-bearing	\$684,614	\$ 666,639
Interest-bearing:		
Demand deposits	785,933	769,245
Savings deposits	817,547	796,275
Time deposits	1,133,684	1,083,475
Total Deposits	3,421,778	3,315,634
Short-term borrowings:		
Federal funds purchased	181,375	54,000
Customer repurchase agreements	196,635	198,219
Long-term debt	16,495	16,495
Other liabilities	54,346	45,426
Total Liabilities	3,870,629	3,629,774
Shareholders' Equity		
Preferred stock, par value \$25 per share: 500,000 shares authorized; none issued	—	—
Common stock, par value \$2.50 per share: 50,000,000 shares authorized; 19,047,548 shares issued at June 30, 2018 and December 31, 2017, less 3,595,092 and 3,429,519 shares in treasury, respectively	47,619	47,619

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Capital surplus	140,091	140,960
Retained earnings	471,515	444,481
Cost of common stock in treasury	(136,520)	(124,909)
Accumulated other comprehensive income (loss):		
Unrealized (loss) on securities available-for-sale	(13,918)	(611)
Underfunded pension liability	(5,033)	(5,033)
Total Accumulated Other Comprehensive Income (Loss)	(18,951)	(5,644)
Total Shareholders' Equity	503,754	502,507
Total Liabilities and Shareholders' Equity	\$4,374,383	\$4,132,281
See notes to consolidated financial statements.		

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Consolidated Statements of Income (Unaudited)
City Holding Company and Subsidiaries
(in thousands, except earnings per share data)

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Interest Income				
Interest and fees on loans	\$34,292	\$31,115	\$67,210	\$61,219
Interest and dividends on investment securities:				
Taxable	4,117	3,480	8,098	6,924
Tax-exempt	710	686	1,413	1,349
Interest on deposits in depository institutions	61	17	103	20
Total Interest Income	39,180	35,298	76,824	69,512
Interest Expense				
Interest on deposits	4,918	3,660	9,244	7,088
Interest on short-term borrowings	459	187	919	344
Interest on long-term debt	230	189	441	370
Total Interest Expense	5,607	4,036	10,604	7,802
Net Interest Income	33,573	31,262	66,220	61,710
(Recovery of) provision for loan losses	(2,064))510	(1,882))1,191
Net Interest Income After (Recovery of) Provision for Loan Losses	35,637	30,752	68,102	60,519
Non-Interest Income				
Net gains on sale of investment securities	—	—	—	4,276
Service charges	7,323	7,074	14,185	13,805
Bankcard revenue	4,532	4,372	8,866	8,512
Trust and investment management fee income	1,645	1,612	3,214	2,998
Bank owned life insurance	722	968	1,543	2,197
Other income	1,389	895	2,297	1,642
Total Non-Interest Income	15,611	14,921	30,105	33,430
Non-Interest Expense				
Salaries and employee benefits	13,551	12,780	26,792	25,948
Occupancy related expense	2,346	2,462	4,750	4,935
Equipment and software related expense	1,895	2,004	3,727	3,895
FDIC insurance expense	313	328	627	703
Advertising	849	781	1,636	1,514
Bankcard expenses	1,064	970	2,139	1,913
Postage, delivery, and statement mailings	515	504	1,093	1,059
Office supplies	329	345	643	706
Legal and professional fees	475	440	925	889
Telecommunications	441	492	941	976
Reposessed asset losses, net of expenses	112	147	482	482
Other expenses	3,021	2,920	6,099	5,756
Total Non-Interest Expense	24,911	24,173	49,854	48,776
Income Before Income Taxes	26,337	21,500	48,353	45,173
Income tax expense	5,358	6,812	9,763	14,459
Net Income Available to Common Shareholders	\$20,979	\$14,688	\$38,590	\$30,714

Total Comprehensive Income	\$18,542	\$16,742	\$27,940	\$33,641
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Average shares outstanding, basic	15,326	15,462	15,370	15,344
Effect of dilutive securities	19	25	20	25
Average shares outstanding, diluted	15,345	15,487	15,390	15,369
Basic earnings per common share	\$ 1.36	\$ 0.94	\$ 2.49	\$ 1.98
Diluted earnings per common share	\$ 1.35	\$ 0.94	\$ 2.48	\$ 1.98
Dividends declared per common share	\$ 0.46	\$ 0.44	\$ 0.92	\$ 0.88

See notes to consolidated financial statements.

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Consolidated Statements of Comprehensive Income (Unaudited)
 City Holding Company and Subsidiaries
 (in thousands)

	Three Months Ended June 30, 2018		Six Months Ended June 30, 2018	
	2017	2018	2017	2018
Net income	\$20,979	\$14,688	\$38,590	\$30,714
Unrealized (losses) gains on available-for-sale securities arising during the period	(3,170)	3,256	(13,882)	8,916
Reclassification adjustment for gains	—	—	—	(4,276)
Other comprehensive (loss) income before income taxes	(3,170)	3,256	(13,882)	4,640
Tax effect	733	(1,202)	3,232	(1,713)
Other comprehensive income (loss), net of tax	(2,437)	2,054	(10,650)	2,927
Comprehensive Income, Net of Tax	\$18,542	\$16,742	\$27,940	\$33,641

See notes to consolidated financial statements.

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Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
City Holding Company and Subsidiaries
Six Months Ended June 30, 2018 and 2017
(in thousands)

	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2017	\$47,619	\$140,960	\$444,481	\$(124,909)	\$ (5,644)	\$ 502,507
Net income	—	—	38,590	—	—	38,590
Other comprehensive income	—	—	—	—	(10,650)	(10,650)
Adoption of new accounting pronouncement (see Note B)	—	—	2,657	—	(2,657)	—
Cash dividends declared (\$0.92 per share)	—	—	(14,213)	—	—	(14,213)
Stock-based compensation expense	—	1,242	—	—	—	1,242
Restricted awards granted	—	(1,494)	—	1,494	—	—
Exercise of 25,147 stock options	—	(617)	—	1,585	—	968
Purchase of 214,327 treasury shares	—	—	—	(14,690)	—	(14,690)
Balance at June 30, 2018	\$47,619	\$140,091	\$471,515	\$(136,520)	\$ (18,951)	\$ 503,754

	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 2016	\$46,518	\$112,873	\$417,017	\$(126,958)	\$ (7,012)	\$ 442,438
Net income	—	—	30,714	—	—	30,714
Other comprehensive income	—	—	—	—	2,927	2,927
Cash dividends declared (\$0.88 per share)	—	—	(13,787)	—	—	(13,787)
Stock-based compensation expense	—	1,210	—	—	—	1,210
Restricted awards granted	—	(1,317)	—	1,317	—	—
Issuance of 440,604 shares of common stock	1,101	27,307	—	—	—	28,408
Exercise of 16,639 stock options	—	(101)	—	698	—	597
Balance at June 30, 2017	\$47,619	\$139,972	\$433,944	\$(124,943)	\$ (4,085)	\$ 492,507

See notes to consolidated financial statements.

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Consolidated Statements of Cash Flows (Unaudited)
City Holding Company and Subsidiaries
(in thousands)

	Six months ended June 30,	
	2018	2017
Net income	\$38,590	\$30,714
Adjustments to reconcile net income to net cash provided by operating activities:		
Accretion and amortization	716	433
(Recovery of) provision for loan losses	(1,882)	1,191
Depreciation of premises and equipment	2,555	3,036
Deferred income tax expense	781	3,387
Net periodic employee benefit cost	342	225
Unrealized gains recognized on securities still held	(772)	—
Realized investment securities gains	—	(4,276)
Stock-compensation expense	1,242	1,210
Excess tax benefit from stock-compensation expense	(154)	(550)
Proceeds from life insurance	210	1,625
Increase in value of bank-owned life insurance	(1,333)	(1,228)
Loans originated for sale	(5,869)	(9,384)
Proceeds from the sale of loans originated for sale	6,011	11,583
Gain on sale of loans	(163)	(309)
Change in accrued interest receivable	(125)	286
Change in other assets	(13,090)	2,576
Change in other liabilities	8,491	(179)
Net Cash Provided by Operating Activities	35,550	40,340
Proceeds from sales of securities available-for-sale	—	5,576
Proceeds from maturities and calls of securities available-for-sale	36,472	35,491
Proceeds from maturities and calls of securities held-to-maturity	4,362	5,301
Purchases of securities available-for-sale	(67,619)	(89,517)
Net increase in loans	(27,473)	(40,321)
Purchases of premises and equipment	(2,710)	(3,070)
Disposals of premises and equipment	510	2,282
Net Cash Used in Investing Activities	(56,458)	(84,258)
Net increase in non-interest-bearing deposits	17,975	15,937
Net increase in interest-bearing deposits	88,169	30,573
Net increase (decrease) in short-term borrowings	125,791	(24,001)
Proceeds from issuance of common stock	—	28,408
Purchases of treasury stock	(14,690)	—
Proceeds from exercise of stock options	968	597
Dividends paid	(14,289)	(13,375)
Net Cash Provided by Financing Activities	203,924	38,139
Increase (Decrease) in Cash and Cash Equivalents	183,016	(5,779)
Cash and cash equivalents at beginning of period	82,508	88,139
Cash and Cash Equivalents at End of Period	\$265,524	\$82,360

See notes to consolidated financial statements.

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Notes to Consolidated Financial Statements (Unaudited)
June 30, 2018

Note A –Background and Basis of Presentation

City Holding Company ("City Holding"), a West Virginia corporation headquartered in Charleston, West Virginia, is a registered financial holding company under the Bank Holding Company Act and conducts its principal activities through its wholly-owned subsidiary, City National Bank of West Virginia ("City National"). City National is a retail and consumer-oriented community bank with 86 banking offices in West Virginia (57), Virginia (14), Kentucky (12) and southeastern Ohio (3). City National provides credit, deposit, and trust and investment management services to its customers in a broad geographical area that includes many rural and small community markets in addition to larger cities including Charleston (WV), Huntington (WV), Martinsburg (WV), Winchester (VA), Staunton (VA), Virginia Beach (VA), Ashland (KY) and Lexington (KY). In addition to its branch network, City National's delivery channels include automated-teller-machines ("ATMs"), interactive-teller machines ("ITMs"), mobile banking, debit cards, interactive voice response systems, and Internet technology. The Company's business activities are currently limited to one reportable business segment, which is community banking.

The accompanying consolidated financial statements, which are unaudited, include all of the accounts of City Holding Company and its wholly-owned subsidiaries (collectively, the "Company"). All material intercompany transactions have been eliminated. The consolidated financial statements include all adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations and financial condition for each of the periods presented. Such adjustments are of a normal recurring nature. The results of operations for the six months ended June 30, 2018 are not necessarily indicative of the results of operations that can be expected for the year ending December 31, 2018. The Company's accounting and reporting policies conform with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Such policies require management to make estimates and develop assumptions that affect the amounts reported in the consolidated financial statements and related footnotes. Actual results could differ from management's estimates.

The consolidated balance sheet as of December 31, 2017 has been derived from audited financial statements included in the Company's 2017 Annual Report to Shareholders. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles have been omitted. These financial statements should be read in conjunction with the financial statements and notes thereto included in the 2017 Annual Report of the Company.

Certain amounts in the financial statements have been reclassified. Such reclassifications had no impact on shareholders' equity or net income for any period.

Note B – Recent Accounting Pronouncements

Recently Adopted:

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)." This standard clarifies the principles for recognizing revenue and developed a common revenue standard. The core principle of the standard is that an entity should recognize 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 and services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract or contracts with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. The FASB also issued several amendments to the

standard, including clarifications relating to performance obligations and licensing implementation guidance and reporting gross versus net revenue. The Company adopted the standard effective January 1, 2018 using the modified retrospective approach, but did not record a cumulative effect adjustment to opening retained earnings given the immaterial impact. As part of the adoption, the Company evaluated the terms of the contracts that supported each of the revenue streams that were within the scope of ASU 2014-09 and determined that the adoption did not significantly change the way the Company recognizes revenue from each stream (see Note M - Contracts with Customers).

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." This standard makes several modifications to Subtopic 825-10 including the elimination of the available-for-sale classification of equity investments, and requires equity investments with readily determinable fair values to be measured at fair value with changes in fair value recognized in net income. This ASU became effective for the Company for interim and annual periods on January 1, 2018. During the six months ended June 30, 2018, a \$0.8

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million gain was recognized in other income in the consolidated statements of income as a result of the change in the fair value of equity and perpetual preferred securities due to the adoption of ASU 2016-01. Additionally, \$2.7 million, net of deferred taxes, was reclassified from other comprehensive income to retained earnings on the consolidated balance sheets to recognize the prior period unrealized gain position of these securities (see Note C - Investments and Note J - Accumulated Other Comprehensive Loss).

In January 2017, the FASB issued ASU No. 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business." This amendment clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. This ASU became effective for the Company on January 1, 2018. The adoption of ASU No. 2017-01 did not have a material impact on the Company's financial statements.

In March 2017, the FASB issued ASU No. 2017-07, "Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." This amendment requires that an employer disaggregate the service cost component from the other components of net benefit cost and also provides explicit guidance on how to present the service cost component and the other components of net benefit cost in the income statement. This ASU became effective for the Company on January 1, 2018. The adoption of ASU No. 2017-07 did not have a material impact on the Company's financial statements.

In May 2017, the FASB issued ASU No. 2017-09, "Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting." This amendment provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in ASU No. 2016-09. This ASU became effective for the Company on January 1, 2018. The adoption of ASU No. 2017-09 did not have a material impact on the Company's financial statements.

In September 2017, the FASB issued ASU No. 2017-13, "Revenue Recognition (Topic 605), Revenue from Contracts with Customers (Topic 606), Leases (Topic 840), and Leases (Topic 842)." This amendment provides modifications to previously issued ASUs 2014-09 and 2016-02. The adoption of ASU No. 2017-13 did not have a material impact on the Company's financial statements.

In November 2017, the FASB issued ASU No. 2017-14, "Income Statement—Reporting Comprehensive Income (Topic 220), Revenue Recognition (Topic 605), and Revenue from Contracts with Customers (Topic 606)." This amendment supersedes various SEC paragraphs and amends an SEC paragraph pursuant to the issuance of Staff Accounting Bulletin No. 116. The adoption of ASU No. 2017-14 did not have a material impact on the Company's financial statements.

In February 2018, the FASB issued ASU No. 2018-02, "Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." This amendment permits entities to reclassify tax effects stranded in accumulated other comprehensive income as a result of the Tax Cuts and Jobs Act ("TCJA") to retained earnings. The guidance is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permissible. The Company elected to early adopt this amendment as of December 31, 2017 and the December 31, 2017 balance sheet reflects this adoption.

Pending Adoption:

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." This standard requires organizations to recognize lease assets and lease liabilities on the balance sheet and disclose key information about leasing requirements for leases that were historically classified as operating leases under previous generally accepted

accounting principals. This ASU will become effective for the Company for interim and annual periods on January 1, 2019. The Company's preliminary evaluation indicates that the adoption of ASU 2016-02 will have an immaterial impact on the Company's consolidated balance sheet. However, the Company continues to evaluate the extent of the potential impact the new guidance will have on the Company's consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." This standard replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendments in this update require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The new current expected credit losses model (CECL) will apply to the allowance for loan losses, available-for-sale and held-to-maturity debt securities, purchased financial assets with credit deterioration and certain off-balance sheet credit exposures. This ASU will become effective for the

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Company for interim and annual periods on January 1, 2020. Management is currently evaluating the potential impact of ASU No. 2016-13 on the Company's financial statements.

In January 2017, the FASB issued ASU No. 2017-04, "Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment." This amendment simplifies the measurement of goodwill by eliminating Step 2 from the goodwill impairment test. This ASU will become effective for the Company on January 1, 2020. The adoption of ASU No. 2017-04 is not expected to have a material impact on the Company's financial statements.

In March 2017, the FASB issued ASU No. 2017-08, "Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities." The amendments in this update shorten the amortization period for certain callable debt securities held at a premium and require the premium to be amortized to the earliest call date. This ASU will become effective for the Company on January 1, 2019. The adoption of ASU No. 2017-08 is not expected to have a material impact on the Company's financial statements.

In August 2017, the FASB issued ASU No. 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities." This amendment expands and refines hedge accounting for both nonfinancial and financial risk components and aligns the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. This ASU will become effective for the Company on January 1, 2019. The adoption of ASU No. 2017-12 is not expected to have a material impact on the Company's financial statements.

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Note C –Investments

The amortized cost and estimated fair values of the Company's securities are shown in the following table (in thousands):

	June 30, 2018				December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available-for-sale:								
U.S. Treasuries and U.S. government agencies	\$1	\$ —	\$ —	\$1	\$2	\$ —	\$ —	\$2
Obligations of states and political subdivisions	93,596	600	1,156	93,040	94,552	2,051	407	96,196
Mortgage-backed securities:								
U.S. government agencies	453,109	407	17,732	435,784	425,559	1,093	7,305	419,347
Private label	558	5	—	563	649	3	—	652
Trust preferred securities	4,769	28	—	4,797	4,764	26	54	4,736
Corporate securities ⁽¹⁾	17,095	23	155	16,963	21,916	475	123	22,268
Total Debt Securities	569,128	1,063	19,043	551,148	547,442	3,648	7,889	543,201
Marketable equity securities								
Investment funds	1,525	—	70	1,455	1,525	—	36	1,489
Total Securities Available-for-Sale	\$570,653	\$ 1,063	\$ 19,113	\$552,603	\$551,103	\$ 7,211	\$ 7,925	\$550,389
Securities held-to-maturity:								
Mortgage-backed securities:								
U.S. government agencies	\$56,030	\$402	\$55,628	\$60,449	\$1,222	\$25	\$61,646	
Trust preferred securities	4,000	—	4,000	4,000	—	—	4,000	
Total Securities Held-to-Maturity	\$60,030	\$402	\$59,628	\$64,449	\$1,222	\$25	\$65,646	
Other investment securities:								
Non-marketable equity securities	\$17,745	\$—	\$17,745	\$14,147	\$—	\$—	\$14,147	
Marketable equity securities ⁽¹⁾	11,175	—	11,175	—	—	—	—	
Total Other Investment Securities	\$28,920	\$—	\$28,920	\$14,147	\$—	\$—	\$14,147	

⁽¹⁾ Effective January 1, 2018, the Company's equity and perpetual preferred securities are measured at fair value through net income.

Marketable equity securities consist of investments made by the Company in equity positions of various regional community banks. Included within this portfolio are ownership positions in the following community bank holding companies: First National Corporation (FXNC) (4%) and Eagle Financial Services, Inc. (EFSI) (1.5%). Securities with limited marketability, such as stock in the Federal Reserve Bank ("Federal Reserve") and the Federal Home Loan Bank ("FHLB"), are carried at cost and are reported as non-marketable equity securities in the table above.

Certain investment securities owned by the Company are in an unrealized loss position (i.e., amortized cost basis exceeded the estimated fair value of the securities). The following table shows the gross unrealized losses and fair value of the Company's investments aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position (in thousands):

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	June 30, 2018					
	Less Than Twelve Months		Twelve Months or Greater		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Securities available-for-sale:						
Obligations of states and political subdivisions	\$29,391	\$ 347	\$18,880	\$ 809	\$48,271	\$ 1,156
Mortgage-backed securities:						
U.S. Government agencies	252,029	7,667	154,105	10,065	406,134	17,732
Corporate securities	14,947	155	—	—	14,947	155
Investment funds	1,500	70	—	—	1,500	70
Total available-for-sale	\$297,867	\$ 8,239	\$172,985	\$ 10,874	\$470,852	\$ 19,113
Securities held-to-maturity:						
Mortgage-backed securities						
U.S. Government agencies	\$50,941	\$ 402	\$—	\$ —	\$50,941	\$ 402
Total held-to-maturity	\$50,941	\$ 402	\$—	\$ —	\$50,941	\$ 402
	December 31, 2017					
	Less Than Twelve Months		Twelve Months or Greater		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Securities available-for-sale:						
Obligations of states and political subdivisions	\$4,913	\$ 28	\$19,440	\$ 379	\$24,353	\$ 407
Mortgage-backed securities:						
U.S. Government agencies	172,807	1,887	140,226	5,418	313,033	7,305
Trust preferred securities	4,475	54	—	—	4,475	54
Corporate securities	3,357	49	2,350	74	5,707	123
Investment funds	1,500	36	—	—	1,500	36
Total available-for-sale	\$187,052	\$ 2,054	\$162,016	\$ 5,871	\$349,068	\$ 7,925
Securities held-to-maturity						
Mortgage-backed securities						
U.S. Government agencies	\$7,182	\$ 25	\$—	\$ —	\$7,182	\$ 25
Total held-to-maturity	\$7,182	\$ 25	\$—	\$ —	\$7,182	\$ 25

During the six months ended June 30, 2018 and 2017, the Company had no investment impairment losses. At June 30, 2018, the cumulative amount of credit-related investment impairment losses that have been recognized by the Company on its equity securities that remain in the Company's investment portfolio as of that date was \$1.6 million.

Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other-than-temporary would be reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers, among other things (i) the length of time and the extent to which the fair value has been less than cost; (ii) the financial condition, capital strength, and near-term (within 12 months) prospects of the

issuer, including any specific events which may influence the operations of the issuer such as changes in technology that may impair the earnings potential of the investment or the discontinuance of a segment of the business that may affect the future earnings potential; (iii) the historical volatility in the market value of the investment and/or the liquidity or illiquidity of the investment; (iv) adverse conditions specifically related to the security, an industry, or a geographic area; and (v) the intent to sell the investment security and if it's more likely than not that the Company will not have to sell the security before recovery of its cost basis. In addition, management also employs a continuous monitoring process in regards to its marketable equity securities, specifically its portfolio of regional community bank holdings. Although the regional community bank stocks that are owned by the Company are publicly traded, the trading activity for these stocks is minimal, with trading volumes of less than 0.5% of each respective company being traded on a daily basis. As part of management's review process for these securities, management reviews the financial condition of each respective regional community bank for any indications of financial weakness.

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Management has the ability and intent to hold the securities classified as held-to-maturity until they mature, at which time the Company expects to receive full value for the securities. Furthermore, as of June 30, 2018, management does not intend to sell an impaired security and it is not more than likely that it will be required to sell the security before the recovery of its amortized cost basis. The unrealized losses on debt securities are primarily the result of interest rate changes, credit spread fluctuations on agency-issued mortgage-related securities, general financial market uncertainty and unprecedented market volatility. These conditions should not prohibit the Company from receiving its contractual principal and interest payments on its debt securities. The fair value is expected to recover as the securities approach their maturity date or repricing date. As of June 30, 2018, management believes the unrealized losses detailed in the table above are temporary and no additional impairment loss has been recognized in the Company's consolidated income statement. Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss will be recognized in net income in the period the other-than-temporary impairment is identified, while any noncredit loss will be recognized in other comprehensive income.

The amortized cost and estimated fair value of debt securities at June 30, 2018, by contractual maturity, are shown in the following table (in thousands). Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties. Mortgage-backed securities have been allocated to their respective maturity groupings based on their contractual maturity.

	Amortized Cost	Estimated Fair Value
Available-for-Sale Debt Securities		
Due in one year or less	\$ 2,861	\$ 2,863
Due after one year through five years	10,933	10,954
Due after five years through ten years	76,575	73,198
Due after ten years	478,759	464,133
Total	\$ 569,128	\$ 551,148
Held-to-Maturity Debt Securities		
Due in one year or less	\$ —	\$ —
Due after one year through five years	—	—
Due after five years through ten years	—	—
Due after ten years	60,030	59,628
Total	\$ 60,030	\$ 59,628

The table below presents the unrealized gains (losses) that were recognized in "Other Income" in the consolidated statements of income during the three and six months ended June 30, 2018 as a result of the change in the fair value of the Company's equity and perpetual preferred securities due to the adoption of ASU 2016-01 (in thousands). Additionally, on January 1, 2018, the Company reclassified \$2.7 million, net of deferred taxes, from other comprehensive income to retained earnings on the consolidated balance sheets to recognize the prior period fair value impact of these securities.

	Three months ended June 30, 2018	Six months ended June 30, 2018
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Equity and perpetual preferred securities:

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Unrealized gains recognized on securities still held	\$ 592	\$	\$772	\$—
Gross realized gains on securities sold	\$—	\$	—	4,276
Gross realized losses on securities sold	—	—	—	—
Net investment security gains	\$—	\$	\$—	\$4,276

During the six months ended June 30, 2017, the Company realized \$4.3 million of investment gains. These gains represented partial recoveries of impairment charges previously recognized on pooled trust preferred securities. As a result of these sales, the Company no longer holds any pooled trust preferred securities in its investment portfolio.

The carrying value of securities pledged to secure public deposits and for other purposes as required or permitted by law approximated \$472 million and \$429 million at June 30, 2018 and December 31, 2017, respectively.

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Note D –Loans

The following summarizes the Company's major classifications for loans (in thousands):

	June 30, 2018	December 31, 2017
Residential real estate	\$1,472,916	\$1,468,278
Home equity	139,245	139,499
Commercial and industrial	213,687	208,484
Commercial real estate	1,294,489	1,277,576
Consumer	31,137	29,162
DDA overdrafts	3,994	4,411
Gross loans	3,155,468	3,127,410
Allowance for loan losses	(16,876)	(18,836)
Net loans	\$3,138,592	\$3,108,574

Construction loans of \$21.7 million and \$25.3 million are included within residential real estate loans at June 30, 2018 and December 31, 2017, respectively. Construction loans of \$28.6 million and \$28.9 million are included within commercial real estate loans at June 30, 2018 and December 31, 2017, respectively. The Company's commercial and residential real estate construction loans are primarily secured by real estate within the Company's principal markets. These loans were originated under the Company's loan policy, which is focused on the risk characteristics of residential and commercial real estate lending, including specific risks related to construction lending. Adequate consideration has been given to these loans in establishing the Company's allowance for loan losses.

Note E – Allowance For Loan Losses

Management systematically monitors the loan portfolio and the adequacy of the allowance for loan losses on a quarterly basis to provide for probable losses inherent in the portfolio. Management assesses the risk in each loan type based on historical trends, the general economic environment of its local markets, individual loan performance and other relevant factors.

Individual credits are selected throughout the year for detailed loan reviews, which are utilized by management to assess the risk in the portfolio and the adequacy of the allowance. Due to the nature of commercial lending, evaluation of the adequacy of the allowance as it relates to these loan types is often based more upon specific credit reviews, with consideration given to the potential impairment of certain credits and historical loss rates, adjusted for economic conditions and other inherent risk factors.

The following table summarizes the activity in the allowance for loan losses, by portfolio loan classification, for the six months ended June 30, 2018 and 2017 (in thousands). The allocation of a portion of the allowance in one portfolio segment does not preclude its availability to absorb losses in other portfolio segments. The following table also presents the balance in the allowance for loan loss disaggregated on the basis of the Company's impairment measurement method and the related recorded investment in loans, by portfolio segment, as of June 30, 2018 and December 31, 2017 (in thousands).

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	Commercial and Industrial	Commercial Real Estate	Residential Real Estate	Home Equity	Consumer	DDA Overdrafts	Total
Six months ended June 30, 2018							
Allowance for loan losses							
Beginning balance	\$ 4,571	\$ 6,183	\$ 5,212	\$ 1,138	\$ 62	\$ 1,670	\$ 18,836
Charge-offs	(724)	(275)	(220)	(111)	(354)	(1,272)	(2,956)
Recoveries	1,477	372	159	—	105	765	2,878
(Recovery of) provision	(1,597)	(350)	(572)	133	455	49	(1,882)
Ending balance	\$ 3,727	\$ 5,930	\$ 4,579	\$ 1,160	\$ 268	\$ 1,212	\$ 16,876
Six months ended June 30, 2017							
Allowance for loan losses							
Beginning balance	\$ 4,206	\$ 6,573	\$ 6,680	\$ 1,417	\$ 82	\$ 772	\$ 19,730
Charge-offs	(110)	(282)	(884)	(239)	(29)	(1,271)	(2,815)
Recoveries	55	31	156	—	25	690	957
(Recovery of) provision	(59)	(165)	695	176	(5)	549	1,191
Ending balance	\$ 4,092	\$ 6,157	\$ 6,647	\$ 1,354	\$ 73	\$ 740	\$ 19,063
As of June 30, 2018							
Allowance for loan losses							
Evaluated for impairment:							
Individually	\$ —	\$ 320	\$ —	\$ —	\$ —	\$ —	\$ 320
Collectively	3,723	5,557	4,482	1,160	261	1,212	16,395
Acquired with deteriorated credit quality	4	53	97	—	7	—	161
Total	\$ 3,727	\$ 5,930	\$ 4,579	\$ 1,160	\$ 268	\$ 1,212	\$ 16,876