

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-K

(Mark One)

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

For the Fiscal Year Ended December 31, 2014

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: 001-33033

PORTER BANCORP, INC.

(Exact name of registrant as specified in its charter)

Kentucky
(State or other jurisdiction of
incorporation or organization)

61-1142247
(I.R.S. Employer
Identification No.)

2500 Eastpoint Parkway,
Louisville, Kentucky
(Address of principal executive offices)

40223
(Zip Code)

Registrant's telephone number, including area code: (502) 499-4800

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

Title of each class	Name of each exchange on which registered
Common Stock, no par value	NASDAQ Capital Market

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer (as defined in Rule 405 of the Securities Act). Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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

Large accelerated filer
Non-accelerated filer

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

The aggregate market value of the voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold as of the close of business on June 30, 2014, was \$12,842,756 based upon the last sales price reported for such date on the NASDAQ Capital Market.

The number of shares outstanding of the registrant's Common Stock, no par value, as of March 15, 2015, was 18,944,090.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the Annual Meeting of Shareholders to be held May 20, 2015 are incorporated by reference into Part III of this Form 10-K.

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PART I

Preliminary Note Concerning Forward-Looking Statements

This report contains statements about the future expectations, activities and events that constitute forward-looking statements. Forward-looking statements express our beliefs, assumptions and expectations of our future financial and operating performance and growth plans, taking into account information currently available to us. These statements are not statements of historical fact. The words “believe,” “may,” “should,” “anticipate,” “estimate,” “expect,” “intend,” “objective,” “seek,” “plan,” “strive” or similar words, or the negatives of these words, identify forward-looking statements.

Forward-looking statements involve risks and uncertainties that may cause our actual results to differ materially from the expectations of future results we expressed or implied in any forward-looking statements. These risks and uncertainties can be difficult to predict and may be beyond our control. Factors that could contribute to differences in our results include, but are not limited to deterioration in the financial condition of borrowers resulting in significant increases in loan losses and provisions for those losses; changes in the interest rate environment, which may reduce our margins or impact the value of securities, loans, deposits and other financial instruments; changes in loan underwriting, credit review or loss reserve policies associated with economic conditions, examination conclusions, or regulatory developments; general economic or business conditions, either nationally, regionally or locally in the communities we serve, may be worse than expected, resulting in, among other things, a deterioration in credit quality or a reduced demand for credit; the results of regulatory examinations; any matter that would cause us to conclude that there was impairment of any asset, including intangible assets; the continued service of key management personnel; our ability to attract, motivate and retain qualified employees; factors that increase the competitive pressure among depository and other financial institutions, including product and pricing pressures; the ability of our competitors with greater financial resources to develop and introduce products and services that enable them to compete more successfully than us; inability to comply with regulatory capital requirements and to secure any required regulatory approvals for capital actions; legislative or regulatory developments, including changes in laws concerning taxes, banking, securities, insurance and other aspects of the financial services industry; and fiscal and governmental policies of the United States federal government.

Other risks are detailed in Item 1A. “Risk Factors” of this Form 10-K all of which are difficult to predict and many of which are beyond our control.

Forward-looking statements are not guarantees of performance or results. A forward-looking statement may include the assumptions or bases underlying the forward-looking statement. We have made our assumptions and bases in good faith and believe they are reasonable. We caution you however, that estimates based on such assumptions or bases frequently differ from actual results, and the differences can be material. The forward-looking statements included in this report speak only as of the date of the report. We do not intend to update these statements unless applicable laws require us to do so.

Item 1. Business

Overview

Porter Bancorp, Inc. (the “Company”) is a bank holding company headquartered in Louisville, Kentucky. We operate the ninth largest bank domiciled in the Commonwealth of Kentucky based on total assets through our wholly-owned subsidiary PBI Bank (the “Bank”). We operate 17 banking offices in twelve counties in Kentucky. Our markets include metropolitan Louisville in Jefferson County and the surrounding counties of Henry and Bullitt. We serve south central Kentucky and southern Kentucky from banking offices in Butler, Green, Hart, Edmonson, Barren, Warren, Ohio, and Daviess Counties. We also have an office in Lexington, the second largest city in Kentucky. The Bank is a community bank with a wide range of commercial and personal banking products. As of December 31, 2014, we had total assets of \$1.0 billion, total loans of \$625.0 million, total deposits of \$926.8 million and stockholders’ equity of \$33.5 million.

History

We were organized in 1988, and historically conducted our banking business through separate community banks. On December 31, 2005, we completed a reorganization in which we consolidated our subsidiary banks into a single bank. We renamed our consolidated subsidiary PBI Bank to create a single brand name for our banking operations throughout our market area. We completed our initial public offering in September 2006.

On November 21, 2008, we issued to the U.S. Treasury (“UST”), in exchange for cash consideration of \$35.0 million, (i) 35,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A, with a liquidation preference of \$1,000 per share (the “Series A Preferred Stock”), and (ii) a warrant to purchase up to 330,561 shares of our common stock for \$15.88 per share.

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In 2010, we completed a \$32.0 million private placement to accredited investors. Following completion of the transactions involved, the Company issued (i) 2,465,569 shares of common stock, (ii) 317,042 shares of Non-Voting Cumulative Mandatorily Convertible Perpetual Preferred Shares, Series C (“Series C Preferred Stock”) and (iii) warrants to purchase 1,163,045 shares of non-voting common stock at a price of \$11.50 per share. See Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operation – Capital.

On June 24, 2011, the Bank entered into a Consent Order with the Federal Deposit Insurance Corporation (“FDIC”) and the Kentucky Department of Financial Institutions (“KDFI”). The consent order requires the Bank to improve its asset quality, reduce its loan concentrations, and maintain a minimum Tier 1 leverage ratio of 9% and a minimum total risk based capital ratio of 12%.

On September 21, 2011, the Company entered into a written agreement with the Federal Reserve Bank of St. Louis. The Company made formal commitments to use its resources to serve as a source of strength for the Bank, to assist the Bank in addressing weaknesses identified by the FDIC and the KDFI, to pay no dividends without prior written approval, to pay no interest on subordinated debentures or principal on trust preferred securities without written approval, and to submit a plan to maintain sufficient capital.

In October 2012, the Bank entered into a revised Consent Order with the FDIC and KDFI again agreeing to maintain a minimum Tier 1 leverage ratio of 9% and a minimum total risk based capital ratio of 12%. The Bank also agreed that if it should be unable to reach the required capital levels, and if directed in writing by the FDIC, then the Bank would within 30 days develop, adopt and implement a written plan to sell or merge itself into another federally insured financial institution or otherwise immediately obtain a capital investment into the Bank sufficient to fully meet the capital requirements. We have not been directed by the FDIC to implement such a plan. The Consent Order also requires the Bank to continue to adhere to the plans implemented in response to the June 2011 Consent Order, and includes the substantive provisions of the June 2011 Consent Order.

In December 2014, we completed a non-cash equity exchange transaction with the accredited investors who acquired all of our issued and outstanding Series A Preferred Shares from UST in a public auction. We acquired and cancelled all of the issued and outstanding Series A Preferred Shares, the accrued dividends thereon, all of the issued and outstanding Series C Preferred Shares, and warrants to purchase 798,915 shares of common stock together having an aggregate book value of approximately \$45.7 million. In exchange, we issued common and preferred shares having a fair value of approximately \$9.6 million. The effect of this exchange transaction was to increase common stockholders’ equity by approximately \$36.1 million and total stockholders’ equity by approximately \$7.4 million.

In the exchange transaction, we issued 1,821,428 common shares, 40,536 mandatorily convertible Series B Preferred Shares and 64,580 mandatorily convertible Series D Preferred Shares, which automatically converted into 4,053,600 common shares and 6,458,000 non-voting common shares after shareholder approval on February 25, 2015. We also issued 6,198 Series E Preferred Shares and 4,304 Series F Preferred Shares, both of which series are not convertible into common shares, have a liquidation preference of \$1,000 per share, and are entitled to a 2% noncumulative annual dividend if and when declared. Series E and Series F Preferred Shares rank senior to, and have liquidation and dividend preferences over, our common shares and non-voting common shares.

Our Markets

We operate in markets that include the four largest cities in Kentucky – Louisville, Lexington, Bowling Green and Owensboro – and in other communities along the I-65 corridor.

- **Louisville/Jefferson, Bullitt and Henry Counties:** Our headquarters are in Louisville, the largest city in Kentucky. We also have banking offices in Bullitt County, south of Louisville, and Henry County, east of Louisville. Our six banking offices in these counties also serve the contiguous counties of Spencer, Shelby and Oldham to the east and northeast of Louisville. The area’s major employers are diversified across many industries and include the air hub for United Parcel Service (“UPS”), two Ford assembly plants, General Electric’s Consumer and Industrial division, Humana, Norton Healthcare, Brown-Forman, YUM! Brands, Papa John’s Pizza, and Texas Roadhouse.
- **Lexington/Fayette County:** Lexington, located in Fayette County, is the second largest city in Kentucky. Lexington is the financial, educational, retail, healthcare and cultural hub for Central and Eastern Kentucky. It is known worldwide for its horse farms and Keeneland Race Track, and proudly boasts of itself as “The Horse Capital of the World.” It is also the home of the University of Kentucky and Transylvania University. The area’s major employers include Toyota, Lexmark, IBM Global Services and Valvoline.
- **Southern Kentucky:** This market includes Bowling Green, the third largest city in Kentucky, located about 60 miles north of Nashville, Tennessee. Bowling Green, located in Warren County, is the home of Western Kentucky University and is the economic hub of the area. This market also includes thriving communities in the contiguous Barren County, including the city of Glasgow. Major employers in Barren and Warren Counties include GM’s Corvette plant, several other automotive facilities, and R.R. Donnelley’s regional printing facility.

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- **Owensboro/Daviess County:** Owensboro, located on the banks of the Ohio River, is Kentucky's fourth largest city. The city is called a festival city, with over 20 annual community celebrations that attract visitors from around the world, including its world famous Bar-B-Q Festival which attracts over 80,000 visitors giving Owensboro recognition as "The Bar-B-Q Capital of the World". It is an industrial, medical, retail and cultural hub for Western Kentucky and the area employers include Owensboro Medical System, US Bank Home Mortgage and Toyotetsu.
- **South Central Kentucky:** South of the Louisville metropolitan area, we have banking offices in Butler, Edmonson, Green, Hart, and Ohio Counties. This region includes stable community markets comprised primarily of agricultural and service-based businesses. Each of our banking offices in these markets has a stable customer and core deposit base.

Our Products and Services

We meet our customers' banking needs with a broad range of financial products and services. Our lending services include real estate, commercial, mortgage and consumer loans to small to medium-sized businesses, the owners and employees of those businesses, as well as other executives and professionals. We complement our lending operations with an array of retail and commercial deposit products. In addition, we offer our customers drive-through banking facilities, automatic teller machines, night depository, personalized checks, credit cards, debit cards, internet banking, mobile banking, treasury management services, remote deposit services, electronic funds transfers through ACH services, domestic and foreign wire transfers, cash management, vault services, lock box services, along with loan and deposit sweep accounts.

Employees

At December 31, 2014, the Company had 264 full-time equivalent employees. Our employees are not subject to a collective bargaining agreement, and management considers the Company's relationship with employees to be good.

Competition

The banking business is highly competitive, and we experience competition from many other financial institutions. Competition among financial institutions is based upon interest rates offered on deposit accounts, interest rates charged on loans, other credit and service charges relating to loans, the quality and scope of the services offered, the convenience of banking facilities and, in the case of loans to commercial borrowers, relative lending limits. We compete with commercial banks, credit unions, savings and loan associations, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market funds and other mutual funds, as well as super-regional, national and international financial institutions that operate offices within our market area and beyond.

Supervision and Regulation

Consent Order and Formal Written Agreement. On June 24, 2011, the Bank entered into a Consent Order with the FDIC and the KDFI. The Bank agreed to obtain the written consent of both agencies before declaring or paying any future dividends. As a practical matter, the Bank will not be able to pay dividends to Porter Bancorp for the foreseeable future. The Consent Order also establishes benchmarks for the Bank to improve its asset quality, reduce its loan concentrations, and maintain a minimum Tier 1 leverage ratio of 9% and a minimum total risk based capital ratio of 12%. At December 31, 2014, the Bank's Tier 1 leverage ratio was 5.78% and its total risk-based capital ratio was 10.57%, which are below the minimums of 9.0% and 12.0% required by the Bank's Consent Order.

On September 21, 2011, we entered into a formal written agreement with the Federal Reserve Bank of St. Louis. The Company made formal commitments in the agreement to use its financial and management resources to serve as a source of strength for the Bank and to assist the Bank in addressing weaknesses identified by the FDIC and the KDFI, to pay no dividends without prior written approval, to pay no interest or principal on subordinated debentures or trust preferred securities without written approval, and to submit an acceptable plan to maintain sufficient capital.

In October 2012, the Bank entered into a revised Consent Order with the FDIC and KDFI again agreeing to maintain a minimum Tier 1 leverage ratio of 9% and a minimum total risk based capital ratio of 12%. The Bank also agreed that if it should be unable to reach the required capital levels, and if directed in writing by the FDIC, then the Bank would within 30 days develop, adopt and implement a written plan to sell or merge itself into another federally insured financial institution or otherwise obtain a capital investment into the Bank sufficient to recapitalize the bank. We have not been directed by the FDIC to implement such a plan.

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We continue to work with our regulators toward capital ratio compliance. The revised Consent Order also requires the Bank to continue to adhere to the plans implemented in response to the June 2011 Consent Order, and includes the substantive provisions of the June 2011 Consent Order. As of December 31, 2014, the capital ratios required by the Consent Order were not met.

Bank and Holding Company Laws, Rules and Regulations. The following is a summary description of the relevant laws, rules and regulations governing banks and bank holding companies. The descriptions of, and references to, the statutes and regulations below are brief summaries and do not purport to be complete. The descriptions are qualified in their entirety by reference to the specific statutes and regulations discussed.

The Dodd-Frank Act. On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”) was signed into law. The Dodd-Frank Act imposed new restrictions and an expanded framework of regulatory oversight for financial institutions, including depository institutions. Because the Dodd-Frank Act requires various federal agencies to adopt a broad range of regulations with significant discretion, certain of the details of the law and the effects it will have on the Company are not known at this time.

The Dodd-Frank Act represents a comprehensive overhaul of the financial services industry within the United States. There are a number of reform provisions that significantly impact the ways in which banks and bank holding companies, including us, do business. For example, the Dodd-Frank Act changed the assessment base for federal deposit insurance premiums by modifying the assessment base calculation to be based on a depository institution’s consolidated assets less tangible capital instead of deposits, and permanently increased the standard maximum amount of deposit insurance per customer to \$250,000. The Dodd-Frank Act also imposed more stringent capital requirements on bank holding companies by, among other things, imposing leverage ratios on bank holding companies and prohibits new trust preferred security issuances from counting as Tier I capital. The Dodd-Frank Act also repealed the federal prohibition on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts. The Act codified and expanded the Federal Reserve’s source of strength doctrine, which requires that all bank holding companies serve as a source of financial strength for its subsidiary banks. Other provisions of the Dodd-Frank Act include, but are not limited to: (i) the creation of a new financial consumer protection agency that is empowered to promulgate new consumer protection regulations and revise existing regulations in many areas of consumer protection; (ii) enhanced regulation of financial markets, including derivatives and securitization markets; (iii) reform related to the regulation of credit rating agencies; (iv) the elimination of certain trading activities by banks; and (v) new disclosure and other requirements relating to executive compensation and corporate governance.

Many provisions of the Dodd-Frank Act require interpretation and rule-making by federal agencies. The Company monitors all relevant sections of the Dodd-Frank Act to ensure continued compliance with laws and regulations. While the ultimate effect of the Dodd-Frank Act on the Company is not fully known, the law is likely to result in greater compliance costs and higher fees paid to regulators, along with possible restrictions on the Company’s operations.

Porter Bancorp. The Company is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended, and is subject to supervision and regulation by the Board of Governors of the Federal Reserve System. As such, we must file with the Federal Reserve Board annual and quarterly reports and other information regarding our business operations and the business operations of our subsidiaries. We are also subject to examination by the Federal Reserve Board and to operational guidelines established by the Federal Reserve Board. We are subject to the Bank Holding Company Act and other federal laws on the types of activities in which we may engage, and to other supervisory requirements, including regulatory enforcement actions for violations of laws and regulations.

Acquisitions. A bank holding company must obtain Federal Reserve Board approval before acquiring, directly or indirectly, ownership or control of more than 5% of the voting stock or all or substantially all of the assets of a bank, merging or consolidating with any other bank holding company and before engaging, or acquiring a company that is not a bank but is engaged in certain non-banking activities. Federal law also prohibits a person or group of persons from acquiring “control” of a bank holding company without notifying the Federal Reserve Board in advance, and then only if the Federal Reserve Board does not object to the proposed transaction. The Federal Reserve Board has established a rebuttable presumptive standard that the acquisition of 10% or more of the voting stock of a bank holding company would constitute an acquisition of control of the bank holding company. In addition, any company is required to obtain the approval of the Federal Reserve Board before acquiring 25% (5% in the case of an acquirer that is a bank holding company) or more of any class of a bank holding company’s voting securities, or otherwise obtaining control or a “controlling influence” over a bank holding company.

Permissible Activities. A bank holding company is generally permitted under the Bank Holding Company Act to engage in or acquire direct or indirect control of more than 5% of the voting shares of any bank, bank holding company or company engaged in any activity that the Federal Reserve Board determines to be so closely related to banking as to be a proper incident to the business of banking.

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Under current federal law, a bank holding company may elect to become a financial holding company, which enables the holding company to conduct activities that are “financial in nature.” Activities that are “financial in nature” include securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; merchant banking activities; and activities that the Federal Reserve Board has determined to be closely related to banking. No regulatory approval will be required for a financial holding company to acquire a company, other than a bank or savings association, engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board. We have not filed an election to become a financial holding company.

U.S. Treasury Capital Purchase Program . On November 21, 2008, pursuant to the UST’s Capital Purchase Program established under the Emergency Economic Stabilization Act of 2008, the Company issued and sold to the UST (i) 35,000 shares of Series A Preferred Stock with an aggregate liquidation preference of \$35.0 million and (ii) a warrant to purchase 330,561 shares of the Company’s common stock, at an exercise price of \$15.88 per share, subject to certain anti-dilution and other adjustments, for an aggregate purchase price of \$35.0 million in cash. Both the number of shares subject to the warrant and price per share reflect adjustments for stock dividends distributed after issuance.

On December 4, 2014, the UST sold the Series A Preferred Stock in a public auction. Promptly thereafter, the Company acquired and retired the Series A Preferred Stock in a non-cash equity exchange transaction with the accredited investors who purchased the Series A Preferred Stock in the auction, which is described in greater detail above under “History.”

Capital Adequacy Requirements. The Federal Reserve Board has adopted a system using risk-based capital guidelines to evaluate the capital adequacy of bank holding companies. Under the guidelines, specific categories of assets are assigned different risk weights, based generally on the perceived credit risk of the asset. These risk weights are multiplied by corresponding asset balances to determine a “risk-weighted” asset base. The guidelines require a minimum total risk-based capital ratio of 8.0%. At least half of the total capital must be composed of common equity, retained earnings, senior perpetual preferred stock, qualifying perpetual preferred stock, and certain hybrid capital instruments, less certain intangible assets (“Tier 1 capital”). The remainder may consist of certain subordinated debt, certain hybrid capital instruments, qualifying preferred stock and a limited amount of the allowance for loan losses (“Tier 2 capital”). Total capital is the sum of Tier 1 and Tier 2 capital. To be considered well-capitalized under the risk-based capital guidelines, an institution must maintain a total capital to total risk-weighted assets ratio of at least 10% and a Tier 1 capital to total risk-weighted assets ratio of 6% or greater. We are under a Consent Order with our primary regulators as previously discussed, and therefore cannot be considered well-capitalized. Please see “Supervision and Regulation” above for our capital requirements.

In addition to the risk-based capital guidelines, the Federal Reserve Board uses a leverage ratio as an additional tool to evaluate the capital adequacy of bank holding companies. The leverage ratio is a company’s Tier 1 capital divided by its average total consolidated assets. Certain highly rated bank holding companies may maintain a minimum leverage ratio of 3.0%, but other bank holding companies may be required to maintain a leverage ratio of 4.0%.

The federal banking agencies’ risk-based and leverage ratios are minimum supervisory ratios generally applicable to banking organizations that meet certain specified criteria, assuming that they have the highest regulatory rating. Banking organizations not meeting these criteria are expected to operate with capital positions well above the minimum ratios. The federal bank regulatory agencies may set capital requirements for a particular banking organization that are higher than the minimum ratios when circumstances warrant. Federal Reserve Board guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets.

Changes to Capital Requirements Resulting from BASEL III. In July 2013, the Federal Reserve Board and the FDIC approved final rules that substantially amend the regulatory risk-based capital rules applicable to Bancorp and Bank. The final rules implement the regulatory capital reforms of the Basel Committee on Banking Supervision reflected in “Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems” (Basel III) and changes required by the Dodd-Frank Act. The final rules implementing the Basel III regulatory capital reforms became effective for the Company and Bank on January 1, 2015, and include new minimum risk-based capital and leverage ratios. These rules refine the definition of what constitutes “capital” for purposes of calculating those ratios, including the definitions of Tier 1 capital and Tier 2 capital.

The new minimum capital level requirements applicable to bank holding companies and banks subject to the rules are a new common equity Tier 1 capital ratio of 4.5%, a Tier 1 risk-based capital ratio of 6% (increased from 4%), a total risk-based capital ratio of 8% (unchanged from current rules), and a Tier 1 leverage ratio of 4% for all institutions.

The rules also establish a “capital conservation buffer” of 2.5%, to be phased in over three years, above the new regulatory minimum risk-based capital ratios, and the minimum ratios once the capital conservation buffer is fully phased in are a common equity Tier 1 risk-based capital ratio of 7.0%, a Tier 1 risk-based capital ratio of 8.5%, and a total risk-based capital ratio of 10.5%.

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The capital conservation buffer requirement is to be phased in beginning in January 2016 at 0.625% of risk-weighted assets and will increase each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases and paying discretionary bonuses if capital levels fall below minimum levels plus the buffer amounts. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions. Under these new rules, Tier 1 capital will generally consist of common stock (plus related surplus) and retained earnings, limited amounts of minority interest in the form of additional Tier 1 capital instruments, and non-cumulative preferred stock and related surplus, subject to certain eligibility standards, less goodwill and other specified intangible assets and other regulatory deductions. The definition of Tier 2 capital is generally unchanged for most banking organizations, subject to certain new eligibility criteria. Common equity Tier 1 capital will generally consist of common stock (plus related surplus) and retained earnings plus limited amounts of minority interest in the form of common stock, less goodwill and other specified intangible assets and other regulatory deductions. Proceeds of trust preferred securities are excluded from Tier 1 capital unless issued before 2010 by an institution with less than \$15 billion of assets.

The final rules allow banks and their holding companies with less than \$250 billion in assets a one-time opportunity to opt-out of a requirement to include unrealized gains and losses in accumulated other comprehensive income in their capital calculation. The Company and the Bank expect to opt-out of this requirement.

Dividends. Under Federal Reserve policy, bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. The policy provides that bank holding companies should not declare a level of cash dividends that undermines the bank holding company's ability to serve as a source of strength to its banking subsidiaries.

The Company is a legal entity separate and distinct from the Bank. Historically, the majority of our revenue has been from dividends paid to us by the Bank. The Bank is subject to laws and regulations that limit the amount of dividends it can pay. If, in the opinion of a federal regulatory agency, an institution under its jurisdiction is engaged in or is about to engage in an unsafe or unsound practice, the agency may require, after notice and hearing, that the institution cease such practice. The federal banking agencies have indicated that paying dividends that deplete an institution's capital base to an inadequate level would be an unsafe and unsound banking practice. Under the Federal Deposit Insurance Corporation Improvement Act (FDICIA), an insured institution may not pay any dividend if payment would cause it to become undercapitalized or if it already is undercapitalized. Moreover, the Federal Reserve and the FDIC have issued policy statements providing that bank holding companies and banks should generally pay dividends only out of current operating earnings. A bank holding company may still declare and pay a dividend if it does not have current operating earnings if the bank holding company expects profits for the entire year and the bank holding company obtains the prior consent of the Federal Reserve. The Company and the Bank must obtain the prior written consent of each of their primary regulators prior to declaring or paying any future dividends.

Under Kentucky law, dividends by Kentucky banks may be paid only from current or retained net profits. Before any dividend may be declared for any period (other than with respect to preferred stock), a bank must increase its capital surplus by at least 10% of the net profits of the bank for the period until the bank's capital surplus equals the amount of its stated capital attributable to its common stock. Moreover, the KDFI must approve the declaration of dividends if the total dividends to be declared by a bank for any calendar year would exceed the bank's total net profits for such year combined with its retained net profits for the preceding two years, less any required transfers to surplus or a fund for the retirement of preferred stock or debt. We are also subject to the Kentucky Business Corporation Act, which generally prohibits dividends to the extent they result in the insolvency of the corporation from a balance sheet perspective or in the corporation becoming unable to pay its debts as they come due. The Bank did not pay any dividends in 2014 or 2013.

With respect to the payment of dividends, Porter Bancorp's issued and outstanding Series E and Series F Preferred Shares rank senior to its common shares and non-voting common shares.

Imposition of Liability for Undercapitalized Subsidiaries. Bank regulators are required to take "prompt corrective action" to resolve problems associated with insured depository institutions whose capital declines below certain levels. In the event an institution becomes "undercapitalized," it must submit a capital restoration plan. The capital restoration plan will not be accepted by the regulators unless each company having control of the undercapitalized institution guarantees the subsidiary's compliance with the capital restoration plan up to a certain specified amount. Any such guarantee from a depository institution's holding company is entitled to a priority of payment in bankruptcy.

The aggregate liability of the holding company of an undercapitalized bank is limited to the lesser of 5% of the institution's assets at the time it became undercapitalized or the amount necessary to cause the institution to be "adequately capitalized." The bank regulators have greater power in situations where an institution becomes "significantly" or "critically" undercapitalized or fails to submit a capital restoration plan. For example, a bank holding company controlling such an institution can be required to obtain prior Federal Reserve Board approval of proposed dividends, or might be required to consent to a consolidation or to divest the troubled institution or other affiliates.

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Source of Financial Strength. Under Federal Reserve policy, a bank holding company is expected to act as a source of financial strength to, and to commit resources to support, its bank subsidiaries. This support may be required at times when, absent such a policy, the bank holding company may not be inclined to provide it. In addition, any capital loans by the bank holding company to its bank subsidiaries are subordinate in right of payment to deposits and to certain other indebtedness of the bank subsidiary. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of subsidiary banks will be assumed by the bankruptcy trustee and entitled to a priority of payment. The Federal Reserve's "Source of Financial Strength" policy was codified in the Dodd-Frank Act.

PBI Bank. The Bank, a Kentucky chartered commercial bank, is subject to regular bank examinations and other supervision and regulation by both the FDIC and the KDFI. Kentucky's banking statutes contain a "super-parity" provision that permits a well-rated Kentucky banking corporation to engage in any banking activity which could be engaged in by a national bank operating in any state; a state bank, a thrift or savings bank operating in any other state; or a federal chartered thrift or federal savings association meeting the qualified thrift lender test and operating in any state could engage, provided the Kentucky bank first obtains a legal opinion specifying the statutory or regulatory provisions that permit the activity.

Capital Requirements. Similar to the Federal Reserve Board's requirements for bank holding companies, the FDIC has adopted risk-based capital requirements for assessing state non-member banks' capital adequacy. The FDIC's risk-based capital guidelines require that all banks maintain a minimum ratio of total capital to total risk-weighted assets of 8.0% and a minimum ratio of Tier 1 capital to total risk-weighted assets of 4.0%. To be well-capitalized, a bank must have a ratio of total capital to total risk-weighted assets of at least 10.0% and a ratio of Tier 1 capital to total risk-weighted assets of 6.0%.

The Bank has agreed with its primary regulators to maintain a ratio of total capital to total risk-weighted assets of at least 12.0% and a Tier 1 leverage ratio of 9%. As of December 31, 2014, the Bank's ratio of total capital to total risk-weighted assets was 10.57% and its Tier I leverage ratio was 5.78%, both under the ratios required by the Consent Order.

The FDIC also requires a minimum leverage ratio of 3.0% of Tier 1 capital to total assets for the highest rated banks and an additional cushion of approximately 100-200 basis points for all other banks. The leverage ratio operates in tandem with the FDIC's risk-based capital guidelines and places a limit on the amount of leverage a bank can undertake by requiring a minimum level of capital to total assets.

Prompt Corrective Action. Pursuant to the Federal Deposit Insurance Act ("FDIA"), the FDIC must take prompt corrective action to resolve the problems of undercapitalized institutions. FDIC regulations define the levels at which an insured institution would be considered "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized." A "well-capitalized" bank has a total risk-based capital ratio of 10.0% or higher; a Tier 1 risk-based capital ratio of 6.0% or higher; a leverage ratio of 5.0% or higher; and is not subject to any written agreement, order or directive requiring it to maintain a specific capital level for any capital measure. An "adequately capitalized" bank has a total risk-based capital ratio of 8.0% or higher; a Tier 1 risk-based capital ratio of 4.0% or higher; a leverage ratio of 4.0% or higher (3.0% or higher if the bank was rated a composite 1 in its most recent examination report and is not experiencing significant growth); and does not meet the criteria for a well-capitalized bank. A bank is "undercapitalized" if it fails to meet any one of the ratios required to be adequately capitalized. A depository institution may be deemed to be in a capitalization category that is lower than is indicated by its actual capital position if it receives an unsatisfactory examination rating. The degree of regulatory scrutiny increases and the permissible activities of a bank decrease, as the bank moves downward through the capital categories. Depending on a bank's level of capital, the FDIC's corrective powers include:

- requiring a capital restoration plan;
- placing limits on asset growth and restriction on activities;
- requiring the bank to issue additional voting or other capital stock or to be acquired;
- placing restrictions on transactions with affiliates;
- restricting the interest rate the bank may pay on deposits;
- ordering a new election of the bank's board of directors;

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- requiring that certain senior executive officers or directors be dismissed;
- prohibiting the bank from accepting deposits from correspondent banks;
- requiring the bank to divest certain subsidiaries;
- prohibiting the payment of principal or interest on subordinated debt; and
- ultimately, appointing a receiver for the bank.

If an institution is required to submit a capital restoration plan, the institution's holding company must guarantee the subsidiary's compliance with the capital restoration plan up to a certain specified amount. Any such guarantee from a depository institution's holding company is entitled to a priority of payment in bankruptcy. The aggregate liability of the holding company of an undercapitalized bank is limited to the lesser of 5% of the institution's assets at the time it became undercapitalized or the amount necessary to cause the institution to be "adequately capitalized." The bank regulators have greater power in situations where an institution becomes "significantly" or "critically" undercapitalized or fails to submit a capital restoration plan. For example, a bank holding company controlling such an institution can be required to obtain prior Federal Reserve Board approval of proposed dividends, or might be required to consent to a consolidation or to divest the troubled institution or other affiliates.

Deposit Insurance Assessments. The deposits of the Bank are insured by the Deposit Insurance Fund (DIF) of the FDIC up to the limits set forth under applicable law and are subject to the deposit insurance premium assessments of the DIF. The FDIC imposes a risk-based deposit premium assessment system, which was amended pursuant to the Federal Deposit Insurance Reform Act of 2005 (the "Reform Act"). Under this system, as amended, the assessment rates for an insured depository institution vary according to the level of risk incurred in its activities. To arrive at an assessment rate for a banking institution, the FDIC places it in one of four risk categories determined by reference to its capital levels and supervisory ratings. The assessment rate schedule can change from time to time, at the discretion of the FDIC, subject to certain limits.

The Dodd-Frank Act imposed additional assessments and costs with respect to deposits. Under the Dodd-Frank Act, the FDIC is directed to impose deposit insurance assessments based on total assets rather than total deposits, as well as make permanent the increase of deposit insurance to \$250,000. Effective April 1, 2011, the FDIC revised the deposit insurance assessment system to comply with Dodd-Frank and implemented a revised assessment rate process with the goal of differentiating insured depository institutions who pose greater risk to the DIF. The first assessments under the new rule were payable in the third quarter of 2011.

Safety and Soundness Standards. The FDIA requires the federal bank regulatory agencies to prescribe standards, by regulations or guidelines, relating to internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings, stock valuation and compensation, fees and benefits, and such other operational and managerial standards as the agencies deem appropriate. Guidelines adopted by the federal bank regulatory agencies establish general standards relating to these matters. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risk and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal shareholder. In addition, the agencies adopted regulations that authorize, but do not require, an agency to order an institution that has been given notice by an agency that it is not satisfying any of such safety and soundness standards to submit a compliance plan. If, after being so notified, an institution fails to submit an acceptable compliance plan or fails in any material respect to implement an acceptable compliance plan, the agency must issue an order directing action to correct the deficiency and may issue an order directing other actions of the types to which an undercapitalized institution is subject under the "prompt corrective action" provisions of FDIA. See "Prompt Corrective Actions" above. If an institution fails to comply with such an order, the agency may seek to enforce such order in judicial proceedings and to impose civil money penalties.

Branching. Kentucky law permits Kentucky chartered banks to establish a banking office in any county in Kentucky. A Kentucky bank may also establish a banking office outside of Kentucky. Well capitalized Kentucky banks that have been in operation at least three years and satisfy certain criteria relating to, among other things, their composite and management ratings, may establish a banking office in Kentucky without the approval of the KDFI upon notice to the KDFI and any other state bank with its main office located in the county where the new banking office will be located. Branching by all other banks requires the approval of the KDFI, which must ascertain and determine that the public convenience and advantage will be served and promoted and that there is reasonable probability of the successful operation of the banking office. The transaction must also be approved by the FDIC, which considers a number of factors, including financial history, capital adequacy, earnings prospects, character of management, needs of the community and consistency with corporate powers.

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Section 613 of the Dodd—Frank Act effectively eliminated the interstate branching restrictions set forth in the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. Banks located in any state may now de novo branch in any other state, including Kentucky. Such unlimited branching power will likely increase competition within the markets in which the Company and the Bank operate.

Insider Credit Transactions. The restrictions on loans to directors, executive officers, principal shareholders and their related interests (collectively referred to as “insiders”) contained in the Federal Reserve Act and Regulation O apply to all insured depository institutions and their subsidiaries. These restrictions include limits on loans to one borrower and conditions that must be met before such a loan can be made. There is also an aggregate limitation on all loans to insiders and their related interests, which may not exceed the institution’s total unimpaired capital and surplus.

Automated Overdraft Payment Regulation. The Federal Reserve and FDIC have enacted consumer protection regulations related to automated overdraft payment programs offered by financial institutions. In November 2009, the Federal Reserve amended its Regulation E to prohibit financial institutions from charging consumers fees for paying overdrafts on automated teller machine and one-time debit card transactions, unless a consumer consents, or opts in, to the overdraft service for those types of transactions. The Regulation E amendments also require financial institutions to provide consumers with a notice that explains the financial institution’s overdraft services, including the fees associated with the service and the consumer’s choices.

In November 2010, the FDIC supplemented the Regulation E amendments by requiring FDIC-supervised institutions to implement additional changes relating to automated overdraft payment programs by July 1, 2011. One material change required financial institutions to monitor overdraft payment programs for “excessive or chronic” customer use and to undertake “meaningful and effective” follow-up action with customers that overdraw their accounts more than six times during a rolling 12-month period. The new guidance also imposes daily limits on overdraft charges, requires institutions to review and modify check-clearing procedures, prominently distinguish account balances from available overdraft coverage amounts and requires increased board and management oversight regarding overdraft payment programs.

Consumer Protection Laws. We are subject to a number of federal and state laws designed to protect borrowers and promote lending to various sectors of the economy and population. These laws include, among others, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Home Mortgage Disclosure Act, and the Real Estate Settlement and Procedures Act, and state law counterparts.

Equal Credit Opportunity Act. This statute prohibits discrimination against an applicant in any credit transaction, whether for consumer or business purposes, on the basis of race, color, religion, national origin, sex, marital status, age (except in limited circumstances), receipt of income from public assistance programs or good faith exercise of any rights under the Consumer Credit Protection Act. Under the Fair Housing Act, it is unlawful for any lender to discriminate in its housing-related lending activities against any person because of race, color, religion, national origin, sex, handicap or familial status. Among other things, these laws prohibit a lender from denying or discouraging credit on a discriminatory basis, making excessively low appraisals of property based on racial considerations, or charging excessive rates or imposing more stringent loan terms or conditions on a discriminatory basis. In addition to private actions by aggrieved borrowers or applicants for actual and punitive damages, the U.S. Department of Justice and other regulatory agencies can take enforcement action seeking injunctive and other equitable relief or sanctions for alleged violations.

Fair Credit Reporting Act (“FCRA”). FCRA requires the Bank to adopt and implement a written identity theft prevention program, paying particular attention to several identified “red flag” events. The program must assess the validity of address change requests for card issuers and for users of consumer reports to verify the subject of a consumer report in the event of notice of an address discrepancy. FCRA gives consumers the ability to challenge banks with respect to credit reporting information provided by the bank. FCRA also prohibits banks from using certain information it may acquire from an affiliate to solicit the consumer for marketing purposes unless the consumer has been given notice and an opportunity to opt out of such solicitation for a period of five years.

Truth in Lending Act (“TILA”). TILA is designed to ensure that credit terms are disclosed in a meaningful way so that consumers may compare credit terms more readily and knowledgeably. As result of TILA, all creditors must use the same credit terminology and expressions of rates, and disclose the annual percentage rate, the finance charge, the amount financed, the total of payments and the payment schedule for each proposed loan. Violations of TILA may result in regulatory sanctions and in the imposition of both civil and, in the case of willful violations, criminal penalties. In certain circumstances, TILA also provides a consumer with a right of rescission, which if exercised within three business days would require the creditor to reimburse any amount paid by the consumer to the creditor or to a third party in connection with the loan, including finance charges, application fees, commitment fees, title search fees and appraisal fees. Consumers may also seek actual and punitive damages for violations of TILA.

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Home Mortgage Disclosure Act (“HMDA”). HMDA has grown out of public concern over credit shortages in certain urban neighborhoods. One purpose of HMDA is to provide public information that will help show whether financial institutions are serving the housing credit needs of the neighborhoods and communities in which they are located. HMDA also includes a “fair lending” aspect that requires the collection and disclosure of data about applicant and borrower characteristics, as a way of identifying possible discriminatory lending patterns and enforcing anti-discrimination statutes. HMDA requires institutions to report data regarding applications for loans for the purchase or improvement of single family and multi-family dwellings, as well as information concerning originations and purchases of such loans. Federal bank regulators rely, in part, upon data provided under HMDA to determine whether depository institutions engage in discriminatory lending practices. The appropriate federal banking agency, or in some cases the Department of Housing and Urban Development, enforces compliance with HMDA and implements its regulations. Administrative sanctions, including civil money penalties, may be imposed by supervisory agencies for violations of HMDA.

Real Estate Settlement Procedures Act (“RESPA”). RESPA requires lenders to provide borrowers with disclosures regarding the nature and cost of real estate settlements. RESPA also prohibits certain abusive practices, such as kickbacks, and places limitations on the amount of escrow accounts. Violations of RESPA may result in imposition of penalties, including: (1) civil liability equal to three times the amount of any charge paid for the settlement services or civil liability of up to \$1,000 per claimant, depending on the violation; (2) awards of court costs and attorneys’ fees; and (3) fines of not more than \$10,000 or imprisonment for not more than one year, or both.

Loans to One Borrower. Under current limits, loans and extensions of credit outstanding at one time to a single borrower and not fully secured generally may not exceed 15% of an institution’s unimpaired capital and unimpaired surplus. Loans and extensions of credit fully secured by certain readily marketable collateral may represent an additional 10% of unimpaired capital and unimpaired surplus.

Consumer Financial Protection Bureau (“CFPB”). The Dodd-Frank Act created a new, independent federal agency called the Consumer Financial Protection Bureau, which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws. The CFPB has examination and primary enforcement authority with respect to depository institutions with \$10 billion or more in assets. Smaller institutions will be subject to rules promulgated by the CFPB, but will continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB has authority to prevent unfair, deceptive or abusive acts or practices in connection with the offering of consumer financial products. The Dodd-Frank Act authorizes the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower’s ability to repay. In addition, the Dodd-Frank Act allows borrowers to raise certain defenses to foreclosure if they receive any loan other than a “qualified mortgage” as defined by the CFPB.

The Dodd-Frank Act also permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations. Federal preemption of state consumer protection law requirements, traditionally an attribute of the federal savings association charter, has also been modified by the Dodd-Frank Act and now requires a case-by-case determination of preemption by the Office of the Comptroller of the Currency (“OCC”) and eliminates preemption for subsidiaries of a bank. Depending on the implementation of this revised federal preemption standard, the operations of the Bank could become subject to additional compliance burdens in the states in which it operates.

Volcker Rule . On December 10, 2013, the final Volcker Rule under the Dodd-Frank Act was approved and implemented by the FRB, the FDIC, the SEC, and the Commodity Futures Trading Commission. The Volcker Rule attempts to reduce risk and banking system instability by restricting U.S. banks from investing in or engaging in proprietary trading and speculation and imposing a strict framework to justify exemptions for underwriting, market-making and hedging activities. U.S. banks will be restricted from investing in funds with collateral comprised of less than 100% loans that are not registered with the SEC and from engaging in hedging activities that do not hedge a specific identified risk. We do not believe the Volcker Rule will have a significant effect on the Bank’s operations.

Privacy. Federal law currently contains extensive customer privacy protection provisions. Under these provisions, a financial institution must provide to its customers, at the inception of the customer relationship and annually thereafter, the institution’s policies and procedures regarding the handling of customers’ nonpublic personal financial information. These provisions also provide that, except for certain limited exceptions, an institution may not provide such personal information to unaffiliated third parties unless the institution discloses to the customer that such information may be so provided and the customer is given the opportunity to opt out of such disclosure. Federal law makes it a criminal offense, except in limited circumstances, to obtain or attempt to obtain customer information of a financial nature by fraudulent or deceptive means.

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Community Reinvestment Act. The Community Reinvestment Act (“CRA”) requires the FDIC to assess our record in meeting the credit needs of the communities we serve, including low- and moderate-income neighborhoods and persons. The FDIC’s assessment of our record is made available to the public. The assessment also is part of the Federal Reserve Board’s consideration of applications to acquire, merge or consolidate with another banking institution or its holding company, to establish a new banking office or to relocate an office.

Bank Secrecy Act. The Bank Secrecy Act of 1970 (“BSA”) was enacted to deter money laundering, establish regulatory reporting standards for currency transactions and improve detection and investigation of criminal, tax and other regulatory violations. BSA and subsequent laws and regulations require us to take steps to prevent the use of the Bank in the flow of illegal or illicit money, including, without limitation, ensuring effective management oversight, establishing sound policies and procedures, developing effective monitoring and reporting capabilities, ensuring adequate training and establishing a comprehensive internal audit of BSA compliance activities. In recent years, federal regulators have increased the attention paid to compliance with the provisions of BSA and related laws, with particular attention paid to “Know Your Customer” practices. Banks have been encouraged by regulators to enhance their identification procedures prior to accepting new customers in order to deter criminal elements from using the banking system to move and hide illegal and illicit activities.

USA Patriot Act. The USA Patriot Act of 2001 (the “Patriot Act”) contains anti-money laundering measures affecting insured depository institutions, broker-dealers and certain other financial institutions. The Patriot Act requires financial institutions to implement policies and procedures to combat money laundering and the financing of terrorism. This includes standards for verifying customer identification at account opening, as well as rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering. It grants the Secretary of the Treasury broad authority to establish regulations and to impose requirements and restrictions on the operations of financial institutions. In addition, the Patriot Act requires the federal bank regulatory agencies to consider the effectiveness of a financial institution’s anti-money laundering activities when reviewing bank mergers and bank holding company acquisitions.

Effect on Economic Environment. The policies of regulatory authorities, including the monetary policy of the Federal Reserve Board, have a significant effect on the operating results of bank holding companies and their subsidiaries. Among the means available to the Federal Reserve Board to affect the money supply are open market operations in U.S. government securities, changes in the discount rate on member bank borrowings and changes in reserve requirements against member bank deposits. These means are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits. Their use may affect interest rates charged on loans or paid for deposits.

Federal Reserve Board monetary policies have materially affected the operating results of commercial banks in the past and are expected to continue to do so in the future. The nature of future monetary policies and the effect of such policies on our business and earnings and those of our subsidiaries cannot be predicted.

Recently Enacted and Future Legislation. Various laws, regulations and governmental programs affecting financial institutions and the financial industry are from time to time introduced in Congress or otherwise promulgated by regulatory agencies. Such measures may change the operating environment of Porter Bancorp and its subsidiaries in substantial and unpredictable ways. The nature and extent of future legislative, regulatory or other changes affecting financial institutions is unpredictable at this time.

We cannot predict what other legislation or economic policies of the various regulatory authorities might be enacted or adopted or what other regulations might be adopted or the effects thereof. Future legislation, policies and the effects thereof might have a significant influence on overall growth and distribution of loans, investments and deposits, as well as affect interest rates charged on loans or paid on time and savings deposits. Such legislation and policies have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future.

Available Information

We file periodic reports with the SEC including our annual report on Form 10-K, quarterly reports on Form 10-Q, current event reports on Form 8-K and proxy statements. The public may read and copy any materials we file with the SEC at the SEC’s Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at <http://www.sec.gov>. Our SEC reports filed are accessible at no cost on our web site at <http://www.pbibank.com>, under the Investors Relations section, once they are electronically filed with or furnished to the SEC. A shareholder may also request a copy of our Annual Report on Form 10-K free of charge upon written request to: Chief Financial Officer, Porter Bancorp, Inc., 2500 Eastpoint Parkway, Louisville, Kentucky 40223.

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Item 1A. Risk Factors

An investment in our common stock involves a number of risks. Realization of any of the risks described below could have a material adverse effect on our business, financial condition, results of operations, cash flow and/or future prospects.

We are subject to a Consent Order with the FDIC and the KDFI and a formal agreement with the Federal Reserve that restrict the conduct of our operations and may have a material adverse effect on our business.

Our good standing with bank regulatory agencies is of fundamental importance to the continuation of our businesses. In June 2011, the Bank agreed to a Consent Order with the FDIC and KDFI in which the Bank agreed, among other things, to improve asset quality, reduce loan concentrations, and maintain a minimum Tier 1 leverage ratio of 9% and a minimum total risk based capital ratio of 12%. The Consent Order was included in our Current Report on 8-K filed on June 30, 2011.

On September 21, 2011, we entered into a Written Agreement with the Federal Reserve Bank of St. Louis. Pursuant to the Agreement, we made formal commitments to, among other things, use our financial and management resources to serve as a source of strength for the Bank and to assist the Bank in addressing weaknesses identified by the FDIC and the KDFI, to pay no dividends without prior written approval, to pay no interest or principal on subordinated debentures or trust preferred securities without prior written approval, and to submit an acceptable plan to maintain sufficient capital.

In October 2012, the Bank entered into a revised Consent Order with the FDIC and KDFI again agreeing to maintain a minimum Tier 1 leverage ratio of 9% and a minimum total risk based capital ratio of 12%. The Bank also agreed that if it should be unable to reach the required capital levels, and if directed in writing by the FDIC, then the Bank would within 30 days develop, adopt and implement a written plan to sell or merge itself into another federally insured financial institution or otherwise immediately obtain a capital investment into the Bank sufficient to fully meet the capital requirements. The revised Consent Order also requires the Bank to continue to adhere to the plans implemented in response to the June 2011 Consent Order, and includes the substantive provisions of the June 2011 Consent Order. We did not meet the capital ratios required by the Consent Order as of December 31, 2014.

Bank regulatory agencies can exercise discretion when an institution does not meet minimum regulatory capital levels and the other terms of a consent order. The agencies may initiate changes in management, issue mandatory directives, impose monetary penalties or refrain from formal sanctions, depending on individual circumstances. Any action taken by bank regulatory agencies could damage our reputation and have a material adverse effect on our business. Compliance with the Consent Order also increases our operating expense, and adversely affects our financial performance.

We have made commitments to the banking regulators to raise additional capital. Our inability to increase our capital to the levels required by our bank regulatory agreements could have a material adverse effect on our business.

We incurred a net loss of \$11.2 million and \$1.6 million in 2014 and 2013, respectively. Losses, non-performing loan costs, expenses for other real estate owned (“OREO”), and asset impairments have reduced our capital below the levels we agreed to maintain with our banking regulators. While we believe we have recognized the probable losses in our portfolio, further credit deterioration could result in additional losses and a reduction in capital levels.

In its consent order with the FDIC and the KDFI, the Bank has agreed to maintain a ratio of total capital to total risk-weighted assets of at least 12.0% and a ratio of Tier 1 capital to average assets of 9.0%. As of December 31, 2014, the Bank’s ratio of total capital to total risk-weighted assets was 10.57% and its ratio of Tier 1 capital to average assets was 5.78%, both below the ratios required by the consent order.

We have agreed with the FDIC, the KDFI and the Federal Reserve Bank of St. Louis to restore our capital ratios to levels that comply with our regulatory agreements. We are evaluating various specific initiatives to increase our regulatory capital and reduce our non-performing assets. Strategic alternatives include divesting of branch offices, selling loans and raising capital by selling stock.

Our ability to raise additional capital will depend on, among other things, conditions in the capital markets at that time (which are outside of our control) and our financial performance, including the management of our revenue, expenses, levels of average assets, credit quality, levels of OREO, and contingent liability risks. We may not have access to capital on acceptable terms or at all. Our inability to raise additional capital on acceptable terms when needed could have a material adverse effect on our businesses, financial condition, and results of operations. In addition, if we are unable to comply with our regulatory capital requirements, it could result in more stringent enforcement actions by the bank regulatory agencies, which could damage our reputation and have a material adverse effect on our business.

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Regulatory restrictions have prevented us from paying interest on the junior subordinated debentures that relate to our trust preferred securities since the fourth quarter of 2011. If we cannot pay accrued and unpaid interest on these securities for more than twenty consecutive quarters, we will be in default.

Effective with the fourth quarter of 2011, we began deferring interest payments on the junior subordinated debentures relating to our trust preferred securities. Deferring interest payments on the junior subordinated debentures resulted in a deferral of distributions on our trust preferred securities.

If we defer distributions on our trust preferred securities for 20 consecutive quarters, we must pay all deferred distributions in full or we will be in default. Our deferral period expires in the third quarter of 2016. Deferred distributions on our trust preferred securities, which totaled \$2.2 million as of December 31, 2014, are cumulative, and unpaid distributions accrue and compound on each subsequent payment date. If as a result of a default we become subject to any liquidation, dissolution or winding up, holders of the trust preferred securities will be entitled to receive the liquidation amounts to which they are entitled, including all accrued and unpaid distributions, before any distribution can be made to our shareholders. In addition, the holders of our Series E and Series F Preferred Shares will be entitled to receive liquidation distributions totaling more than \$10.5 million before any distribution can be made to the holders of our common shares.

As a bank holding company, we depend on dividends and distributions paid by our banking subsidiary.

The Company is a legal entity separate and distinct from the Bank and our other subsidiaries. Our principal source of cash flow, from which we would fund any dividends paid to our shareholders, has historically been dividends the Company receives from the Bank. Regulations of the FDIC and the KDFI govern the ability of the Bank to pay dividends and other distributions to us, and regulations of the Federal Reserve govern our ability to pay dividends or make other distributions to our shareholders. In its consent order with the FDIC and the KDFI, the Bank agreed not to pay dividends to us without the prior consent of those regulators. During 2011, the Company contributed \$13.1 million to the Bank. The contribution, which was made to strengthen the Bank's capital in an effort to help it comply with its capital ratio requirements under the consent order, also substantially decreased the liquid assets of the Company. Liquid assets decreased from \$20.3 million at December 31, 2010 to \$1.9 million at December 31, 2014. Since the Bank is unlikely to be in a position to pay dividends to the Company for the foreseeable future, cash inflows for the Company are limited to earnings on investment securities, sales of investment securities, and interest on its deposits held at the Bank. These cash inflows, along with the liquid assets held at December 31, 2014, are needed to cover ongoing operating expenses of the Company, which are forecasted at approximately \$1.0 million for 2015. See the "Supervision-Porter Bancorp-Dividends" section of Item 1. "Business" and the "Dividends" section of Item 5. "Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities" of this Annual Report on Form 10-K.

We are effectively precluded from paying any dividends for the foreseeable future.

Our agreement with the holders of our trust preferred securities provides that we cannot pay dividends until we pay all deferred distributions in full and resume paying quarterly distributions. We have also agreed with the Federal Reserve to obtain its written consent prior to declaring or paying any future dividends. As a practical matter, we cannot pay dividends for the foreseeable future. In addition, the dividend preferences of our Series E and Series F Preferred Shares entitle our preferred shareholders to receive an annual, noncumulative 2% dividend before we can pay a dividend on our non-voting common shares and voting common shares.

Our holding company debt could make it difficult to raise capital.

At December 31, 2014, we had an aggregate obligation of \$27.2 million relating to the principal and accrued unpaid interest on our four issues of junior subordinated debentures, which has resulted in a deferral of distributions on our trust preferred securities. Although we are permitted to defer payments on these securities for up to five years (and we commenced doing so in 2011), the deferred interest payments continue to accrue until paid in full.

Our holding company debt could make it difficult to recapitalize or enter into a business combination transaction because any investor or purchaser would effectively assume the outstanding liability on the debt in addition to the amount of funds such investors or purchaser would need to provide in order to recapitalize the Bank and the Company.

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We are defendants in various legal proceedings.

The Company and the Bank are involved in judicial proceedings and regulatory investigations concerning matters arising from our business activities. Although we believe we have a meritorious defense in all significant litigation pending against us, we cannot assure you as to the ultimate outcome. Litigation is subject to inherent uncertainties and unfavorable rulings could occur. We record contingent liabilities resulting from claims against us when a loss is assessed to be probable and the amount of the loss is reasonably estimable. Assessing probability of loss and estimating probable losses requires analysis of multiple factors, including in some cases judgments about the potential actions of third party claimants and courts. Recorded contingent liabilities are based on the best information available and actual losses in any future period are inherently uncertain. Accruals are not made in cases where liability is not probable or the amount cannot be reasonably estimated. We provide disclosure of matters where we believe liability is reasonably possible and which may be material to our consolidated financial statements. If we do not prevail, the ultimate outcome of litigation matter could have a material adverse effect on our financial condition, results of operations, or cash flows. For more information about ongoing legal proceedings, see “Note 24 – Contingencies” of the Notes to Consolidated Financial Statements.

The Bank previously has served as trustee for Employee Stock Ownership Plans (“ESOP”) which engaged in transactions that under review are the subject of litigation initiated by the Department of Labor (“DOL”), subjecting us to certain financial risks.

From 2007 until the first quarter of 2013, the Bank served as trustee for certain ESOPs that purchased the stock of companies from prior owners in purchase transactions. Stock purchase transactions by ESOPs are subject to regular and routine reviews by the DOL for compliance with ERISA. Failure to fulfill our fiduciary duties under ERISA with respect to any such plan would subject us to certain financial risks such as claims for damages as well as fines and penalties assessable under ERISA. The Bank is a defendant in legal proceedings initiated by the DOL with respect to two stock purchase transactions by ESOPs for which the Bank served as trustee. A ruling that the Bank failed to fulfill its fiduciary duties under ERISA with respect to an ESOP, including stock purchases by the ESOP, would subject us to certain financial risks, including claims for damages as well as fines and penalties assessable under ERISA. See “Note 24 – Contingencies” of the Notes to Consolidated Financial Statements.

Investigations into and heightened scrutiny of our operations could result in additional costs and damage our reputation.

The U.S. Attorney’s office for the Eastern District of Virginia is conducting an investigation concerning possible violations of federal laws, including, among other things, possible violations related to false bank entries, bank fraud and securities fraud. The investigation concerns allegations that Bank personnel engaged in practices intended to delay or avoid disclosure of the Bank’s asset quality at the time of and following the United States Treasury’s purchase of preferred stock from the Company in November 2008. We are cooperating with this investigation. Heightened scrutiny of the operations of the Company and the Bank by federal and state officials may subject us to governmental or regulatory inquiries, investigations, actions, penalties and fines, which could adversely affect our reputation and result in costs to us in excess of current reserves and management’s estimate of the aggregate range of possible loss for litigation matters.

Our business has been and may continue to be adversely affected by conditions in the financial markets and by economic conditions generally.

Ongoing weakness in business and economic conditions generally or specifically in our markets has had, and could continue to have one or more of the following adverse effects on our business:

- A decrease in the demand for loans and other products and services offered by us;
- A decrease in the value of collateral securing our loans;
- An impairment of certain intangible assets, such as core deposit intangibles; and
- An increase in the number of customers who become delinquent, file for protection under bankruptcy laws or default on their loans.

Adverse conditions in the general business environment have had an adverse effect on our business in the past. Although the general business environment has improved, we can give no assurance that such improvement can be sustained. In addition, the improvement of certain economic indicators, such as real estate asset values, rents, and unemployment, may vary between geographic markets and may continue to lag behind improvement in the overall economy. These economic indicators typically affect the real estate and financial services industries, in which we have a significant number of customers, more significantly than other economic sectors. Furthermore, we have a substantial lending business that depends upon the ability of borrowers to make debt service payments on loans. Should economic conditions worsen, our business, financial condition or results of operations could be adversely affected.

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A large percentage of our loans are collateralized by real estate, and prolonged weakness in the real estate market may result in losses and adversely affect our profitability.

Approximately 84.0% of our loan portfolio as of December 31, 2014, was comprised of commercial and residential loans collateralized by real estate. Adverse economic conditions could decrease demand for real estate and depress real estate values in our markets. Persistent weakness in the real estate market could significantly impair the value of our collateral and our ability to sell the collateral upon foreclosure. The real estate collateral in each case provides an alternate source of repayment in the event of default by the borrower and may deteriorate in value during the time the credit is extended. If real estate values decline further, it will become more likely that we would be required to increase our allowance for loan losses. If during a period of depressed real estate values, we are required to liquidate the collateral securing a loan to satisfy the debt or to increase our allowance for loan losses, it could materially reduce our profitability and adversely affect our financial condition.

We offer real estate construction and development loans, which carry a higher degree of risk than other real estate loans. Weakness in the residential construction and commercial development real estate markets has in the past increased the non-performing assets in our loan portfolio and our provision expense for losses on loans. These impacts have had, and could in the future have a material adverse effect on our capital, financial condition and results of operations.

Approximately 5.3% of our loan portfolio as of December 31, 2014 consisted of real estate construction and development loans, down from 6.1% at December 31, 2013 and 7.8% at December 2012. These loans generally carry a higher degree of risk than long-term financing of existing properties because repayment depends on the ultimate completion of the project and usually on the sale of the property. If we are forced to foreclose on a project prior to its completion, we may not be able to recover the entire unpaid portion of the loan or we may be required to fund additional money to complete the project, or hold the property for an indeterminate period of time. Any of these outcomes may result in losses and adversely affect our profitability and financial condition.

Residential construction and commercial development real estate activity in our markets were affected by challenging economic conditions following the financial crisis of 2008. Weakness in these sectors could lead to additional valuation adjustments to our loan portfolios and real estate owned as we continue to reassess the fair value of our non-performing assets, the loss severity of loans in default and the fair value of real estate owned. We also may realize additional losses in connection with our disposition of non-performing assets. A weak real estate market could further reduce demand for residential housing, which, in turn, could adversely affect real estate development and construction activities. Consequently, the longer challenging economic conditions persist, the more likely they are to adversely affect the ability of residential real estate development borrowers to repay these loans and the value of property used as collateral for such loans. These economic conditions and market factors have negatively affected some of our larger loans in the past, causing our total net-charge offs to increase and requiring us to significantly increase our allowance for loan losses. Any further increase in our non-performing assets and related increases in our provision expense for losses on loans could negatively affect our business and could have a material adverse effect on our capital, financial condition and results of operations.

Our decisions regarding credit risk may not be accurate, and our allowance for loan losses may not be sufficient to cover actual losses, which could adversely affect our business, financial condition and results of operations.

We maintain an allowance for loan losses at a level we believe is adequate to absorb probable incurred losses in our loan portfolio based on historical loan loss experience, economic and environmental factors, specific problem loans, value of underlying collateral and other relevant factors. If our assessment of these factors is ultimately inaccurate, the allowance may not be sufficient to cover actual future loan losses, which would adversely affect our operating results. Our estimates are subjective, and their accuracy depends on the outcome of future events. Changes in economic, operating, and other conditions that are generally beyond our control could cause actual loan losses to increase significantly. In addition, bank regulatory agencies, as an integral part of their supervisory functions, periodically review the adequacy of our allowance for loan losses. Regulatory agencies have from time to time required us to increase our provision for loan losses or to recognize additional loan charge-offs when their judgment has differed from ours. Any of these events could have a material negative impact on our operating results.

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Our levels of classified loans and non-performing assets may increase in the foreseeable future if economic conditions cause more borrowers to default. Further, the value of the collateral underlying a given loan, and the realizable value of such collateral in a foreclosure sale, may decline, making us less likely to realize a full recovery if a borrower defaults on a loan. Any additional increases in the level of our non-performing assets, loan charge-offs or provision for loan losses, or our inability to realize the estimated net value of underlying collateral in the event of a loan default, could negatively affect our business, financial condition, results of operations and the trading price of our securities.

If we experience greater credit losses than anticipated, our operating results may be adversely affected.

As a lender, we are exposed to the risk that our customers will be unable to repay their loans according to their terms and that any collateral securing the payment of their loans may not be sufficient to assure repayment. Credit losses are inherent in the business of making loans and could have a material adverse effect on our operating results. Our credit risk with respect to our real estate and construction loan portfolio will relate principally to the creditworthiness of borrowers and the value of the real estate serving as security for the repayment of loans. Our credit risk with respect to our commercial and consumer loan portfolio will relate principally to the general creditworthiness of businesses and individuals within our local markets.

We make various assumptions and judgments about the collectability of our loan portfolio and provide an allowance for estimated loss losses based on a number of factors. We believe that our allowance for loan losses is adequate. However, if our assumptions or judgments are wrong, our allowance for loan losses may not be sufficient to cover our actual loan losses. We may have to increase our allowance in the future in response to the request of one of our primary banking regulators, to adjust for changing conditions and assumptions, or as a result of any deterioration in the quality of our loan portfolio. The actual amount of future provisions for loan losses cannot be determined at this time and may vary from the amounts of past provisions.

We continue to hold and acquire a significant amount of OREO properties, which could increase operating expenses and result in future losses to the Company.

During recent years, we have acquired a significant amount of real estate as a result of foreclosure or by deed in lieu of foreclosure that is listed on our balance sheet as OREO. An increase in our OREO portfolio increases the expenses incurred to manage and dispose of these properties, which sometimes includes funding construction required to facilitate sale. We expect that our operating results in 2015 will continue to be adversely affected by expenses associated with OREO, including insurance and taxes, completion and repair costs, as well as by the funding costs associated with OREO assets.

Properties in our OREO portfolio are recorded at the lower of the recorded investment in the loans for which the properties previously served as collateral or “fair value,” which represents the estimated sales price of the properties on the date acquired less estimated selling costs. Generally, in determining “fair value” an orderly disposition of the property is assumed, except where a different disposition strategy is expected. Significant judgment is required in estimating the fair value of OREO, and the period of time within which such estimates can be considered current may change during periods of market volatility.

Any decreases in market prices of real estate in our market areas may lead to additional OREO write downs, with a corresponding expense in our statement of operations. We evaluate OREO property values periodically and write down the carrying value of the properties if and when the results of our analysis require it.

In response to market conditions and other economic factors, we may utilize alternative sale strategies other than orderly disposition as part of our OREO disposition strategy, such as bulk sales. In this event, as a result of the significant judgments required in estimating fair value and the variables involved in different methods of disposition, the net proceeds realized from such sales transactions could differ significantly from appraisals, comparable sales, and other estimates used to determine the fair value of our OREO properties. In addition, our disposition of OREO through alternative sales strategies could impact the fair value of comparable OREO properties remaining in our portfolio.

Our profitability depends significantly on local economic conditions.

Because most of our business activities are conducted in central Kentucky and most of our credit exposure is in that region, we are at risk from adverse economic or business developments affecting this area, including declining regional and local business and employment activity, a downturn in real estate values and agricultural activities and natural disasters. To the extent the central Kentucky economy weakens, the rates of delinquencies, foreclosures, bankruptcies and losses in our loan portfolio will likely increase. Moreover, the value of real estate or other collateral that secures our loans could be adversely affected by the economic downturn or a localized natural disaster. Events that adversely affect business activity and real estate values in Central Kentucky have had and may continue to have a negative impact on our business, financial condition, results of operations and future prospects.

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Our small to medium-sized business portfolio may have fewer resources to weather a downturn in the economy.

Our portfolio includes loans to small and medium-sized businesses and other commercial enterprises. Small and medium-sized businesses frequently have smaller market shares than their competitors, may be more vulnerable to economic downturns, often need substantial additional capital to expand or compete and may experience substantial variations in operating results, any of which may impair a borrower's ability to repay a loan. In addition, the success of a small or medium-sized business often depends on the management talents and efforts of one or two persons or a small group of persons. The death, disability or resignation of one or more of these persons could have a material adverse impact on the business and its ability to repay our loan. A continued economic downturn may have a more pronounced negative impact on our target market, causing us to incur substantial credit losses that could materially harm our operating results.

Our profitability is vulnerable to fluctuations in interest rates.

Changes in interest rates could harm our financial condition or results of operations. Our results of operations depend substantially on net interest income, the difference between interest earned on interest-earning assets (such as investments and loans) and interest paid on interest-bearing liabilities (such as deposits and borrowings). Interest rates are highly sensitive to many factors, including governmental monetary policies and domestic or international economic or political conditions. Factors beyond our control, such as inflation, recession, unemployment and money supply may also affect interest rates. If, as a result of decreasing interest rates, our interest-earning assets mature or reprice more quickly than our interest-bearing liabilities in a given period, our net interest income may decrease. Likewise, our net interest income may decrease if interest-bearing liabilities mature or reprice more quickly than interest-earning assets in a given period as a result of increasing interest rates.

Fixed-rate loans increase our exposure to interest rate risk in a rising rate environment because interest-bearing liabilities would be subject to repricing before assets become subject to repricing. Adjustable-rate loans decrease the risk associated with changes in interest rates but involve other risks, such as the inability of borrowers to make higher payments in an increasing interest rate environment. At the same time, for secured loans, the marketability of the underlying collateral may be adversely affected by higher interest rates. In a declining interest rate environment, there may be an increase in prepayments on loans as the borrowers refinance their loans at lower interest rates, which could reduce net interest income and harm our results of operations.

If we cannot obtain adequate funding, we may not be able to meet the cash flow requirements of our depositors and borrowers, or meet the operating cash needs of the Company.

Our liquidity policies and limits are established by the Board of Directors of the Bank, with operating limits set by the Asset Liability Committee ("ALCO"), based upon analyses of the ratio of loans to deposits and the percentage of assets funded with non-core or wholesale funding. The ALCO regularly monitors the overall liquidity position of the Bank and the Company to ensure that various alternative strategies exist to meet unanticipated events that could affect liquidity. Liquidity is the ability to meet cash flow needs on a timely basis at a reasonable cost. If our liquidity policies and strategies do not work as well as intended, then we may be unable to make loans and to repay deposit liabilities as they become due or are demanded by customers. The ALCO follows established board approved policies and monitors guidelines to diversify our wholesale funding sources to avoid concentrations in any one-market source. Wholesale funding sources include Federal funds purchased, securities sold under repurchase agreements, and Federal Home Loan Bank ("FHLB") advances that are collateralized with mortgage-related assets.

We maintain a portfolio of securities that can be used as a secondary source of liquidity. There are other available sources of liquidity, including additional collateralized borrowings such as FHLB advances, the issuance of debt securities, and the issuance of preferred or common shares in public or private transactions. If we were unable to access any of these funding sources when needed, we might not be able to meet the needs of our customers, which could adversely impact our financial condition, our results of operations, cash flows, and our level of regulatory-qualifying capital.

We may need to raise additional capital in the future by selling capital stock. Future sales or other dilution of our equity may adversely affect the market price of our common shares.

We are not restricted from issuing additional common shares, including securities that are convertible into or exchangeable for, or that represent the right to receive, common shares. The issuance of additional shares of common shares or the issuance of convertible securities would dilute the ownership interest of our existing common shareholders. The market price of our common shares could decline as a result of such an offering as well as other sales of a large block of shares of our common shares or similar securities in the market after such an offering, or the perception that such sales could occur.

Our common shares have traded from time-to-time at a price below our book value per share. Accordingly, a sale of common shares at or below our book value would be dilutive to current shareholders.

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We may not be able to realize the value of our tax losses and deductions.

Due to our losses, we have a net operating loss carry-forward of \$32.1 million, credit carry-forwards of \$900,000, and other net deferred tax assets of \$17.6 million. In order to realize the benefit of these tax losses, credits and deductions, we will need to generate substantial taxable income in future periods. We established a 100% valuation allowance for all deferred tax assets in 2011. Should the Company issue a sufficient number of new shares to raise additional capital, a change in control could be triggered, as defined by Section 382 of the Internal Revenue Code, which could negatively impact or limit the ability to utilize our net operating loss carry-forwards, credit loss carry-forwards, and other net deferred tax assets.

Higher FDIC deposit insurance premiums and assessments could significantly increase our non-interest expense.

Our deposits are insured by the FDIC up to legal limits and, accordingly, we are subject to FDIC deposit insurance premiums and assessments. Pursuant to the Dodd-Frank Act, the FDIC amended its regulations regarding assessment for federal deposit insurance to base such assessments on the average total consolidated assets of the insured institution during the assessment period, less the average tangible equity of the institution during the assessment period. Prior to this change, we were assessed only on deposit balances. The FDIC adopted a rule implementing this change, as well as adopting a revised risk-based assessment calculation in February 2011. The FDIC has also proposed a rule tying assessment rates of FDIC-insured institutions to the institution's employee compensation programs. The exact nature and cumulative effect of these recent changes are not yet known, but they are expected to increase the amount of premiums we must pay for FDIC insurance. Any such increase may adversely affect our business, financial condition or results of operations.

We face strong competition from other financial institutions and financial service companies, which could adversely affect our results of operations and financial condition.

We compete with other financial institutions in attracting deposits and making loans. Our competition in attracting deposits comes principally from other commercial banks, credit unions, savings and loan associations, securities brokerage firms, insurance companies, money market funds, and other mutual funds. Our competition in making loans comes principally from other commercial banks, credit unions, savings and loan associations, mortgage banking firms, and consumer finance companies. In addition, competition for business in the Louisville and Lexington metropolitan area has grown in recent years as changes in banking law have allowed several banks to enter the market by establishing new branches.

Competition in the banking industry may also limit our ability to attract and retain banking clients. We maintain smaller staffs of associates and have fewer financial and other resources than larger institutions with which we compete. Financial institutions that have far greater resources and greater efficiencies than we do may have several marketplace advantages resulting from their ability to:

- offer higher interest rates on deposits and lower interest rates on loans than we can;
- offer a broader range of services than we do;
- maintain more branch locations than we do; and
- mount extensive promotional and advertising campaigns.

In addition, banks and other financial institutions with larger capitalization and other financial intermediaries may not be subject to the same regulatory restrictions as we are and may have larger lending limits than we do. Some of our current commercial banking clients may seek alternative banking sources as they develop needs for credit facilities larger than we can accommodate. If we are unable to attract and retain customers, we may not be able to maintain growth and our results of operations and financial condition may otherwise be negatively impacted.

We depend on our senior management team, and the unexpected loss of one or more of our senior executives could impair our relationship with customers and adversely affect our business and financial results.

Our future success significantly depends on the continued services and performance of our key management personnel. Our future performance will depend on our ability to motivate and retain these and other key officers. The Dodd-Frank Act, and the policies of bank regulatory agencies have placed restrictions on our executive compensation practices. Such restrictions and standards may further impact our Company's ability to compete for talent with other businesses and financial institutions that are not subject to the same limitations as we are. The loss of the services of members of our senior management or other key officers or our inability to attract additional qualified personnel as needed could materially harm our business.

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Our reported financial results depend on management's selection of accounting methods and certain assumptions and estimates.

Our accounting policies and assumptions are fundamental to our reported financial condition and results of operations. Our management must exercise judgment in selecting and applying many of these accounting policies and methods so they comply with generally accepted accounting principles and reflect management's judgment of the most appropriate manner in which to report our financial condition and results. In some cases, management must select the accounting policy or method to apply from two or more alternatives, any of which may be reasonable under the circumstances, yet may result in our reporting materially different results than would have been reported under a different alternative.

Certain accounting policies are critical to presenting our reported financial condition and results. They require management to make difficult, subjective or complex judgments about matters that are uncertain. Materially different amounts could be reported under different conditions or using different assumptions or estimates. These critical accounting policies include the allowance for loan losses, valuation of OREO, valuation of securities and valuation of deferred income taxes. Because of the uncertainty of estimates involved in these matters, we may be required, among other things, to significantly increase the allowance for credit losses, sustain credit losses that are significantly higher than the reserve provided, recognize significant impairment on our OREO, or permanently impair deferred tax assets.

While management continually monitors and improves our system of internal controls, data processing systems, and corporate wide processes and procedures, we may suffer losses from operational risk in the future.

Management maintains internal operational controls, and we have invested in technology to help us process large volumes of transactions. However, we may not be able to continue processing at the same or higher levels of transactions. If our systems of internal controls should fail to work as expected, if our systems were to be used in an unauthorized manner, or if employees were to subvert the system of internal controls, significant losses could occur.

We process large volumes of transactions on a daily basis and are exposed to numerous types of operational risk, which could cause us to incur substantial losses. Operational risk resulting from inadequate or failed internal processes, people, and systems includes the risk of fraud by employees or persons outside of our company, the execution of unauthorized transactions by employees, errors relating to transaction processing and systems, and breaches of the internal control system and compliance requirements. This risk of loss also includes potential legal actions that could arise as a result of the operational deficiency or as a result of noncompliance with applicable regulatory standards.

We establish and maintain systems of internal operational controls that provide management with timely and accurate information about our level of operational risk. While not foolproof, these systems have been designed to manage operational risk at appropriate, cost effective levels. We have also established procedures that are designed to ensure that policies relating to conduct, ethics and business practices are followed. Nevertheless, we experience loss from operational risk from time to time, including the effects of operational errors, and these losses may be substantial.

Our information systems may experience an interruption or security breach.

Failure in or breach of our operational or security systems or infrastructure, or those of our third party vendors and other service providers, including as a result of cyber attacks, could disrupt our businesses, result in the disclosure or misuse of confidential or proprietary information, damage our reputation, increase our costs and cause losses. As a large financial institution, we depend on our ability to process, record and monitor a large number of customer transactions on a continuous basis. As customer, public and regulatory expectations regarding operational and information security have increased, our operational systems and infrastructure must continue to be safeguarded and monitored for potential failures, disruptions, and breakdowns. Our business, financial, accounting, data processing systems or other operating systems and facilities may stop operating properly or become disabled or damaged as a result of a number of factors including events that are wholly or partially beyond our control. For example, there could be sudden increases in customer transaction volume, electrical or telecommunications outages, natural disasters such as earthquakes, tornadoes, and hurricanes; disease pandemics, events arising from local or larger scale political or social matters, including terrorist acts, and, as described below, cyber attacks. Although we have business continuity plans and other safeguards in place, our business operations may be adversely affected by significant and widespread disruption to our physical infrastructure or operating systems that support our businesses and customers.

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Information security risks for financial institutions have generally increased in recent years in part because of the proliferation of new technologies, the use of the Internet and telecommunications technologies to conduct financial transactions, and the increased sophistication and activities of organized crime, hackers, terrorists, activists, and other external parties. As noted above, our operations rely on the secure processing, transmission and storage of confidential information in our computer systems and networks. In addition, to access our products and services, our customers may use personal smartphones, tablet PC's, and other mobile devices that are beyond our control systems. Although we believe we have robust information security procedures and controls, our technologies, systems, networks, and our customers' devices may become the target of cyber attacks or information security breaches. These events could result in the unauthorized release, gathering, monitoring, misuse, loss or destruction of our customers' confidential, proprietary and other information or that of our customers, or otherwise disrupt the business operations of ourselves, our customers or other third parties.

Third parties with which we do business or that facilitate our business activities, could also be sources of operational and information security risk to us, including from breakdowns or failures of their own systems or capacity constraints. Although to date we have not experienced any material losses relating to cyber attacks or other information security breaches, we can give no assurance that we will not suffer such losses in the future. Our risk and exposure to these matters remains heightened because of, among other things, the evolving nature of these threats and the prevalence of Internet and mobile banking. As cyber threats continue to evolve, we may be required to expend significant additional resources to continue to modify or enhance our protective measures or to investigate and remediate any information security vulnerabilities. Disruptions or failures in the physical infrastructure or operating systems that support our businesses and customers, or cyber attacks or security breaches of the networks, systems or devices that our customers use to access our products and services could result in customer attrition, regulatory fines, penalties or intervention, reputational damage, reimbursement or other compensation costs, and/or additional compliance costs, any of which could materially adversely affect our business, results of operations or financial condition.

We operate in a highly regulated environment and, as a result, are subject to extensive regulation and supervision that could adversely affect our financial performance and our ability to implement our growth and operating strategies.

We are subject to examination, supervision and comprehensive regulation by federal and state regulatory agencies, which is described under "Item 1 – Business—Supervision and Regulation." Regulatory oversight of banks is primarily intended to protect depositors, the federal deposit insurance funds, and the banking system as a whole, not our shareholders. Compliance with these regulations is costly and may make it more difficult to operate profitably.

Federal and state banking laws and regulations govern numerous matters including the payment of dividends, the acquisition of other banks, and the establishment of new banking offices. We must also meet specific regulatory capital requirements. Our failure to comply with these laws, regulations, and policies or to maintain our capital requirements could affect our ability to pay dividends on common shares, our ability to grow through the development of new offices, our ability to make acquisitions, and our ability to remain independent. These limitations may prevent us from successfully implementing our growth and operating strategies.

In addition, the laws and regulations applicable to banks could change at any time, which could significantly impact our business and profitability. For example, new legislation or regulation could limit the manner in which we may conduct our business, including our ability to attract deposits and make loans. Events that may not have a direct impact on us, such as the bankruptcy or insolvency of a prominent U.S. corporation, can cause legislators and banking regulators and other agencies such as the Financial Accounting Standards Board, the SEC, the Public Company Accounting Oversight Board and various taxing authorities to respond by adopting and or proposing substantive revisions to laws, regulations, rules, standards, policies, and interpretations. The nature, extent, and timing of the adoption of significant new laws and regulations, or changes in or repeal of existing laws and regulations may have a material impact on our business and results of operations. Changes in regulation may cause us to devote substantial additional financial resources and management time to compliance, which may negatively affect our operating results.

Changes in banking laws could have a material adverse effect on us.

We are subject to changes in federal and state laws as well as changes in banking and credit regulations, and governmental economic and monetary policies. We cannot predict whether any of these changes could adversely and materially affect us. The current regulatory environment for financial institutions entails significant potential increases in compliance requirements and associated costs. Federal and state banking regulators also possess broad powers to take supervisory actions as they deem appropriate. These supervisory actions may result in higher capital requirements, higher insurance premiums and limitations on our activities that could have a material adverse effect on our business and profitability.

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Recent legislation regarding the financial services industry may have a significant adverse effect on our operations.

The Dodd-Frank Act was signed into law on July 21, 2010. The Dodd-Frank Act has had a significant impact the U.S. financial system, including among other things:

- new requirements on banking, derivative and investment activities, including the repeal of the prohibition on the payment of interest on business demand accounts, and debit card interchange fee requirements;
- the creation of the Consumer Financial Protection Bureau with supervisory authority, including the power to conduct examinations and take enforcement actions with respect to financial institutions with assets of \$10 billion or more and implement regulations that will affect all financial institutions;
- provisions affecting corporate governance and executive compensation of all companies subject to the reporting requirements of the Securities and Exchange Act of 1934, as amended; and
- a provision that would require bank regulators to set minimum capital levels for bank holding companies that are as strong as those required for their insured depository subsidiaries, subject to a grandfather clause for holding companies with less than \$15 billion in assets as of December 31, 2009.

Many provisions in the Dodd-Frank Act remain subject to regulatory rule-making, implementation, and interpretation, the effects of which are not yet known. As a result, it is difficult to gauge the ultimate impact of certain provisions of the Dodd-Frank Act because the implementation of many concepts is left to regulatory agencies. For example, the CFPB is given the power to adopt new regulations to protect consumers and is given control over existing consumer protection regulations adopted by federal banking regulators. The CFPB has begun the rule-making process but it is not known at this time when all rules will be finalized and implemented.

The provisions of the Dodd-Frank Act and any rules adopted to implement those provisions, as well as any additional legislative or regulatory changes may impact the profitability of our business activities and costs of operations, require that we change certain of our business practices, materially affect our business model or affect retention of key personnel, require us to raise additional regulatory capital, including additional Tier 1 capital, and could expose us to additional costs (including increased compliance costs). These and other changes may also require us to invest significant management attention and resources to make any necessary changes and may adversely affect our ability to conduct our business as previously conducted or our results of operations or financial condition.

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Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

The Bank operates 17 banking offices located in Kentucky. The following table shows the location, square footage and ownership of each property. We believe that each of these locations is adequately insured. Support operations are located in the Main office in Louisville and the Glasgow office building on Columbia Avenue.

<u>Markets</u>	<u>Square Footage</u>	<u>Owned/ Leased</u>
Louisville/Jefferson, Bullitt and Henry Counties		
Main Office: 2500 Eastpoint Parkway, Louisville	30,000	Owned
Eminence Office: 645 Elm Street, Eminence	1,500	Owned
Hillview Office: 11998 Preston Highway, Hillview	3,500	Owned
Pleasureville Office: 5440 Castle Highway, Pleasureville	10,000	Owned
Shepherdsville Office: 340 South Buckman Street, Shepherdsville	10,000	Owned
Conestoga Office: 155 Conestoga Parkway, Shepherdsville	3,900	Owned
Lexington/Fayette County		
Lexington Office: 2424 Harrodsburg Road, Suite 100, Lexington	8,500	Leased
South Central Kentucky		
Brownsville Office: 113 East Main, Brownsville	8,500	Owned
Greensburg Office: 202-04 North Main Street, Greensburg	11,000	Owned
Horse Cave Office: 210 East Main Street, Horse Cave	5,000	Owned
Morgantown Office: 112 West Logan Street, Morgantown	7,500	Owned
Munfordville Office: 949 South Dixie Highway, Munfordville	9,000	Owned
Beaver Dam Office: 1300 North Main Street, Beaver Dam	3,200	Owned
Wal-Mart Office: 1701 North Main Street, Beaver Dam	500	Leased
Owensboro/Daviess County		
Owensboro Office: 1819 Frederica Street, Owensboro	3,000	Owned
Southern Kentucky		
Campbell Lane Office: 751 Campbell Lane, Bowling Green	7,500	Owned
Glasgow Office: 1006 West Main Street, Glasgow	12,000	Owned
Other Properties		
Office Building: 701 Columbia Avenue, Glasgow	19,000	Owned

Item 3. Legal Proceedings

We are defendants in various legal proceedings. Litigation is subject to inherent uncertainties and unfavorable outcomes could occur. See Note 24, "Contingencies" in the Notes to our consolidated financial statements for detail regarding ongoing legal proceedings and other matters.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information

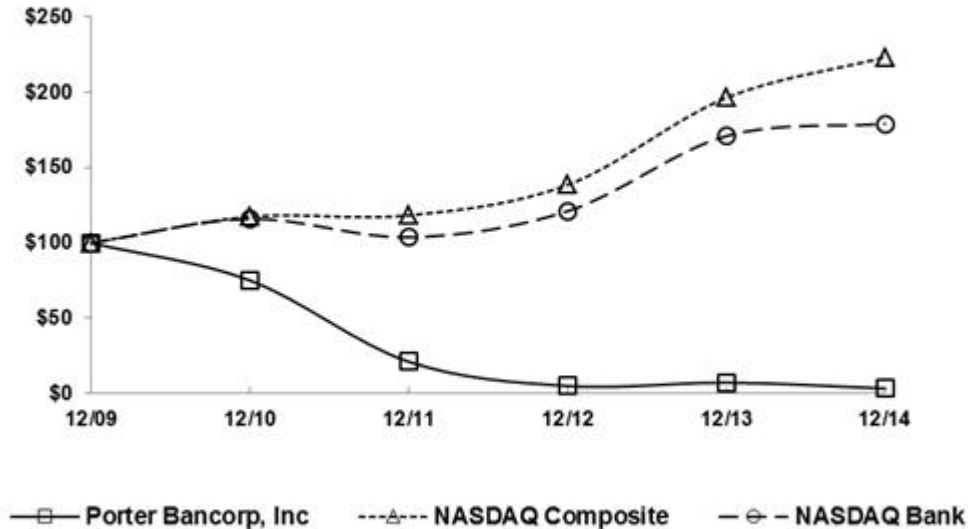
Our common shares are traded on the NASDAQ Capital Market under the ticker symbol “PBIB”. The following table presents the high and low sales prices for our common shares reported on the NASDAQ Capital Market for the periods indicated.

Quarter Ended	2014		
	Market Value		Dividend
	High	Low	
Fourth Quarter	\$1.03	\$0.48	\$ 0.00
Third Quarter	1.08	0.95	0.00
Second Quarter	1.18	0.90	0.00
First Quarter	1.24	0.94	0.00

Quarter Ended	2013		
	Market Value		Dividend
	High	Low	
Fourth Quarter	\$1.24	\$0.97	\$ 0.00
Third Quarter	2.23	0.80	0.00
Second Quarter	0.90	0.79	0.00
First Quarter	1.59	0.66	0.00

As of January 31, 2015, we had approximately 1,204 shareholders, including 360 shareholders of record and approximately 844 beneficial owners whose shares are held in “street” name by securities broker-dealers or other nominees.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*
 Among Porter Bancorp, Inc, the NASDAQ Composite Index
 and the NASDAQ Bank Index



*\$100 invested on 12/31/09 in stock or index, including reinvestment of dividends.
 Fiscal year ending December 31.

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Dividends

We will not be able to pay dividends on our common shares for the foreseeable future. We historically paid quarterly cash dividends on our common shares until we suspended dividend payments in October 2011. As a bank holding company, our ability to declare and pay dividends depends on certain federal regulatory considerations, including the guidelines of the Federal Reserve regarding capital adequacy and dividends. We have agreed with the Federal Reserve to obtain its written consent prior to declaring or paying any future dividends.

Our principal source of revenue with which to pay dividends on our common shares is the dividends that the Bank may declare and pay to us out of funds legally available for payment of dividends. Currently, the Bank must obtain the prior written consent of its primary regulators prior to declaring or paying any dividends. In addition to this current restriction, various laws applicable to the Bank also limit its payment of dividends to us. A Kentucky chartered bank may declare a dividend of an amount of the bank's net profits as the board deems appropriate. The approval of the KDFI is required if the total of all dividends declared by the bank in any calendar year exceeds the total of its net profits for that year combined with its retained net profits for the preceding two years, less any required transfers to surplus or a fund for the retirement of preferred stock or debt. As a practical matter, the Bank will not be able to pay dividends to us for the foreseeable future.

Effective with the fourth quarter of 2011, we began deferring interest payments on the junior subordinated notes relating to our trust preferred securities. Deferring interest payments on the junior subordinated notes resulted in the deferral of distributions on our trust preferred securities. If we defer interest payments on our trust preferred securities for 20 consecutive quarters, we must pay all deferred interest or we will be in default.

We will not be able to pay cash dividends on our common shares until we have paid all deferred distributions on our trust preferred securities. Deferred distributions on our trust preferred securities are cumulative, and distributions accrue and compound on each subsequent payment date. If we become subject to any liquidation, dissolution or winding up of affairs, holders of the trust preferred securities and then holders of the preferred stock will be entitled to receive the liquidation amounts to which they are entitled including the amount of any accrued and unpaid distributions and dividends, before any distribution can be made to the holders of our common shares or preferred stock. Our Series E and Series F preferred shares have priority over our common shares and non-voting common shares with respect to any payment of dividends.

Purchase of Equity Securities by Issuer

Except for the exchange transaction in December 2014, described in greater detail in "Item 1 – Business – History", the Company did not repurchase any of its issued and outstanding equity securities in 2014 or 2013.

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Item 6. Selected Financial Data

The following table summarizes our selected historical consolidated financial data from 2010 to 2014. You should read this information in conjunction with Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Item 8. “Financial Statements and Supplementary Data.”

Selected Consolidated Financial Data

(Dollars in thousands except per share data)	As of and for the Years Ended December 31,				
	2014	2013	2012	2011	2010
Income Statement Data:					
Interest income	\$ 39,513	\$ 43,228	\$ 57,729	\$ 73,554	\$ 86,407
Interest expense	9,795	11,143	15,774	22,039	28,841
Net interest income	29,718	32,085	41,955	51,515	57,566
Provision for loan losses	7,100	700	40,250	62,600	30,100
Non-interest income	4,079	5,919	9,590	7,833	11,582
Non-interest expense	39,435	38,890	44,292	104,273	46,478
Loss before income taxes	(12,738)	(1,586)	(32,997)	(107,525)	(7,430)
Income tax benefit	(1,583)	—	(65)	(218)	(3,046)
Net loss	(11,155)	(1,586)	(32,932)	(107,307)	(4,384)
Less:					
Dividends and accretion on preferred stock	2,362	2,079	1,929	1,927	1,987
Effect of exchange of preferred stock for common stock	(36,104)	—	—	—	—
Earnings (loss) allocated to participating securities	3,159	(267)	(1,429)	(4,080)	(184)
Net income (loss) attributable to common	\$ 19,428	\$ (3,398)	\$ (33,432)	\$ (105,154)	\$ (6,187)
Common Share Data (1):					
Basic earnings (loss) per common share	\$ 1.59	\$ (0.29)	\$ (2.85)	\$ (8.98)	\$ (0.60)
Diluted earnings (loss) per common share	1.59	(0.29)	(2.85)	(8.98)	(0.60)
Cash dividends declared per common share	0.00	0.00	0.00	0.02	0.49
Book value per common share (2)	1.67	(0.18)	0.74	3.74	12.76
Tangible book value per common share (2)	1.61	(0.29)	0.58	3.54	10.33
Balance Sheet Data (at period end):					
Total assets	\$1,017,989	\$1,076,121	\$1,162,631	\$1,455,424	\$1,723,952
Debt obligations:					
FHLB advances	15,752	4,492	5,604	7,116	15,022
Junior subordinated debentures	25,000	25,000	25,000	25,000	25,000
Subordinated capital note	4,950	5,850	6,975	7,650	8,550
Average Balance Data:					
Average assets	\$1,049,232	\$1,098,400	\$1,341,565	\$1,659,959	\$1,747,648
Average loans	662,442	788,176	1,033,320	1,243,474	1,353,295
Average deposits	961,671	1,004,052	1,217,083	1,434,462	1,459,041
Average FHLB advances	4,473	4,990	6,325	15,315	47,800
Average junior subordinated debentures	25,000	25,000	25,000	25,000	25,000
Average subordinated capital note	5,508	6,404	7,309	8,208	8,941
Average stockholders’ equity	33,881	42,631	75,679	159,434	188,015

(1) Common share data has been adjusted to reflect a 5% stock dividend effective December 14, 2010.

(2) After shareholder approval on February 25, 2015, the mandatorily convertible Series B preferred shares converted into 4,053,600 common shares and the mandatorily convertible Series D preferred shares converted into 6,458,000 non-voting common shares. Assuming conversion as of December 31, 2014, the proforma book value per common share would have been \$1.21 per share and the proforma tangible book value per common share would have been \$1.17 per share.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

Management's discussion and analysis of financial condition and results of operations analyzes the consolidated financial condition and results of operations of Porter Bancorp, Inc. (the "Company") and its wholly owned subsidiary, PBI Bank (the "Bank"). The Company is a Louisville, Kentucky-based bank holding company which operates banking offices in twelve counties through its wholly-owned subsidiary, the Bank. Our markets include metropolitan Louisville in Jefferson County and the surrounding counties of Henry and Bullitt. We serve south central Kentucky and southern Kentucky from banking offices in Butler, Green, Hart, Edmonson, Barren, Warren, Ohio, and Daviess Counties. We also have an office in Lexington, the second largest city in Kentucky. The Bank is a community bank with a wide range of commercial and personal banking products.

Historically, we have focused on commercial and commercial real estate lending, both in markets where we have banking offices and other growing markets in our region. Commercial, commercial real estate and real estate construction loans accounted for 55.5% of our total loan portfolio as of December 31, 2014, and 56.3% as of December 31, 2013. Commercial lending generally produces higher yields than residential lending, but involves greater risk and requires more rigorous underwriting standards and credit quality monitoring.

The following discussion should be read in conjunction with our consolidated financial statements and accompanying notes and other schedules presented elsewhere in the report.

Overview

For the year ended December 31, 2014, we reported a net loss of \$11.2 million compared with net loss of \$1.6 million for the year ended December 31, 2013 and \$32.9 million for the year ended December 31, 2012. After deductions for dividends and accretion on preferred stock, allocating losses to participating securities, and the effect of the exchange of preferred stock for common stock, net income attributable to common shareholders was \$19.4 million for the year ended December 31, 2014, compared with a net loss attributable to common shareholders of \$3.4 million for the year ended December 31, 2013. Basic and diluted income per common share were \$1.59 for the year ended December 31, 2014, compared with loss per common share of \$(0.29) for 2013.

Our financial performance in 2014 continued to be negatively impacted by the Bank's high level of non-performing assets. Asset quality remediation, capital restoration, and lowering the risk profile of the Company remain our major objectives for 2015.

Non-performing loans were 7.57% of total loans and non-performing assets were 9.19% of total assets, at December 31, 2014. We remain diligent in the management of our loan portfolio and are striving to improve credit quality by working throughout our markets to balance selective new customer acquisition, customer service for our existing clients and prudent risk management.

The following significant items are of note for the year ended December 31, 2014:

- In December 2014, we completed a non-cash equity exchange transaction with the accredited investors who acquired all of our issued and outstanding Series A preferred shares from UST in a public auction. We acquired and cancelled all of the issued and outstanding Series A Preferred Stock, the accrued dividends thereon, all of the issued and outstanding Series C Preferred Stock, and warrants to purchase 798,915 shares of common stock together having an aggregate book value of approximately \$45.7 million. In exchange, we issued common and preferred shares having a fair value of approximately \$9.6 million. The effect of the exchange was to increase common shareholders' equity by approximately \$36.1 million.

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- In the exchange transaction, we issued 1,821,428 common shares, 40,536 mandatorily convertible Series B Preferred Shares and 64,580 mandatorily convertible Series D Preferred Shares, which automatically converted into 4,053,600 common shares and 6,458,000 non-voting common shares after shareholder approval on February 25, 2015. We also issued 6,198 Series E Preferred Shares and 4,304 Series F Preferred Shares, both of which series are not convertible into common shares, have a liquidation preference of \$1,000 per share, and are entitled to a 2% noncumulative annual dividend if and when declared. Series E and Series F Preferred Shares rank senior to, and have liquidation and dividend preferences over, our common shares and non-voting common shares.
- The net effect of the exchange transaction and subsequent conversion of mandatorily convertible Series B Preferred and mandatorily convertible Series D Preferred shares was an increase in total shareholders' equity of \$7.4 million, and an increase in voting and non-voting common shares issued and outstanding of 12,333,028 shares.
- We have reduced the size of our balance sheet in accordance with our capital plan. Average assets were \$1.049 billion for the year ended December 31, 2014, compared with \$1.098 billion for the year ended December 31, 2013. This reduction was accomplished primarily by reducing our commercial real estate and construction and development loans within our loan portfolio and through the redemption of higher cost certificates of deposit accounts.
- Net interest margin decreased one basis point to 3.09% for the year ended December 31, 2014, compared with 3.10% for the year ended December 31, 2013. Average loans decreased 16.0% to \$662.4 million in 2014, compared with \$788.2 million in 2013. Net loans decreased 11.1% to \$605.6 million at December 31, 2014, compared with \$681.2 million at December 31, 2013.
- Provision for loan losses expense increased to \$7.1 million for 2014, compared with \$700,000 for the year ended December 31, 2013. Net charge-offs were \$15.9 million in 2014, compared with \$29.3 million in 2013 and \$36.1 million in 2012.
- We continued to execute on our strategy to reduce our exposure to commercial real estate and construction and development loans. Construction and development loans totaled \$33.2 million, or 45% of total risk-based capital, at December 31, 2014, compared with \$43.3 million, or 52% of total risk-based capital, at December 31, 2013. Non-owner occupied commercial real estate loans, construction and development loans, and multi-family residential real estate loans as a group totaled \$193.0 million, or 262% of total risk-based capital, at December 31, 2014 compared with \$237.0 million, or 284% of total risk-based capital, at December 31, 2013.
- Loan proceeds received from the repayment of our commercial real estate and construction and development loans were used primarily to redeem maturing certificates of deposit during 2014. Deposits decreased 6.2% to \$926.8 million compared with \$987.7 million at December 31, 2013. Certificate of deposit balances declined \$105.3 million during 2014 to \$574.7 million at December 31, 2014, from \$680.0 million at December 31, 2013.
- Total loans past due and nonaccrual loans decreased to \$52.3 million at December 31, 2014 from \$113.5 million at December 31, 2013.
- Non-performing loans decreased \$54.7 million to \$47.3 million at December 31, 2014, compared with \$102.0 million at December 31, 2013. The decrease in non-performing loans was due to the migration of non-performing loans to the OREO portfolio, as well as \$27.5 million in paydowns. Net charge-offs were \$15.9 million for the year ended December 31, 2014.
- Loans past due 30-59 days decreased from \$10.7 million at December 31, 2013 to \$4.0 million at December 31, 2014 and loans past due 60-89 days increased from \$775,000 at December 31, 2013 to \$980,000 at December 31, 2014.
- Foreclosed properties increased to \$46.2 million at December 31, 2014, compared with \$30.9 million at December 31, 2013. During the year ended December 31, 2014, the Company acquired \$32.3 million and sold \$13.1 million of OREO. In addition, we recorded fair value write-downs of \$4.3 million during the year reflecting declines in appraisal valuations and changes in pricing strategies. Our ratio of non-performing assets to total assets decreased to 9.19% at December 31, 2014, compared with 12.35% at December 31, 2013.

These items are discussed in further detail throughout this "Management's Discussion and Analysis of Financial Condition and Results of Operations" Section.

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Going Concern Considerations and Future Plans

Our consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business for the foreseeable future. However, the events and circumstances described in this discussion create substantial doubt about the Company's ability to continue as a going concern.

For the year ended December 31, 2014, we reported a net loss of \$11.2 million. The net loss was primarily attributable to loan loss provision of \$7.1 million, OREO expense of \$5.8 million resulting from fair value write-downs driven by new appraisals and reduced marketing prices, and ongoing operating expense, along with \$3.0 million in loan collection expenses. We also had lower net interest margin due to lower average loans outstanding, loans re-pricing at lower rates, and the level of non-performing loans in our portfolio. After deductions for dividends and accretion on preferred stock of \$2.4 million, allocating losses to participating securities of \$3.2 million, and the effect of the exchange of preferred stock for common stock of \$36.1 million, net income attributable to common shareholders was \$19.4 million for the year ended December 31, 2014, compared with a net loss attributable to common shareholders of \$3.4 million for the year ended December 31, 2013.

For the year ended December 31, 2013, we reported net loss attributable to common shareholders of \$3.4 million. This loss was attributable primarily to loan collection expenses of \$4.7 million and OREO expense of \$4.5 million resulting from fair value write-downs driven by new appraisals and reduced marketing prices, net loss on sales, and ongoing operating expenses. We also had lower net interest margin due to lower average loans outstanding, loans re-pricing at lower rates, and the level of non-performing loans in our portfolio. Net loss to common shareholders of \$3.4 million for the year ended December 31, 2013, compares with net loss to common shareholders of \$33.4 million for year ended December 31, 2012.

In June 2011, the Bank entered into a Consent Order with the FDIC and KDFI in which the Bank agreed, among other things, to improve asset quality, reduce loan concentrations, and maintain a minimum Tier 1 leverage ratio of 9% and a minimum total risk based capital ratio of 12%. The Consent Order was included in our Current Report on 8-K filed on June 30, 2011. In October 2012, the Bank entered into a revised Consent Order with the FDIC and KDFI, again agreeing to maintain a minimum Tier 1 leverage ratio of 9% and a minimum total risk based capital ratio of 12%. The Bank also agreed that if it should be unable to reach the required capital levels, and if directed in writing by the FDIC, then the Bank would within 30 days develop, adopt and implement a written plan to sell or merge itself into another federally insured financial institution or otherwise immediately obtain a capital investment into the Bank sufficient to fully meet the capital requirements.

We continue to work with our regulators toward capital ratio compliance. The revised Consent Order also requires the Bank to continue to adhere to the plans implemented in response to the June 2011 Consent Order, and includes the substantive provisions of the June 2011 Consent Order. The revised Consent Order was included in our Current Report on 8-K filed on September 19, 2012. As of December 31, 2014, the capital ratios required by the Consent Order were not met.

In order to meet these capital requirements, the Board of Directors and management are continuing to evaluate strategies to achieve the following objectives:

- Increasing capital through a possible public offering or private placement of common stock to new and existing shareholders. We have engaged a financial advisor to assist our Board in this evaluation.
- Continuing to operate the Company and Bank in a safe and sound manner. This strategy will require us to reduce our lending concentrations, remediate non-performing loans, and reduce other noninterest expense through the disposition of OREO.
- Evaluating and implementing improvements to our internal processes and procedures, distribution of labor, and work-flow to ensure we have adequately and appropriately deployed resources in an efficient manner in the current environment.
- Executing on our commitment to improve credit quality and reduce loan concentrations and balance sheet risk.
 - We have reduced our loan portfolio significantly from \$1.3 billion at December 31, 2010 to \$625.0 million at December 31, 2014.
 - We have reduced our construction and development loans to less than 75% of total risk-based capital at December 31, 2014, and have now been in compliance with the Consent Order for eleven quarters.

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- We have reduced our non-owner occupied commercial real estate loans, construction and development loans, and multi-family residential real estate loans. Compliance with our Consent Order requires those loans represent less than 250% of total risk-based capital. These loans represented 262% of total risk-based capital at December 31, 2014, down from 284% at December 31, 2013.
- Executing on our commitment to sell OREO and reinvest in quality income producing assets.
 - Our acquisition of real estate assets through the loan remediation process increased during 2014, as we acquired \$32.3 million of OREO in 2014 compared with \$20.6 million during 2013. This coincides with the reduction of nonaccrual loans from \$101.8 million at the end of 2013, to \$47.2 million at the end of 2014, as many of these loans were resolved by foreclosure.
 - We incurred OREO losses totaling \$3.9 million during the 2014, comprised of \$4.3 million in fair value write-downs to reflect declines in appraisal valuations and changes in our pricing strategies, offset by \$306,000 in net gain on sales.
 - We continually evaluate opportunities to maximize the value we receive from the sale of OREO. We pursue multiple sales channels with focus primarily on internal marketing and the use of brokers.
 - Real estate construction represents 40% of the OREO portfolio at December 31, 2014 compared with 62% at December 31, 2013. Commercial real estate represents 31% of the OREO portfolio at December 31, 2014 compared with 19% at December 31, 2013, and 1-4 family residential properties represent 17% of the portfolio at December 31, 2014 compared with 16% at December 31, 2013.

Bank regulatory agencies can exercise discretion when an institution does not meet the terms of a consent order. Based on individual circumstances, the agencies may issue mandatory directives, impose monetary penalties, initiate changes in management, or take more serious adverse actions such as require an institution to sell or merge itself into another institution or require the Bank to be taken into receivership.

Liquid assets were \$1.9 million at December 31, 2014. Since the Bank is unlikely to be in a position to pay dividends to the parent company for the foreseeable future, cash inflows for the parent are limited to earnings on investment securities, sales of investment securities, and interest on deposits with the Bank. These cash inflows along with the liquid assets held at December 31, 2014, are needed to cover ongoing operating expenses of the parent company which are forecasted at approximately \$1.0 million for 2015. Parent company liquidity could be improved through a sale of common or preferred shares.

Effective with the fourth quarter of 2011, we began deferring interest payments on the junior subordinated debentures relating to our trust preferred securities. Deferring interest payments on the junior subordinated debentures resulted in a deferral of distributions on our trust preferred securities.

If we defer distributions on our trust preferred securities for 20 consecutive quarters, we must pay all deferred distributions in full or we will be in default. Our deferral period expires in the third quarter of 2016. Deferred distributions on our trust preferred securities, which totaled \$2.2 million as of December 31, 2014, are cumulative, and unpaid distributions accrue and compound on each subsequent payment date. If as a result of a default we become subject to any liquidation, dissolution or winding up, holders of the trust preferred securities will be entitled to receive the liquidation amounts to which they are entitled, including all accrued and unpaid distributions, before any distribution can be made to our shareholders. In addition, the holders of our Series E and Series F Preferred Shares will be entitled to receive liquidation distributions totaling \$10.5 million before any distribution can be made to the holders of our common shares.

Our consolidated financial statements do not include any adjustments that may result should the Company be unable to continue as a going concern.

Application of Critical Accounting Policies

Our accounting and reporting policies comply with GAAP and conform to general practices within the banking industry. We believe that of our significant accounting policies, the following may involve a higher degree of management assumptions and judgments that could result in materially different amounts to be reported if conditions or underlying circumstances were to change.

Allowance for Loan Losses – The Bank maintains an allowance for loan losses believed to be sufficient to absorb probable incurred credit losses existing in the loan portfolio. The Board of Directors evaluates the adequacy of the allowance for loan losses on a quarterly basis. We evaluate the adequacy of the allowance using, among other things, historical loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of the underlying collateral and current economic conditions and trends. The allowance may be allocated for specific loans or loan categories, but the entire allowance is available for any loan that, in management's judgment, should be charged off. The allowance consists of specific and general components. The specific component relates to loans that are individually evaluated and measured for impairment. The general component is based on historical loss experience adjusted for qualitative environmental factors. We develop allowance estimates based on actual loss experience adjusted for current economic conditions and trends. Allowance estimates are a prudent measurement of the risk in the loan portfolio which we apply to individual loans based on loan type. If the mix and amount of future charge-off percentages differ significantly from those assumptions used by management in making its determination, we may be required to materially increase our allowance for loan losses and provision for loan losses, which could adversely affect our results.

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Other Real Estate Owned – OREO is real estate acquired as a result of foreclosure or by deed in lieu of foreclosure. It is classified as real estate owned until such time as it is sold. When property is acquired as a result of foreclosure or by deed in lieu of foreclosure, it is recorded at its fair market value less estimated cost to sell. Any write-down of the property at the time of acquisition is charged to the allowance for loan losses. Subsequent reductions in fair value are recorded as non-interest expense. To determine the fair value of OREO for smaller dollar single family homes, we consult with internal real estate sales staff and external realtors, investors, and appraisers. If the internally evaluated market price is below our underlying investment in the property, appropriate write-downs are recorded. For larger dollar residential and commercial real estate properties, we obtain a new appraisal of the subject property or have staff from our special assets group or in our centralized appraisal department evaluate the latest in-file appraisal in connection with the transfer to OREO. We typically obtain updated appraisals within five quarters or the anniversary date of ownership unless a sale is imminent.

Intangible Assets – We evaluate intangible assets for impairment at least annually and more frequently if circumstances indicate their value may not be recoverable. Identifiable intangible assets that are subject to amortization are amortized on an accelerated basis over the years expected to be benefited, which we believe is 10 years. We review these amortizable intangible assets for impairment if circumstances indicate their value may not be recoverable based on a comparison of fair value to carrying value. Based on our annual review, management does not believe our intangible assets are impaired at December 31, 2014.

Stock-based Compensation – Compensation cost is recognized for restricted stock awards issued to employees, based on the fair value of these awards at the date of grant. The market price of the Company's common shares at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Valuation of Deferred Tax Asset – We evaluate deferred tax assets for impairment on a quarterly basis. We established a 100% deferred tax valuation allowance of \$31.7 million in December 2011 based upon the analysis of our past performance and our expected future performance. When evaluating our deferred tax assets for realizability during 2014 and 2013, we concluded that a full valuation allowance was still necessary at December 31, 2014 and 2013, due to the additional losses incurred during those years. A return to profitability would enable us to reduce the valuation allowance and thereby offset income tax expense that would otherwise be recognized. Examinations of our income tax returns or changes in tax law may impact our deferred tax assets and liabilities as well as our provision for income taxes.

Contingencies – We are defendants in various legal proceedings. We record contingent liabilities resulting from claims against us when a loss is assessed to be probable and the amount of the loss is reasonably estimable. Assessing probability of loss and estimating probable losses requires analysis of multiple factors, including in some cases judgments about the potential actions of third party claimants and courts. Recorded contingent liabilities are based on the best information available and actual losses in any future period are inherently uncertain.

Results of Operations

The following table summarizes components of income and expense and the change in those components for 2014 compared with 2013:

	For the Years Ended December 31,		Change from Prior Period	
	2014	2013	Amount	Percent
	(dollars in thousands)			
Gross interest income	\$ 39,513	\$43,228	\$ (3,715)	(8.6)%
Gross interest expense	9,795	11,143	(1,348)	(12.1)
Net interest income	29,718	32,085	(2,367)	(7.4)
Provision for credit losses	7,100	700	6,400	914.3
Non-interest income	3,987	5,196	(1,209)	(23.3)
Gains on sale of securities, net	92	723	(631)	(87.3)
Non-interest expense	39,435	38,890	545	1.4
Net loss before taxes	(12,738)	(1,586)	(11,152)	703.2
Income tax benefit	(1,583)	—	(1,583)	—
Net loss	(11,155)	(1,586)	(9,569)	603.3
Dividends and accretion on preferred stock	(2,362)	(2,079)	(283)	13.6
Effect of exchange of preferred stock for common stock	36,104	—	36,104	100.0
Losses (earnings) attributable to participating securities	(3,159)	267	(3,426)	(1283.1)
Net income (loss) attributable to common shareholders	19,428	(3,398)	22,826	(671.7)

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Net loss of \$11.2 million for the year ended December 31, 2014 increased by \$9.6 million from net loss of \$1.6 million for 2013. This was primarily due to a \$2.4 million decrease in net interest income driven by lower average earning assets, an increase of \$6.4 million in provision for loan losses expense, and reductions in non-interest income from our exit of trust services in 2013 and lower gains on the sale of securities. Net income attributable to common shareholders of \$19.4 million for the year ended December 31, 2014, improved \$22.8 million from net loss to common shareholders of \$3.4 million for 2013. This increase was primarily attributable to the \$36.1 million effect of the exchange of preferred stock for common stock.

The following table summarizes components of income and expense and the change in those components for 2013 compared with 2012:

	For the Years Ended December 31,		Change from Prior Period	
	2013	2012	Amount	Percent
	(dollars in thousands)			
Gross interest income	\$43,228	\$ 57,729	\$(14,501)	(25.1)%
Gross interest expense	11,143	15,774	(4,631)	(29.4)
Net interest income	32,085	41,955	(9,870)	(23.5)
Provision for credit losses	700	40,250	(39,550)	(98.3)
Non-interest income	5,196	6,354	(1,158)	(18.2)
Gains on sale of securities, net	723	3,236	(2,513)	(77.7)
Non-interest expense	38,890	44,292	(5,402)	(12.2)
Net loss before taxes	(1,586)	(32,997)	31,411	(95.2)
Income tax benefit	—	(65)	65	(100.0)
Net loss	(1,586)	(32,932)	31,346	(95.2)
Dividends on and accretion on preferred stock	(2,079)	(1,929)	(150)	7.8
Losses attributable to participating securities	267	1,429	(1,162)	(81.3)
Net loss attributable to common shareholders	(3,398)	(33,432)	30,034	(89.8)

Net loss before taxes of \$1.6 million for the year ended December 31, 2013, improved by \$31.4 million from net loss of \$33.0 million for 2012. Net loss to common shareholders of \$3.4 million for the year ended December 31, 2013, decreased \$30.0 million from net loss to common shareholders of \$33.4 million for 2012. This decrease in net loss was attributable primarily to lower provision for loan losses expense and decreased non-interest expense associated with our OREO, partially offset by lower net gain on sales of securities and lower net interest income.

Net Interest Income – Our net interest income was \$29.7 million for the year ended December 31, 2014, a decrease of \$2.4 million, or 7.4%, compared with \$32.1 million for the same period in 2013. Net interest spread and margin were 2.98% and 3.09%, respectively, for 2014, compared with 2.97% and 3.10%, respectively, for 2013. Average nonaccrual loans were \$63.1 million and \$107.3 million in 2014 and 2013, respectively. The decrease in net interest income was primarily the result of lower average earning assets coupled with lower rates on those assets. In addition, net interest income and net interest margin were adversely affected by \$3.3 million and \$5.6 million of interest lost on nonaccrual loans during 2014 and 2013, respectively.

Our average interest-earning assets were \$979.2 million for 2014, compared with \$1.05 billion for 2013, a 6.8% decrease, primarily attributable to lower average loans and partially offset by higher average investment securities and interest bearing deposits with financial institutions. Average loans were \$662.4 million for 2014, compared with \$788.2 million for 2013, a 16.0% decrease. Average interest bearing deposits with financial institutions were \$87.0 million in 2014, compared with \$65.1 million in 2013, a 33.7% increase. Average investment securities were \$220.5 million for 2014, compared with \$184.2 million for 2013, a 19.7% increase. Our total interest income decreased 8.6% to \$39.5 million for 2014, compared with \$43.2 million for 2013.

Our average interest-bearing liabilities decreased by 5.5% to \$885.8 million for 2014, compared with \$937.4 million for 2013. Our total interest expense decreased by 12.1% to \$9.8 million for 2014, compared with \$11.1 million during 2013, due primarily to lower interest rates paid on and lower volume of certificates of deposit. Our average volume of certificates of deposit decreased 10.2% to \$632.0 million for 2014, compared with \$704.0 million for 2013. The average interest rate paid on certificates of deposit decreased to 1.29% for 2014, compared with 1.35% for 2013, as the result of continued re-pricing of certificates of deposit at maturity to lower interest rates. Our average volume of NOW and money market deposit accounts increased 16.1% to \$179.7 million for 2014, compared with \$154.8 million for 2013. The average interest rate paid on NOW and money market deposit accounts increased to 0.36% for 2014, compared with 0.35% for 2013.

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Our net interest income was \$32.1 million for the year ended December 31, 2013, a decrease of \$9.9 million, or 23.5%, compared with \$42.0 million for the same period in 2012. Net interest spread and margin were 2.97% and 3.10%, respectively, for 2013, compared with 3.16% and 3.31%, respectively, for 2012. Average nonaccrual loans were \$107.3 million and \$90.8 million in 2013 and 2012, respectively. The decrease in net interest income was primarily the result of lower average earning assets. In addition, net interest income and net interest margin were adversely affected by \$5.6 million and \$4.9 million of interest lost on nonaccrual loans during 2013 and 2012, respectively.

Our average interest-earning assets were \$1.05 billion for 2013, compared with \$1.28 billion for 2012, an 18.1% decrease, primarily attributable to lower average loans and partially offset by higher average investment securities and interest bearing deposits with financial institutions. Average loans were \$788.2 million for 2013, compared with \$1.03 billion for 2012, a 23.7% decrease. Average interest bearing deposits with financial institutions were \$65.1 million in 2013, compared with \$62.1 million in 2012, a 4.7% increase. Average investment securities were \$184.2 million for 2013, compared with \$173.1 million for 2012, a 6.4% increase. Our total interest income decreased 25.1% to \$43.2 million for 2013, compared with \$57.7 million for 2012. The change was due primarily to lower interest rates on loans, lower volume of loans and lower interest rates on investment securities.

Our average interest-bearing liabilities decreased by 18.1% to \$937.4 million for 2013, compared with \$1.14 billion for 2012. Our total interest expense decreased by 29.4% to \$11.1 million for 2013, compared with \$15.8 million during 2011, due primarily to lower interest rates paid on and lower volume of certificates of deposit, NOW and money market deposits. Our average volume of certificates of deposit decreased 22.8% to \$704.0 million for 2013, compared with \$912.1 million for 2012. The average interest rate paid on certificates of deposit decreased to 1.35% for 2013, compared with 1.52% for 2012, as the result of continued re-pricing of certificates of deposit at maturity to lower interest rates. Our average volume of NOW and money market deposit accounts increased 1.1% to \$154.8 million for 2013, compared with \$153.0 million for 2012. The average interest rate paid on NOW and money market deposit accounts decreased to 0.35% for 2013, compared with 0.42% for 2012.

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Average Balance Sheets

The following table sets forth the average daily balances, the interest earned or paid on such amounts, and the weighted average yield on interest-earning assets and weighted average cost of interest-bearing liabilities for the periods indicated. Dividing income or expense by the average daily balance of assets or liabilities, respectively, derives such yields and costs for the periods presented.

	For the Years Ended December 31,					
	2014			2013		
	Average Balance	Interest Earned/ Paid	Average Yield/ Cost	Average Balance	Interest Earned/ Paid	Average Yield/ Cost
	(dollars in thousands)					
ASSETS						
Interest-earning assets:						
Loans receivables (1)(2)						
Real estate	\$ 562,829	\$27,654	4.91%	\$ 696,785	\$32,591	4.68%
Commercial	60,419	3,002	4.97	50,990	2,772	5.44
Consumer	12,786	1,087	8.50	16,982	1,402	8.26
Agriculture	25,806	1,321	5.12	22,639	1,229	5.43
Other	602	26	4.32	780	21	2.69
U.S. Treasury and agencies	32,459	755	2.33	23,685	546	2.31
Mortgage-backed securities	114,103	2,780	2.44	83,160	1,552	1.87
State and political subdivision securities (3)	30,428	936	4.73	30,292	933	4.74
State and political subdivision securities	24,873	757	3.04	24,861	787	3.17
Corporate bonds	18,041	607	3.36	20,864	745	3.57
FHLB stock	7,760	337	4.34	10,072	421	4.18
Other debt securities	572	46	8.04	572	46	8.04
Other equity securities	21	—	—	744	30	4.03
Federal funds sold	1,502	2	0.13	2,640	3	0.11
Interest-bearing deposits in other financial institutions	86,986	203	0.23	65,076	150	0.23
Total interest-earning assets	979,187	39,513	4.09%	1,050,142	43,228	4.16%
Less: Allowance for loan losses	(25,390)			(40,343)		
Non-interest-earning assets	95,435			88,601		
Total assets	\$1,049,232			\$1,098,400		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Interest-bearing liabilities						
Certificates of deposit and other time deposits	\$ 632,020	\$ 8,125	1.29%	\$ 703,982	\$ 9,482	1.35%
NOW and money market deposits	179,698	653	0.36	154,759	541	0.35
Savings accounts	36,803	89	0.24	39,158	114	0.29
Federal funds purchased and repurchase agreements	2,255	3	0.13	3,113	6	0.19
FHLB advances	4,473	124	2.77	4,990	157	3.15
Junior subordinated debentures	30,508	801	2.63	31,404	843	2.68
Total interest-bearing liabilities	885,757	9,795	1.11%	937,406	11,143	1.19%
Non-interest-bearing liabilities						
Non-interest-bearing deposits	113,150			106,153		
Other liabilities	16,444			12,210		
Total liabilities	1,015,351			1,055,769		
Stockholders' equity	33,881			42,631		
Total liabilities and stockholders' equity	\$1,049,232			\$1,098,400		
Net interest income		\$29,718			\$32,085	
Net interest spread			2.98%			2.97%
Net interest margin			3.09%			3.10%
Ratio of average interest-earning assets to average interest-bearing liabilities			110.55%			112.03%

(1) Includes loan fees in both interest income and the calculation of yield on loans.

(2) Calculations include non-accruing loans of \$63.1 million and \$107.3 million in average loan amounts outstanding.

(3) Taxable equivalent yields are calculated assuming a 35% federal income tax rate.

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	For the Years Ended December 31,					
	2013			2012		
	Average Balance	Interest Earned/ Paid	Average Yield/ Cost	Average Balance	Interest Earned/ Paid	Average Yield/ Cost
(dollars in thousands)						
ASSETS						
Interest-earning assets:						
Loans receivables (1)(2)						
Real estate	\$ 696,785	\$32,591	4.68%	\$ 921,314	\$46,179	5.01%
Commercial	50,990	2,772	5.44	64,252	3,510	5.46
Consumer	16,982	1,402	8.26	22,720	1,903	8.38
Agriculture	22,639	1,229	5.43	24,196	1,304	5.39
Other	780	21	2.69	838	22	2.63
U.S. Treasury and agencies	23,685	546	2.31	6,588	199	3.02
Mortgage-backed securities	83,160	1,552	1.87	111,637	1,986	1.78
State and political subdivision securities (3)	30,292	933	4.74	26,631	887	5.12
State and political subdivision securities	24,861	787	3.17	17,363	563	3.24
Corporate bonds	20,864	745	3.57	8,957	482	5.38
FHLB stock	10,072	421	4.18	10,072	447	4.44
Other debt securities	572	46	8.04	572	46	8.04
Other equity securities	744	30	4.03	1,359	57	4.19
Federal funds sold	2,640	3	0.11	3,109	2	0.06
Interest-bearing deposits in other financial institutions	65,076	150	0.23	62,127	142	0.23
Total interest-earning assets	1,050,142	43,228	4.16%	1,281,735	57,729	4.54%
Less: Allowance for loan losses	(40,343)			(53,484)		
Non-interest-earning assets	88,601			113,314		
Total assets	\$1,098,400			\$1,341,565		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Interest-bearing liabilities						
Certificates of deposit and other time deposits	\$ 703,982	\$ 9,482	1.35%	\$ 912,061	\$13,828	1.52%
NOW and money market deposits	154,759	541	0.35	153,032	641	0.42
Savings accounts	39,158	114	0.29	38,665	154	0.40
Federal funds purchased and repurchase agreements	3,113	6	0.19	2,088	7	0.34
FHLB advances	4,990	157	3.15	6,325	207	3.27
Junior subordinated debentures	31,404	843	2.68	32,309	937	2.90
Total interest-bearing liabilities	937,406	11,143	1.19%	1,144,480	15,774	1.38%
Non-interest-bearing liabilities						
Non-interest-bearing deposits	106,153			113,325		
Other liabilities	12,210			8,081		
Total liabilities	1,055,769			1,265,886		
Stockholders' equity	42,631			75,679		
Total liabilities and stockholders' equity	\$1,098,400			\$1,341,565		
Net interest income		\$32,085			\$41,955	
Net interest spread			2.97%			3.16%
Net interest margin			3.10%			3.31%
Ratio of average interest-earning assets to average interest-bearing liabilities			112.03%			111.99%

(1) Includes loan fees in both interest income and the calculation of yield on loans.

(2) Calculations include non-accruing loans of \$107.3 million and \$90.8 million in average loan amounts outstanding.

(3) Taxable equivalent yields are calculated assuming a 35% federal income tax rate.

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Rate/Volume Analysis

The table below sets forth information regarding changes in interest income and interest expense for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (1) changes in rate (changes in rate multiplied by old volume); (2) changes in volume (changes in volume multiplied by old rate); and (3) changes in rate-volume (change in rate multiplied by change in volume). Changes in rate-volume are proportionately allocated between rate and volume variance.

	<u>Year Ended December 31, 2014 vs. 2013</u>			<u>Year Ended December 31, 2013 vs. 2012</u>		
	Increase (decrease)			Increase (decrease)		
	due to change in			due to change in		
	<u>Rate</u>	<u>Volume</u>	<u>Net Change</u>	<u>Rate</u>	<u>Volume</u>	<u>Net Change</u>
	(in thousands)					
Interest-earning assets:						
Loan receivables	\$ 1,316	\$ (6,241)	\$ (4,925)	\$ (2,935)	\$ (11,967)	\$ (14,902)
U.S. Treasury and agencies	5	204	209	(35)	382	347
Mortgage-backed securities	554	674	1,228	93	(528)	(435)
State and political subdivision securities	(32)	5	(27)	(81)	351	270
Corporate bonds	(41)	(97)	(138)	(206)	469	263
FHLB stock	16	(100)	(84)	(26)	—	(26)
Other equity securities	(15)	(15)	(30)	(2)	(25)	(27)
Federal funds sold	0	(1)	(1)	1	—	1
Interest-bearing deposits in other financial institutions	1	52	53	1	7	8
Total increase (decrease) in interest income	<u>1,804</u>	<u>(5,519)</u>	<u>(3,715)</u>	<u>(3,190)</u>	<u>(11,311)</u>	<u>(14,501)</u>
Interest-bearing liabilities:						
Certificates of deposit and other time deposits	(418)	(939)	(1,357)	(1,427)	(2,919)	(4,346)
NOW and money market accounts	22	90	112	(107)	7	(100)
Savings accounts	(18)	(7)	(25)	(42)	2	(40)
Federal funds purchased and repurchase agreements	(1)	(2)	(3)	(3)	2	(1)
FHLB advances	(18)	(15)	(33)	(8)	(42)	(50)
Junior subordinated debentures	(18)	(24)	(42)	(69)	(25)	(94)
Total increase (decrease) in interest expense	<u>(451)</u>	<u>(897)</u>	<u>(1,348)</u>	<u>(1,656)</u>	<u>(2,975)</u>	<u>(4,631)</u>
Increase (decrease) in net interest income	<u>\$ 2,255</u>	<u>\$ (4,622)</u>	<u>\$ (2,367)</u>	<u>\$ (1,534)</u>	<u>\$ (8,336)</u>	<u>\$ (9,870)</u>

Non-interest Income – The following table presents for the periods indicated the major categories of non-interest income:

	For the Years Ended		
	December 31,		
	<u>2014</u>	<u>2013</u>	<u>2012</u>
	(in thousands)		
Service charges on deposit accounts	\$1,988	\$2,058	\$2,239
Income from fiduciary activities	—	517	1,177
Bank card interchange fees	765	718	727
Other real estate owned rental income	256	399	420
Net gain on sales of securities	92	723	3,236
Income from bank owned life insurance	276	534	312
Other	<u>702</u>	<u>970</u>	<u>1,479</u>
Total non-interest income	<u>\$4,079</u>	<u>\$5,919</u>	<u>\$9,590</u>

Non-interest income decreased by \$1.8 million to \$4.1 million for 2014 compared with \$5.9 million for 2013. This was due primarily to decreased gain on sales of investment securities of \$631,000, or 87.3%, due to lower volume of sales. This decrease was also caused by a reduction in income from fiduciary activities as we transitioned away from providing trust services, including ESOP and employee benefit plan services throughout our markets in 2013.

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Non-interest income decreased by \$3.7 million to \$5.9 million for 2013 compared with \$9.6 million for 2012. This was due primarily to decreased gain on sales of investment securities of \$2.5 million, or 77.7%, due to lower volume of sales. This decrease was also caused by a reduction in income from fiduciary activities as we transitioned away from providing trust services, including ESOP and employee benefit plan services throughout our markets. This decrease was offset partially by an increase in income from bank owned life insurance, which increased by 71.2% from 2012.

Non-interest Expense – The following table presents the major categories of non-interest expense:

	For the Years Ended December 31,		
	2014	2013	2012
	(in thousands)		
Salary and employee benefits	\$15,658	\$15,501	\$16,648
Other real estate owned expense	5,839	4,516	10,549
Occupancy and equipment	3,497	3,583	3,642
Loan collection expense	2,994	4,707	2,442
Professional fees	2,771	1,892	1,985
FDIC insurance	2,272	2,378	2,835
State franchise tax	1,445	1,944	2,174
Data processing expense	1,106	184	96
Communications	752	711	710
Postage and delivery	407	423	454
Insurance expense	575	648	373
Advertising	563	308	154
Other	1,556	2,095	2,230
Total non-interest expense	<u>\$39,435</u>	<u>\$38,890</u>	<u>\$44,292</u>

Non-interest expense for the year ended December 31, 2014 of \$39.4 million represented a 1.4% increase from \$38.9 million for the same period last year. The increase in non-interest expense was attributable primarily to increases in OREO expenses, professional fees and data processing expenses, offset by decreases in loan collection expenses and state franchise tax. In late 2013, we began outsourcing out data processing functions, leading to an increase in expense year over year. Expenses related to OREO include:

	2014	2013
	(in thousands)	
Net (gain) loss on sales	\$ (306)	\$ 132
Provision to allowance for declining market values	4,255	2,466
Operating expense	1,890	1,918
Total	<u>\$5,839</u>	<u>\$4,516</u>

During 2014, we recorded approximately \$4.3 million of provision to OREO allowance related to fair value writedowns resulting from declines in the fair value of the real estate based upon updated appraisals and reduced marketing prices. This compares with \$2.5 million of provision related to new appraisals received for properties in the portfolio during 2013.

Loan collection expenses declined by \$2.7 million, or 36.4%, but this improvement was offset by a \$1.3 million increase in OREO expenses primarily as a result of fair value writedowns resulting from declines in the fair value of the real estate based upon updated appraisals and reduced marketing prices.

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Non-interest Expense Comparison – 2013 to 2012

Non-interest expense for the year ended December 31, 2013 of \$38.9 million represented a 12.2% decrease from \$44.3 million for the same period last year. The decrease in non-interest expense was attributable primarily to decreased other real estate owned expense due to lower loss on sales of OREO and lower valuation write-downs. Expenses related to other real estate owned include:

	<u>2013</u>	<u>2012</u>
	(in thousands)	
Net loss on sales	\$ 132	\$ 1,672
Provision to allowance	2,466	7,154
Operating expense	<u>1,918</u>	<u>1,723</u>
Total	<u>\$4,516</u>	<u>\$10,549</u>

During 2013, we recorded approximately \$2.5 million of provision to OREO allowance related to new appraisals received for properties in the portfolio during the year. This compares with \$7.2 million of provision related to new appraisals received for properties in the portfolio during 2012.

FDIC insurance assessments decreased \$457,000, or 16.1%, to \$2.4 million in 2013 from \$2.8 million in 2012 due to decreased average total consolidated assets, less the average tangible equity during the assessment period. Salary and employee benefit expenses decreased by \$1.1 million, or 6.9% to \$15.5 million from \$16.6 million in 2012.

These improvements were offset partially by an increase in loan collection expense of \$2.3 million, or 92.8%, due primarily to continued remediation of problem loans.

Income Tax Expense – No income tax expense was recorded for 2014 or 2013, with an income tax benefit of \$1.6 million recorded for 2014. The December 31, 2014 tax benefit is entirely due to gains in other comprehensive income that are presented in current operations in accordance with the applicable accounting standards. Our deferred tax valuation allowance increased to \$50.6 million at December 31, 2014. Our statutory federal tax rate was 35% in both 2014 and 2013. The effective tax rate for 2014 and 2013 is not meaningful due to the reduction of income tax benefit as the result of the establishment of the deferred tax valuation allowance.

The valuation allowance for our deferred tax assets does not have any impact on our liquidity, nor does it preclude us from using the tax losses, tax credits or other timing differences in the future. To the extent we generate taxable income in a given quarter, the valuation allowance may be reduced to offset fully or partially the corresponding income tax expense. Any remaining deferred tax asset valuation allowance may be reversed through income tax expense once we can demonstrate a sustainable return to profitability and conclude it is more likely than not the deferred tax asset will be utilized.

See Note 14, “Income Taxes”, for additional discussion of our income taxes.

No income tax benefit was recorded for 2013, compared with \$65,000 for 2012. Our deferred tax valuation allowance increased to \$47.8 million at December 31, 2013. Our statutory federal tax rate was 35% in both 2013 and 2012. The effective tax rate for 2013 and 2012 is not meaningful due to the reduction of income tax benefit as the result of the establishment of the deferred tax valuation allowance.

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Analysis of Financial Condition

Total assets at December 31, 2014 were \$1.018 billion compared with \$1.076 billion at December 31, 2013, a decrease of \$58.1 million or 5.4%. This decrease was attributable primarily to a decrease of \$75.6 million in net loans and a decrease in cash and cash equivalents of \$31.0 million, which were offset by increases in investment securities of \$26.1 million and OREO of \$15.3 million. The decrease in loans was attributable to principal reductions by customers outpacing loan originations and advances, as well as \$15.9 million in loan charge-offs and the transfer of loan balances totaling \$32.3 million to OREO.

The Bank's total risk-based capital was \$73.2 million at December 31, 2014. The Bank's consent order with its primary regulators required its Board of Directors to adopt and implement a plan to reduce its construction and development loans to not more than 75% of total risk-based capital. These loans totaled \$33.2 million, or 45% of total risk-based capital, at December 31, 2014. The consent order also required a plan to reduce non-owner occupied commercial real estate loans, construction and development loans, and multifamily residential real estate loans as a group, to not more than 250% of total risk-based capital. These loans totaled \$193.0 million, or 262% of total risk-based capital, at December 31, 2014.

Total assets at December 31, 2013 were \$1.076 billion compared with \$1.163 billion at December 31, 2012, a decrease of \$86.5 million or 7.4%. This decrease was attributable primarily to a decrease of \$189.8 million in loans. The decrease in loans was attributable to principal reductions by customers outpacing loan originations and advances, as well as \$32.6 million in loan charge-offs and the transfer of loan balances totaling \$20.6 million to OREO.

Loans Receivable – Loans receivable decreased \$84.3 million, or 11.9%, during the year ended December 31, 2014, to \$625.0 million. Our commercial, commercial real estate and real estate construction portfolios decreased by an aggregate of \$52.4 million, or 13.1%, during 2014 and comprised 55.5% of the total loan portfolio at December 31, 2014.

Loans receivable decreased \$189.8 million, or 21.1%, during the year ended December 31, 2013, to \$709.3 million. Our commercial, commercial real estate and real estate construction portfolios decreased by an aggregate of \$126.9 million, or 24.1%, during 2013, comprising 56.3% of the total loan portfolio at December 31, 2013.

Loan Portfolio Composition – The following table presents a summary of the loan portfolio at the dates indicated, net of deferred loan fees, by type. There are no foreign loans in our portfolio and other than the categories noted, there is no concentration of loans in any industry exceeding 10% of total loans, with the exception of loans for retail facilities (included in other commercial real estate below). Those loans totaled \$71.1 million at December 31, 2014 and \$98.5 million at December 31, 2013.

	As of December 31,			
	2014		2013	
	Amount	Percent	Amount	Percent
	(dollars in thousands)			
Commercial	\$ 60,936	9.75%	\$ 52,878	7.45%
Commercial Real Estate:				
Construction	33,173	5.31	43,326	6.11
Farmland	77,419	12.39	71,189	10.04
Other	175,452	28.07	232,026	32.71
Residential Real Estate:				
Multi-family	41,891	6.70	46,858	6.61
1-4 Family	197,278	31.56	228,505	32.21
Consumer	11,347	1.82	14,365	2.03
Agriculture	26,966	4.31	19,199	2.71
Other	537	0.09	980	0.13
Total loans	<u>\$624,999</u>	<u>100.0%</u>	<u>\$709,326</u>	<u>100.00%</u>

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	As of December 31,					
	2012		2011		2010	
	Amount	Percent	Amount	Percent	Amount	Percent
Commercial	\$ 52,567	5.85%	\$ 71,216	6.27%	\$ 90,290	6.93%
Commercial Real Estate:						
Construction	70,284	7.82	101,471	8.93	199,524	15.32
Farmland	80,825	8.99	90,958	8.01	85,523	6.56
Other	322,687	35.89	423,844	37.31	441,844	33.92
Residential Real Estate:						
Multi-family	50,986	5.67	60,410	5.31	74,919	5.75
1-4 Family	278,273	30.95	337,350	29.70	353,418	27.13
Consumer	20,383	2.27	26,011	2.29	31,913	2.45
Agriculture	22,317	2.48	23,770	2.09	24,177	1.86
Other	770	0.08	993	0.09	1,060	0.08
Total loans	<u>\$899,092</u>	<u>100.00%</u>	<u>\$1,136,023</u>	<u>100.00%</u>	<u>\$1,302,668</u>	<u>100.00%</u>

Our lending activities are subject to a variety of lending limits imposed by state and federal law. The Bank's secured legal lending limit to a single borrower was approximately \$18.1 million at December 31, 2014.

At December 31, 2014, we had three loan relationships each with aggregate extensions of credit in excess of \$10.0 million, all of which were classified as pass by the Bank's internal loan review process. In 2013, we had four loan relationships each with aggregate extensions of credit in excess of \$10.0 million. At December 31, 2013, two of the four relationships included loans that had been classified as substandard by the Bank's internal loan review process. For further discussion of classified loans refer to the asset quality discussion in our "Allowance for Loan Losses" section.

Our real estate construction portfolio declined approximately \$10.2 million from 2013 to 2014. This decrease was the result of construction projects being completed and sold to end users or refinanced under permanent financing arrangements and loans in this category being transferred to OREO through the normal progression of collection, workout, and ultimate disposition.

As of December 31, 2014, we had \$7.0 million of loan participations purchased from, and \$28.0 million of loan participations sold to, other banks. As of December 31, 2013, we had \$7.2 million of loan participations purchased from, and \$38.2 million of loan participations sold to, other banks.

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Loan Maturity Schedule – The following table sets forth information at December 31, 2014, regarding the dollar amount of loans, net of deferred loan fees, maturing in the loan portfolio based on their contractual terms to maturity:

	As of December 31, 2014			
	Maturing			
	Within One Year	Maturing 1 through 5 Years	Maturing Over 5 Years	Total Loans
	(dollars in thousands)			
Loans with fixed rates:				
Commercial	\$ 4,026	\$ 19,549	\$ 681	\$ 24,256
Commercial Real Estate:				
Construction	5,837	11,525	402	17,764
Farmland	10,065	15,968	6,257	32,290
Other	48,088	60,305	20,692	129,085
Residential Real Estate:				
Multi-family	757	26,116	7,030	33,903
1-4 Family	19,607	83,563	45,301	148,471
Consumer	1,516	8,164	1,333	11,013
Agriculture	2,408	2,431	294	5,133
Other	74	206	237	517
Total fixed rate loans	<u>\$92,378</u>	<u>\$227,827</u>	<u>\$ 82,227</u>	<u>\$402,432</u>
Loans with floating rates:				
Commercial	\$11,602	\$ 16,285	\$ 8,793	\$ 36,680
Commercial Real Estate:				
Construction	4,266	10,563	580	15,409
Farmland	3,221	3,675	38,233	45,129
Other	2,680	22,444	21,243	46,367
Residential Real Estate:				
Multi-family	46	6,218	1,724	7,988
1-4 Family	5,382	6,630	36,795	48,807
Consumer	176	109	49	334
Agriculture	8,177	13,560	96	21,833
Other	—	—	20	20
Total floating rate loans	<u>\$35,550</u>	<u>\$ 79,484</u>	<u>\$107,533</u>	<u>\$222,567</u>

Loan Portfolio by Risk Category – The following table presents a summary of the loan portfolio at the dates indicated, by risk category.

	As of December 31,				
	2014	2013	2012 (in thousands)	2011	2010
Pass	\$461,126	\$369,529	\$437,886	\$ 713,822	\$ 984,636
Watch	68,200	144,316	177,419	143,247	130,335
Special Mention	4,189	5,865	34,700	48,922	18,988
Substandard	91,484	189,616	248,691	229,641	168,691
Doubtful	—	—	396	391	18
Total	<u>\$624,999</u>	<u>\$709,326</u>	<u>\$899,092</u>	<u>\$1,136,023</u>	<u>\$1,302,668</u>

Our loans receivable decreased \$84.3 million, or 11.9%, during the year ended December 31, 2014. All loan risk categories have decreased since December 31, 2013, with the exception of pass graded loans. The pass category increased approximately \$91.6 million, the watch category declined approximately \$76.2 million, the special mention category declined approximately \$1.7 million, and the substandard category declined approximately \$98.1 million. During the first quarter of 2014, management instituted a new risk category within its pass classification. The purpose was to better identify certain loans where the borrower's sustained satisfactory repayment history was deemed a more relevant predictor of future loss than certain underwriting criteria at origination. The establishment of this new pass risk category helps to ensure the watch risk category remains transitory and event driven in nature. A total of \$24.2 million in commercial, \$8.5 million in residential, and \$2.2 million in agriculture loans were reclassified from watch to the new pass risk category during the first quarter of 2014.

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In December 2014, the Company identified and transferred certain substandard accruing loans to loans held for sale. The loans were transferred to held for sale at the lower of cost or fair value. The Company identified \$10.7 million of loans to sell and recorded a \$1.8 million charge to the allowance for loan losses to reduce the loan balances to the estimated fair value. Loans held for sale total \$8.9 million at December 31, 2014, comprised of \$6.0 million in commercial real estate, \$1.9 million in 1-4 family residential real estate, and \$1.0 million in multi-family real estate. These loans were not past due at December 31, 2014.

Loan Delinquency – The following table presents a summary of loan delinquencies at the dates indicated.

	As of December 31,				
	2014	2013	2012 (in thousands)	2011	2010
Past Due Loans:					
30-59 Days	\$ 3,960	\$ 10,696	\$ 38,219	\$ 17,346	\$20,956
60-89 Days	980	775	20,303	3,947	6,148
90 Days and Over	151	232	86	1,350	594
Total Loans Past Due 30-90+ Days	5,091	11,703	58,608	22,643	27,698
Nonaccrual Loans	47,175	101,767	94,517	92,020	59,799
Total Past Due and Nonaccrual Loans	<u>\$52,266</u>	<u>\$113,470</u>	<u>\$153,125</u>	<u>\$114,663</u>	<u>\$87,497</u>

Loans past due 30-59 days decreased from \$10.7 million at December 31, 2013 to \$4.0 million at December 31, 2014, and loans past due 60-89 days increased from \$775,000 at December 31, 2013 to \$980,000 at December 31, 2014. This represents a \$6.5 million decrease from December 31, 2013 to December 31, 2014, in loans past due 30-89 days. We considered this trend in delinquency levels during the evaluation of qualitative trends in the portfolio when establishing the general component of our allowance for loan losses.

Loans more than 90 days past due decreased \$81,000, and nonaccrual loans decreased \$54.6 million, respectively, from December 31, 2013 to December 31, 2014. The \$47.2 million in non-performing loans at December 31, 2014, and \$102.0 million at December 31, 2013, were primarily construction, land development, other land, commercial real estate, and residential real estate loans. Weakness in housing unit sales and loss of tenants or inability to lease vacant office and retail space placed inordinate stress on these borrowers and their ability to repay according to the contractual terms of the loans. As such, we have placed these credits on nonaccrual and have begun the appropriate collection actions to resolve them. Management believes it has established adequate loan loss reserves for these credits.

Non-Performing Assets – Non-performing assets consist of certain restructured loans for which interest rate or other terms have been renegotiated, loans past due 90 days or more still on accrual, loans on which interest is no longer accrued, real estate acquired through foreclosure and repossessed assets. Loans, including impaired loans, are placed on nonaccrual status when they become past due 90 days or more as to principal or interest, unless they are adequately secured and in the process of collection. Loans are considered impaired if full principal or interest payments are not anticipated in accordance with the contractual loan terms. Impaired loans are carried at the present value of expected future cash flows discounted at the loan's effective interest rate or at the fair value of the collateral less cost to sell if the loan is collateral dependent. Loans are reviewed on a regular basis and normal collection procedures are implemented when a borrower fails to make a required payment on a loan. If the delinquency on a mortgage loan exceeds 120 days and is not cured through normal collection procedures or an acceptable arrangement is not worked out with the borrower, we institute measures to remedy the default, including commencing a foreclosure action. Consumer loans generally are charged off when a loan is deemed uncollectible by management and any available collateral has been disposed of. Commercial business and real estate loan delinquencies are handled on an individual basis by management with the advice of legal counsel.

Interest income on loans is recognized on the accrual basis except for those loans placed on nonaccrual status. The accrual of interest on impaired loans is discontinued when management believes, after consideration of economic and business conditions and collection efforts, that the borrowers' financial condition is such that collection of interest is doubtful, which typically occurs after the loan becomes 90 days delinquent. When interest accrual is discontinued, existing accrued interest is reversed and interest income is subsequently recognized only to the extent cash payments are received on well-secured loans.

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Real estate acquired as a result of foreclosure or by deed in lieu of foreclosure is classified as real estate owned until such time as it is sold. New and used automobiles and other motor vehicles acquired as a result of foreclosure are classified as repossessed assets until they are sold. When such property is acquired it is recorded at its fair market value less cost to sell. Any write-down of the property at the time of acquisition is charged to the allowance for loan losses. Subsequent gains and losses are included in non-interest expense.

The following table sets forth information with respect to non-performing assets as of the dates indicated:

	As of December 31,				
	2014	2013	2012	2011	2010
	(dollars in thousands)				
Past due 90 days or more still on accrual	\$ 151	\$ 232	\$ 86	\$ 1,350	\$ 594
Loans on nonaccrual status	47,175	101,767	94,517	92,020	59,799
Total non-performing loans	47,326	101,999	94,603	93,370	60,393
Real estate acquired through foreclosure	46,197	30,892	43,671	41,449	67,635
Other repossessed assets	—	—	—	5	52
Total non-performing assets	\$93,523	\$132,891	\$138,274	\$134,824	\$128,080
Non-performing loans to total loans	7.57%	14.38%	10.52%	8.22%	4.63%
Non-performing assets to total assets	9.19%	12.35%	11.89%	9.26%	7.43%
Allowance for non-performing loans	\$ 1,253	\$ 2,285	\$ 13,250	\$ 11,382	\$ 7,977
Allowance for non-performing loans to non-performing loans	2.7%	2.2%	14.0%	12.2%	13.2%

Troubled Debt Restructuring – A troubled debt restructuring (TDR) occurs when the Company has agreed to a loan modification in the form of a concession to a borrower who is experiencing financial difficulty. The majority of the Company’s TDRs involve a reduction in interest rate, a deferral of principal for a stated period of time, or an interest only period. All TDRs are considered impaired, and the Company has allocated reserves for these loans to reflect the present value of the concessionary terms granted to the borrower. If the loan is considered collateral dependent, it is reported net of allocated reserves, at the fair value of the collateral less cost to sell.

We do not have a formal loan modification program. Rather, we work with individual borrower on a case-by-case basis to facilitate the orderly collection of our principal and interest before a loan becomes a non-performing loan. If a borrower is unable to make contractual payments, we review the particular circumstances of that borrower’s situation and negotiate a revised payment stream. In other words, we identify performing borrowers experiencing financial difficulties, and through negotiations, we lower their interest rate, most typically on a short-term basis for three to six months. Our goal when restructuring a credit is to afford the borrower a reasonable period of time to remedy the issue causing cash flow constraints within their business so that they can return to performing status over time.

Our loan modifications have taken the form of reduction in interest rate and/or curtailment of scheduled principal payments for a short-term period, usually three to six months, but in some cases until maturity of the loan. In some circumstances we restructure real estate secured loans in a bifurcated fashion whereby we have a fully amortizing “A” loan at a market interest rate and an interest-only “B” loan at a reduced interest rate. The majority of our restructured loans are collateral secured loans. If a borrower fails to perform under the modified terms, we place the loan(s) on nonaccrual status and begin the process of working with the borrower to liquidate the underlying collateral to satisfy the debt.

At December 31, 2014, we had 52 restructured loans totaling \$42.5 million with borrowers who experienced deterioration in financial condition compared with 98 loans totaling \$91.3 million at December 31, 2013. In general, these loans were granted interest rate reductions to provide cash flow relief to borrowers experiencing cash flow difficulties. Of these restructured loans for 2014, four loans totaling approximately \$3.9 million were also granted principal payment deferrals until maturity. There were no concessions made to forgive principal relative to these loans, although we have recorded partial charge-offs for certain restructured loans. In general, these loans are secured by first liens on 1-4 residential or commercial real estate properties, or farmland. Restructured loans also included \$883,000 of commercial loans for 2014. At December 31, 2014, \$22.0 million of TDRs were performing according to their modified terms.

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The following table sets forth information with respect to TDRs, non-performing loans, real estate acquired through foreclosure, and other repossessed assets.

	As of December 31,				
	2014	2013	2012	2011	2010
	(dollars in thousands)				
Total non-performing loans	\$ 47,326	\$101,999	\$ 94,603	\$ 93,370	\$ 60,393
TDRs on accrual	21,985	44,346	77,344	74,144	25,543
Total non-performing loans and TDRs on accrual	\$ 69,311	\$146,345	\$171,947	\$167,514	\$ 85,936
Real estate acquired through foreclosure	46,197	30,892	43,671	41,449	67,635
Other repossessed assets	—	—	—	5	52
Total non-performing assets and TDRs on accrual	\$115,508	\$177,237	\$215,618	\$208,968	\$153,623
Total non-performing loans and TDRs on accrual to total loans	11.09%	20.63%	19.12%	14.75%	6.60%
Total non-performing assets and TDRs on accrual to total assets	11.35%	16.47%	18.55%	14.36%	8.91%

We consider any loan that is restructured for a borrower experiencing financial difficulties due to a borrower's potential inability to pay in accordance with contractual terms of the loan to be a troubled debt restructure. Specifically, we consider a concession involving a modification of the loan terms, such as (i) a reduction of the stated interest rate, (ii) reduction or deferral of principal, or (iii) reduction or deferral of accrued interest at a stated interest rate lower than the current market rate for new debt with similar risk all to be troubled debt restructurings. When a modification of terms is made for a competitive reason, we do not consider that to be a troubled debt restructuring. A primary example of a competitive modification would be an interest rate reduction for a performing customer's loan to a market rate as the result of a market decline in rates.

Management periodically reviews renewals/modifications of previously identified TDRs for which there was no principal forgiveness, to consider if it is appropriate to remove the TDR classification. If the borrower is no longer experiencing financial difficulty and the renewal/modification did not contain a concessionary interest rate or other concessionary terms, management considers the potential removal of the TDR classification. If deemed appropriate, the TDR classification is removed as the borrower has complied with the terms of the loan at the date of renewal/modification and there was a reasonable expectation that the borrower would continue to comply with the terms of the loan after the date of the renewal/modification. In this instance, the TDR was originally considered a restructuring in a prior year as a result of a modification with an interest rate that was not commensurate with the risk of the underlying loan. Additionally, TDR classification can be removed in circumstances in which the Company performs a non-concessionary re-modification of the loan at terms that were considered to be at market for loans with comparable risk. Management expects the borrower will continue to perform under the re-modified terms based on the borrower's past history of performance.

At December 31, 2014 and 2013, TDRs totaled \$42.5 million and \$91.3 million, respectively. During the twelve months ended December 31, 2014, TDRs were reduced as a result of \$17.1 million in payments, the transfer of \$4.5 million to loans held for sale, and the transfer of \$16.7 million to OREO. In addition, the TDR classification was removed from two loans that met the requirements discussed above in the second quarter of 2014. These two loans totaled \$7.3 million at December 31, 2013. These loans are no longer evaluated individually for impairment.

If the borrower fails to perform, we place the loan on nonaccrual status and seek to liquidate the underlying collateral. Our nonaccrual policy for restructured loans is identical to our nonaccrual policy for all loans. Our policy calls for a loan to be reported as nonaccrual if it is maintained on a cash basis because of deterioration in the financial condition of the borrower, payment in full of principal and interest is not expected, or principal or interest is past due 90 days or more unless the assets are both well secured and in the process of collection. Changes in value for impairment, including the amount attributed to the passage of time, are recorded entirely within the provision for loan losses. Upon determination that a loan is collateral dependent, the loan is charged down to the fair value of collateral less estimated costs to sell.

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See Footnote 4, “Loans”, to the financial statements for additional disclosure related to troubled debt restructuring.

Interest income that would have been earned on non-performing loans was \$3.3 million, \$5.6 million, and \$4.9 million for the years ended December 31, 2014, 2013, and 2012, respectively. Interest income recognized on accruing non-performing loans was \$785,000, \$895,000, and \$460,000 for the years ended December 31, 2014, 2013, and 2012, respectively.

Allowance for Loan Losses – The allowance for loan losses is based on management’s continuing review and evaluation of individual loans, loss experience, current economic conditions, risk characteristics of various categories of loans and such other factors that, in management’s judgment, require current recognition in estimating loan losses.

Management has established loan grading procedures that result in specific allowance allocations for any estimated inherent risk of loss. For loans not individually evaluated, a general allowance allocation is computed using factors developed over time based on actual loss experience. The specific and general allocations plus consideration of qualitative factors represent management’s estimate of probable losses contained in the loan portfolio at the evaluation date. Although the allowance for loan losses is comprised of specific and general allocations, the entire allowance is available to absorb any credit losses.

The following table sets forth an analysis of loan loss experience as of and for the periods indicated:

	As of December 31,				
	2014	2013	2012	2011	2010
	(dollars in thousands)				
Balances at beginning of period	\$ 28,124	\$ 56,680	\$ 52,579	\$ 34,285	\$ 26,392
Loans charged-off:					
Real estate	17,943	28,879	31,437	38,538	19,261
Commercial	1,099	2,828	3,784	4,197	2,675
Consumer	354	773	1,130	1,070	496
Agriculture	30	128	1,164	841	29
Total charge-offs	19,426	32,608	37,515	44,646	22,461
Recoveries:					
Real estate	2,726	1,622	1,040	184	114
Commercial	614	1,212	129	69	28
Consumer	213	266	125	87	104
Agriculture	13	252	72	—	8
Total recoveries	3,566	3,352	1,366	340	254
Net charge-offs	15,860	29,256	36,149	44,306	22,207
Provision for loan losses	7,100	700	40,250	62,600	30,100
Balance at end of period	\$ 19,364	\$ 28,124	\$ 56,680	\$ 52,579	\$ 34,285
Allowance for loan losses to period-end loans	3.10%	3.96%	6.30%	4.63%	2.63%
Net charge-offs to average loans	2.39%	3.71%	3.50%	3.56%	1.64%
Allowance for loan losses to non-performing loans	40.92%	27.57%	59.91%	56.31%	56.77%
Allowance for loan losses for loans individually evaluated for impairment	\$ 752	\$ 3,471	\$ 21,034	\$ 12,314	\$ 5,119
Loans individually evaluated for impairment	71,993	149,883	188,808	150,727	71,726
Allowance for loan losses to loans individually evaluated for impairment	1.04%	2.32%	11.14%	8.17%	7.14%
Allowance for loan losses for loans collectively evaluated for impairment	\$ 18,612	\$ 24,653	\$ 35,646	\$ 40,265	\$ 29,166
Loans collectively evaluated for impairment	553,006	559,443	710,284	985,296	1,230,942
Allowance for loan losses to loans collectively evaluated for impairment	3.37%	4.41%	5.02%	4.09%	2.37%

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Our allowance for loan losses is a reserve established through charges to earnings in the form of a provision for loan losses. The allowance for loan losses is comprised of general reserves and specific reserves. Our loan loss reserve, as a percentage of total loans at December 31, 2014, decreased to 3.10% from 3.96% at December 31, 2013. The change in our loan loss reserve as a percentage of total loans between periods is attributable to the decline in historical loss experience, qualitative factors, fewer loans migrating downward in risk grade classifications, charge-off levels, and provision expense. Our allowance for loan losses to non-performing loans was 40.92% at December 31, 2014, compared with 27.57% at December 31, 2013. Net charge-offs in 2014 totaled \$15.9 million of which \$13.7 million were the result of charging off the allowance for individually evaluated loans deemed to be collateral dependent during the period. This resulted in the decline in our allowance for loan losses for loans individually evaluated for impairment.

The following table sets forth the net charge-offs (recoveries) for the periods indicated:

	Year Ended December 31,	Year Ended December 31,	Year Ended December 31,
	2014	2013	2012
Commercial	\$ 485	\$ 1,616	\$ 3,655
Commercial Real Estate	11,878	20,045	21,531
Residential Real Estate	3,339	7,212	8,866
Consumer	167	507	1,005
Agriculture	17	(124)	1,092
Other	(26)	—	—
Total net charge-offs	<u>\$ 15,860</u>	<u>\$ 29,256</u>	<u>\$ 36,149</u>

We maintain a general reserve for each loan type in the loan portfolio. In determining the amount of the general reserve portion of our allowance for loan losses, management considers factors such as our historical loan loss experience, the growth, composition and diversification of our loan portfolio, current delinquency levels, loan quality grades, the results of recent regulatory examinations and general economic conditions. Based on these factors, we apply estimated percentages to the various categories of loans, not including any loan that has a specific allowance allocated to it, based on our historical experience, portfolio trends and economic and industry trends. This information is used by management to set the general reserve portion of the allowance for loan losses at a level it deems prudent.

Generally, all loans that have been identified as impaired are reviewed on a quarterly basis in order to determine whether a specific allowance is required. A loan is considered impaired when, based on current information, it is probable that we will not receive all amounts due in accordance with the contractual terms of the loan agreement. Once a loan has been identified as impaired, management measures impairment in accordance with ASC 310.10, "Impairment of a Loan." When management's measured value of the impaired loan is less than the recorded investment in the loan, the amount of the impairment is recorded as a specific reserve or charged-off if the loan is deemed collateral dependent. These specific reserves are determined on an individual loan basis based on management's current evaluation of our loss exposure for each credit given the payment status, financial condition of the borrower and value of any underlying collateral. Loans for which specific reserves have been provided are excluded from the general reserve calculations described below. Changes in specific reserves from period to period are the result of changes in the circumstances of individual loans such as charge-offs, pay-offs, changes in collateral values or other factors.

The allowance for loan losses represents management's estimate of the amount necessary to provide for probable losses in the loan portfolio in the normal course of business. Due to the uncertainty of risks in the loan portfolio, management's judgment of the amount of the allowance necessary to absorb loan losses is approximate. The allowance for loan losses is also subject to regulatory examinations and may be adjusted in response to a determination by the regulatory agencies as to its adequacy in comparison with peer institutions.

We make specific allowances for each impaired loan based on its type and risk classification as discussed above. At year-end 2014, our allowance for loan losses to total non-performing loans increased to 40.9% from 27.6% at year-end 2013. It is important to look more closely at this ratio as a significant portion of our impaired loans are collateral dependent and have been charged down to the estimated fair value of the underlying collateral less cost to sell. Please see the next table for comparison and disclosure of our recorded investment less allocated allowance relative to the unpaid principal balance. We have assessed these impaired loans for collectability and considered, among other things, the borrower's ability to repay, the value of the underlying collateral, and other market conditions to ensure that the allowance for loan losses is adequate to absorb probable incurred losses.

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The following table presents the unpaid principal balance, recorded investment and allocated allowance related to loans individually evaluated for impairment in the commercial real estate and residential real estate portfolios as of December 31, 2014 and 2013.

	December 31, 2014		December 31, 2013	
	Commercial	Residential	Commercial	Residential
	Real Estate	Real Estate	Real Estate	Real Estate
	(in thousands)			
Unpaid principal balance	\$ 65,899	\$ 24,633	\$ 116,740	\$ 56,665
Prior charge-offs	(17,758)	(3,249)	(22,410)	(7,153)
Recorded investment	48,141	21,384	94,330	49,512
Allocated allowance	(491)	(227)	(2,345)	(827)
Recorded investment, less allocated allowance	<u>\$ 47,650</u>	<u>\$ 21,157</u>	<u>\$ 91,985</u>	<u>\$ 48,685</u>
Recorded investment, less allocated allowance/ Unpaid principal balance	72.31%	85.89%	78.79%	85.92%

Based on previous charge-offs, our current recorded investment in the commercial real estate and residential real estate segments are significantly below the unpaid principal balance for the loans. Consideration of the recorded investment and allocated allowance further indicated, we are at 72.31% and 85.89% of the unpaid principal balance in the commercial real estate and residential real estate segments of the portfolio, respectively, at December 31, 2014.

The following table illustrates recent trends in loans collectively evaluated for impairment and the related allowance for loan losses by portfolio segment:

	December 31, 2014			December 31, 2013		
	Loans	Allowance	% to Total	Loans	Allowance	% to Total
	(dollars in thousands)					
Commercial	\$ 58,914	\$ 2,013	3.42%	\$ 47,883	\$ 2,931	6.12%
Commercial real estate	237,903	10,440	4.39	252,211	14,069	5.58
Residential real estate	217,785	5,560	2.55	225,851	6,935	3.07
Consumer	11,286	273	2.42	14,272	407	2.85
Agriculture	26,703	319	1.19	18,877	305	1.62
Other	415	7	1.69	349	6	1.72
Total	<u>\$553,006</u>	<u>\$ 18,612</u>	<u>3.37%</u>	<u>\$559,443</u>	<u>\$ 24,653</u>	<u>4.41%</u>

Loans collectively evaluated for impairment and the related allowance for loan losses trended downward from 4.41% at December 31, 2013 to 3.37% at December 31, 2014 as a result of declining historical charge-off levels and improving trends in loan category risk ratings. The residential real estate segment constitutes approximately 39% of total loans collectively evaluated for impairment. The related allowance for the residential real estate segment trended downward from 3.07% at December 31, 2013 to 2.55% at December 31, 2014 as our net charge-offs declined from approximately \$7.2 million in 2013 to \$3.3 million in 2014. The commercial real estate segment constitutes approximately 43% of total loans collectively evaluated for impairment. The related allowance for the commercial real estate segment trended downward from 5.58% at December 31, 2013 to 4.39% at December 31, 2014. This is consistent with our net charge-off experience in the commercial real estate segment of the portfolio which totaled approximately \$20.0 million in 2013 and \$11.9 million in 2014. The decreasing allowance also reflects improving past due trends, nonaccrual trends, and loan classification trends within the portfolio.

A significant portion of our portfolio is comprised of loans secured by real estate. A decline in the value of the real estate serving as collateral for our loans may impact our ability to collect those loans. In general, we obtain updated appraisals on property securing our loans when circumstances are warranted such as at the time of renewal or when market conditions have significantly changed. We use qualified licensed appraisers approved by our Board of Directors. These appraisers possess prerequisite certifications and knowledge of the local and regional marketplace.

Based on an evaluation of the loan portfolio, management presents a quarterly review of the allowance for loan losses to our Board of Directors, indicating any change in the allowance for loan losses since the last review and any recommendations as to adjustments in the allowance for loan losses.

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This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as events change. We decreased the allowance for loan losses as a percentage of loans outstanding to 3.10% at December 31, 2014 from 3.96% at December 31, 2013. This decline is the result of declining historical charge-off levels and improving trends in loan category risk ratings. The level of the allowance is based on estimates and the ultimate losses may vary from these estimates.

We follow a loan grading program designed to evaluate the credit risk in our loan portfolio. Through this loan grading process, we maintain an internally classified watch list which helps management assess the overall quality of the loan portfolio and the adequacy of the allowance for loan losses. Loans categorized as watch list loans show warning elements where the present status exhibits one or more deficiencies that require attention in the short-term or where pertinent ratios of the loan account have weakened to a point where more frequent monitoring is warranted. These loans do not have all of the characteristics of a classified loan (substandard or doubtful) but do show weakened elements as compared with those of a satisfactory credit. We review these loans to assist in assessing the adequacy of the allowance for loan losses.

In establishing the appropriate classification for specific assets, management considers, among other factors, the borrower's ability to repay, the borrower's repayment history, the current delinquent status, and the estimated value of the underlying collateral. As a result of this process, loans are categorized as special mention, substandard or doubtful.

Loans classified as "special mention" do not have all of the characteristics of substandard or doubtful loans. They have one or more deficiencies which warrant special attention and which corrective action, such as accelerated collection practices, may remedy.

Loans classified as "substandard" are those loans with clear and defined weaknesses such as a highly leveraged position, unfavorable financial ratios, uncertain repayment sources or poor financial condition which may jeopardize the repayment of the debt as contractually agreed. They are characterized by the distinct possibility that we will sustain some losses if the deficiencies are not corrected.

Loans classified as "doubtful" are those loans which have characteristics similar to substandard loans but with an increased risk that collection or liquidation in full is highly questionable and improbable.

Specific reserves may be carried for accruing TDRs in compliance with restructured terms. Once a loan is deemed impaired or uncollectible as contractually agreed (other than performing TDRs), the loan is charged-off either partially or in-full against the allowance for loan losses, based upon the expected future cash flows discounted at the loan's effective interest rate, or the fair value of collateral less estimated cost to sell with respect to collateral-based loans if collateral dependent.

As of December 31, 2014, we had \$91.5 million of loans classified as substandard, \$4.2 million classified as special mention and none classified as doubtful or loss. This compares with \$189.6 million of loans classified as substandard, \$5.9 million classified as special mention and none classified as doubtful or loss as of December 31, 2013. The \$98.1 million decrease in loans classified as substandard was primarily driven by \$40.7 in principal payments received, \$30.6 in migration to OREO, and \$19.1 in charge-offs. In addition, the Company transferred \$8.9 million in substandard accruing loans to loans held for sale in December 2014. Substandard loans are primarily concentrated in the commercial real estate portfolio. As of December 31, 2014, we had allocations of \$4.0 million in the allowance for loan losses related to these substandard loans. This compares to allocations of \$12.5 million in the allowance for loan losses related to substandard loans at December 31, 2013.

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The following table depicts management's allocation of the allowance for loan losses by loan type. Allowance funding and allocation is based on management's current evaluation of risk in each category, economic conditions, past loss experience, loan volume, past due history and other factors. Since these factors and management's assumptions are subject to change, the allocation is not necessarily predictive of future portfolio performance. The allocation is made by analytical purposes and is not necessarily indicative of the categories in which future losses may occur. The total allowance is available to absorb losses from any segment of loans.

	As of December 31,			
	2014		2013	
	Amount of	Percent of	Amount of	Percent of
	Allowance	Loans to Total Loans	Allowance	Loans to Total Loans
	(dollars in thousands)			
Commercial	\$ 2,046	9.75%	\$ 3,221	7.45%
Commercial Real Estate:				
Construction	739	5.31	2,149	6.11
Farmland	1,094	12.39	1,623	10.04
Other	9,098	28.07	12,642	32.71
Residential Real Estate:				
Multi-family	886	6.70	1,449	6.61
1-4 Family	4,901	31.56	6,313	32.21
Consumer	274	1.82	416	2.03
Agriculture	319	4.31	305	2.71
Other	7	0.09	6	0.13
Total	<u>\$ 19,364</u>	<u>100.0%</u>	<u>\$ 28,124</u>	<u>100.00%</u>

	As of December 31,					
	2012		2011		2010	
	Amount of	Percent of	Amount of	Percent of	Amount of	Percent of
	Allowance	Loans to Total Loans	Allowance	Loans to Total Loans	Allowance	Loans to Total Loans
	(dollars in thousands)					
Commercial	\$ 4,402	5.85%	\$ 4,207	6.27%	\$ 2,147	6.93%
Commercial Real Estate:						
Construction	5,989	7.82	13,920	8.93	11,164	15.32
Farmland	2,600	8.99	2,023	8.01	702	6.56
Other	26,179	35.89	17,081	37.31	12,209	33.92
Residential Real Estate:						
Multi-family	2,464	5.67	1,797	5.31	517	5.75
1-4 Family	13,771	30.95	12,420	29.70	6,707	27.13
Consumer	857	2.27	792	2.29	701	2.45
Agriculture	403	2.48	325	2.09	134	1.86
Other	15	0.08	14	0.09	4	0.08
Unallocated	—	—	—	—	—	—
Total	<u>\$ 56,680</u>	<u>100.0%</u>	<u>\$ 52,579</u>	<u>100.0%</u>	<u>\$ 34,285</u>	<u>100.00%</u>

Provision for Loan Losses – Provision expense of \$7.1 million was recorded for the year ended December 31, 2014, compared with \$700,000 for 2013 and \$40.3 million for 2012. The total allowance for loan losses was \$19.4 million, or 3.10% of total loans, at December 31, 2014, compared with \$28.1 million, or 3.96% of total loans, at December 31, 2013, and \$56.7 million, or 6.30% of total loans, at December 31, 2012. The decreased allowance is consistent with the decrease in our classified loans of \$175.9 million from December 31, 2013 to December 31, 2014 and loan charge-off trends. Net charge-offs were \$15.9 million for the year ended December 31, 2014, compared with \$29.3 million for 2013 and \$36.1 million for 2012. Charge-offs for 2014 were concentrated in the loans secured by real estate category of the portfolio. Real estate net charge-offs represent 95.95% of our net charge-offs for 2014. These net charge-offs consisted of \$10.9 million of commercial real estate loans, \$3.3 million of residential real estate loans, and \$1.0 million of construction and land development loans. During the first quarter of 2014, management instituted a new risk category within its pass classification. The purpose was to better identify certain loans where the borrower's sustained satisfactory repayment history was deemed a more relevant predictor of future loss than certain underwriting criteria at origination. The establishment of this new pass risk category helps to ensure the watch risk category remains transitory and event driven in nature. A total of \$24.2 million in commercial, \$8.5 million in residential, and \$2.2 million in agriculture loans were reclassified from watch to the new pass risk category during the first quarter. We consider the size and volume of our portfolio as well as the credit quality of our loan portfolio based upon risk category classification when determining the loan loss provision for each period and the allowance for loan losses at period end.

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Foreclosed Properties – Foreclosed properties at December 31, 2014 were \$46.2 million compared with \$30.9 million at December 31, 2013. See Footnote 6, “Other Real Estate Owned”, to the financial statements. During 2014, we acquired \$32.3 million of OREO properties and sold properties totaling approximately \$13.1 million. We value foreclosed properties at fair value less estimated cost to sell when acquired and expect to liquidate these properties to recover our investment in the due course of business.

OREO is recorded at fair market value less estimated cost to sell at time of acquisition. Any write-down of the property at the time of acquisition is charged to the allowance for loan losses. Subsequent reductions in fair value are recorded as non-interest expense. To determine the fair value of OREO for smaller dollar single family homes, we consult with internal real estate sales staff and external realtors, investors, and appraisers. If the internally evaluated market price is below our underlying investment in the property, appropriate write-downs are recorded.

For larger dollar commercial real estate properties, we obtain a new appraisal of the subject property or have staff in our special assets group or centralized appraisal department evaluate the latest in-file appraisal in connection with the transfer to OREO. In some of these circumstances, an appraisal is in process at quarter end and we must make our best estimate of the fair value of the underlying collateral based on our internal evaluation of the property, our review of the most recent appraisal, and discussions with the currently engaged appraiser. We typically obtain updated appraisals within five quarters of the anniversary date of ownership unless a sale is imminent.

The following table presents the major categories of OREO at the year-ends indicated:

	<u>2014</u>	<u>2013</u> (in thousands)	<u>2012</u>
Commercial Real Estate:			
Construction, land development, and other land	\$18,325	\$19,049	\$22,323
Farmland	654	690	602
Other	14,525	4,888	15,175
Residential Real Estate:			
Multi-family	4,875	246	195
1-4 Family	7,818	6,019	5,376
	<u>\$46,197</u>	<u>\$30,892</u>	<u>\$43,671</u>

Net activity relating to other real estate owned during the years indicated is as follows:

	<u>2014</u>	<u>2013</u> (in thousands)	<u>2012</u>
OREO Activity			
OREO as of January 1	\$ 30,892	\$ 43,671	\$ 41,449
Real estate acquired	32,338	20,606	33,528
Valuation adjustments for declining market values	(4,255)	(2,466)	(7,154)
Improvements	—	—	1
Net gain (loss) on sale	306	(132)	(1,672)
Proceeds from sale of properties	(13,084)	(30,787)	(22,481)
OREO as of December 31	<u>\$ 46,197</u>	<u>\$ 30,892</u>	<u>\$ 43,671</u>

Net loss on sales, write-downs, and operating expenses for OREO totaled \$5.8 million for the year ended December 31, 2014, compared with \$4.5 million for the same period of 2013.

During the year ended December 31, 2014, fair value write-downs of \$4.3 million were recorded to reflect declining values evidenced by new appraisals and our reduction of marketing prices in connection with our sales strategies compared with \$2.5 million for the year ended December 31, 2013. We were successful in selling OREO totaling \$13.1 million and \$30.9 million during 2014 and 2013, respectively. We continue to have an elevated level of real estate secured non-performing loans. We expect to resolve a significant level of these non-performing loans through the acquisition and sale of the underlying real estate collateral.

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Investment Securities – The securities portfolio serves as a source of liquidity and earnings and contributes to the management of interest rate risk. We have the authority to invest in various types of liquid assets, including short-term United States Treasury obligations and securities of various federal agencies, obligations of states and political subdivisions, corporate bonds, certificates of deposit at insured savings and loans and banks, bankers' acceptances and federal funds. We may also invest a portion of our assets in certain commercial paper and corporate debt securities. We are also authorized to invest in mutual funds and stocks whose assets conform to the investments that we are authorized to make directly. The investment portfolio increased by \$26.2 million, or 12.6%, to \$233.1 million at December 31, 2014, compared with \$207.0 million at December 31, 2013.

The following table sets forth the carrying value of our securities portfolio at the dates indicated.

	December 31, 2014				December 31, 2013			
	Amortized	Gross Unrealized	Gross Unrealized	Fair Value	Amortized	Gross Unrealized	Gross Unrealized	Fair Value
	Cost	Gains	Losses	(dollars in thousands)	Cost	Gains	Losses	Value
Securities available for sale								
U.S. Government and federal agencies	\$ 35,725	\$ 308	\$ (590)	\$ 35,443	\$ 31,026	\$ 284	\$ (1,444)	\$ 29,866
Agency mortgage-backed:								
residential	121,985	1,970	(357)	123,598	102,435	458	(1,950)	100,943
State and municipal	11,690	722	(8)	12,404	12,965	608	(28)	13,545
Corporate	18,087	853	(252)	18,688	18,002	769	(610)	18,161
Other debt	572	86	—	658	572	60	—	632
Equity	—	—	—	—	135	62	—	197
Total available for sale	<u>\$188,059</u>	<u>\$ 3,939</u>	<u>\$ (1,207)</u>	<u>\$190,791</u>	<u>\$165,135</u>	<u>\$ 2,241</u>	<u>\$ (4,032)</u>	<u>\$163,344</u>
Securities held to maturity								
State and municipal	\$ 42,325	\$ 2,173	\$ —	\$ 44,498	\$ 43,612	\$ 3	\$ (668)	\$ 42,947
Total held to maturity	<u>\$ 42,325</u>	<u>\$ 2,173</u>	<u>\$ —</u>	<u>\$ 44,498</u>	<u>\$ 43,612</u>	<u>\$ 3</u>	<u>\$ (668)</u>	<u>\$ 42,947</u>

The following table sets forth the contractual maturities, fair values and weighted-average yields for our available for sale securities held at December 31, 2014:

	Due Within One Year		After One Year But Within Five Years		After Five Years But Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Available for sale										
U.S. Government and federal agencies	\$ 90	5.27%	\$ 979	1.92%	\$14,673	2.44%	\$ 19,701	2.21%	\$ 35,443	2.30%
Agency mortgage-backed:										
residential	—	—	212	5.18	1,870	2.54	121,516	2.47	123,598	2.48
State and municipal	1,235	5.44	2,075	5.00	8,711	5.05	383	6.19	12,404	5.12
Corporate bonds	—	—	5,533	5.77	1,131	5.14	12,024	2.18	18,688	3.35
Other debt	—	—	—	—	—	—	658	6.50	658	6.50
Total available for sale	<u>\$1,325</u>	<u>5.43%</u>	<u>\$8,799</u>	<u>5.11%</u>	<u>\$26,385</u>	<u>3.39%</u>	<u>\$154,282</u>	<u>2.44%</u>	<u>\$190,791</u>	<u>2.70%</u>

The following table sets forth the contractual maturities, amortized cost and weighted-average yields for our held to maturity securities held at December 31, 2014:

	Due Within One Year		After One Year But Within Five Years		After Five Years But Within Ten Years		After Ten Years		Total	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Held to maturity										
State and municipal	\$ —	— %	\$ 446	1.76%	\$24,984	3.63%	\$19,068	4.52%	\$44,498	4.00%
Total held to maturity	<u>\$ —</u>	<u>— %</u>	<u>\$ 446</u>	<u>1.76%</u>	<u>\$24,984</u>	<u>3.63%</u>	<u>\$19,068</u>	<u>4.52%</u>	<u>\$44,498</u>	<u>4.00%</u>

Average yields in the table above were calculated on a tax equivalent basis using a federal income tax rate of 35%. Mortgage-backed securities are securities that have been developed by pooling a number of real estate mortgages. These securities are issued by federal agencies such as Government National Mortgage Association ("Ginnie Mae"), Fannie Mae and Freddie Mac, as well as non-agency company issuers. These securities are deemed to have high credit ratings, and minimum regular monthly cash flows of principal and interest. Cash flows from agency backed mortgage-backed securities are guaranteed by the issuing agencies.

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Unlike U.S. Treasury and U.S. government agency securities, which have a lump sum payment at maturity, mortgage-backed securities provide cash flows from regular principal and interest payments and principal prepayments throughout the lives of the securities. Mortgage-backed securities that are purchased at a premium will generally return decreasing net yields as interest rates drop because home owners tend to refinance their mortgages. Thus, the premium paid must be amortized over a shorter period. Therefore, those securities purchased at a discount will obtain higher net yields in a decreasing interest rate environment. As interest rates rise, the opposite will generally be true. During a period of increasing interest rates, fixed rate mortgage-backed securities do not tend to experience heavy prepayments of principal and consequently, average life will not be shortened. If interest rates begin to fall, prepayments will generally increase. Non-agency issuer mortgage-backed securities do not carry a government guarantee. We limit our purchases of these securities to bank qualified issues with high credit ratings. We regularly monitor the performance and credit ratings of these securities and evaluate these securities, as we do all of our securities, for other-than-temporary impairment on a quarterly basis. At December 31, 2014, 98.3% of the agency mortgage-backed securities we held had contractual final maturities of more than ten years with a weighted average life of 23.7 years.

Deposits – We attract both short-term and long-term deposits from the general public by offering a wide range of deposit accounts and interest rates. In recent years, we have been required by market conditions to rely increasingly on short to mid-term certificate accounts and other deposit alternatives, including brokered and wholesale deposits, which are more responsive to market interest rates. We use forecasts based on interest rate risk simulations to assist management in monitoring our use of certificates of deposit and other deposit products as funding sources and the impact of their use on interest income and net interest margin in various rate environments. Our remaining brokered deposits matured during 2013. We are currently restricted from accepting, renewing, or rolling-over brokered deposits without the prior receipt of a waiver on a case-by-case basis from our regulators.

We primarily rely on our banking office network to attract and retain deposits in our local markets and leverage our online Ascencia division to attract out-of-market deposits. Market interest rates and rates on deposit products offered by competing financial institutions can significantly affect our ability to attract and retain deposits. During 2014, total deposits decreased \$60.9 million compared with 2013. During 2013, total deposits decreased \$77.4 million compared with 2012. The decrease in deposits for 2014 and 2013 was primarily in certificates of deposit balances.

To evaluate our funding needs in light of deposit trends resulting from continually changing conditions, we evaluate simulated performance reports that forecast changes in margins along with other pertinent economic data. We continue to offer attractively priced deposit products along our product line to allow us to retain deposit customers and reduce interest rate risk during various rising and falling interest rate cycles.

We offer savings accounts, NOW accounts, money market accounts and fixed rate certificates with varying maturities. The flow of deposits is influenced significantly by general economic conditions, changes in interest rates and competition. Our management adjusts interest rates, maturity terms, service fees and withdrawal penalties on our deposit products periodically. The variety of deposit products allows us to compete more effectively in obtaining funds and to respond with more flexibility to the flow of funds away from depository institutions into outside investment alternatives. However, our ability to attract and maintain deposits and the costs of these funds has been, and will continue to be, significantly affected by market conditions.

The following table sets forth the average daily balances and weighted average rates paid for our deposits for the periods indicated:

	For the Years Ended December 31,					
	2014		2013		2012	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
	(dollars in thousands)					
Demand	\$113,150		\$ 106,153		\$ 113,325	
Interest Checking	83,504	0.15%	84,917	0.23%	89,820	0.37%
Money Market	96,194	0.55	69,842	0.50	63,212	0.49
Savings	36,803	0.24	39,158	0.29	38,665	0.40
Certificates of Deposit	632,020	1.29	703,982	1.35	912,061	1.52
Total Deposits	<u>\$961,671</u>		<u>\$1,004,052</u>		<u>\$1,217,083</u>	
Weighted Average Rate		0.92%		1.01%		1.20%

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The following table sets forth the average daily balances and weighted average rates paid for our certificates of deposit for the periods indicated:

	For the Years Ended December 31,					
	2014		2013		2012	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Certificates of Deposit	(dollars in thousands)					
Less than \$100,000	\$354,250	1.22%	\$405,758	1.28%	\$478,502	1.40%
\$100,000 or more	277,770	1.37	298,224	1.44	433,559	1.64
Total	<u>\$632,020</u>	1.29%	<u>\$703,982</u>	1.35%	<u>\$912,061</u>	1.52%

The following table shows at December 31, 2014 the amount of our time deposits of \$100,000 or more by time remaining until maturity:

<u>Maturity Period</u> (in thousands)	
Three months or less	\$ 50,811
Three months through six months	41,836
Six months through twelve months	93,658
Over twelve months	66,767
Total	<u>\$253,072</u>

We strive to maintain competitive pricing on our deposit products which we believe allows us to retain a substantial percentage of our customers when their time deposits mature.

Borrowing – Deposits are the primary source of funds for our lending and investment activities and for our general business purposes. We can also use advances (borrowings) from the FHLB of Cincinnati to supplement our pool of lendable funds, meet deposit withdrawal requirements and manage the terms of our liabilities. Advances from the FHLB are secured by our stock in the FHLB, and substantially all of our first mortgage residential loans. At December 31, 2014, we had \$15.8 million in advances outstanding from the FHLB and the capacity to increase our borrowings an additional \$13.0 million. The FHLB of Cincinnati functions as a central reserve bank providing credit for savings banks and other member financial institutions. As a member, we are required to own capital stock in the FHLB and are authorized to apply for advances on the security of such stock and certain of our home mortgages and other assets (principally, securities which are obligations of, or guaranteed by, the United States) provided that we meet certain standards related to creditworthiness.

The following table sets forth information about our FHLB advances as of and for the periods indicated:

	December 31,		
	2014	2013	2012
	(dollars in thousands)		
Average balance outstanding	\$ 4,473	\$4,990	\$6,325
Maximum amount outstanding at any month-end during the period	16,940	5,517	7,015
End of period balance	15,752	4,492	5,604
Weighted average interest rate:			
At end of period	1.02%	3.07%	3.21%
During the period	2.77%	3.15%	3.27%

Subordinated Capital Note – At December 31, 2014, the Bank had a subordinated capital note outstanding in the amount of \$5.0 million. The note is unsecured, bears interest at the BBA three-month LIBOR floating rate plus 300 basis points, and qualifies as Tier 2 capital. Interest only was due quarterly through September 30, 2010, at which time quarterly principal payments of \$225,000 plus interest commenced. The note matures July 1, 2020. At December 31, 2014, the interest rate on this note was 3.24%.

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Junior Subordinated Debentures – At December 31, 2014, we had four issues of junior subordinated debentures outstanding totaling \$25.0 million as shown in the table below.

Description	Liquidation		End of 20 Quarter Deferral Period (1)	Interest Rate (2)	Junior Subordinated	
	Amount Trust Preferred Securities (dollars in thousands)	Issuance Date			Debt and Investment in Trust (dollars in thousands)	Maturity Date
Porter Statutory Trust II	\$ 5,000	2/13/2004	9/19/2016	3-month LIBOR + 2.85%	\$ 5,155	2/13/2034
Porter Statutory Trust III	3,000	4/15/2004	9/18/2016	3-month LIBOR + 2.79%	3,093	4/15/2034
Porter Statutory Trust IV	14,000	12/14/2006	9/1/2016	3-month LIBOR + 1.67%	14,434	3/1/2037
Ascencia Statutory Trust I	3,000	2/13/2004	9/19/2016	3-month LIBOR + 2.85%	3,093	2/13/2034
	<u>\$ 25,000</u>				<u>\$ 25,775</u>	

(1) Accrued and unpaid interest totaled \$2.2 million at December 31, 2014.

(2) As of December 31, 2014, the 3-month LIBOR was 0.26%.

The trust preferred securities are subject to mandatory redemption, in whole or in part, upon repayment of the subordinated debentures at maturity or their earlier redemption at the liquidation preference. The subordinated debentures, which mature February 13, 2034, April 15, 2034, and March 1, 2037, are redeemable before the maturity date at our option at their principal amount plus accrued interest.

We have the option to defer interest payments on the subordinated debentures from time to time for a period not to exceed 20 consecutive quarters. After such period, we must pay all deferred interest or we will be in default. Effective with the fourth quarter of 2011, we began deferring interest payments on our junior subordinated debentures. The deferral period ends September 30, 2016 at which time we will be required to pay all accrued interest or be in default.

Deferring interest payments on our junior subordinated notes resulted in the deferral of distributions on our trust preferred securities. We are prohibited from paying cash dividends on our preferred and common shares until such time as we have paid all deferred distributions on our trust preferred securities.

The trust preferred securities issued by our subsidiary trusts are currently included in our Tier 1 capital for regulatory purposes. On March 1, 2005, the Federal Reserve Board adopted final rules that continue to allow trust preferred securities to be included in Tier 1 capital, subject to quantitative and qualitative limits. Currently, no more than 25% of our Tier 1 capital can consist of trust preferred securities and qualifying perpetual preferred stock. To the extent the amount of our trust preferred securities exceeds the 25% limit, the excess would be includable in Tier 2 capital. The new quantitative limits were effective March 31, 2011. As of December 31, 2014, the Company's trust preferred securities totaled 25% of its Tier 1 capital and 49% of its Tier 2 capital.

Each of the trusts issuing the trust preferred securities holds junior subordinated debentures we issued with a 30-year maturity. The final rules provide that in the last five years before the junior subordinated debentures mature, the associated trust preferred securities will be excluded from Tier 1 capital and included in Tier 2 capital. In addition, the trust preferred securities during this five-year period would be amortized out of Tier 2 capital by one-fifth each year and excluded from Tier 2 capital completely during the year before maturity.

Liquidity

Liquidity risk arises from the possibility we may not be able to satisfy current or future financial commitments, or may become unduly reliant on alternative funding sources. The objective of liquidity risk management is to ensure that we meet the cash flow requirements of depositors and borrowers, as well as our operating cash needs, taking into account all on- and off-balance sheet funding demands. Liquidity risk management also involves ensuring that we meet our cash flow needs at a reasonable cost. We maintain an investment and funds management policy, which identifies the primary sources of liquidity, establishes procedures for monitoring and measuring liquidity, and establishes minimum liquidity requirements in compliance with regulatory guidance. Our Asset Liability Committee continually monitors and reviews our liquidity position.

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Funds are available from a number of sources, including the sale of securities in the available for sale portion of the investment portfolio, principal pay-downs on loans and mortgage-backed securities, customer deposit inflows, brokered deposits and other wholesale funding. Historically, we have utilized brokered and wholesale deposits to supplement our funding strategy. We are currently restricted from accepting, renewing, or rolling-over brokered deposits without the prior receipt of a waiver on a case-by-case basis from our regulators. At December 31, 2014, we had no brokered deposits.

Traditionally, we have borrowed from the FHLB to supplement our funding requirements. At December 31, 2014, we had an unused borrowing capacity with the FHLB of \$13.0 million. Our borrowing capacity is under a detailed loan listing requirement and is based on the market value of the underlying pledged loans rather than the unpaid principal balance of the pledged loans. The listing requirement also increases the level of collateral required for borrowings.

We also have available on a secured basis federal funds borrowing lines from correspondent banks totaling \$5.0 million. Management believes our sources of liquidity are adequate to meet expected cash needs for the foreseeable future, however, the availability of these lines could be affected by our financial position. We are also subject to FDIC interest rate restrictions for deposits. As such, we are permitted to offer up to the “national rate” plus 75 basis points as published weekly by the FDIC.

We have used cash to pay dividends on common shares, if and when declared by the Board of Directors, and to service debt. The Company’s main sources of funding include dividends paid by the Bank and financing obtained in the capital markets. During 2011, Porter Bancorp contributed \$13.1 million to its subsidiary, the Bank, which substantially decreased its liquid assets. The contribution was made to strengthen the Bank’s capital in an effort to help it comply with its capital ratio requirements under the consent order. Liquid assets decreased from \$20.3 million at December 31, 2010 to \$1.9 million at December 31, 2014. Since the Bank is unlikely to be in a position to pay dividends to the parent company for the foreseeable future, cash inflows for the parent are limited to earnings on investment securities, sales of investment securities, and interest on deposits with the Bank. These cash inflows along with the liquid assets held at December 31, 2014, are needed to cover ongoing operating expenses of the parent company which are forecasted at \$1.0 million for 2015. Parent company liquidity could be improved through a sale of common or preferred shares. See the “Supervision-Porter Bancorp-Dividends” section of Item 1. “Business” and the “Dividends” section of Item 5. “Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities” of this Annual Report on Form 10-K.

Capital

In the fourth quarter of 2011, we began deferring interest payments on our junior subordinated notes, which resulted in a deferral of distributions on our trust preferred securities. Therefore, we will not be able to pay cash dividends on our common shares until such time that we have paid all deferred distributions on our trust preferred securities. If we defer interest payments on our trust preferred securities for 20 consecutive quarters (through September 30, 2016), we must pay all deferred interest or we will be in default. At December 31, 2014, cumulative accrued and unpaid interest on our junior subordinated notes totaled \$2.2 million.

Stockholders’ equity decreased \$2.5 million to \$33.5 million at December 31, 2014, compared with \$35.9 million at December 31, 2013. The decrease was due to the current year net loss, offset by the conversion of a \$7.4 million dividend liability into stockholders’ equity in the exchange transaction and an increase in the fair value of our securities portfolio of \$3.1 million.

In 2010, we completed a \$32.0 million private placement to accredited investors. In the transactions involved, the Company issued (i) 2,465,569 common shares, (ii) 317,042 Series C Preferred Shares and (iii) warrants to purchase 1,163,045 non-voting common shares at a price of \$11.50 per share.

The Series C Preferred Shares had no voting rights (except when required by law), had a liquidation preference over our common shares, and dividend rights equivalent to our common shares. Each Series C Preferred Share would have automatically converted into 1.05 common shares if transferred by the holder in certain transactions in accordance with the policy of the Federal Reserve.

On November 21, 2008, we issued to the UST 35,000 shares of our Series A Preferred Stock and a warrant to purchase up to 330,561 of our common shares for \$15.88 per share for aggregate consideration of \$35.0 million.

In December 2014, we completed a non-cash equity exchange transaction with the accredited investors who acquired all of our issued and outstanding Series A Preferred Shares from UST in a public auction. We acquired and cancelled all of the issued and outstanding Series A Preferred Shares, the accrued dividends thereon, all of the issued and outstanding Series C Preferred Shares, and warrants to purchase 798,915 shares of common stock together having an aggregate book value of approximately \$45.7 million. In exchange, we issued common and preferred shares having a fair value of approximately \$9.6 million. The effect of this exchange transaction was to increase common stockholders’ equity by approximately \$36.1 million, and total stockholders’ equity by \$7.4 million.

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In the exchange transaction, we issued 1,821,428 common shares, 40,536 mandatorily convertible Series B Preferred Shares and 64,580 mandatorily convertible Series D Preferred Shares, which automatically converted into 4,053,600 common shares and 6,458,000 non-voting common shares after shareholder approval on February 25, 2015. We also issued 6,198 Series E Preferred Shares and 4,304 Series F Preferred Shares, both of which series are not convertible into common shares, have a liquidation preference of \$1,000 per share, and are entitled to a 2% noncumulative annual dividend if and when declared. Series E and Series F Preferred Shares rank senior to, and have liquidation and dividend preferences over, our common shares and non-voting common shares.

Kentucky banking laws limit the amount of dividends that may be paid to a holding company by its subsidiary banks without prior approval. These laws limit the amount of dividends that may be paid in any calendar year to current year's net income, as defined in the laws, combined with the retained net income of the preceding two years, less any dividends declared during those periods. During 2015, the amount available to be paid by the Bank to the Company would be equal to 2015 earnings to date. However, the Bank has agreed with its primary regulators to obtain their written consent prior to declaring or paying any future dividends.

Each of the federal bank regulatory agencies has established risk-based capital requirements for banking organizations. See Item 1. Business – Supervision and Regulation – Porter Bancorp – Capital Adequacy Requirements and PBI Bank – Capital Requirements. In addition, the Bank has agreed with its primary regulators to maintain a ratio of total capital to total risk-weighted assets (“total risk-based capital ratio”) of at least 12.0%, and a ratio of Tier 1 capital to average assets (“leverage ratio”) of 9.0%.

The following table shows the ratios of Tier 1 capital and total capital to risk-adjusted assets and the leverage ratios for the Company and the Bank at December 31, 2014:

	Regulatory	Well-Capitalized	Minimum		
	Minimums	Minimums	Capital Ratios Under Consent Order	Porter Bancorp	PBI Bank
Tier 1 Capital	4.0%	6.0%	N/A	6.70%	8.59%
Total risk-based capital	8.0	10.0	12.0%	10.61	10.57
Tier 1 leverage ratio	4.0	5.0	9.0	4.51	5.78

At December 31, 2014, the Bank's Tier 1 leverage ratio was 5.78% and its total risk-based capital ratio was 10.57%, which are both below the 9% minimum leverage ratio and the 12% minimum risk-based capital ratio required by the Consent Order shown in the table above. Bank regulatory agencies can exercise discretion when an institution does not maintain minimum capital levels or meet the other terms of a consent order. The agencies may initiate changes in management, issue mandatory directives, impose monetary penalties or refrain from formal sanctions, depending on individual circumstances. Any action taken by bank regulatory agencies could damage our reputation and have a material adverse effect on our business.

Off Balance Sheet Arrangements

In the normal course of business, we enter into various transactions, which, in accordance with GAAP, are not included in our consolidated balance sheets. We enter into these transactions to meet the financing needs of our customers. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets.

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Our commitments associated with outstanding standby letters of credit and commitments to extend credit as of December 31, 2014 are summarized below. Since commitments associated with letters of credit and commitments to extend credit may expire unused, the amounts shown do not necessarily reflect our actual future cash funding requirements:

	One year or less	More than 1 year but less than 3 years	3 years or more but less than 5 years	5 years or more	Total
	(dollars in thousands)				
Commitments to extend credit	\$22,755	\$ 18,622	\$ 5,484	\$21,409	\$68,270
Standby letters of credit	2,320	—	—	—	2,320
Total	\$25,075	\$ 18,622	\$ 5,484	\$21,409	\$70,590

Standby Letters of Credit – Standby letters of credit are written conditional commitments we issue to guarantee the performance of a borrower to a third party. If the borrower does not perform in accordance with the terms of the agreement with the third party, we may be required to fund the commitment. The maximum potential amount of future payments we could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, we would be entitled to seek recovery from the borrower. Our policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements.

Commitments to Extend Credit – We enter into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of our commitments to extend credit are contingent upon borrowers maintaining specific credit standards at the time of loan funding. We minimize our exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures.

Contractual Obligations

The following table summarizes our contractual obligations and other commitments to make future payments as of December 31, 2014:

	One year or less	More than 1 year but less than 3 years	3 years or more but less than 5 years	5 years or more	Total
	(dollars in thousands)				
Time deposits	\$416,486	\$ 107,684	\$ 50,509	\$ 2	\$574,681
FHLB borrowing (1)	12,709	1,166	451	1,426	15,752
Subordinated capital note	900	1,800	1,800	450	4,950
Junior subordinated debentures	—	—	—	25,000	25,000
Total	\$430,095	\$ 110,650	\$ 52,760	\$26,878	\$620,383

(1) Fixed rate mortgage-matched borrowings with rates ranging from 0% to 5.25%, and maturities ranging from 2015 through 2033, averaging 1.02%.

Impact of Inflation and Changing Prices

The financial statements and related data presented herein have been prepared in accordance with U.S. generally accepted accounting principles, which require the measurement of financial position and operating results in historical dollars without considering changes in the relative purchasing power of money over time due to inflation.

We have an asset and liability structure that is essentially monetary in nature. As a result, interest rates have a more significant impact on our performance than the effects of general levels of inflation. Periods of high inflation are often accompanied by relatively higher interest rates, and periods of low inflation are accompanied by relatively lower interest rates. As market interest rates rise or fall in relation to the rates earned on our loans and investments, the value of these assets decreases or increases respectively.

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Item 7A. Quantitative and Qualitative Disclosures About Market Risk

To minimize the volatility of net interest income and exposure to economic loss that may result from fluctuating interest rates, we manage our exposure to adverse changes in interest rates through asset and liability management activities within guidelines established by our Asset Liability Committee (“ALCO”). The ALCO, which is comprised of senior management representatives, has the responsibility for approving and ensuring compliance with asset/liability management policies. Interest rate risk is the exposure to adverse changes in the net interest income as a result of market fluctuations in interest rates. The ALCO, on an ongoing basis, monitors interest rate and liquidity risk in order to implement appropriate funding and balance sheet strategies. Management considers interest rate risk to be our most significant market risk.

We utilize an earnings simulation model to analyze net interest income sensitivity. We then evaluate potential changes in market interest rates and their subsequent effects on net interest income. The model projects the effect of instantaneous movements in interest rates of both 100 and 200 basis points that are sustained for one year. Assumptions based on the historical behavior of our deposit rates and balances in relation to changes in interest rates are also incorporated into the model. These assumptions are inherently uncertain and, as a result, the model cannot precisely measure future net interest income or precisely predict the impact of fluctuations in market interest rates on net interest income. Actual results will differ from the model’s simulated results due to timing, magnitude and frequency of interest rate changes as well as changes in market conditions and the application and timing of various management strategies.

Our interest sensitivity profile was liability sensitive at December 31, 2014 and asset sensitive at December 31, 2013. Given an instantaneous 100 basis point increase in interest rates our base net interest income would decrease by an estimated 3.2% at December 31, 2014 compared with an increase of 2.5% at December 31, 2013.

The following table indicates the estimated impact on net interest income under various interest rate scenarios for the year ended December 31, 2014, as calculated using the static shock model approach:

	<u>Change in Future Net Interest Income</u>	
	<u>Dollar Change</u>	<u>Percentage Change</u>
	(dollars in thousands)	
+ 200 basis points	\$(1,613)	(5.86)%
+ 100 basis points	(868)	(3.15)

We did not run a model simulation for declining interest rates as of December 31, 2014, because the Federal Reserve’s federal funds target rate currently stands between 0.00% to 0.25%. Therefore, further short-term rate reductions are not practical. As we implement strategies to mitigate the risk of rising interest rates in the future, these strategies will lessen our forecasted “base case” net interest income in the event of no interest rate changes.

Our interest sensitivity at any point in time will be affected by a number of factors. These factors include the mix of interest sensitive assets and liabilities as well as their relative pricing schedules. It is also influenced by market interest rates, deposit growth, loan growth, decay rates and prepayment speed assumptions.

The following table sets forth the amounts of our interest-earning assets and interest-bearing liabilities outstanding at December 31, 2014, which we anticipate, based upon certain assumptions, to reprice or mature in each of the future time periods shown. The projected repricing of assets and liabilities anticipates prepayments and scheduled rate adjustments, as well as contractual maturities under an interest rate unchanged scenario within the selected time intervals. While we believe such assumptions are reasonable, we cannot assure you that assumed repricing rates will approximate our actual future activity.

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	Volume Subject to Repricing Within					Non-Interest Sensitive	Total
	0 – 90 Days	91 – 181 Days	182 – 365 Days	1 – 5 Years	Over 5 Years		
	(dollars in thousands)						
Assets:							
Federal funds sold and short-term investments	\$ 66,011	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 66,011
Investment securities	30,635	6,784	16,669	85,795	85,718	7,515	233,116
FHLB stock	7,323	—	—	—	—	—	7,323
Loans held for sale	8,926	—	—	—	—	—	8,926
Loans, net of allowance	226,686	62,466	94,296	174,686	66,865	(19,364)	605,635
Fixed and other assets	—	—	—	—	—	96,978	96,978
Total assets	<u>\$339,581</u>	<u>\$ 69,250</u>	<u>\$ 110,965</u>	<u>\$260,481</u>	<u>\$152,583</u>	<u>\$ 85,129</u>	<u>\$1,017,989</u>
Liabilities and Stockholders' Equity							
Interest-bearing checking, savings, and money market accounts	\$237,250	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 237,250
Certificates of deposit	116,909	101,885	195,412	159,576	899	—	574,681
Borrowed funds	43,471	182	368	2,286	736	—	47,043
Other liabilities	—	—	—	—	—	125,550	125,550
Stockholders' equity	—	—	—	—	—	33,465	33,465
Total liabilities and stockholders' equity	<u>\$397,630</u>	<u>\$102,067</u>	<u>\$ 195,780</u>	<u>\$161,862</u>	<u>\$ 1,635</u>	<u>\$159,015</u>	<u>\$1,017,989</u>
Period gap	<u>\$ (58,049)</u>	<u>\$ (32,817)</u>	<u>\$ (84,815)</u>	<u>\$ 98,619</u>	<u>\$150,948</u>		
Cumulative gap	<u>\$ (58,049)</u>	<u>\$ (90,866)</u>	<u>\$ (175,681)</u>	<u>\$ (77,062)</u>	<u>\$ 73,886</u>		
Period gap to total assets	<u>(5.70)%</u>	<u>(3.22)%</u>	<u>(8.33)%</u>	<u>9.69%</u>	<u>14.83%</u>		
Cumulative gap to total assets	<u>(5.70)%</u>	<u>(8.93)%</u>	<u>(17.26)%</u>	<u>(7.57)%</u>	<u>7.26%</u>		
Cumulative interest-earning assets to cumulative interest-bearing liabilities	<u>85.40%</u>	<u>81.82%</u>	<u>74.74%</u>	<u>91.01%</u>	<u>108.60%</u>		

Our one-year cumulative gap position as of December 31, 2014 was negative \$ 175.7 million or 17.3% of total assets. This is a one-day position that is continually changing and is not necessarily indicative of our position at any other time. Any gap analysis has inherent shortcomings because certain assets and liabilities may not move proportionally as interest rates change.

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Item 8. Financial Statements and Supplementary Data

The following consolidated financial statements and reports are included in this section:

Management's Report on Internal Control Over Financial Reporting

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2014 and 2013

Consolidated Statements of Operations for the Years Ended December 31, 2014, 2013, and 2012

Consolidated Statements of Comprehensive Income (Loss) for the Years Ended December 31, 2014, 2013, and 2012

Consolidated Statements of Change in Stockholders' Equity for the Years Ended December 31, 2014, 2013, and 2012

Consolidated Statements of Cash Flows for the Years Ended December 31, 2014, 2013, and 2012

Notes to Consolidated Financial Statements



MANAGEMENT’S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Porter Bancorp, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(1) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of; our principal executive and principal financial officers and effected by the board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles and includes those policies and procedures that:

Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2014. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) in the 1992 Internal Control-Integrated Framework. Based on that assessment, we believe that, as of December 31, 2014, our internal control over financial reporting is not effective based on those criteria. See “Item 9A. Controls and Procedures” for further discussion of the material weakness related to controls over the initial recording of an other real estate owned transaction at fair value less cost to sell. This annual report does not include an attestation report of our registered public accounting firm regarding internal controls over financial reporting. Management’s report was not subject to attestation by our registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit us to provide only management’s report in this annual report.

/s/ John T. Taylor

John T. Taylor
Chief Executive Officer

/s/ Phillip W. Barnhouse

Phillip W. Barnhouse
Chief Financial Officer

March 30, 2015



Crowe Horwath LLP
Independent Member Crowe Horwath International

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Porter Bancorp, Inc.
Louisville, Kentucky

We have audited the accompanying consolidated balance sheets of Porter Bancorp, Inc. as of December 31, 2014 and 2013, and the related consolidated statements of operations, comprehensive income (loss), changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2014. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Porter Bancorp, Inc. as of December 31, 2014 and 2013, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles.

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has incurred substantial losses in 2014, 2013 and 2012, largely as a result of asset impairments resulting from the re-evaluation of fair value and ongoing operating expenses related to the high volume of other real estate owned and non-performing loans. In addition, the Company's bank subsidiary is not in compliance with a regulatory enforcement order issued by its primary federal regulator requiring, among other things, increased minimum regulatory capital ratios as well as being involved in various legal proceedings in which the Company disputes material factual allegations against the Company. Additional losses, adverse outcomes from legal proceedings or the continued inability to comply with the regulatory enforcement order may result in additional adverse regulatory action. These events raise substantial doubt about the Company's ability to continue as a going concern. Management's plans with regard to these matters are also discussed in Note 2 to the consolidated financial statements. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Crowe Horwath, LLP

Louisville, Kentucky
March 30, 2015

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PORTER BANCORP, INC.
CONSOLIDATED BALANCE SHEETS
December 31,
(Dollar amounts in thousands except share data)

	2014	2013
Assets		
Cash and due from banks	\$ 14,169	\$ 7,465
Interest bearing deposits in banks	66,011	103,669
Cash and cash equivalents	80,180	111,134
Securities available for sale	190,791	163,344
Securities held to maturity (fair value of \$44,498 and \$42,947, respectively)	42,325	43,612
Loans held for sale	8,926	149
Loans, net of allowance of \$19,364 and \$28,124, respectively	605,635	681,202
Premises and equipment	19,507	19,983
Other real estate owned	46,197	30,892
Federal Home Loan Bank stock	7,323	10,072
Bank owned life insurance	9,167	8,911
Accrued interest receivable and other assets	7,938	6,822
Total assets	<u>\$1,017,989</u>	<u>\$1,076,121</u>
Liabilities and Stockholders' Equity		
Deposits		
Non-interest bearing	\$ 114,910	\$ 107,486
Interest bearing	811,931	880,219
Total deposits	926,841	987,705
Repurchase agreements	1,341	2,470
Federal Home Loan Bank advances	15,752	4,492
Accrued interest payable and other liabilities	10,640	14,673
Subordinated capital note	4,950	5,850
Junior subordinated debentures	25,000	25,000
Total liabilities	984,524	1,040,190
Commitments and contingent liabilities (Note 18)	—	—
Stockholders' equity		
Preferred stock, no par		
Series A - 0 and 35,000 issued and outstanding; Liquidation preference of \$0 and \$35 million, respectively	—	35,000
Series B - 40,536 and 0 issued and outstanding, respectively	2,229	—
Series C - 0 and 317,042 issued and outstanding; Liquidation preference of \$0 and \$3.6 million, respectively	—	3,283
Series D - 64,580 and 0 issued and outstanding, respectively	3,552	—
Series E - 6,198 and 0 issued and outstanding; Liquidation preference of \$6.2 million and \$0, respectively	1,644	—
Series F - 4,304 and 0 issued and outstanding; Liquidation preference of \$4.3 million and \$0, respectively	1,127	—
Total preferred stockholders' equity	8,552	38,283
Common stock, no par, 86,000,000 shares authorized, 14,890,514 and 12,840,999 shares issued and outstanding, respectively	113,238	112,236
Additional paid-in capital	21,442	20,887
Retained deficit	(107,595)	(130,182)
Accumulated other comprehensive income (loss)	(2,172)	(5,293)
Total common stockholders' equity (deficit)	24,913	(2,352)
Total stockholders' equity	33,465	35,931
Total liabilities and stockholders' equity	<u>\$1,017,989</u>	<u>\$1,076,121</u>

See accompanying notes.

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PORTER BANCORP, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
Years Ended December 31,
(Dollar amounts in thousands except per share data)

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Interest income			
Loans, including fees	\$ 33,090	\$38,015	\$ 52,918
Taxable securities	4,945	3,706	3,333
Tax exempt securities	936	933	887
Federal funds sold and other	542	574	591
	<u>39,513</u>	<u>43,228</u>	<u>57,729</u>
Interest expense			
Deposits	8,867	10,137	14,623
Federal Home Loan Bank advances	124	157	207
Junior subordinated debentures	612	622	671
Subordinated capital note	189	221	266
Federal funds purchased and other	3	6	7
	<u>9,795</u>	<u>11,143</u>	<u>15,774</u>
Net interest income	29,718	32,085	41,955
Provision for loan losses	7,100	700	40,250
Net interest income after provision for loan losses	22,618	31,385	1,705
Non-interest income			
Service charges on deposit accounts	1,988	2,058	2,239
Bank card interchange fees	765	718	727
Income from bank owned life insurance	276	534	312
Other real estate owned rental income	256	399	420
Net gain on sales of securities	92	723	3,236
Income from fiduciary activities	—	517	1,177
Other	702	970	1,479
	<u>4,079</u>	<u>5,919</u>	<u>9,590</u>
Non-interest expense			
Salaries and employee benefits	15,658	15,501	16,648
Occupancy and equipment	3,497	3,583	3,642
Loan collection expense	2,994	4,707	2,442
Other real estate owned expense	5,839	4,516	10,549
FDIC insurance	2,272	2,378	2,835
State franchise and deposit tax	1,445	1,944	2,174
Professional fees	2,771	1,892	1,985
Communications	752	711	710
Insurance expense	575	648	373
Postage and delivery	407	423	454
Data processing expense	1,106	184	96
Advertising	563	308	154
Other	1,556	2,095	2,230
	<u>39,435</u>	<u>38,890</u>	<u>44,292</u>
Loss before income taxes	(12,738)	(1,586)	(32,997)
Income tax expense (benefit)	(1,583)	—	(65)
Net loss	(11,155)	(1,586)	(32,932)
Less:			
Dividends and accretion on preferred stock	2,362	2,079	1,929
Effect of exchange of preferred stock for common stock	(36,104)	—	—
Earnings (loss) allocated to participating securities	3,159	(267)	(1,429)
Net income (loss) attributable to common shareholders	<u>\$ 19,428</u>	<u>\$ (3,398)</u>	<u>\$ (33,432)</u>
Basic and diluted income (loss) per common share	<u>\$ 1.59</u>	<u>\$ (0.29)</u>	<u>\$ (2.85)</u>

See accompanying notes.

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PORTER BANCORP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
Years Ended December 31,
(in thousands)

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Net loss	\$(11,155)	\$(1,586)	\$(32,932)
Other comprehensive income (loss):			
Unrealized gain (loss) on securities:			
Unrealized gain (loss) arising during the period	4,612	(9,081)	(4,335)
Reclassification of amount realized through sales	92	723	3,236
Net unrealized gain/(loss) recognized in comprehensive income	4,704	(8,358)	(1,099)
Tax effect	(1,583)	—	—
Other comprehensive income (loss)	3,121	(8,358)	(1,099)
Comprehensive loss	<u>\$ (8,034)</u>	<u>\$ (9,944)</u>	<u>\$ (34,031)</u>

See accompanying notes.

stock for common stock	1,821,428	(35,000)	40,536	(317,042)	64,580	6,198	4,304	1,002	(35,000)	2,229	(3,283)	3,552	1,644	1,127	—	36,104	—	7,375
Dividends on Series A preferred stock	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	(2,362)	—	(2,362)
Balances, December 3 2014	<u>14,890,514</u>	<u>—</u>	<u>40,536</u>	<u>—</u>	<u>64,580</u>	<u>6,198</u>	<u>4,304</u>	<u>\$ 113,238</u>	<u>\$ —</u>	<u>\$ 2,229</u>	<u>\$ —</u>	<u>\$ 3,552</u>	<u>\$ 1,644</u>	<u>\$ 1,127</u>	<u>\$ 21,442</u>	<u>\$ (107,595)</u>	<u>\$ (2,172)</u>	<u>\$ 33,465</u>

See accompanying notes.

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PORTER BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31,
(in thousands)

	2014	2013	2012
Cash flows from operating activities			
Net loss	\$ (11,155)	\$ (1,586)	\$ (32,932)
Adjustments to reconcile net loss to net cash from operating activities			
Depreciation and amortization	1,738	2,017	2,288
Provision for loan losses	7,100	700	40,250
Net amortization on securities	1,614	2,132	3,335
Stock-based compensation expense	555	604	442
Tax benefit from OCI components	(1,583)	—	—
Net gain on sales of loans originated for sale	(53)	(87)	(338)
Loans originated for sale	(2,528)	(4,035)	(16,365)
Proceeds from sales of loans originated for sale	2,730	4,469	16,827
Net (gain) loss on sales of other real estate owned	(306)	132	1,672
Net write-down of other real estate owned	4,255	2,466	7,154
Net realized gain on sales of investment securities	(92)	(723)	(3,236)
Earnings on bank owned life insurance, net of premium expense	(256)	(513)	(292)
Net change in accrued interest receivable and other assets	(1,574)	1,364	16,150
Net change in accrued interest payable and other liabilities	980	2,585	791
Net cash from operating activities	<u>1,425</u>	<u>9,525</u>	<u>35,746</u>
Cash flows from investing activities			
Purchases of available for sale securities	(45,803)	(72,814)	(162,840)
Sales of available for sale securities	6,251	8,061	93,199
Maturities and prepayments of available for sale securities	15,573	26,506	48,800
Calls of held to maturity securities	1,000	—	—
Proceeds from mandatory redemption of Federal Home Loan Bank stock	2,749	—	—
Proceeds from sale of other real estate owned	13,084	30,772	21,940
Improvements to other real estate owned	—	—	(1)
Loan originations and payments, net	26,923	139,548	167,272
Purchases of premises and equipment, net	(523)	(281)	(511)
Net cash from investing activities	<u>19,254</u>	<u>131,792</u>	<u>167,859</u>
Cash flows from financing activities			
Net change in deposits	(60,864)	(77,354)	(258,704)
Net change in repurchase agreements	(1,129)	(164)	896
Repayment of Federal Home Loan Bank advances	(23,765)	(1,112)	(1,512)
Advances from Federal Home Loan Bank	35,025	—	—
Repayment of subordinated capital note	(900)	(1,125)	(675)
Net cash from financing activities	<u>(51,633)</u>	<u>(79,755)</u>	<u>(259,995)</u>
Net change in cash and cash equivalents	(30,954)	61,562	(56,390)
Beginning cash and cash equivalents	111,134	49,572	105,962
Ending cash and cash equivalents	<u>\$ 80,180</u>	<u>\$ 111,134</u>	<u>\$ 49,572</u>
Supplemental cash flow information:			
Interest paid	\$ 9,475	\$ 10,711	\$ 15,402
Income taxes paid (refunded)	—	—	(12,726)
Supplemental non-cash disclosure:			
Transfer from loans to other real estate	\$ 32,338	\$ 20,606	\$ 33,528
Financed sales of other real estate owned	—	15	541
Transfer from available for sale to held to maturity securities	—	44,934	—
AOCI component of transfer from available for sale to held to maturity	—	(1,281)	—
Transfer of loans to loans held for sale at fair value	8,926	—	—
Effect of accrued and unpaid dividends on preferred stock redemption	7,375	—	—

See accompanying notes.

PORTER BANCORP, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2014, 2013 and 2012

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations and Principles of Consolidation – The consolidated financial statements include Porter Bancorp, Inc. (Company) and its subsidiary, PBI Bank (Bank). The Company owns a 100% interest in the Bank.

The Company provides financial services through its offices in Central Kentucky and Louisville. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are residential mortgage, commercial, agricultural, and real estate loans. Substantially all loans are collateralized by specific items of collateral including business assets, commercial real estate, and residential real estate. Commercial loans are expected to be repaid from cash flow from operations of businesses. There are no significant concentrations of loans to any one industry or customer. However, customers' ability to repay their loans is dependent on the real estate and general economic conditions in the area. Other financial instruments which potentially represent concentrations of credit risk include deposit accounts in other financial institutions and federal funds sold.

Use of Estimates – To prepare financial statements in conformity with U.S. generally accepted accounting principles, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ.

Cash and Cash Equivalents – For the purpose of presentation in the statements of cash flows, the Company considers all cash and amounts due from depository institutions as well as interest bearing deposits in banks that mature within one year and are carried at cost to be cash equivalents. The Bank is required to maintain average reserve balances with the Federal Reserve Bank of St. Louis.

Interest Bearing Deposits in Banks – Interest bearing deposits in banks mature within one year and are carried at cost. At December 31, 2014, approximately \$9.8 million of interest bearing deposits in banks were pledged to a secure letter of credit issued by a third party for the benefit of the Bank.

Securities – Debt securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity. Equity securities with readily determined fair values are classified as available for sale. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method anticipating prepayments on mortgage backed securities. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment (“OTTI”) on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

Loans Held for Sale – Loans held for sale include residential mortgage loans originated for sale into the secondary market and loans transferred from held for investment. Held for investment loans that have been transferred to held for sale are carried at lower of cost or fair value. The credit component or any write down upon transfer to held for sale is reflected in charge-offs to the allowance for loan losses.

Residential mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

Mortgage loans held for sale are generally sold with servicing rights released. If sold with servicing retained, the carrying value of mortgage loans sold is reduced by the amount allocated to the servicing right. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

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Mortgage banking derivatives used in the ordinary course of business consist of mandatory forward sales contracts and rate lock loan commitments. Forward contracts represent future commitments to deliver loans at a specified price and date and are used to manage interest rate risk on loan commitments and mortgage loans held for sale. Rate lock commitments represent commitments to fund loans at a specific rate. These derivatives involve underlying items, such as interest rates, and are designed to transfer risk. Substantially all of these instruments expire within 60 days from the date of issuance. Notional amounts are amounts on which calculations and payments are based, but which do not represent credit exposure, as credit exposure is limited to the amounts required to be received or paid.

We adopted FASB ASC topic 815, “*Derivative and Hedging*” during the first quarter of 2009. Our commitments to deliver loans and our rate lock loan commitments were insignificant at year end.

Loans – Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs, and an allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method without anticipating prepayments. The recorded investment in loans includes the outstanding principal balance and unamortized deferred origination costs and fees.

Interest income on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the loan is well collateralized and in process of collection. Consumer and credit card loans are typically charged off no later than 90 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is not expected.

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Loan Losses – The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. We estimate the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in our judgment, should be charged off.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

Factors considered in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. We determine the significance of payment delays and payment shortfalls on case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan’s existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures. Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan’s effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported at the fair value of the collateral. For troubled debt restructurings that subsequently default, we determine the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

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The general component covers non-impaired loans and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on our actual loss history experienced over the most recent three years with weighting towards the most recent periods. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: changes in lending policies, procedures, and practices; effects of any change in risk selection and underwriting standards; national and local economic trends and conditions; industry conditions; trends in volume and terms of loans; experience, ability and depth of lending management and other relevant staff; levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; and effects of changes in credit concentrations.

A portfolio segment is defined as the level at which an entity develops and documents a systematic methodology to determine its allowance for loan losses. We identified the following portfolio segments: commercial, commercial real estate, residential real estate, consumer, agricultural, and other.

- Commercial loans depend on the strength of the industries of the related borrowers and the success of their businesses. Commercial loans are advances for equipment purchases, or to provide working capital, or to meet other financing needs of business enterprises. These loans may be secured by accounts receivable, inventory, equipment or other business assets. Financial information is obtained from the borrowers to evaluate their ability to repay the loans.
- Commercial real estate loans are affected by the local commercial real estate market and the local economy. Commercial real estate loans include loans on properties occupied by the borrowers and on properties for commercial purposes. Construction and development loans are a component of this segment. These loans are generally secured by land under development or homes and commercial buildings under construction. Appraisals are obtained to support the loan amount. Financial information is obtained from the borrowers and/or the individual project to evaluate cash flows sufficiency to service the debt.
- Residential real estate loans are affected by the local residential real estate market, local economy, and, for variable rate mortgages, movement in indices tied to these loans. For owner occupied residential loans, the borrowers' repayment ability is evaluated through a review of credit scores and debt to income ratios. For non-owner occupied residential loans, such as rental real estate, financial information is obtained from the borrowers and/or the individual project to evaluate cash flows sufficiency to service the debt. Appraisals are obtained to support the loan amount.
- Consumer loans depend on local economies. Consumer loans are generally secured by consumer assets, but may be unsecured. We evaluate the borrowers' repayment ability through a review of credit scores and an evaluation of debt to income ratios.
- Agriculture loans depend on the industries tied to these loans and are generally secured by livestock, crops, and/or equipment, but may be unsecured. We evaluate the borrowers' repayment ability through a review of credit scores and an evaluation of debt to income ratios.
- Other loans include loans to municipalities, loans secured by stock, and overdrafts. For municipal loans, we evaluate the borrowers' revenue streams as well as ability to repay from general funds. For loans secured by stock, we evaluate the market value of the stock securing the loan in relation to the loan amount. Overdrafts are funded based on pre-established criteria related to the deposit account relationship.

We analyze key relevant risk characteristics for each portfolio segment and have determined that loans in each segment possess similar general risk characteristics that are analyzed in connection with our loan underwriting processes and procedures. In determining the allocated allowance, we utilize weighted average loss rates for the past three years most heavily weighting the current year. Commercial real estate qualitative adjustment considerations include due to trends in our markets for underlying collateral values and risks related to tenant rents and for economic factors such as decreased sales demand, elevated inventory levels, and declining collateral values. Residential real estate loan considerations include macro factors such as unemployment rates, trends in vacancy rates, and home value trends. The commercial portfolio qualitative adjustments are related to industry concentrations and geographical market. Our agricultural, consumer, and other portfolios are less significant in terms of size and risk is assessed based on the smaller dollar size of these loans and the more geographical areas where the collateral is located.

Transfers of Financial Assets – Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Other Real Estate Owned – Assets acquired through or instead of loan foreclosure are initially recorded at fair value less estimated costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at the lower of cost or fair value, less estimated costs to sell. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Costs after acquisition are expensed.

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Premises and Equipment – Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line method with useful lives ranging from 5 to 33 years. Furniture, fixtures and equipment are depreciated using the straight-line or accelerated method with useful lives ranging from 3 to 7 years.

Federal Home Loan Bank (FHLB) Stock – The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment. Because this stock is viewed as long term investment, impairment is based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Intangible Assets – Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Other intangible assets consist of core deposit intangible assets arising from whole bank and branch acquisitions. They are initially measured at fair value and then are amortized on an accelerated or straight-line basis over their estimated useful lives, which range from 7 to 10 years.

Bank Owned Life Insurance – The Bank has purchased life insurance policies on certain key executives. Company owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Long-Term Assets – Premises and equipment, other intangible assets, and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Repurchase Agreements – Substantially all repurchase agreement liabilities represent amounts advanced by various customers. Securities are pledged to cover these liabilities, which are not covered by federal deposit insurance.

Benefit Plans – Employee 401(k) and profit sharing plan expense is the amount of matching contributions. Deferred compensation and supplemental retirement plan expense allocates the benefits over years of service.

Stock-Based Compensation – Compensation cost is recognized for unvested stock awards issued to employees, based on the fair value of these awards at the date of grant. The market price of the Corporation's common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

Income Taxes – Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

Loan Commitments and Related Financial Instruments – Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer-financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Comprehensive Loss – Comprehensive loss consists of net income (loss) and other comprehensive loss. Other comprehensive loss includes unrealized gains and losses on securities available for sale, which are also recognized as a separate component of equity.

Preferred Stock – In December 2014, we completed a non-cash equity exchange transaction with the accredited investors who acquired all of our issued and outstanding Series A Preferred Shares from UST in a public auction. We acquired and cancelled all of the issued and outstanding Series A Preferred Shares, the accrued dividends thereon, all of the issued and outstanding Series C Preferred Shares, and warrants to purchase 798,915 shares of common stock together having an aggregate book value of approximately \$45.7 million. In exchange, we issued common and preferred shares having a fair value of approximately \$9.6 million. The effect of this exchange transaction was to increase common stockholders' equity by approximately \$36.1 million, and total stockholders' equity by \$7.4 million.

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In the exchange transaction, we issued 1,821,428 common shares, 40,536 mandatorily convertible Series B Preferred Shares and 64,580 mandatorily convertible Series D Preferred Shares, which automatically converted into 4,053,600 common shares and 6,458,000 non-voting common shares after shareholder approval on February 25, 2015. We also issued 6,198 Series E Preferred Shares and 4,304 Series F Preferred Shares, both of which series are not convertible into common shares, have a liquidation preference of \$1,000 per share, and are entitled to a 2% noncumulative annual dividend if and when declared. Series E and Series F Preferred Shares rank senior to, and have liquidation and dividend preferences over, our common shares and non-voting common shares.

Earnings (Loss) Per Common Share – Basic earnings (loss) per common share are net income (loss) attributable to common shareholders divided by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per common share include the dilutive effect, if any, of additional potential common shares issuable under stock options and warrants. Earnings (loss) and dividends per share are restated for all stock splits and dividends through the date of issue of the financial statements.

Earnings (Loss) Allocated to Participating Securities – Our issued and outstanding Series C Preferred Stock was automatically convertible into common stock at such time as the holder together with its affiliates beneficially owned less than 9.9% of the then outstanding common shares of the company. Our Series B and Series D mandatorily convertible preferred stock converted to common and nonvoting common shares after shareholder approval on February 25, 2015. We also have issued and outstanding unvested common shares to employees and directors through our stock incentive plan. Earnings (loss) are allocated to these participating securities based on their percentage of total issued and outstanding shares.

Loss Contingencies – Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. (See Note 24 for more specific disclosure.)

Dividend Restriction – Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the Company or by the Company to shareholders. (See Note 17 for more specific disclosure.)

Fair Value of Financial Instruments – Fair values of financial instruments are estimated using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates. (See Note 19 for more specific disclosure.)

Reclassifications – Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net loss or stockholders' equity.

Adoption of New Accounting Standards – In January 2014, FASB issued Accounting Standards Update 2014-04, Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. The amendments in this ASU clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this ASU are effective for the Company beginning January 1, 2015 and are not expected to have a material impact on the Company's financial statements.

In May 2014, FASB issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers (Topic 606). The ASU creates a new topic, Topic 606, to provide guidance on revenue recognition for entities that enter into contracts with customers to transfer goods or services or enter into contracts for the transfer of nonfinancial assets. The core principle of the guidance 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 or services. Additional disclosures are required to provide quantitative and qualitative information regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new guidance is effective for annual reporting periods, and interim reporting periods within those annual periods, beginning after December 15, 2016. Early adoption is not permitted. Management is currently evaluating the impact of the adoption of this guidance on the Company's financial statements.

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In August 2014, the FASB amended existing guidance related to the disclosures about an entity's ability to continue as a going concern. These amendments are intended to define management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. These amendments provide guidance to an organization's management, with principles and definitions that are intended to reduce diversity in the timing and content of disclosures that are commonly provided by organizations in the financial statement footnotes. The amendments are effective for annual periods ending after December 15, 2016, and interim periods within annual periods beginning after December 15, 2016. Early application is permitted for annual or interim reporting periods for which the financial statements have not previously been issued. The effect of adopting this standard is not expected to have a material effect on the Company's operating results or financial condition.

NOTE 2 – GOING CONCERN CONSIDERATIONS AND FUTURE PLANS

The consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business for the foreseeable future. However, the events and circumstances described in this Note create substantial doubt about the Company's ability to continue as a going concern.

For the year ended December 31, 2014, we reported a net loss of \$11.2 million. This loss was attributable primarily to loan loss provision of \$7.1 million, OREO expense of \$5.8 million resulting from fair value write-downs driven by new appraisals and reduced marketing prices, and ongoing operating expense, along with \$3.0 million in loan collection expenses. We also had lower net interest margin due to lower average loans outstanding, loans re-pricing at lower rates, and the level of non-performing loans in our portfolio. After deductions for dividends and accretion on preferred stock of \$2.4 million, allocating losses to participating securities of \$3.2 million, and the effect of the exchange of preferred stock for common stock of \$36.1 million, net income attributable to common shareholders was \$19.4 million for the year ended December 31, 2014, compared with a net loss attributable to common shareholders of \$3.4 million for the year ended December 31, 2013.

At December 31, 2014, we continued to be involved in various legal proceedings in which we dispute the material factual allegations against us. After conferring with our legal advisors, we believe we have meritorious grounds on which to prevail. If we do not prevail, the ultimate outcome of any one of these matters could have a material adverse effect on our financial condition, results of operations, or cash flows. These matters are more fully described in Note 24 – "Contingencies".

For the year ended December 31, 2013, we reported a net loss to common shareholders of \$3.4 million. This loss coupled with the comprehensive loss for the year reduced shareholders equity to \$35.9 million, from \$47.2 million at the end of 2012. This reduction was attributable primarily to OREO expense of \$4.5 million resulting from fair value write-downs driven by new appraisals and reduced marketing prices, net loss on sales, and ongoing operating expense, along with \$4.7 million in loan collection expenses. The reduction was also attributable to a reduction in the fair value of securities of \$8.4 million, net, as well as the accrual of dividends and accretion to preferred shareholders of \$2.1 million. We also had lower net interest margin due to lower average loans outstanding, loans re-pricing at lower rates, and the level of non-performing loans in our portfolio. Net loss to common shareholders of \$3.4 million, for the year ended December 31, 2013, compares with net loss to common shareholders of \$33.4 million for year ended December 31, 2012.

In June 2011, the Bank agreed to a Consent Order with the FDIC and KDFI in which the Bank agreed, among other things, to improve asset quality, reduce loan concentrations, and maintain a minimum Tier 1 leverage ratio of 9% and a minimum total risk based capital ratio of 12%. The Consent Order was included in our Current Report on 8-K filed on June 30, 2011. In October 2012, the Bank entered into a revised Consent Order with the FDIC and KDFI again agreeing to maintain a minimum Tier 1 leverage ratio of 9% and a minimum total risk based capital ratio of 12%. The Bank also agreed that if it should be unable to reach the required capital levels, and if directed in writing by the FDIC, then the Bank would within 30 days develop, adopt and implement a written plan to sell or merge itself into another federally insured financial institution or otherwise immediately obtain a capital investment into the Bank sufficient to fully meet the capital requirements. We have not been directed by the FDIC to implement such a plan.

We expect to continue to work with our regulators toward capital ratio compliance. The revised Consent Order also requires the Bank to continue to adhere to the plans implemented in response to the June 2011 Consent Order, and includes the substantive provisions of the June 2011 Consent Order. The revised Consent Order was included in our Current Report on 8-K filed on September 19, 2012. As of December 31, 2014, the capital ratios required by the Consent Order were not met.

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In order to meet these capital requirements, the Board of Directors and management are continuing to evaluate strategies to achieve the following objectives:

- Increasing capital through a possible public offering or private placement of common stock to new and existing shareholders. We have engaged a financial advisor to assist our Board in this evaluation.
- Continuing to operate the Company and Bank in a safe and sound manner. This strategy will require us to reduce our lending concentrations, remediate non-performing loans, and reduce other noninterest expense through the disposition of OREO.
- Evaluating and implementing improvements to our internal processes and procedures, distribution of labor, and work-flow to ensure we have adequately and appropriately deployed resources in an efficient manner in the current environment.
- Executing on our commitment to improve credit quality and reduce loan concentrations and balance sheet risk.
 - We have reduced our loan portfolio significantly from \$1.3 billion at December 31, 2010 to \$625.0 million at December 31, 2014.
 - We have reduced our construction and development loans to less than 75% of total risk-based capital at December 31, 2014, and have now been in compliance with the Consent Order for eleven quarters.
 - We have reduced our non-owner occupied commercial real estate loans, construction and development loans, and multi-family residential real estate loans. Compliance with the Consent Order requires those loans represent less than 250% of total risk-based capital. These loans represented 262% of total risk-based capital at December 31, 2014, down from 284% at December 31, 2013.
- Executing on our commitment to sell other real estate owned and reinvest in quality income producing assets.
 - The remediation process for loans secured by real estate has led the Bank to acquire significant levels of OREO since 2010. The Bank acquired \$20.6 million, \$33.5 million, \$41.9 million, and \$90.8 million during 2013, 2012, 2011, and 2010, respectively. For the year ended December 31, 2014, we acquired \$32.3 million of OREO.
 - We have incurred significant losses in disposing of this real estate. We incurred losses totaling \$2.6 million, \$9.3 million, \$42.8 million, and \$13.9 million in 2013, 2012, 2011, and 2010, respectively, from sales at less than carrying values and fair value write-downs attributable to declines in appraisal valuations and changes in our pricing strategies. During the year ended December 31, 2014, we incurred OREO losses totaling \$3.9 million comprised of \$4.3 million in fair value write-downs from declining values as evidenced by new appraisals and reduced marketing prices in connection with our sales strategies, offset by \$306,000 in net gain on sales of OREO.
 - To ensure we maximize the value we receive upon the sale of OREO, we continually evaluate sales opportunities. Proceeds from the sale of OREO totaled \$13.1 million during the year ended December 31, 2014 and \$30.8 million, \$22.5 million, \$26.0 million and \$25.0 million during the years ended December 31, 2013, 2012, 2011, and 2010, respectively.
 - At December 31, 2014, the OREO portfolio consisted of 40% construction, development, and land assets, compared to 62% at December 31, 2013. Commercial real estate represents 31% of the OREO portfolio at December 31, 2014 compared with 19% at December 31, 2013. 1-4 family residential properties represent 17% of the OREO portfolio at December 31, 2014 compared with 16% at December 31, 2013, and multi-family properties represent 11% of the OREO portfolio at December 31, 2014, compared to 1% at December 31, 2013.

Bank regulatory agencies can exercise discretion when an institution does not meet the terms of a consent order. Based on individual circumstances, the agencies may issue mandatory directives, impose monetary penalties, initiate changes in management, or take more serious adverse actions such as require an institution to sell or merge itself into another institution or require the Bank to be taken into receivership.

Liquid assets were \$1.9 million at December 31, 2014. Since the Bank is unlikely to be in a position to pay dividends to the parent company for the foreseeable future, cash inflows for the parent are limited to earnings on investment securities, sales of investment securities, and interest on deposits with the Bank. These cash inflows along with the liquid assets held at December 31, 2014, are needed to cover ongoing operating expenses of the parent company which are forecasted at approximately \$1.0 million for 2015. Parent company liquidity could be improved through a sale of common or preferred shares.

Effective with the fourth quarter of 2011, we began deferring interest payments on the junior subordinated debentures relating to our trust preferred securities. Deferring interest payments on the junior subordinated debentures resulted in a deferral of distributions on our trust preferred securities.

If we defer distributions on our trust preferred securities for 20 consecutive quarters, we must pay all deferred distributions in full or we will be in default. Our deferral period expires in the third quarter of 2016. Deferred distributions on our trust preferred securities, which totaled \$2.2 million as of December 31, 2014, are cumulative, and unpaid distributions accrue and compound on each subsequent payment date. If as a result of a default we become subject to any liquidation, dissolution or winding up, holders of the trust preferred securities will be entitled to receive the liquidation amounts to which they are entitled, including all accrued and unpaid distributions, before any distribution can be made to our shareholders. In addition, the holders of our Series E and Series F Preferred Shares will be entitled to receive liquidation distributions totaling

\$10.5 million before any distribution can be made to the holders of our common shares.

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These financial statements do not include any adjustments that may result should the Company be unable to continue as a going concern.

NOTE 3 – SECURITIES

The fair value of available for sale and held to maturity securities and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

	Amortized <u>Cost</u>	Gross Unrealized <u>Gains</u>	Gross Unrealized <u>Losses</u>	<u>Fair Value</u>
	(in thousands)			
December 31, 2014				
Available for sale				
U.S. Government and federal agency	\$ 35,725	\$ 308	\$ (590)	\$ 35,443
Agency mortgage-backed: residential	121,985	1,970	(357)	123,598
State and municipal	11,690	722	(8)	12,404
Corporate bonds	18,087	853	(252)	18,688
Other debt securities	572	86	—	658
Total available for sale	<u>\$188,059</u>	<u>\$ 3,939</u>	<u>\$ (1,207)</u>	<u>\$190,791</u>
Held to maturity				
State and municipal	\$ 42,325	\$ 2,173	\$ —	\$ 44,498
Total held to maturity	<u>\$ 42,325</u>	<u>\$ 2,173</u>	<u>\$ —</u>	<u>\$ 44,498</u>
December 31, 2013				
Available for sale				
U.S. Government and federal agency	\$ 31,026	\$ 284	\$ (1,444)	\$ 29,866
Agency mortgage-backed: residential	102,435	458	(1,950)	100,943
State and municipal	12,965	608	(28)	13,545
Corporate bonds	18,002	769	(610)	18,161
Other debt securities	572	60	—	632
Total debt securities	165,000	2,179	(4,032)	163,147
Equity	135	62	—	197
Total available for sale	<u>\$165,135</u>	<u>\$ 2,241</u>	<u>\$ (4,032)</u>	<u>\$163,344</u>
Held to maturity				
State and municipal	\$ 43,612	\$ 3	\$ (668)	\$ 42,947
Total held to maturity	<u>\$ 43,612</u>	<u>\$ 3</u>	<u>\$ (668)</u>	<u>\$ 42,947</u>

Sales and calls of available for sale securities were as follows:

	<u>2014</u>	<u>2013</u>	<u>2012</u>
	(in thousands)		
Proceeds	\$6,251	\$8,061	\$93,199
Gross gains	132	873	3,543
Gross losses	—	150	307

The tax provision related to these net gains and losses realized on sales were \$46,000, \$253,000, and \$1.1 million, respectively.

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The amortized cost and fair value of our debt securities are shown by contractual maturity. Expected maturities may differ from actual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date, mortgage-backed, are shown separately.

Maturity	December 31, 2014	
	Amortized	
	Cost	Fair Value
	(in thousands)	
Available for sale		
Within one year	\$ 15,739	\$ 15,749
One to five years	14,171	15,058
Five to ten years	35,592	35,728
Beyond ten years	572	658
Agency mortgage-backed: residential	121,985	123,598
Total	<u>\$188,059</u>	<u>\$190,791</u>
Held to maturity		
One to five years	\$ 8,876	\$ 9,258
Five to ten years	29,327	30,832
Beyond ten years	4,122	4,408
Total	<u>\$ 42,325</u>	<u>\$ 44,498</u>

Securities pledged at year-end 2014 and 2013 had carrying values of approximately \$80.8 million and \$84.2 million, respectively, and were pledged to secure public deposits and repurchase agreements.

At December 31, 2014 and 2013, we held securities issued by the state of Kentucky or municipalities in the state of Kentucky having a book value of \$19.1 million and \$21.1 million, respectively. Additionally, at December 31, 2014 and 2013, we held securities issued by the state of Texas or municipalities in the state of Texas having a book value of \$4.4 million at each period end. At year-end 2014 and 2013, there were no other holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of stockholders' equity.

Securities with unrealized losses at year-end 2014 and 2013, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

Description of Securities	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized	Fair Value	Unrealized	Fair Value	Unrealized
		Loss		Loss		Loss
	(in thousands)					
2014						
Available for sale						
U.S. Government and federal agency	\$ 7,778	\$ (60)	\$18,681	\$ (530)	\$26,459	\$ (590)
Agency mortgage-backed: residential	6,960	(12)	17,938	(345)	24,898	(357)
State and municipal	569	(8)	—	—	569	(8)
Corporate bonds	4,884	(119)	1,660	(133)	6,544	(252)
Total temporarily impaired	<u>\$20,191</u>	<u>\$ (199)</u>	<u>\$38,279</u>	<u>\$ (1,008)</u>	<u>\$58,470</u>	<u>\$ (1,207)</u>

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Description of Securities	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
2013						
Available for sale						
U.S. Government and federal agency	\$24,129	\$ (1,444)	\$ —	\$ —	\$ 24,129	\$ (1,444)
Agency mortgage-backed: residential	58,257	(1,672)	10,344	(278)	68,601	(1,950)
State and municipal	458	(28)	—	—	458	(28)
Corporate bonds	11,313	(610)	—	—	11,313	(610)
Total temporarily impaired	<u>\$94,157</u>	<u>\$ (3,754)</u>	<u>\$10,344</u>	<u>\$ (278)</u>	<u>\$104,501</u>	<u>\$ (4,032)</u>
Held to maturity						
State and municipal	\$39,743	\$ (654)	\$ 1,031	\$ (14)	\$ 40,774	\$ (668)
Total temporarily impaired	<u>\$39,743</u>	<u>\$ (654)</u>	<u>\$ 1,031</u>	<u>\$ (14)</u>	<u>\$ 40,774</u>	<u>\$ (668)</u>

There were no held to maturity securities in an unrealized loss position at December 31, 2014.

The Company evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, underlying credit quality of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, the Company may consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, the sector or industry trends and cycles affecting the issuer, and the results of reviews of the issuer's financial condition. As of December 31, 2014, management does not believe any securities in our portfolio with unrealized losses should be classified as other than temporarily impaired at this time. Management currently intends to hold all securities with unrealized losses until recovery, which for fixed income securities may be at maturity.

NOTE 4 – LOANS

Loans at year-end by class were as follows:

	2014	2013
	(in thousands)	
Commercial	\$ 60,936	\$ 52,878
Commercial Real Estate:		
Construction	33,173	43,326
Farmland	77,419	71,189
Other	175,452	232,026
Residential Real Estate:		
Multi-family	41,891	46,858
1-4 Family	197,278	228,505
Consumer	11,347	14,365
Agriculture	26,966	19,199
Other	537	980
Subtotal	624,999	709,326
Less: Allowance for loan losses	(19,364)	(28,124)
Loans, net	<u>\$605,635</u>	<u>\$681,202</u>

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The following table presents the activity in the allowance for loan losses by portfolio segment for the year ended December 31, 2014:

	Commercial		Residential				Total
	Commercial	Real Estate	Real Estate	Consumer	Agriculture	Other	
			(in thousands)				
Beginning balance	\$ 3,221	\$ 16,414	\$ 7,762	\$ 416	\$ 305	\$ 6	\$ 28,124
Provision for loan losses	(690)	6,395	1,364	25	31	(25)	7,100
Loans charged off	(1,099)	(13,846)	(4,097)	(335)	(30)	(19)	(19,426)
Recoveries	614	1,968	758	168	13	45	3,566
Ending balance	<u>\$ 2,046</u>	<u>\$ 10,931</u>	<u>\$ 5,787</u>	<u>\$ 274</u>	<u>\$ 319</u>	<u>\$ 7</u>	<u>\$ 19,364</u>

The following table presents the activity in the allowance for loan losses by portfolio segment for the year ended December 31, 2013:

	Commercial		Residential				Total
	Commercial	Real Estate	Real Estate	Consumer	Agriculture	Other	
			(in thousands)				
Beginning balance	\$ 4,402	\$ 34,768	\$ 16,235	\$ 857	\$ 403	\$ 15	\$ 56,680
Provision for loan losses	435	1,691	(1,261)	66	(222)	(9)	700
Loans charged off	(2,828)	(21,176)	(7,703)	(773)	(128)	—	(32,608)
Recoveries	1,212	1,131	491	266	252	—	3,352
Ending balance	<u>\$ 3,221</u>	<u>\$ 16,414</u>	<u>\$ 7,762</u>	<u>\$ 416</u>	<u>\$ 305</u>	<u>\$ 6</u>	<u>\$ 28,124</u>

The following table presents the activity in the allowance for loan losses by portfolio segment for the year ended December 31, 2012:

	Commercial		Residential				Total
	Commercial	Real Estate	Real Estate	Consumer	Agriculture	Other	
			(in thousands)				
Beginning balance	\$ 4,207	\$ 33,024	\$ 14,217	\$ 792	\$ 325	\$ 14	\$ 52,579
Provision for loan losses	3,850	23,275	10,884	1,070	1,170	1	40,250
Loans charged off	(3,784)	(22,366)	(9,071)	(1,130)	(1,164)	—	(37,515)
Recoveries	129	835	205	125	72	—	1,366
Ending balance	<u>\$ 4,402</u>	<u>\$ 34,768</u>	<u>\$ 16,235</u>	<u>\$ 857</u>	<u>\$ 403</u>	<u>\$ 15</u>	<u>\$ 56,680</u>

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on the impairment method as of December 31, 2014:

	Commercial		Residential				Total
	Commercial	Real Estate	Real Estate	Consumer	Agriculture	Other	
			(in thousands)				
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	\$ 33	\$ 491	\$ 227	\$ 1	\$ —	\$ —	\$ 752
Collectively evaluated for impairment	2,013	10,440	5,560	273	319	7	18,612
Total ending allowance balance	<u>\$ 2,046</u>	<u>\$ 10,931</u>	<u>\$ 5,787</u>	<u>\$ 274</u>	<u>\$ 319</u>	<u>\$ 7</u>	<u>\$ 19,364</u>
Loans:							
Loans individually evaluated for impairment	\$ 2,022	\$ 48,141	\$ 21,384	\$ 61	\$ 263	\$ 122	\$ 71,993
Loans collectively evaluated for impairment	58,914	237,903	217,785	11,286	26,703	415	553,006
Total ending loans balance	<u>\$ 60,936</u>	<u>\$ 286,044</u>	<u>\$ 239,169</u>	<u>\$ 11,347</u>	<u>\$ 26,966</u>	<u>\$ 537</u>	<u>\$ 624,999</u>

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The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on the impairment method as of December 31, 2013:

	Commercial		Residential				Total
	Commercial	Real Estate	Real Estate	Consumer	Agriculture	Other	
	(in thousands)						
Allowance for loan losses:							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	\$ 290	\$ 2,345	\$ 827	\$ 9	\$ —	\$ —	\$ 3,471
Collectively evaluated for impairment	2,931	14,069	6,935	407	305	6	24,653
Total ending allowance balance	<u>\$ 3,221</u>	<u>\$ 16,414</u>	<u>\$ 7,762</u>	<u>\$ 416</u>	<u>\$ 305</u>	<u>\$ 6</u>	<u>\$ 28,124</u>
Loans:							
Loans individually evaluated for impairment	\$ 4,995	\$ 94,330	\$ 49,512	\$ 93	\$ 322	\$ 631	\$149,883
Loans collectively evaluated for impairment	47,883	252,211	225,851	14,272	18,877	349	559,443
Total ending loans balance	<u>\$ 52,878</u>	<u>\$ 346,541</u>	<u>\$ 275,363</u>	<u>\$ 14,365</u>	<u>\$ 19,199</u>	<u>\$ 980</u>	<u>\$709,326</u>

Impaired Loans

Impaired loans include restructured loans and loans on nonaccrual or classified as doubtful, whereby collection of the total amount is improbable, or loss, whereby all or a portion of the loan has been written off or a specific allowance for loss had been provided.

The following table presents information related to loans individually evaluated for impairment by class of loan as of and for the year ended December 31, 2014:

	Unpaid Principal Balance	Recorded Investment	Allowance		Interest Income Recognized	Cash Basis Income Recognized
			For Loan Losses Allocated	Average Recorded Investment		
	(in thousands)					
With No Related Allowance Recorded:						
Commercial	\$ 1,348	\$ 921	\$ —	\$ 1,114	\$ 55	\$ 55
Commercial real estate:						
Construction	106	27	—	21	—	—
Farmland	1,840	1,542	—	2,518	75	75
Other	4,785	1,476	—	1,285	128	128
Residential real estate:						
Multi-family	80	80	—	147	—	—
1-4 Family	8,332	6,319	—	8,091	226	226
Consumer	95	29	—	14	—	—
Agriculture	275	263	—	277	3	3
Other	51	51	—	54	13	13
Subtotal	<u>16,912</u>	<u>10,708</u>	<u>—</u>	<u>13,521</u>	<u>500</u>	<u>500</u>
With An Allowance Recorded:						
Commercial	1,343	1,101	33	2,103	32	—
Commercial real estate:						
Construction	4,608	4,073	—	6,013	28	—
Farmland	5,454	3,512	38	3,744	—	—
Other	49,106	37,511	453	52,500	925	—
Residential real estate:						
Multi-family	4,266	4,266	91	5,944	180	—
1-4 Family	11,955	10,719	136	16,419	528	—
Consumer	32	32	1	49	3	—
Agriculture	—	—	—	—	—	—
Other	316	71	—	201	3	—
Subtotal	<u>77,080</u>	<u>61,285</u>	<u>752</u>	<u>86,973</u>	<u>1,699</u>	<u>—</u>
Total	<u>\$ 93,992</u>	<u>\$ 71,993</u>	<u>\$ 752</u>	<u>\$ 100,494</u>	<u>\$ 2,199</u>	<u>\$ 500</u>

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The following table presents information related to loans individually evaluated for impairment by class of loan as of and for the year ended December 31, 2013:

	<u>Unpaid Principal Balance</u>	<u>Recorded Investment</u>	<u>Allowance For Loan Losses Allocated</u> (in thousands)	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	<u>Cash Basis Income Recognized</u>
With No Related Allowance Recorded:						
Commercial	\$ 2,131	\$ 1,533	\$ —	\$ 1,622	\$ 30	\$ 30
Commercial real estate:						
Construction	64	38	—	467	164	164
Farmland	4,074	3,898	—	4,259	268	268
Other	1,568	1,404	—	1,724	367	366
Residential real estate:						
Multi-family	444	392	—	541	3	3
1-4 Family	11,011	10,083	—	11,533	115	116
Consumer	9	9	—	21	—	—
Agriculture	401	322	—	213	—	—
Other	14	13	—	10	11	11
Subtotal	<u>19,716</u>	<u>17,692</u>	<u>—</u>	<u>20,390</u>	<u>958</u>	<u>958</u>
With An Allowance Recorded:						
Commercial	3,734	3,462	290	3,905	99	—
Commercial real estate:						
Construction	10,409	9,264	218	20,173	88	—
Farmland	6,117	4,238	65	5,579	37	—
Other	94,508	75,488	2,062	77,726	1,324	—
Residential real estate:						
Multi-family	13,883	12,117	393	13,121	208	—
1-4 Family	31,327	26,920	434	27,755	557	—
Consumer	84	84	9	134	3	—
Agriculture	—	—	—	2	—	—
Other	861	618	—	539	17	—
Subtotal	<u>160,923</u>	<u>132,191</u>	<u>3,471</u>	<u>148,934</u>	<u>2,333</u>	<u>—</u>
Total	<u>\$180,639</u>	<u>\$149,883</u>	<u>\$ 3,471</u>	<u>\$169,324</u>	<u>\$ 3,291</u>	<u>\$ 958</u>

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The following table presents information related to loans individually evaluated for impairment by class of loan as of and for the year ended December 31, 2012:

	<u>Unpaid Principal Balance</u>	<u>Recorded Investment</u>	<u>Allowance</u>		<u>Interest Income Recognized</u>	<u>Cash Basis Income Recognized</u>
			<u>For Loan Losses Allocated</u>	<u>Average Recorded Investment</u>		
			(in thousands)			
With No Related Allowance Recorded:						
Commercial	\$ 1,460	\$ 1,234	\$ —	\$ 1,637	\$ 5	\$ 4
Commercial real estate:						
Construction	1,155	1,109	—	1,745	2	2
Farmland	4,448	4,448	—	4,706	57	57
Other	2,134	1,892	—	3,436	3	3
Residential real estate:						
Multi-family	643	643	—	910	—	—
1-4 Family	13,539	13,158	—	11,291	56	56
Consumer	70	70	—	219	8	5
Agriculture	45	45	—	366	2	—
Other	—	—	—	—	—	—
Subtotal	<u>23,494</u>	<u>22,599</u>	<u>—</u>	<u>24,310</u>	<u>133</u>	<u>127</u>
With An Allowance Recorded:						
Commercial	4,108	4,062	263	3,964	169	27
Commercial real estate:						
Construction	26,645	25,455	1,543	19,514	348	5
Farmland	8,557	6,456	734	5,794	43	2
Other	100,289	86,562	13,769	83,087	2,011	185
Residential real estate:						
Multi-family	14,906	14,906	1,643	11,187	468	—
1-4 Family	32,835	28,092	2,998	27,404	787	9
Consumer	142	142	68	29	—	—
Agriculture	10	10	5	6	—	—
Other	524	524	11	533	17	—
Subtotal	<u>188,016</u>	<u>166,209</u>	<u>21,034</u>	<u>151,518</u>	<u>3,843</u>	<u>228</u>
Total	<u>\$211,510</u>	<u>\$188,808</u>	<u>\$ 21,034</u>	<u>\$175,828</u>	<u>\$ 3,976</u>	<u>\$ 355</u>

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Troubled Debt Restructuring

A troubled debt restructuring (TDR) is where the Company has agreed to a loan modification in the form of a concession for a borrower who is experiencing financial difficulty. The majority of the Company's TDRs involve a reduction in interest rate, a deferral of principal for a stated period of time, or an interest only period. All TDRs are considered impaired and the Company has allocated reserves for these loans to reflect the present value of the concessionary terms granted to the customer.

The following table presents the types of TDR loan modifications by portfolio segment outstanding as of December 31, 2014 and 2013:

	<u>TDRs Performing to Modified Terms</u>	<u>TDRs Not Performing to Modified Terms</u> (in thousands)	<u>Total TDRs</u>
<u>December 31, 2014</u>			
Commercial			
Rate reduction	\$ 14	\$ —	\$ 14
Principal deferral	—	869	869
Commercial Real Estate:			
Construction			
Rate reduction	268	3,379	3,647
Farmland			
Principal deferral	—	2,365	2,365
Other			
Rate reduction	8,622	13,894	22,516
Principal deferral	671	—	671
Residential Real Estate:			
Multi-family			
Rate reduction	4,266	—	4,266
1-4 Family			
Rate reduction	8,112	—	8,112
Consumer			
Rate reduction	32	—	32
Total TDRs	<u>\$ 21,985</u>	<u>\$ 20,507</u>	<u>\$42,492</u>
<u>December 31, 2013</u>			
Commercial			
Rate reduction	\$ 1,933	\$ —	\$ 1,933
Principal deferral	—	869	869
Commercial Real Estate:			
Construction			
Rate reduction	275	6,345	6,620
Principal deferral	499	—	499
Farmland			
Rate reduction	150	—	150
Principal deferral	—	2,365	2,365
Other			
Rate reduction	22,457	21,235	43,692
Principal deferral	691	—	691
Interest only payments	2,439	1,489	3,928
Residential Real Estate:			
Multi-family			
Rate reduction	4,354	6,655	11,009
Interest only payments	641	—	641
1-4 Family			
Rate reduction	10,312	7,958	18,270
Consumer			
Rate reduction	84	—	84
Other			
Rate reduction	511	—	511
Total TDRs	<u>\$ 44,346</u>	<u>\$ 46,916</u>	<u>\$91,262</u>

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At December 31, 2014 and 2013, 52% and 49%, respectively, of the Company's TDRs were performing according to their modified terms. The Company allocated \$579,000 and \$2.9 million as of December 31, 2014 and 2013, respectively, in reserves to customers whose loan terms have been modified in TDRs. The Company has committed to lend no additional amounts to customers as of December 31, 2014, and additional amounts totaling \$261,000 as of December 31, 2013 to customers with outstanding loans that are classified as TDRs.

Management periodically reviews renewals/modifications of previously identified TDRs, for which there was no principal forgiveness, to consider if it is appropriate to remove the TDR classification. If the borrower is no longer experiencing financial difficulty and the renewal/modification did not contain a concessionary interest rate or other concessionary terms, management considers the potential removal of the TDR classification. If deemed appropriate, the TDR classification is removed as the borrower has complied with the terms of the loan at the date of renewal/modification and there was a reasonable expectation that the borrower would continue to comply with the terms of the loan subsequent to the date of the renewal/modification. In this instance, the TDR was originally considered a restructuring in a prior year as a result of a modification with an interest rate that was not commensurate with the risk of the underlying loan. Additionally, TDR classification can be removed in circumstances in which the Company performs a non-concessionary re-modification of the loan at terms that were considered to be at market for loans with comparable risk. Management expects the borrower will continue to perform under the re-modified terms based on the borrower's past history of performance.

No TDR loan modifications occurred during the twelve months ended December 31, 2014. The following table presents a summary of the types of TDR loan modifications by portfolio type that occurred during the twelve months ended December 31, 2013:

	<u>TDRs Performing to Modified Terms</u>	<u>TDRs Not Performing to Modified Terms</u> (in thousands)	<u>Total TDRs</u>
December 31, 2013			
Commercial			
Rate reduction	\$ 34	\$ —	\$ 34
Commercial Real Estate:			
Construction			
Rate reduction	—	1,291	1,291
Principal deferral	499	—	499
Other			
Rate reduction	385	—	385
Residential Real Estate:			
1-4 Family			
Rate reduction	2,145	—	2,145
Consumer			
Rate reduction	84	—	84
Total TDRs	\$ 3,147	\$ 1,291	\$4,438

As of December 31, 2013, 71% of the Company's TDRs that occurred during 2013 were performing in accordance with their modified terms. The Company has allocated \$345,000 in reserves to customers whose loan terms have been modified during 2013. For modifications occurring during the twelve months ended December 31, 2013, the post-modification balances approximate the pre-modification balances.

During 2013, approximately \$1.3 million of TDRs defaulted on their restructured loan and the default occurred within the 12 month period following the loan modification. The defaults in 2013 were all construction loans. A default is considered to have occurred once the TDR is past due 90 days or more or it has been placed on nonaccrual.

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Non-performing Loans

Non-performing loans include impaired loans and smaller balance homogeneous loans, such as residential mortgage and consumer loans, that are collectively evaluated for impairment.

The following table presents the recorded investment in nonaccrual and loans past due 90 days and still on accrual by class of loan as of December 31, 2014 and 2013:

	<u>Nonaccrual</u>		<u>Loans Past Due 90 Days And Over Still Accruing</u>	
	<u>2014</u>	<u>2013</u>	<u>2014</u>	<u>2013</u>
	(in thousands)			
Commercial	\$ 1,978	\$ 2,886	\$—	\$—
Commercial Real Estate:				
Construction	3,831	8,528	—	—
Farmland	5,054	7,844	—	—
Other	26,892	48,447	—	—
Residential Real Estate:				
Multi-family	80	7,513	—	—
1-4 Family	8,925	26,098	151	230
Consumer	30	9	—	2
Agriculture	263	322	—	—
Other	122	120	—	—
Total	<u>\$47,175</u>	<u>\$101,767</u>	<u>\$151</u>	<u>\$232</u>

The following table presents the aging of the recorded investment in past due loans by class as of December 31, 2014 and 2013:

	<u>30 – 59 Days Past Due</u>	<u>60 – 89 Days Past Due</u>	<u>90 Days And Over Past Due</u>	<u>Nonaccrual</u>	<u>Total Past Due And Nonaccrual</u>
	(in thousands)				
<u>December 31, 2014</u>					
Commercial	\$ 86	\$ —	\$ —	\$ 1,978	\$ 2,064
Commercial Real Estate:					
Construction	—	—	—	3,831	3,831
Farmland	400	14	—	5,054	5,468
Other	241	318	—	26,892	27,451
Residential Real Estate:					
Multi-family	—	—	—	80	80
1-4 Family	3,124	601	151	8,925	12,801
Consumer	109	47	—	30	186
Agriculture	—	—	—	263	263
Other	—	—	—	122	122
Total	<u>\$ 3,960</u>	<u>\$ 980</u>	<u>\$ 151</u>	<u>\$ 47,175</u>	<u>\$ 52,266</u>

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	<u>30 – 59 Days Past Due</u>	<u>60 – 89 Days Past Due</u>	<u>90 Days And Over Past Due (in thousands)</u>	<u>Nonaccrual</u>	<u>Total Past Due And Nonaccrual</u>
<u>December 31, 2013</u>					
Commercial	\$ 156	\$ 123	\$ —	\$ 2,886	\$ 3,165
Commercial Real Estate:					
Construction	261	—	—	8,528	8,789
Farmland	484	41	—	7,844	8,369
Other	4,375	—	—	48,447	52,822
Residential Real Estate:					
Multi-family	1,181	—	—	7,513	8,694
1-4 Family	4,059	577	230	26,098	30,964
Consumer	145	34	2	9	190
Agriculture	35	—	—	322	357
Other	—	—	—	120	120
Total	<u>\$10,696</u>	<u>\$ 775</u>	<u>\$ 232</u>	<u>\$ 101,767</u>	<u>\$ 113,470</u>

Credit Quality Indicators

We categorize all loans into risk categories at origination based upon original underwriting. Thereafter, we categorize loans into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, credit documentation, public information, and current economic trends. Additionally, loans are analyzed continuously through our internal and external loan review processes. Borrower relationships in excess of \$500,000 are routinely analyzed through our credit administration processes which classify the loans as to credit risk. The following definitions are used for risk ratings:

Watch – Loans classified as watch are those loans which have experienced a potentially adverse development which necessitates increased monitoring.

Special Mention – Loans classified as special mention do not have all of the characteristics of substandard or doubtful loans. They have one or more deficiencies which warrant special attention and which corrective action, such as accelerated collection practices, may remedy.

Substandard – Loans classified as substandard are those loans with clear and defined weaknesses such as a highly leveraged position, unfavorable financial ratios, uncertain repayment sources or poor financial condition which may jeopardize the repayment of the debt as contractually agreed. They are characterized by the distinct possibility that we will sustain some losses if the deficiencies are not corrected.

Doubtful – Loans classified as doubtful are those loans which have characteristics similar to substandard loans but with an increased risk that collection or liquidation in full is highly questionable and improbable.

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Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be “Pass” rated loans. As of December 31, 2014 and 2013, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

	<u>Pass</u>	<u>Watch</u>	<u>Special Mention</u> (in thousands)	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
December 31, 2014						
Commercial	\$ 49,440	\$ 5,063	\$ —	\$ 6,433	\$ —	\$ 60,936
Commercial Real Estate:						
Construction	25,266	2,990	—	4,917	—	33,173
Farmland	61,672	7,922	—	7,825	—	77,419
Other	111,426	21,017	3,747	39,262	—	175,452
Residential Real Estate:						
Multi-family	31,526	6,039	—	4,326	—	41,891
1-4 Family	145,450	23,928	131	27,769	—	197,278
Consumer	10,115	537	311	384	—	11,347
Agriculture	25,816	704	—	446	—	26,966
Other	415	—	—	122	—	537
Total	\$461,126	\$68,200	\$4,189	\$ 91,484	\$ —	\$624,999

	<u>Pass</u>	<u>Watch</u>	<u>Special Mention</u> (in thousands)	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
December 31, 2013						
Commercial	\$ 35,438	\$ 8,517	\$ 329	\$ 8,594	\$ —	\$ 52,878
Commercial Real Estate:						
Construction	16,706	10,771	2,277	13,572	—	43,326
Farmland	46,909	9,121	1,735	13,424	—	71,189
Other	93,327	51,522	734	86,443	—	232,026
Residential Real Estate:						
Multi-family	16,506	17,320	—	13,032	—	46,858
1-4 Family	130,833	43,785	784	53,103	—	228,505
Consumer	12,718	968	6	673	—	14,365
Agriculture	16,742	1,802	—	655	—	19,199
Other	350	510	—	120	—	980
Total	\$369,529	\$144,316	\$5,865	\$ 189,616	\$ —	\$709,326

In December 2014, the Company identified and transferred certain substandard accruing loans to loans held for sale. The loans were transferred to held for sale at the lower of cost or fair value. The Company identified \$10.7 million of loans to sell and recorded a \$1.8 million charge to the allowance for loan losses to reduce the loan balances to the estimated fair value. Loans held for sale total \$8.9 million at December 31, 2014, comprised of \$6.0 million in commercial real estate, \$1.9 million in 1-4 family residential real estate, and \$1.0 million in multi-family real estate. Approximately \$4.5 million of these loans were classified as TDRs prior to transfer to loans held for sale. These loans were not past due at December 31, 2014.

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NOTE 5 – PREMISES AND EQUIPMENT

Year-end premises and equipment were as follows:

	<u>2014</u>	<u>2013</u>
	(in thousands)	
Land and buildings	\$ 24,711	\$ 24,673
Furniture and equipment	17,641	17,211
	42,352	41,884
Accumulated depreciation	(22,845)	(21,901)
	<u>\$ 19,507</u>	<u>\$ 19,983</u>

Depreciation expense was \$940,000, \$1,043,000 and \$1,165,000 for 2014, 2013 and 2012, respectively.

NOTE 6 – OTHER REAL ESTATE OWNED

Other real estate owned (OREO) is real estate acquired as a result of foreclosure or by deed in lieu of foreclosure. It is classified as real estate owned until such time as it is sold. When property is acquired as a result of foreclosure or by deed in lieu of foreclosure, it is recorded at its fair market value less cost to sell. Any write-down of the property at the time of acquisition is charged to the allowance for loan losses. Costs incurred in order to perfect the lien prior to foreclosure may be capitalized if the fair value less the cost to sell exceeds the balance of the loan at the time of transfer to OREO. Examples of eligible costs to be capitalized are payments of delinquent property taxes to clear tax liens or payments to contractors and subcontractors to clear mechanics' liens. Subsequent reductions in fair value are recorded as non-interest expense.

To determine the fair value of OREO for smaller dollar single family homes, we consult with internal real estate sales staff and external realtors, investors, and appraisers. If the internally evaluated market price is below our underlying investment in the property, appropriate write-downs are taken. For larger dollar residential and commercial real estate properties, we obtain a new appraisal of the subject property or have staff from our special assets group or in our centralized appraisal department evaluate the latest in-file appraisal in connection with the transfer to other real estate owned. We typically obtain updated appraisals within five quarters of the anniversary date of ownership unless a sale is imminent.

The following table presents the major categories of OREO at the period-ends indicated:

	<u>2014</u>	<u>2013</u>
	(in thousands)	
Commercial Real Estate:		
Construction, land development, and other land	\$18,748	\$19,199
Farmland	669	695
Other	14,860	6,064
Residential Real Estate:		
Multi-family	4,988	248
1-4 Family	7,998	4,916
	47,263	31,122
Valuation allowance	(1,066)	(230)
	<u>\$46,197</u>	<u>\$30,892</u>

Activity relating to the other real estate owned valuation allowance during the years indicated is as follows:

	<u>2014</u>	<u>2013</u>	<u>2012</u>
	(in thousands)		
Beginning balance	\$ 230	\$ 1,154	\$ 1,667
Provision to allowance	4,255	2,466	7,154
Write-downs	(3,419)	(3,390)	(7,667)
Ending balance	<u>\$ 1,066</u>	<u>\$ 230</u>	<u>\$ 1,154</u>

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Activity relating to other real estate owned during the years indicated is as follows:

	<u>2014</u>	<u>2013</u> (in thousands)	<u>2012</u>
OREO Activity			
OREO as of January 1	\$ 30,892	\$ 43,671	\$ 41,449
Real estate acquired	32,338	20,606	33,528
Valuation adjustments for declining market values	(4,255)	(2,466)	(7,154)
Improvements	—	—	1
Net gain (loss) on sale	306	(132)	(1,672)
Proceeds from sale of properties	(13,084)	(30,787)	(22,481)
OREO as of December 31	<u>\$ 46,197</u>	<u>\$ 30,892</u>	<u>\$ 43,671</u>

Expenses related to other real estate owned include:

	<u>2014</u>	<u>2013</u> (in thousands)	<u>2012</u>
Net (gain) loss on sales	\$ (306)	\$ 132	\$ 1,672
Provision to allowance	4,255	2,466	7,154
Operating expense	<u>1,890</u>	<u>1,918</u>	<u>1,723</u>
Total	<u>\$5,839</u>	<u>\$4,516</u>	<u>\$10,549</u>

NOTE 7 – INTANGIBLE ASSETS

Acquired intangible assets were as follows as of year-end:

	<u>2014</u>		<u>2013</u>	
	<u>Gross</u>	<u>Accumulated</u>	<u>Gross</u>	<u>Accumulated</u>
	<u>Amount</u>	<u>Amortization</u>	<u>Amount</u>	<u>Amortization</u>
	(in thousands)			
Amortized intangible assets:				
Core deposit intangibles	\$ 4,183	\$ 3,405	\$ 4,183	\$ 3,008

Aggregate amortization expense was \$397,000, \$428,000 and \$467,000 for 2014, 2013 and 2012, respectively.

Estimated aggregate amortization expense for intangible assets for each of the next five years is as follows (in thousands):

2015	\$335
2016	334
2017	109
2018	—
2019	—

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NOTE 8 – DEPOSITS

The following table shows deposits by category:

	December 31, <u>2014</u>	December 31, <u>2013</u>
	(in thousands)	
Non-interest bearing	\$ 114,910	\$ 107,486
Interest checking	91,086	84,626
Money market	109,734	79,349
Savings	36,430	36,292
Certificates of deposit	574,681	679,952
Total	<u>\$ 926,841</u>	<u>\$ 987,705</u>

Time deposits of \$250,000 or more were approximately \$34,399,000 and \$39,763,000 at year-end 2014 and 2013, respectively.

Scheduled maturities of total time deposits for each of the next five years are as follows (in thousands):

	Total
2015	\$416,486
2016	95,506
2017	12,178
2018	10,223
2019	40,286
Thereafter	2
	<u>\$574,681</u>

NOTE 9 – SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Securities sold under agreements to repurchase are financing arrangements that mature within two years. At maturity, the securities underlying the agreements are returned to the Company. Securities sold under agreements to repurchase are secured by agency, mortgage-backed, and municipal securities. Information concerning securities sold under agreements to repurchase is summarized as follows:

	<u>2014</u>	<u>2013</u> (in thousands)	<u>2012</u>
Balance at year-end	\$1,341	\$2,470	\$2,634
Average daily balance during the year	\$2,255	\$3,113	\$2,088
Average interest rate during the year	0.15%	0.20%	0.35%
Maximum month-end balance during the year	\$3,473	\$4,747	\$2,634
Weighted average interest rate at year-end	0.14%	0.17%	0.23%
Fair value of securities sold under agreements to repurchase at year-end	\$1,341	\$2,470	\$2,634

NOTE 10 – ADVANCES FROM FEDERAL HOME LOAN BANK

At year-end, advances from the Federal Home Loan Bank were as follows:

	<u>2014</u>	<u>2013</u>
	(in thousands)	
Monthly amortizing advances with fixed rates from 0.00% to 5.25% and maturities ranging from 2015 through 2033, averaging 1.02% for 2014 and 3.07% for 2013	<u>\$15,752</u>	<u>\$4,492</u>

Each advance is payable per terms on agreement, with a prepayment penalty. No prepayment penalties were incurred during 2013 or 2014. The advances were collateralized by approximately \$131.5 million and \$138.4 million of first mortgage loans, under a blanket lien arrangement at year-end 2014 and 2013, respectively. Our borrowing capacity is based on the market value of the underlying pledged loans rather than the unpaid principal balance of the pledged loans. The availability of our borrowing capacity could be affected by our financial position and the FHLB could require additional collateral or, among other things, exercise its rights to deny a funding request, at its discretion. Additionally, any new advances are limited to a one year maturity or less. At December 31, 2014, our additional borrowing capacity with the FHLB was \$13.0 million.

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Scheduled principal payments on the above during the next five years and thereafter (in thousands):

	<u>Advances</u>
2015	\$12,709
2016	625
2017	541
2018	266
2019	185
Thereafter	1,426
	<u>\$15,752</u>

At year-end 2014, the Company had a \$5.0 million federal funds line of credit available on a secured basis from a correspondent institution; however, the availability of this line could be affected by our financial position.

NOTE 11 – SUBORDINATED CAPITAL NOTE

The subordinated capital note issued by the Bank totaled \$5.0 million at December 31, 2014. The note is unsecured, bears interest at the BBA three-month LIBOR floating rate plus 300 basis points, and qualifies as Tier 2 capital. Principal payments of \$225,000 plus interest are due quarterly. Scheduled principal payments of \$900,000 per year are due each of the next five years with \$450,000 due thereafter. The note matures July 1, 2020. The interest rate on this note was 3.24% and 3.25% at December 31, 2014 and 2013, respectively.

NOTE 12 – JUNIOR SUBORDINATED DEBENTURES

The junior subordinated debentures are redeemable at par prior to the maturity dates of February 13, 2034, April 15, 2034, and March 1, 2037, at the option of the Company as defined within the trust indenture. The Company has the option to defer interest payments on the junior subordinated debentures from time to time for a period not to exceed twenty (20) consecutive quarters. If payments are deferred, the Company is prohibited from paying dividends on its preferred and common shares. Effective with the fourth quarter of 2011, we began deferring interest payments on the junior subordinated notes which resulted in a deferral of distributions on our trust preferred securities. Therefore, future cash dividends on our common stock are subject to the prior payment of all deferred distributions on our trust preferred securities. Dividends accrued and unpaid on our junior subordinated debentures totaled \$2.2 million at December 31, 2014. A summary of the junior subordinated debentures is as follows:

<u>Description</u>	<u>Issuance Date</u>	<u>Interest Rate (1)</u>	<u>Junior Subordinated Debt Owed To Trust</u>	<u>End of 20 Quarter Deferral Period</u>	<u>Maturity Date (2)</u>
Porter Statutory Trust II	02-13-2004	3-month LIBOR + 2.85%	\$ 5,000,000	09-19-2016	02-13-2034
Porter Statutory Trust III	04-15-2004	3-month LIBOR + 2.79%	3,000,000	09-18-2016	04-15-2034
Porter Statutory Trust IV	12-14-2006	3-month LIBOR + 1.67%	14,000,000	09-01-2016	03-01-2037
Ascencia Statutory Trust I	02-13-2004	3-month LIBOR + 2.85%	3,000,000	09-19-2016	02-13-2034
			<u>\$25,000,000</u>		

(1) As of December 31, 2014, the 3-month LIBOR was 0.26%.

(2) The debentures are callable at our option at their principal amount plus accrued interest.

NOTE 13 – OTHER BENEFIT PLANS

401(K) Plan – The Company 401(k) Savings Plan allows employees to contribute up to the annual limits as determined by the Internal Revenue Service, which is matched equal to 50% of the first 4% of compensation contributed. The Company, at its discretion, may make an additional contribution. Total contributions made by the Company to the plan totaled approximately \$187,000, \$195,000 and \$148,000 in 2014, 2013 and 2012, respectively.

Supplemental Executive Retirement Plan – The Company has created a supplemental executive retirement plan covering certain executive officers. Under the plan, the Company pays each participant, or their beneficiary, a specific defined benefit amount over 10 years, beginning with the individual's retirement or early termination of service for reasons other than cause. A liability is accrued for the obligation under these plans. The expense incurred for the plan was \$122,000, \$87,000 and \$151,000 for the years ended December 31, 2014, 2013 and 2012, respectively. The related liability was \$1,341,000, \$1,348,000 and \$1,338,000 at December 31, 2014, 2013 and 2012, respectively, and is included in other liabilities on the balance sheets.

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The Company purchased life insurance on the participants of the plan. The cash surrender value of all insurance policies was \$9,167,000 and \$8,911,000 at December 31, 2014 and 2013, respectively. Income earned from the cash surrender value of life insurance totaled \$276,000, \$534,000, and \$312,000 for the years ended December 31, 2014, 2013 and 2012, respectively. The income is recorded as other non-interest income.

NOTE 14 – INCOME TAXES

Income tax expense (benefit) was as follows:

	<u>2014</u>	<u>2013</u> (in thousands)	<u>2012</u>
Current	\$ —	\$ —	\$ (65)
Deferred	2,151	9,489	754
Net operating loss	(6,651)	(10,430)	(12,581)
Change in valuation allowance	2,917	941	11,827
	<u>\$ (1,583)</u>	<u>\$ —</u>	<u>\$ (65)</u>

Effective tax rates differ from federal statutory rate of 35% applied to income (loss) before income taxes due to the following.

	<u>2014</u>	<u>2013</u> (in thousands)	<u>2012</u>
Federal statutory rate times financial statement income (loss)	\$(4,458)	\$(555)	\$(11,549)
Effect of:			
Valuation allowance	2,917	941	11,827
Tax-exempt income	(319)	(324)	(314)
Nontaxable life insurance income	(97)	(180)	(102)
Other, net	374	118	73
Total	<u>\$ (1,583)</u>	<u>\$ —</u>	<u>\$ (65)</u>

Year-end deferred tax assets and liabilities were due to the following.

	<u>December 31,</u> <u>2014</u>	<u>December 31,</u> <u>2013</u>
	(in thousands)	
Deferred tax assets:		
Net operating loss carry-forward	\$ 32,111	\$ 25,460
Allowance for loan losses	6,777	9,843
Other real estate owned write-down	10,000	9,478
Alternative minimum tax credit carry-forward	692	692
Net assets from acquisitions	668	644
Other than temporary impairment on securities	46	89
Net unrealized loss on securities	—	1,067
New market tax credit carry-forward	208	208
Nonaccrual loan interest	958	911
Amortization of non-compete agreements	14	16
Other	1,371	1,640
	<u>52,845</u>	<u>50,048</u>
Deferred tax liabilities:		
FHLB stock dividends	928	1,276
Fixed assets	264	333
Originated mortgage servicing rights	53	75
Net unrealized gain on securities	579	—
Other	373	570
	<u>2,197</u>	<u>2,254</u>
Net deferred tax assets before valuation allowance	<u>50,648</u>	<u>47,794</u>
Valuation allowance	(50,648)	(47,794)
Net deferred tax asset	<u>\$ —</u>	<u>\$ —</u>

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Our estimate of the realizability of the deferred tax asset is dependent on our estimate of projected future levels of taxable income. In analyzing future taxable income levels, we considered all evidence currently available, both positive and negative. Based on our analysis, we established a valuation allowance for all deferred tax assets as of December 31, 2011. The valuation allowance remains in effect as of December 31, 2014.

The calculation for the income tax provision or benefit generally does not consider the tax effects of changes in other comprehensive income, or OCI, which is a component of stockholders' equity on the balance sheet. However, an exception is provided in certain circumstances, such as when there is a full valuation allowance against net deferred tax assets, there is a loss from continuing operations and there is income in other components of the financial statements. In such a case, pre-tax income from other categories, such as changes in OCI, must be considered in determining a tax benefit to be allocated to the loss from continuing operations. For the year ended December 31, 2014, this resulted in \$1.6 million of income tax benefit allocated to continuing operations. The December 31, 2014 tax benefit is entirely due to gains in other comprehensive income that are presented in current operations in accordance with applicable accounting standards.

The Company does not have any beginning and ending unrecognized tax benefits. The Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months. There were no interest and penalties recorded in the income statement or accrued for the year ended December 31, 2014 related to unrecognized tax benefits.

The Company and its subsidiaries are subject to U.S. federal income tax and the Company is subject to income tax in the state of Kentucky. The Company is no longer subject to examination by taxing authorities for years before 2011.

NOTE 15 – RELATED PARTY TRANSACTIONS

Loans to principal officers, directors, significant shareholders, and their affiliates in 2014 were as follows (in thousands):

Beginning balance	\$1,093
New loans	11
Loans to directors who did not stand for re-election	(196)
Repayments	(908)
Ending balance	<u>\$ —</u>

Deposits from principal officers, directors, significant shareholders, and their affiliates at year-end 2014 and 2013 were \$307,000 and \$1.4 million, respectively.

Our loan participation totals include participation loans sold to The Peoples Bank, Mt. Washington and The Peoples Bank, Taylorsville. The Estate of J. Chester Porter, one of our significant shareholders, and Mr. Porter's brother and former director, William G. Porter, each own a 50% interest in Lake Valley Bancorp, Inc., the parent holding company of The Peoples Bank, Taylorsville, Kentucky. The Estate of J. Chester Porter owns an interest of approximately 37.0% and Mr. Porter's brother, William G. Porter, owns an interest of approximately 3.0% in Crossroads Bancorp, Inc., the parent holding company of The Peoples Bank, Mount Washington, Kentucky.

As of December 31, 2014, we had \$3.2 million of participation loans sold to these banks. As of December 31, 2013, we had \$4.9 million of participation loans sold to these banks. At December 31, 2014, \$527,000 of loan participations sold to Peoples Bank, Taylorsville, and \$527,000 sold to Peoples Bank, Mt. Washington were on nonaccrual. There were no participation loans purchased from these banks at December 31, 2014 or 2013.

The Bank entered into a Real Estate Listing and Property Management Agreement with Hogan Development Company, an entity in which our director, W. Glenn Hogan, has an ownership interest. Under this agreement, Hogan Development Company assists the Bank in onboarding, managing, and selling the Bank's OREO. The agreement is periodically reviewed and evaluated by the independent members of our Audit Committee. The Bank paid real estate management fees of \$221,000 and \$207,000 and real estate sales commissions of \$64,000 and \$773,000 to Hogan Development Company in 2014 and 2013, respectively.

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In December 2014, we completed a non-cash equity exchange transaction with the accredited investors who acquired all of our issued and outstanding Series A Preferred Shares from UST in a public auction. The investors included W. Glenn Hogan and Michael T. Levy, both directors of the Company, as well as Patriot Financial Partners L.P. and Patriot Financial Partners Parallel L.P. (the “Patriot Funds”), funds for whom a director of the Company, W. Kirk Wycoff, serves as general partner. Mr. Hogan exchanged 5,000 shares of Series A Preferred Stock, and was issued 17,143 shares of mandatorily convertible Series B Preferred Stock, 885 shares of Series E Preferred Stock, and 1,405 shares of Series F Preferred Stock. Mr. Levy exchanged 750 shares of Series A Preferred Stock, and was issued 257,143 common shares, 133 shares of Series E Preferred Stock, and 211 shares of Series F Preferred Stock. The Patriot Funds exchanged 19,688 shares of Series A Preferred Stock, 317,042 shares of Series C Preferred Stock, and 753,263 warrants to purchase non-voting common shares, and was issued 6,250 shares of mandatorily convertible Series B Preferred Stock, 64,580 shares of mandatorily convertible Series D Preferred Stock, and 3,486 shares of Series E Preferred Stock. After shareholder approval on February 25, 2015, Mr. Hogan’s 17,143 shares of Series B Preferred Stock converted into 1,714,300 common shares and the Patriot Funds’ Series B Preferred Stock converted into 625,000 common shares. The Patriot Funds’ Series D Preferred Stock converted into 6,458,000 non-voting common shares.

NOTE 16 – PREFERRED STOCK AND STOCK PURCHASE WARRANTS

On November 21, 2008, we issued to the U.S. Treasury 35,000 shares of our Series A Preferred Stock and a warrant to purchase up to 330,561 of our common shares for \$15.88 per share in exchange for aggregate consideration of \$35.0 million. The warrant is exercisable and has a 10-year term. The Series A Preferred Stock qualified as Tier 1 capital and was entitled to receive cumulative cash dividends quarterly at an annual rate of 5% for the first five years, and 9% beginning in November 2013. The Series A Preferred Stock was non-voting (except when required by law) and redeemable at \$1,000 per share plus accrued unpaid dividends.

In 2010, we completed a \$32.0 million private placement to accredited investors. In the transactions involved, the Company issued (i) 2,465,569 common shares, (ii) 317,042 Series C Preferred Shares and (iii) warrants to purchase 1,163,045 non-voting common shares at a price of \$11.50 per share.

The Series C Preferred Shares had no voting rights (except when required by law), had a liquidation preference over our common shares, and dividend rights equivalent to our common shares. Each Series C Preferred Share would have automatically converted into 1.05 common shares if transferred by the holder in certain transactions in accordance with the policy of the Federal Reserve.

In December 2014, we completed a non-cash equity exchange transaction with the accredited investors who acquired all of our issued and outstanding Series A Preferred Shares from UST in a public auction. We acquired and cancelled all of the issued and outstanding Series A Preferred Shares, the accrued dividends thereon, all of the issued and outstanding Series C Preferred Shares, and warrants to purchase 798,915 shares of common stock together having an aggregate book value of approximately \$45.7 million. In exchange, we issued common and preferred shares having a fair value of approximately \$9.6 million. The effect of this exchange transaction was to increase common stockholders’ equity by approximately \$36.1 million, and total stockholders’ equity by \$7.4 million.

In the exchange transaction, we issued 1,821,428 common shares, 40,536 mandatorily convertible Series B Preferred Shares and 64,580 mandatorily convertible Series D Preferred Shares, which automatically converted into 4,053,600 common shares and 6,458,000 non-voting common shares after shareholder approval on February 25, 2015. We also issued 6,198 Series E Preferred Shares and 4,304 Series F Preferred Shares, both of which series are not convertible into common shares, have a liquidation preference of \$1,000 per share, and are entitled to a 2% noncumulative annual dividend if and when declared. Series E and Series F Preferred Shares rank senior to, and have liquidation and dividend preferences over, our common shares and non-voting common shares.

NOTE 17 – CAPITAL REQUIREMENTS AND RESTRICTIONS ON RETAINED EARNINGS

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action.

On June 24, 2011, the Bank entered into a Consent Order with the FDIC and the Kentucky Department of Financial Institutions. The consent order requires the Bank to complete a management study, to maintain Tier 1 capital as a percentage of total assets of at least 9% and a total risk based capital ratio of at least 12%, to develop a plan to reduce our risk position in each substandard asset in excess of \$1 million, to complete board review of the adequacy of the allowance for loan losses prior to quarterly Call Report submissions, to adopt procedures which strengthen the loan review function and ensure timely and accurate grading of credit relationships, to charge-off all assets classified as loss, to develop a plan to reduce concentrations of construction and development loans to not more than 75% of total risk based capital and non-owner occupied commercial real estate loans to not more than 250% of total risk based capital, to limit asset growth to no more than 5% in any quarter or 10% annually, to not extend additional credit to any borrower classified substandard unless the board of directors adopts prior to the extension a detailed statement giving reasons why the extension is in the best interest of the bank, and to not declare or pay any dividend without the prior consent of our regulators. We are also restricted from accepting, renewing, or rolling-over brokered deposits without the prior receipt of a waiver on a case-by-case basis from our regulators.

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On September 21, 2011, we entered into a Written Agreement with the Federal Reserve Bank of St. Louis. Pursuant to the Agreement, we made formal commitments to use our financial and management resources to serve as a source of strength for the Bank and to assist the Bank in addressing weaknesses identified by the FDIC and the KDFI, to pay no dividends without prior written approval, to pay no interest or principal on subordinated debentures or trust preferred securities without prior written approval, and to submit an acceptable plan to maintain sufficient capital.

In October 2012, the Bank entered into a revised Consent Order with the FDIC and KDFI again agreeing to maintain a minimum Tier 1 leverage ratio of 9% and a minimum total risk based capital ratio of 12%. The Bank cannot be considered well-capitalized while under the Consent Order. The Bank also agreed that if it should be unable to reach the required capital levels, and if directed in writing by the FDIC, then the Bank would within 30 days develop, adopt and implement a written plan to sell or merge itself into another federally insured financial institution or otherwise immediately obtain a capital investment into the Bank sufficient to fully meet the capital requirements. We have not been directed by the FDIC to implement such a plan.

The revised Consent Order also requires the Bank to continue to adhere to the plans implemented in response to the June 2011 Consent Order, and includes the substantive provisions of the June 2011 Consent Order. As of December 31, 2014, the capital ratios required by the Consent Order were not met.

The following table shows the ratios and amounts of Tier 1 capital and total capital to risk-adjusted assets and the leverage ratios for Porter Bancorp, Inc. and the Bank at the dates indicated (dollars in thousands):

	Actual		For Capital Adequacy Purposes	
	Amount	Ratio	Amount	Ratio
As of December 31, 2014:				
Total risk-based capital (to risk-weighted assets)				
Consolidated	\$73,595	10.61%	\$55,483	8.00%
Bank	73,174	10.57	55,383	8.00
Tier I capital (to risk-weighted assets)				
Consolidated	46,459	6.70	27,741	4.00
Bank	59,438	8.59	27,691	4.00
Tier I capital (to average assets)				
Consolidated	46,459	4.51	41,193	4.00
Bank	59,438	5.78	41,143	4.00
	Actual		For Capital Adequacy Purposes	
	Amount	Ratio	Amount	Ratio
As of December 31, 2013:				
Total risk-based capital (to risk-weighted assets)				
Consolidated	\$80,203	11.03%	\$58,178	8.00%
Bank	83,055	11.44	58,064	8.00
Tier I capital (to risk-weighted assets)				
Consolidated	53,371	7.34	29,089	4.00
Bank	67,897	9.35	29,032	4.00
Tier I capital (to average assets)				
Consolidated	53,371	4.95	43,156	4.00
Bank	67,897	6.28	43,221	4.00

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The Consent Order requires the Bank to achieve the minimum capital ratios presented below:

	Actual as of December 31, 2014		Ratio Required by Consent Order	
	Amount	Ratio	Amount	Ratio
Total capital to risk-weighted assets	\$73,174	10.57%	\$83,074	12.00%
Tier I capital to average assets	59,438	5.78	92,572	9.00

At December 31, 2014, the Bank's Tier 1 leverage ratio was 5.78% and its total risk-based capital ratio was 10.57%, which are below the 9% minimum capital ratio and the 12% minimum capital ratio required by the Consent Order. Bank regulatory agencies can exercise discretion when an institution does not meet the terms of a Consent Order. Based on individual circumstances, the agencies may issue mandatory directives, impose monetary penalties, initiate changes in management, or take more serious adverse actions.

Kentucky banking laws limit the amount of dividends that may be paid to a holding company by its subsidiary banks without prior approval. These laws limit the amount of dividends that may be paid in any calendar year to current year's net income, as defined in the laws, combined with the retained net income of the preceding two years, less any dividends declared during those periods. The Bank has agreed with its primary regulators to obtain their written consent prior to declaring or paying any future dividends. As a practical matter, the Bank cannot pay dividends for the foreseeable future.

NOTE 18 – LOAN COMMITMENTS AND OTHER RELATED ACTIVITIES

Some financial instruments, such as loan commitments, lines of credit and letters of credit are issued to meet customer-financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance-sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

The Company holds instruments, in the normal course of business, with clients that are considered financial guarantees. Standby letters of credit guarantees are issued in connection with agreements made by clients to counterparties. Standby letters of credit are contingent upon failure of the client to perform the terms of the underlying contract. The Company evaluates each credit request of its customers in accordance with established lending policies. Based on these evaluations and the underlying policies, the amount of required collateral (if any) is established. Collateral held varies but may include negotiable instruments, accounts receivable, inventory, property, plant and equipment, income producing properties, residential real estate, and vehicles. The Company's access to these collateral items is generally established through the maintenance of recorded liens or, in the case of negotiable instruments, possession. No liability is currently established for the standby letters of credit.

The contractual amounts of financial instruments with off-balance-sheet risk at year end were as follows:

	2014		2013	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
	(in thousands)			
Commitments to make loans	\$11,790	\$ 7,843	\$ 3,125	\$ 5,751
Unused lines of credit	13,075	35,562	11,814	40,721
Standby letters of credit	966	1,354	995	1,504

Commitments to make loans are generally made for periods of one year or less.

NOTE 19 – FAIR VALUES

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. We use various valuation techniques to determine fair value, including market, income and cost approaches. There are three levels of inputs that may be used to measure fair values:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that an entity has the ability to access as of the measurement date, or observable inputs.

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Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect an entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. When that occurs, we classify the fair value hierarchy on the lowest level of input that is significant to the fair value measurement. We used the following methods and significant assumptions to estimate fair value.

Securities: The fair values of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges, if available. This valuation method is classified as Level 1 in the fair value hierarchy. For securities where quoted prices are not available, fair values are calculated on market prices of similar securities, or matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities. Matrix pricing relies on the securities' relationship to similarly traded securities, benchmark curves, and the benchmarking of like securities. Matrix pricing utilizes observable market inputs such as benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, and industry and economic events. In instances where broker quotes are used, these quotes are obtained from market makers or broker-dealers recognized to be market participants. This valuation method is classified as Level 2 in the fair value hierarchy. For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators. This valuation method is classified as Level 3 in the fair value hierarchy. Discounted cash flows are calculated using spread to swap and LIBOR curves that are updated to incorporate loss severities, volatility, credit spread and optionality. During times when trading is more liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations.

Impaired Loans: An impaired loan is evaluated at the time the loan is identified as impaired and is recorded at fair value less costs to sell. Fair value is measured based on the value of the collateral securing the loan and is classified as Level 3 in the fair value hierarchy. Fair value is determined using several methods. Generally, the fair value of real estate is determined based on appraisals by qualified licensed appraisers. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach.

Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. These routine adjustments are made to adjust the value of a specific property relative to comparable properties for variations in qualities such as location, size, and income production capacity relative to the subject property of the appraisal. Such adjustments are typically significant and result in a Level 3 classification of the inputs for determining fair value.

We routinely apply an internal discount to the value of appraisals used in the fair value evaluation of our impaired loans. The deductions to the appraisal take into account changing business factors and market conditions, as well as potential value impairment in cases where our appraisal date predates a likely change in market conditions. These deductions range from 10% for routine real estate collateral to 25% for real estate that is determined (1) to have a thin trading market or (2) to be specialized collateral. This is in addition to estimated discounts for cost to sell of six to ten percent.

We also apply discounts to the expected fair value of collateral for impaired loans where the likely resolution involves litigation or foreclosure. Resolution of this nature generally results in receiving lower values for real estate collateral in a more aggressive sales environment. We have utilized discounts ranging from 10% to 33% in our impairment evaluations when applicable.

Impaired loans are evaluated quarterly for additional impairment. We obtain updated appraisals on properties securing our loans when circumstances are warranted such as at the time of renewal or when market conditions have significantly changed. This determination is made on a property-by-property basis in light of circumstances in the broader economic climate and our assessment of deterioration of real estate values in the market in which the property is located. The first stage of our assessment involves management's inspection of the property in question. Management also engages in conversations with local real estate professionals, investors, and market participants to determine the likely marketing time and value range for the property. The second stage involves an assessment of current trends in the regional market. After thorough consideration of these factors, management will either internally evaluate fair value or order a new appraisal.

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Other Real Estate Owned (OREO) : OREO is evaluated at the time of acquisition and recorded at fair value as determined by independent appraisal or internal evaluation less cost to sell. Our quarterly evaluations of OREO for impairment are driven by property type. For smaller dollar single family homes, we consult with internal real estate sales staff and external realtors, investors, and appraisers. Based on these consultations, we determine asking prices for OREO properties we are marketing for sale. If the internally evaluated fair value is below our recorded investment in the property, appropriate write-downs are taken.

For larger dollar commercial real estate properties, we obtain a new appraisal of the subject property or have staff in our special assets group or centralized appraisal department evaluate the latest in-file appraisal in connection with the transfer to other real estate owned. In some of these circumstances, an appraisal is in process at quarter end, and we must make our best estimate of the fair value of the underlying collateral based on our internal evaluation of the property, review of the most recent appraisal, and discussions with the currently engaged appraiser. We generally obtain updated appraisals within five quarters of the anniversary date of ownership unless a sale is imminent.

We routinely apply an internal discount to the value of appraisals used in the fair value evaluation of our OREO. The deductions to the appraisal take into account changing business factors and market conditions, as well as potential value impairment in cases where our appraisal date predates a likely change in market conditions. These deductions range from 10% for routine real estate collateral to 25% for real estate that is determined (1) to have a thin trading market or (2) to be specialized collateral. This is in addition to estimated discounts for cost to sell of six to ten percent.

Financial assets measured at fair value on a recurring basis are summarized below:

Description	Carrying Value	Fair Value Measurements at December 31, 2014 Using		
		Quoted Prices In Active Markets for Identical Assets (Level 1)	(in thousands) Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities				
U.S. Government and federal agency	\$ 35,443	\$ —	\$ 35,443	\$ —
Agency mortgage-backed: residential	123,598	—	123,598	—
State and municipal	12,404	—	12,404	—
Corporate bonds	18,688	—	18,688	—
Other debt securities	658	—	—	658
Total	<u>\$190,791</u>	<u>\$ —</u>	<u>\$ 190,133</u>	<u>\$ 658</u>

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Description	Carrying Value	Fair Value Measurements at December 31, 2013 Using		
		Quoted Prices In Active Markets for Identical Assets (Level 1)	(in thousands)	
			Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities				
U.S. Government and federal agency	\$ 29,866	\$ —	\$ 29,866	\$ —
Agency mortgage-backed: residential	100,943	—	100,943	—
State and municipal	13,545	—	13,545	—
Corporate bonds	18,161	—	18,161	—
Other debt securities	632	—	—	632
Equity securities	197	197	—	—
Total	<u>\$163,344</u>	<u>\$ 197</u>	<u>\$ 162,515</u>	<u>\$ 632</u>

There were no transfers between Level 1 and Level 2 during 2014 or 2013.

The table below presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the periods ended December 31, 2014 and 2013:

	Other Debt Securities	
	2014	2013
Balances of recurring Level 3 assets at January 1	\$632	\$618
Total gain (loss) for the period:		
Included in other comprehensive income (loss)	26	14
Balance of recurring Level 3 assets at December 31	<u>\$658</u>	<u>\$632</u>

Our other debt security valuation is determined internally by calculating discounted cash flows using the security's coupon rate of 6.5% and an estimated current market rate of 8.0% based upon the current yield curve plus spreads that adjust for volatility, credit risk, and optionality. We also consider the issuer(s) publicly filed financial information as well as assumptions regarding the likelihood of deferrals and defaults.

Financial assets measured at fair value on a non-recurring basis are summarized below:

Description	Carrying Value	Fair Value Measurements at December 31, 2014 Using		
		Quoted Prices In Active Markets for Identical Assets (Level 1)	(in thousands)	
			Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans:				
Commercial	\$ 1,068	\$ —	\$ —	\$ 1,068
Commercial real estate:				
Construction	4,073	—	—	4,073
Farmland	3,474	—	—	3,474
Other	37,058	—	—	37,058
Residential real estate:				
Multi-family	4,175	—	—	4,175
1-4 Family	10,583	—	—	10,583
Consumer	31	—	—	31
Agriculture	—	—	—	—
Other	71	—	—	71
Other real estate owned, net:				
Commercial real estate:				
Construction	18,325	—	—	18,325
Farmland	654	—	—	654
Other	14,525	—	—	14,525
Residential real estate:				
Multi-family	4,875	—	—	4,875
1-4 Family	7,818	—	—	7,818

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Description	Carrying Value	Fair Value Measurements at December 31, 2013 Using		
		Quoted Prices In Active Markets for Identical Assets (Level 1)	(in thousands) Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans:				
Commercial	\$ 3,172	\$ —	\$ —	\$ 3,172
Commercial real estate:				
Construction	9,046	—	—	9,046
Farmland	4,173	—	—	4,173
Other	73,426	—	—	73,426
Residential real estate:				
Multi-family	11,724	—	—	11,724
1-4 Family	26,486	—	—	26,486
Consumer	75	—	—	75
Agriculture	—	—	—	—
Other	618	—	—	618
Other real estate owned, net:				
Commercial real estate:				
Construction	19,057	—	—	19,057
Farmland	690	—	—	690
Other	6,019	—	—	6,019
Residential real estate:				
Multi-family	246	—	—	246
1-4 Family	4,880	—	—	4,880

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of \$61.3 million, with a valuation allowance of \$752,000, at December 31, 2014, resulting in an additional provision for loan losses for the year ended December 31, 2014 of \$5.2 million. At December 31, 2013, impaired loans had a carrying amount of \$132.2 million, with a valuation allowance of \$3.5 million, at December 31, 2013, resulting in no additional provision for loan losses for the year ended December 31, 2013.

Other real estate owned, which is measured at the lower of carrying or fair value less costs to sell, had a net carrying amount of \$46.2 million as of December 31, 2014, compared with \$30.9 million at December 31, 2013. Write-downs of \$4.3 million and \$2.5 million were recorded on other real estate owned for the years ended December 31, 2014 and 2013, respectively.

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The following table presents qualitative information about level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2014:

	<u>Fair Value</u> (in thousands)	<u>Valuation Technique(s)</u>	<u>Unobservable Input(s)</u>	<u>Range (Weighted Average)</u>
Impaired loans – Commercial	\$ 1,068	Market value approach	Adjustment for receivables and inventory discounts	16% - 32% (24%)
Impaired loans – Commercial real estate	\$ 44,605	Sales comparison approach	Adjustment for differences between the comparable sales	0% - 62% (14%)
		Income approach	Discount or capitalization rate	8% - 9% (8%)
Impaired loans – Residential real estate	\$ 14,758	Sales comparison approach	Adjustment for differences between the comparable sales	0% - 39% (11%)
Other real estate owned – Commercial real estate	\$ 33,504	Sales comparison approach	Adjustment for differences between the comparable sales	0% - 45% (18%)
		Income approach	Discount or capitalization rate	9% - 20% (13%)
Other real estate owned – Residential real estate	\$ 12,693	Sales comparison approach	Adjustment for differences between the comparable sales	0% - 15% (6%)

The following table presents qualitative information about level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2013:

	<u>Fair Value</u> (in thousands)	<u>Valuation Technique(s)</u>	<u>Unobservable Input(s)</u>	<u>Range (Weighted Average)</u>
Impaired loans – Commercial	\$ 3,172	Market value approach	Adjustment for receivables and inventory discounts	16% - 32% (24%)
Impaired loans – Commercial real estate	\$ 86,645	Sales comparison approach	Adjustment for differences between the comparable sales	0% - 69% (20%)
Impaired loans – Residential real estate	\$ 38,210	Sales comparison approach	Adjustment for differences between the comparable sales	0% - 68% (15%)
Other real estate owned – Commercial real estate	\$ 25,766	Sales comparison approach	Adjustment for differences between the comparable sales	3% - 51% (22%)
		Income approach	Discount or capitalization rate	7% - 16% (11%)
Other real estate owned – Residential real estate	\$ 5,126	Sales comparison approach	Adjustment for differences between the comparable sales	2% - 54% (11%)

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Carrying amount and estimated fair values of financial instruments were as follows at year-end 2014:

	Carrying Amount	Fair Value Measurements at December 31, 2014 Using			
		Level 1	Level 2 (in thousands)	Level 3	Total
Financial assets					
Cash and cash equivalents	\$ 80,180	\$ 49,007	\$ 31,173	\$ —	\$ 80,180
Securities available for sale	190,791	—	190,133	658	190,791
Securities held to maturity	42,325	—	44,498	—	44,498
Federal Home Loan Bank stock	7,323	N/A	N/A	N/A	N/A
Loans held for sale	8,926	—	8,926	—	8,926
Loans, net	605,635	—	—	615,914	615,914
Accrued interest receivable	3,503	—	1,389	2,114	3,503
Financial liabilities					
Deposits	\$926,841	\$114,910	\$804,508	\$ —	\$919,418
Securities sold under agreements to repurchase	1,341	—	1,341	—	1,341
Federal Home Loan Bank advances	15,752	—	15,758	—	15,758
Subordinated capital notes	4,950	—	—	4,765	4,765
Junior subordinated debentures	25,000	—	—	14,214	14,214
Accrued interest payable	2,858	—	751	2,107	2,858

Carrying amount and estimated fair values of financial instruments were as follows at year-end 2013:

	Carrying Amount	Fair Value Measurements at December 31, 2013 Using			
		Level 1	Level 2 (in thousands)	Level 3	Total
Financial assets					
Cash and cash equivalents	\$111,134	\$106,885	\$ 4,249	\$ —	\$111,134
Securities available for sale	163,344	197	162,515	632	163,344
Securities held to maturity	43,612	—	42,947	—	42,947
Federal Home Loan Bank stock	10,072	N/A	N/A	N/A	N/A
Loans held for sale	149	—	149	—	149
Loans, net	681,202	—	—	695,999	695,999
Accrued interest receivable	3,891	—	1,343	2,548	3,891
Financial liabilities					
Deposits	\$987,705	\$107,486	\$879,707	\$ —	\$987,193
Securities sold under agreements to repurchase	2,470	—	2,470	—	2,470
Federal Home Loan Bank advances	4,492	—	4,495	—	4,495
Subordinated capital notes	5,850	—	—	5,586	5,586
Junior subordinated debentures	25,000	—	—	13,526	13,526
Accrued interest payable	2,535	—	1,042	1,493	2,535

The methods and assumptions used to estimate fair value are described as follows:

(a) Cash and Cash Equivalents

The carrying amounts of cash and short-term instruments approximate fair values and are classified as either Level 1 or Level 2. Noninterest bearing deposits are Level 1 whereas interest bearing due from bank accounts and fed funds sold are Level 2.

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(b) FHLB Stock

It is not practical to determine the fair value of FHLB stock due to restrictions placed on its transferability.

(c) Loans, Net

Fair values of loans, excluding loans held for sale, are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described previously. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

(d) Loans Held for Sale

The fair value of loans held for sale is estimated based upon binding contracts and quotes from third party investors resulting in a Level 2 classification.

(e) Deposits

The fair values disclosed for non-interest bearing deposits are, by definition, equal to the amount payable on demand at the reporting date resulting in a Level 1 classification. The carrying amounts of variable rate interest bearing deposits approximate their fair values at the reporting date resulting in a Level 2 classification. Fair values for fixed rate interest bearing deposits are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

(f) Securities Sold Under Agreements to Repurchase

The carrying amounts of borrowings under repurchase agreements approximate their fair values resulting in a Level 2 classification.

(g) Other Borrowings

The fair values of the Company's FHLB advances are estimated using discounted cash flow analyses based on the current borrowing rates resulting in a Level 2 classification.

The fair values of the Company's subordinated capital notes and junior subordinated debentures are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 3 classification.

(h) Accrued Interest Receivable/Payable

The carrying amounts of accrued interest approximate fair value resulting in a Level 2 or Level 3 classification based on the level of the asset or liability with which the accrual is associated.

NOTE 20 – STOCK PLANS AND STOCK BASED COMPENSATION

The Company has two stock incentive plans. On February 23, 2006, the Company adopted the Porter Bancorp, Inc. 2006 Stock Incentive Plan. In May 2013, shareholders approved an amendment to the plan to increase the number of shares authorized for issuance by 800,000 shares. In May 2014, shareholders approved an amendment to the Plan to increase the number of shares authorized for issuance by 300,000 shares. The 2006 Plan now permits the issuance of up to 1,563,050 shares of the Company's common stock upon the grant of stock awards. As of December 31, 2014, the Company had issued and outstanding 770,440 unvested shares net of forfeitures and vesting under the stock incentive plan. Shares issued under the plan vest annually on the anniversary date of the grant over three to ten years. The Company has 533,271 shares remaining available for issue under the plan.

On May 15, 2006, the Board of Directors approved the Porter Bancorp, Inc. 2006 Non-Employee Directors Stock Ownership Incentive Plan, which was approved by holders of the Company's voting common stock on June 8, 2006. On May 16, 2012, holders of the Company's voting common stock voted to further amend the 2006 Non-Employee Directors Stock Ownership Incentive Plan to award restricted shares having a fair market value of \$25,000 annually to each non-employee director, and to increase the number of shares issuable under the Directors' Plan from 100,000 shares to 400,000 shares. In May 2014, the Plan was further amended to increase the number of shares issuable to 700,000 shares. Unvested shares are granted automatically under the plan at fair market value on the date of grant and vest on December 31 in the year of grant. To date, the Company has issued and outstanding 5,052 unvested shares, net of forfeitures and vesting, to non-employee directors. At December 31, 2014, 301,512 shares remain available for issuance under this plan.

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The fair value of the 2014 unvested shares issued to employees was \$113,000, or \$0.93 per weighted-average share. The fair value of the 2014 unvested shares issued to directors was \$150,000, or \$0.90 per weighted-average share. The Company recorded \$555,000 and \$604,000 of stock-based compensation during the 2014 and 2013, respectively, to salaries and employee benefits. We expect substantially all of the unvested shares outstanding at the end of the period will vest according to the vesting schedule. No deferred tax benefit was recognized related to this expense for either period.

The following table summarizes unvested share activity as of and for the periods indicated for the Stock Incentive Plan:

	Twelve Months Ended December 31, 2014		Twelve Months Ended December 31, 2013	
	Shares	Average Grant Price	Shares	Average Grant Price
Outstanding, beginning	787,426	\$ 1.56	153,316	\$ 5.92
Granted	122,220	0.93	693,214	1.18
Vested	(133,227)	2.20	(22,113)	12.19
Forfeited	(5,979)	4.21	(36,991)	6.22
Outstanding, ending	<u>770,440</u>	\$ 1.33	<u>787,426</u>	\$ 1.56

The following table summarizes unvested share activity as of and for the periods indicated for the Non-Employee Directors Stock Ownership Incentive Plan:

	Twelve Months Ended December 31, 2014		Twelve Months Ended December 31, 2013	
	Shares	Average Grant Price	Shares	Average Grant Price
Outstanding, beginning	47,428	\$ 1.69	80,078	\$ 1.77
Granted	166,668	0.90	182,355	0.85
Vested	(154,222)	0.98	(215,005)	1.01
Forfeited	(54,822)	1.29	—	—
Outstanding, ending	<u>5,052</u>	\$ 1.65	<u>47,428</u>	\$ 1.69

Unrecognized stock based compensation expense related to unvested shares for 2015 and beyond is estimated as follows (in thousands):

2015	\$371
2016	263
2017	50
2018	—
2019 & thereafter	—

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NOTE 21 – EARNINGS (LOSS) PER SHARE

The factors used in the basic and diluted earnings per share computation follow:

	<u>2014</u>	<u>2013</u>	<u>2012</u>
	(in thousands, except share and per share data)		
Net loss	\$ (11,155)	\$ (1,586)	\$ (32,932)
Less:			
Preferred stock dividends	2,362	1,919	1,750
Effect of preferred stock exchange	(36,104)	—	—
Accretion of Series A preferred stock discount	—	160	179
Income (loss) attributable to unvested shares	1,435	(171)	(482)
Income (loss) attributable to participating preferred shares	1,724	(96)	(947)
Net income (loss) attributable to common shareholders, basic and diluted	<u>\$ 19,428</u>	<u>\$ (3,398)</u>	<u>\$ (33,432)</u>
Basic			
Weighted average common shares including unvested common shares and participating preferred shares outstanding	14,230,936	12,722,782	12,248,936
Less:			
Weighted average unvested common shares	904,208	595,150	169,323
Weighted average Series B preferred shares	299,855	—	—
Weighted average Series C preferred shares	308,269	332,894	332,894
Weighted average Series D preferred shares	477,715	—	—
Weighted average common shares outstanding	<u>12,240,889</u>	<u>11,794,738</u>	<u>11,746,719</u>
Basic income (loss) per common share	<u>\$ 1.59</u>	<u>\$ (0.29)</u>	<u>\$ (2.85)</u>
Diluted			
Add: Dilutive effects of assumed exercises of common and Preferred Series C stock warrants	—	—	—
Weighted average common shares and potential common shares	<u>12,240,889</u>	<u>11,794,738</u>	<u>11,746,719</u>
Diluted income (loss) per common share	<u>\$ 1.59</u>	<u>\$ (0.29)</u>	<u>\$ (2.85)</u>

The Company had no outstanding stock options at December 31, 2014, 2013 or 2012. A warrant for the purchase of 330,561 shares of the Company's common stock at an exercise price of \$15.88 was outstanding at December 31, 2014, 2013 and 2012 but was not included in the diluted EPS computation as inclusion would have been anti-dilutive. Additionally, warrants for the purchase of 650,544 and 1,449,459 shares of non-voting common stock at an exercise price of \$10.95 per share were outstanding at December 31, 2014 and 2013, respectively, but were not included in the diluted EPS computation as inclusion would have been anti-dilutive.

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NOTE 22 – PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION

Condensed financial information of Porter Bancorp Inc. is presented as follows:

CONDENSED BALANCE SHEETS

December 31,

	<u>2014</u>	<u>2013</u>
	(in thousands)	
ASSETS		
Cash and cash equivalents	\$ 1,275	\$ 1,815
Securities available for sale	658	829
Investment in banking subsidiary	58,097	63,815
Investment in and advances to other subsidiaries	776	776
Other assets	730	740
Total assets	<u>\$61,536</u>	<u>\$67,975</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Debt	\$25,775	\$25,775
Accrued expenses and other liabilities	2,296	6,269
Shareholders' equity	33,465	35,931
Total liabilities and shareholders' equity	<u>\$61,536</u>	<u>\$67,975</u>

CONDENSED STATEMENTS OF OPERATIONS

Years ended December 31,

	<u>2014</u>	<u>2013</u>	<u>2012</u>
	(in thousands)		
Interest income	\$ 53	\$ 82	\$ 114
Dividends from subsidiaries	19	20	21
Other income	44	966	72
Interest expense	(631)	(642)	(692)
Other expense	(1,765)	(2,064)	(1,453)
Loss before income tax and undistributed subsidiary income	(2,280)	(1,638)	(1,938)
Income tax expense	13	—	864
Equity in undistributed subsidiary income (loss)	(8,862)	52	(30,130)
Net loss	<u>\$(11,155)</u>	<u>\$(1,586)</u>	<u>\$(32,932)</u>

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CONDENSED STATEMENTS OF CASH FLOWS

Years ended December 31,

	<u>2014</u>	<u>2013</u> (in thousands)	<u>2012</u>
Cash flows from operating activities			
Net loss	\$(11,155)	\$(1,586)	\$(32,932)
Adjustments:			
Equity in undistributed subsidiary (income) loss	8,862	(52)	30,130
Gain on sale of assets	(44)	(727)	—
Tax expense from OCI components	13	—	—
Change in other assets	(26)	(240)	(21)
Change in other liabilities	1,040	833	776
Other	591	640	478
Net cash (used in) operating activities	(719)	(1,132)	(1,569)
Cash flows from investing activities			
Investments in subsidiaries	—	—	—
Sales of securities	179	1,952	—
Net cash (used in) from investing activities	179	1,952	—
Cash flows from financing activities			
Dividends paid on preferred stock	—	—	—
Dividends paid on common stock	—	—	—
Net cash (used in) financing activities	—	—	—
Net change in cash and cash equivalents	(540)	820	(1,569)
Beginning cash and cash equivalents	1,815	995	2,564
Ending cash and cash equivalents	<u>\$ 1,275</u>	<u>\$ 1,815</u>	<u>\$ 995</u>

NOTE 23 – QUARTERLY FINANCIAL DATA (UNAUDITED)

	Interest Income	Net Interest Income	Provision			Earnings (Loss) Per Common Share	
			For Loan Losses	OREO Expense	Net Income (Loss)	Basic (1)	Diluted (1)
2014							
First quarter	\$ 9,897	\$ 7,300	\$ —	\$ 662	\$ (287)	\$ (0.08)	\$ (0.08)
Second quarter	10,166	7,614	6,300	774	(6,234) ⁽²⁾	(0.53)	(0.53)
Third quarter	9,814	7,337	—	560	(849)	(0.12)	(0.12)
Fourth quarter	9,636	7,467	800	3,843	(3,785) ⁽³⁾	1.91	1.91
2013							
First quarter	\$11,258	\$ 8,298	\$ 450	\$ 791	\$ (69)	\$ (0.04)	\$ (0.04)
Second quarter	11,168	8,352	—	1,657	(1,309)	(0.14)	(0.14)
Third quarter	10,543	7,849	250	669	298	(0.01)	(0.01)
Fourth quarter	10,259	7,586	—	1,399	(506)	(0.09)	(0.09)

- (1) The sum of the quarterly net income (loss) per share (basic and diluted) differs from the annual net income (loss) per share (basic and diluted) because of the differences in the weighted average number of common shares outstanding and the common shares used in the quarterly and annual computations as well as differences in rounding.
- (2) The \$6.2 million loss for the second quarter was primarily due to provision for loan losses expense of \$6.3 million.
- (3) The \$3.8 million loss for the fourth quarter was primarily due to elevated OREO expenses of \$3.8 million.

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NOTE 24 – CONTINGENCIES

We are defendants in various legal proceedings. Litigation is subject to inherent uncertainties and unfavorable rulings could occur. We record contingent liabilities resulting from claims against us when a loss is assessed to be probable and the amount of the loss is reasonably estimable. Assessing probability of loss and estimating probable losses requires analysis of multiple factors, including in some cases judgments about the potential actions of third party claimants and courts. Recorded contingent liabilities are based on the best information available and actual losses in any future period are inherently uncertain. Currently, we have accrued approximately \$2.1 million related to ongoing litigation matters for which we believe liability is probable and reasonably estimable. Accruals are not made in cases where liability is not probable or the amount cannot be reasonably estimated. We disclose legal matters when we believe liability is reasonably possible and may be material to our consolidated financial statements.

Signature Point Litigation. On June 18, 2010, three real estate development companies filed suit in Kentucky state court against the Bank and Managed Assets of Kentucky (“MAKY”). *Signature Point Condominiums LLC, et al. v. PBI Bank, et al.*, Jefferson Circuit Court, Case No 10-CI-04295. On July 16, 2013, a jury in Louisville, Kentucky returned a verdict against the Bank, awarding the plaintiffs compensatory damages of \$1,515,000 and punitive damages of \$5,500,000. The case arose from a settlement in which the Bank agreed to release the plaintiffs and guarantors from obligations of more than \$26 million related to a real estate project in Louisville. The plaintiffs were granted a right of first refusal to repurchase a tract of land within the project. In exchange, the plaintiffs conveyed the real estate securing the loans to the Bank. After plaintiffs declined to exercise their right of first refusal, the Bank sold the tract to the third party. Plaintiffs alleged the Bank had knowledge of the third party offer before the conveyance of the land by the Plaintiffs to the Bank. Plaintiffs asserted claims of fraud, breach of fiduciary duty, breach of the duty of good faith and fair dealing, tortious interference with prospective business advantage and conspiracy to commit fraud, negligence, and conspiracy against the Bank.

After conferring with its legal advisors, the Bank believes the findings and damages are excessive and contrary to law, and that it has meritorious grounds on which it has moved to appeal. The Bank’s Notice of Appeal was filed on October 25, 2013. After a number of procedural issues were resolved, the Bank filed its appellate brief on September 30, 2014. Appellee’s brief was filed on December 1, 2014. We will continue to defend this matter vigorously. Although we have made provisions in our consolidated financial statements for this self-insured matter, the amount of our legal accrual is less than the original amount of the damages awarded, plus accrued interest. The ultimate outcome of this matter could have a material adverse effect on our financial condition, results of operations or cash flows.

SBAV LP Litigation. On December 17, 2012, SBAV LP filed a lawsuit against the Company, the Bank, J. Chester Porter and Maria L. Bouvette in New York state court. The proceeding was removed to New York federal district court on January 16, 2013, and on February 27, 2013, SBAV LP filed an Amended Complaint. On July 10, 2013, the New York federal district court granted the defendants’ motion to transfer the case to federal district court in Kentucky. *SBAV LP v. Porter Bancorp, et. al.*, Civ. Action 3:13-CV-710 (W.D.KY). The Amended Complaint alleges a violation of the Kentucky Securities Act and negligent misrepresentation against all named defendants, and breach of contract against Porter Bancorp alone. The plaintiff seeks damages in an amount in excess of \$4,500,000, or the difference between the \$5,000,016 purchase price and the value of the securities when sold by the plaintiff, plus interest at the applicable statutory rate, costs and reasonable attorneys’ fees. On September 13, 2013, defendants filed a motion to dismiss all claims in the complaint for pleading failures and for failure to state a claim upon which relief may be granted. On March 25, 2014, the judge ruled that SBAV had failed to state a claim against the Bank and dismissed the Bank from the case. The claims against the Company, the Estate of J. Chester Porter and Ms. Bouvette remain and have proceeded to discovery. On April 21, 2014, the Company filed a third-party complaint for contribution against SBAV’s investment adviser, the Clinton Group, Inc. On September 16, 2014, the Court dismissed the Third-Party Complaint, but held that, if proven, Clinton’s errors in conducting due diligence may lessen any recovery available to SBAV. Discovery is continuing. On February 9, 2015, the parties jointly requested the Court to vacate the current trial date of October 20, 2015 to provide additional time for discovery and motion practice in the case. We dispute the material factual allegations made in SBAV’s complaint and intend to defend against SBAV’s claims vigorously.

Miller’s Health System Inc. Employee Stock Ownership Plan. On December 26, 2013, the United States Department of Labor (“DOL”) filed a lawsuit against the Bank in U.S. District Court for the Northern District of Indiana. *Thomas E. Perez, Secretary of the United States Department of Labor v. PBI Bank, Inc.* (Civ. Action 3:13-CV-1400-PPS). The complaint alleges that in 2007 the Bank, in the capacity of trustee for the Miller’s Health System’s Inc. Employee Stock Ownership Plan, authorized the alleged imprudent and disloyal purchase of the stock of Miller’s Health Systems, Inc. (“Miller’s Health”) in 2007 for \$40 million, a price allegedly far in excess of the stock’s fair market value. The suit also alleges, among other things, that the Bank approved 100% seller financing for the transaction at an excessive rate of interest. On March 31, 2014, the Bank filed its answer, disputing the material factual allegations of the complaint. On April 10, 2014, the Bank filed a third-party complaint against Miller’s Health seeking to enforce its indemnity rights, as well as third party claims for contribution against named directors and officers of Miller’s Health. On March 12, 2015, the parties agreed to settle the litigation, subject to the execution of a written settlement agreement. The Bank has agreed to a settlement payment, most of which has either been previously reserved for or will be paid from insurance proceeds. We do not anticipate the settlement of this litigation will have a material adverse effect on the Company’s financial condition or operating results.

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AIT Laboratories Employee Stock Ownership Plan. On August 29, 2014, the United States Department of Labor (“DOL”) filed a lawsuit against the Bank and Michael A. Evans in the U.S. District Court for the Southern District of Indiana. *Thomas E. Perez, Secretary of the United States Department of Labor v. PBI Bank, Inc. and Michael A. Evans* (Case No. 1:14-CV-01429-SEB-MJD). The complaint alleges that in 2009, the Bank, in the capacity of trustee for the AIT Laboratories Employee Stock Ownership Plan, authorized the alleged imprudent and disloyal purchase of the stock of AIT Holdings, Inc. in 2009 for \$90 million, a price allegedly far in excess of the stock’s fair market value. The Bank’s responsive pleading was filed on November 4, 2014, disputing the material factual allegations that have been made by the DOL. Discovery is in the early stages. We intend to defend against DOL’s claims vigorously.

United States Department of Justice Investigation. On October 17, 2014, the United States Department of Justice (the “DOJ”) notified the Bank that the Bank was the subject of an investigation into possible violations of federal laws, including, among other things, possible violations related to false bank entries, bank fraud and securities fraud. The investigation concerns allegations that Bank personnel engaged in practices intended to delay or avoid disclosure of the Bank’s asset quality at the time of and following the United States Treasury’s purchase of preferred stock from the Company in November 2008. The Bank will respond to and cooperate with any requests for information from DOJ. At this time the investigation is ongoing, and DOJ has made no determination whether to pursue any action in the matter.

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Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None

Item 9A. Controls and Procedures

Management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined under Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. As of December 31, 2014, an evaluation was performed under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures.

Management determined that a material weakness existed in the Company's internal control over financial reporting at June 30, 2014. The Company utilized information to record the fair value of other real estate owned at June 30, 2014 which was obtained prior to taking possession of commercial real estate through a settlement agreement with a contentious borrower on June 24, 2014, rather than promptly obtaining new information material to the fair value of the properties before the filing of the financial statements as of and for the three and six month periods ended June 30, 2014. We determined, after the filing of those financial statements, that our initial estimate of fair value was significantly higher than the actual fair value as it was not based upon the best information available. Based upon the restatement of the Company's financial statements as of and for the three and six month periods ended June 30, 2014, the Company determined that our internal controls for recording other real estate owned at estimated fair value less costs to sell did not in this instance establish an accurate initial book value and were not effective. Our management, overseen by the Audit Committee, worked throughout the fourth quarter of 2014 to implement controls, procedures, and processes to remediate this control weakness.

These enhanced controls, procedures, and process improvements include:

- The Special Assets Group promptly and thoroughly reviews new information material to the fair value of the property and analyzes key assumptions relevant to the fair value conclusion and cost to sell estimate. New information includes, but is not limited to, updated appraisals, site visits performed by the Special Assets Group, and discussions with current tenants.
- Personnel, including senior management, consult with the Special Assets Group and external experts, such as property management professionals, to evaluate the new information material to the fair value of the property including comparable sales, income and expenses, and other relevant valuation factors.
- Finance and accounting personnel engage in detailed discussions regarding valuation issues and review other real estate owned, including additions, with the Special Assets Group throughout each reporting period and through the subsequent period up to the filing of the financial statements.

During the fourth quarter of 2014, we took steps to resolve the material weakness by changing our controls, procedures, and processes for recording other real estate owned at estimated fair value less cost to sell, as discussed above. Notwithstanding the steps taken during the fourth quarter of 2014, the identified material weakness will not be considered remediated until the new procedures have been in operation for a sufficient period of time to be tested and determined by management to be operating effectively. Based on our evaluation and the reason described above, management, including our Chief Executive Officer and our Chief Financial Officer, concluded that our disclosure controls and procedures were not effective as of the end of the period covered by this report. Management's Report on Internal Control Over Financial Reporting is set forth under Item 8 "Financial Statements and Supplementary Data." There were no other changes in our internal control over financial reporting that occurred during the year ended December 31, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

None

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

We have adopted a code of ethics applicable to our Chief Executive Officer and our senior financial officers, which is posted on our website at <http://www.pbibank.com>. If we amend or waive any of the provisions of the Code of Ethics applicable to our Chief Executive Officer or senior financial officers, we intend to disclose the amendment or waiver on our website. We will provide to any person without charge, upon request, a copy of this Code of Ethics. You can request a copy by contacting Porter Bancorp, Inc., Chief Financial Officer, 2500 Eastpoint Parkway, Louisville, Kentucky, 40223, (telephone) 502-499-4800.

Additional information required by this Item 10 is omitted because we are filing a definitive proxy statement pursuant to Regulation 14A on or before April 30, 2015, which includes the required information. The required information contained in our proxy statement is incorporated herein by reference.

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Item 11. Executive Compensation.

The information required by this Item 11 is omitted because we are filing a definitive proxy statement pursuant to Regulation 14A on or before April 30, 2015, which includes the required information. The required information contained in our proxy statement is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item 12 is omitted because we are filing a definitive proxy statement pursuant to Regulation 14A on or before April 30, 2015, which includes the required information. The required information contained in our proxy statement is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information required by this Item 13 is omitted because we are filing a definitive proxy statement pursuant to Regulation 14A on or before April 30, 2015, which includes the required information. The required information contained in our proxy statement is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services.

The information required by this Item 14 is omitted because we are filing a definitive proxy statement pursuant to Regulation 14A on or before April 30, 2015, which includes the required information. The required information contained in our proxy statement is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

- (a) 1. The following financial statements are included in this Form 10-K:
- Consolidated Balance Sheets as of December 31, 2014 and 2013
 - Consolidated Statements of Operations for the Years Ended December 31, 2014, 2013, and 2012
 - Consolidated Statements of Comprehensive Income (Loss) for the Years Ended December 31, 2014, 2013, and 2012
 - Consolidated Statements of Change in Stockholders' Equity for the Years Ended December 31, 2014, 2013, and 2012
 - Consolidated Statements of Cash Flows for the Years Ended December 31, 2014, 2013, and 2012
 - Notes to Consolidated Financial Statements
 - Report of Independent Registered Public Accounting Firm
- (a) 2. List of Financial Statement Schedules
- Financial statement schedules are omitted because the information is not applicable.
- (a) 3. List of Exhibits
- The Exhibit Index of this report is incorporated by reference. The compensatory plans or arrangement required to be filed as exhibits to this Form 10-K pursuant to Item 15(c) are noted with an asterisk in the Exhibit Index.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PORTER BANCORP, INC.

March 30, 2015

By: /s/ John T. Taylor
John T. Taylor
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated.

<u>/s/ John T. Taylor</u> John T. Taylor	Chief Executive Officer	March 30, 2015
<u>/s/ Phillip W. Barnhouse</u> Phillip W. Barnhouse	Chief Financial Officer	March 30, 2015
<u>s/ W. Glenn Hogan</u> W. Glenn Hogan	Director	March 30, 2015
<u>/s/ Michael T. Levy</u> Michael T. Levy	Director	March 30, 2015
<u>/s/ Bradford T. Ray</u> Bradford T. Ray	Director	March 30, 2015
<u>/s/ N. Marc Satterthwaite</u> N. Marc Satterthwaite	Director	March 30, 2015
<u>/s/ W. Kirk Wycoff</u> W. Kirk Wycoff	Director	March 30, 2015

EXHIBIT INDEX

<u>Exhibit No. (1)</u>	<u>Description</u>
3.1	Amended and Restated Articles of Incorporation, dated March 2, 2015. Exhibit 3.1 to Form 8-K filed March 2, 2015 is incorporated by reference.
3.2	Amended and Restated Bylaws of Porter Bancorp, Inc. Exhibit 3.1 to Form 8-K filed May 22, 2014 is hereby incorporated by reference. Bylaws dated November 30, 2005. Exhibit 3.2 to Form S-1 Registration Statement (Reg. No. 333-133198) filed April 11, 2006 is incorporated by reference.
4.1	Warrant to purchase up to 299,829 shares. Exhibit 4.1 to Form 8-K filed November 24, 2008 is incorporated by reference.
4.2	Securities Purchase Agreement between Porter Bancorp, Inc. and Patriot Financial Partners, L.P. and other purchasers named therein, dated as of June 30, 2010. Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on July 7, 2010 is incorporated by reference.
10.1+	Porter Bancorp, Inc. 2006 Stock Incentive Plan as amended and restated as of March 26, 2014. Exhibit 10.1 to Registration Statement (Reg. No. 333-202749) filed March 13, 2015 is incorporated by reference. Appendix B to Definitive Proxy Statement filed April 28, 2014 is incorporated by reference.
10.2+	Form of Porter Bancorp, Inc. Restricted Stock Award Agreement. Exhibit 10.1 to Form 10-Q filed November 13, 2012 is incorporated by reference.
10.3+	Porter Bancorp, Inc. 2006 Non-Employee Directors Stock Ownership Incentive Plan, as amended and restated as of March 26, 2014. Exhibit 10.1 to Form S-8 Registration Statement (Reg. No. 333-202746) filed March 13, 2015 is incorporated by reference. Appendix A to Definitive Proxy Statement filed April 28, 2014 is incorporated by reference.
10.4+	Porter Bancorp, Inc. 2014 Incentive Compensation Bonus Plan incorporated by reference in the Definitive Proxy Statement filed April 28, 2014.
10.5+	Form of Ascencia Bank (now PBI Bank) Supplemental Executive Retirement Plan. Exhibit 10.5 to Form S-1 Registration Statement (Reg. No. 333-133198) filed April 11, 2006 is incorporated by reference.
10.6+	Form of Amendment to PBI Bank Supplemental Executive Retirement Plan. Exhibit 10.7 to Form 10-K filed March 29, 2009 is incorporated by reference.
10.7	Consent Order with Federal Deposit Insurance Corporation and Kentucky Department of Financial Institutions dated June 24, 2011. Exhibit 99.1 to Form 8-K filed June 30, 2011 is incorporated by reference.
10.8	Employment Agreement with John T. Taylor (Exhibit 10 to Form 8-K filed August 6, 2012 is incorporated by reference.
10.9	Employment Agreement with John R. Davis (Exhibit 10.1 to Form 8-K filed September 25, 2012 is incorporated by reference.
10.10	Employment Agreement with Joseph C. Seiler (Exhibit 10.1 to Form 10-Q filed August 8, 2013 is incorporated by reference.
10.11	Employment Agreement with Phillip W. Barnhouse (Exhibit 10.2 to Form 10-Q filed August 8, 2013 is incorporated by reference.
10.12	Description of Exchange Agreements dated November 19, 2014, between Porter Bancorp, Inc. and holders of Series A Preferred Stock is incorporated by reference to Item 1.01 to Form 8-K filed November 24, 2014.
10.13	Form of Exchange Agreement dated November 19, 2014, between Porter Bancorp, Inc. and holders of Series A Preferred Stock. Exhibit 10.1 to Form 8-K filed November 24, 2014 is incorporated by reference.
21.1	List of Subsidiaries of Porter Bancorp, Inc.
23.1	Consent of Crowe Horwath LLP, Independent Registered Public Accounting Firm
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14 or 15d-14
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14 or 15d-14

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32.1	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(b) or 15d-14(b) and 18 U.S.C. Section 1350
32.2	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(b) or 15d-14(b) and U.S.C. Section 1350
99.1	Certification of Principal Executive Officer pursuant to Section 30.15 of the U.S. Treasury's Interim Final Rule on TARP Standards for Compensation and Corporate Governance.
99.2	Certification of Principal Executive Officer pursuant to Section 30.15 of the U.S. Treasury's Interim Final Rule on TARP Standards for Compensation and Corporate Governance.
101	The following financial statements from the Company's Annual Report on Form 10K for the year ended December 31, 2011, formatted in XBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Changes in Stockholders' Equity, (v) Consolidated Statements of Cash Flows, (vi) Notes to Consolidated Financial Statements.

+ Management contract or compensatory plan or arrangement.

(1) The Company has other long-term debt agreements that meet the exclusion set forth in Section 601(b)(4)(iii)(A) of Regulation S-K. The Company hereby agrees to furnish a copy of such agreements to the Securities and Exchange Commission upon request.

SUBSIDIARIES OF PORTER BANCORP, INC.

Direct Subsidiary

	<u>Jurisdiction of Organization</u>	<u>Does Business As</u>
PBI Bank	Kentucky	PBI Bank
Ascencia Statutory Trust I	Connecticut	Ascencia Statutory Trust I
Porter Statutory Trust II	Connecticut	Porter Statutory Trust II
Porter Statutory Trust III	Connecticut	Porter Statutory Trust III
Porter Statutory Trust IV	Connecticut	Porter Statutory Trust IV
PBIB Corporation, Inc.	Kentucky	PBIB Corporation, Inc.

Indirect Subsidiary

	<u>Jurisdiction of Organization</u>	<u>Does Business As</u>	<u>Parent Entity</u>
PBI Title Services, LLC	Kentucky	PBI Title Services, LLC	PBI Bank

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement Nos. 333-188988; 333-189005; 333-202746 and 333-202749 on Form S-8 of Porter Bancorp, Inc. of our report dated March 30, 2015 with respect to the consolidated financial statements of Porter Bancorp, Inc., which report appears in this Annual Report on Form 10-K of Porter Bancorp, Inc. for the year ended December 31, 2014.

/s/ Crowe Horwath LLP

Louisville, Kentucky
March 30, 2015

PORTER BANCORP, INC .
RULE 13A-14(A) CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, John T. Taylor, Chief Executive Officer of Porter Bancorp, Inc. (the “Company”), certify that:

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

Dated: March 30, 2015

/s/ John T. Taylor

John T. Taylor
Chief Executive Officer

PORTER BANCORP, INC .
RULE 13A-14(A) CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Phillip W. Barnhouse, Chief Financial Officer of Porter Bancorp, Inc. (the "Company"), certify that:

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

Dated: March 30, 2015

/s/ Phillip W. Barnhouse
Phillip W. Barnhouse
Chief Financial Officer

SECTION 906 CERTIFICATION

In connection with the Annual Report on Form 10-K of Porter Bancorp, Inc. (the "Company") for the annual period ended December 31, 2014, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John T. Taylor, Chief Executive Officer of the Company, do hereby certify, in accordance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

PORTER BANCORP, INC.

Dated: March 30, 2015

By: /s/ John T. Taylor

John T. Taylor
Chief Executive Officer

SECTION 906 CERTIFICATION

In connection with the Annual Report on Form 10-K of Porter Bancorp, Inc. (the "Company") for the annual period ended December 31, 2014, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Phillip W. Barnhouse, Chief Financial Officer of the Company, do hereby certify, in accordance with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

PORTER BANCORP, INC.

Dated: March 30, 2015

By: /s/ Phillip W. Barnhouse

Phillip W. Barnhouse
Chief Financial Officer

PORTER BANCORP, INC.
TARP CERTIFICATION OF CHIEF EXECUTIVE OFFICER

Note: This Certification covers the portion of the most recently completed fiscal year of Porter Bancorp, Inc. that was a TARP period, specifically, January 1, 2014 through the last day of the TARP period, December 4, 2014, the date Porter Bancorp, Inc. and the Treasury completed the disposition of Porter Bancorp, Inc.'s TARP securities.

I, John T. Taylor, Chief Executive Officer of Porter Bancorp, Inc. (the "Company"), certify that:

- (1) The compensation committee (the "Compensation Committee") of the Board of Directors (the "Board") of the Company has met at least every six months during the prior fiscal year with the senior risk officers of the Company to discuss and evaluate senior executive officer compensation plans and employee compensation plans and the risks these plans pose to the Company;
- (2) The Compensation Committee has identified and limited the features in the senior executive officer compensation plans that could lead senior executive officers to take unnecessary and excessive risks that could threaten the value of the Company, has identified any features in the employee compensation plans that pose risks to the Company, and has limited those features to ensure that the Company is not unnecessarily exposed to risks;
- (3) The Compensation Committee has reviewed at least every six months the terms of each employee compensation plan and identified and limited the features in the plan that could encourage the manipulation of reported earnings of the Company to enhance the compensation of an employee;
- (4) The Compensation Committee will certify to these reviews;
- (5) The Compensation Committee will provide a narrative description of how it limited the features in (i) senior executive officer compensation plans that could lead senior executive officers to take unnecessary and excessive risks that could threaten the value of the Company, (ii) employee compensation plans to ensure that the Company is not unnecessarily exposed to risks, and (iii) employee compensation plans that could encourage the manipulation of reported earnings of the Company to enhance the compensation of an employee;
- (6) The Company has required that all bonuses, retention awards, and incentive compensation of the senior executive officers and next twenty most highly compensated employees be subject to a provision for recovery or "clawback" by the Company if the payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria;
- (7) The Company has prohibited any golden parachute payment to the senior executive officers and the next five most highly compensated employees. For this purpose, a golden parachute payment is any payment triggered by involuntary termination with or without cause; bankruptcy, insolvency or receivership of the Company; or a change in control of the Company;
- (8) The Company has limited bonuses, retention awards, and incentive compensation paid to or accrued by employees to whom the bonus payment limitation applies;
- (9) The Company will permit a non-binding shareholder resolution on the senior executive officer compensation disclosures provided under the Federal securities laws in accordance with any guidance, rules, and regulations promulgated by the SEC;
- (10) The Company and its employees have complied with the excessive or luxury expenditures policy, as defined in the regulations and guidance established under section 111 of EESA; and any expenses that, pursuant to the policy, required approval of the Board of Directors, a committee of the Board of Directors, a senior executive officer, or an executive officer with a similar level of responsibility were properly approved;
- (11) The Company will disclose the amount, nature, and justification for the offering of any perquisites whose total value exceeds \$25,000 for each of the employees subject to the bonus payment limitations;
- (12) The Company will disclose whether the Company, the Board, or the Compensation Committee has engaged a compensation consultant, and the services the compensation consultant or any affiliate provided;
- (13) The Company has prohibited any tax gross-ups on compensation to the senior executive officers and the next twenty most highly compensated employees;
- (14) The Company has substantially complied with any compensation requirements set forth in the agreement between the Company and the Treasury, as may have been amended;
- (15) The Company has submitted to Treasury a complete and accurate list of the senior executive officers and the twenty next most highly compensated employees for the current fiscal year with the non-senior executive officers ranked in descending order of level of annual compensation, and with the name, title, and employer of each senior executive officer and most highly compensated employee identified; and,
- (16) The officer certifying understands that a knowing and willful false or fraudulent statement made in connection with the certification may be punished by fine, imprisonment or both.

Dated: March 30, 2015

By: /s/ John T. Taylor
John T. Taylor
Chief Executive Officer

PORTER BANCORP, INC.
TARP CERTIFICATION OF CHIEF FINANCIAL OFFICER

Note: This Certification covers the portion of the most recently completed fiscal year of Porter Bancorp, Inc. that was a TARP period, specifically, January 1, 2014 through the last day of the TARP period, December 4, 2014, the date Porter Bancorp, Inc. and the Treasury completed the disposition of Porter Bancorp, Inc.'s TARP securities.

I, Phillip W. Barnhouse, Chief Financial Officer of Porter Bancorp, Inc. (the "Company"), certify that:

- (1) The compensation committee (the "Compensation Committee") of the Board of Directors (the "Board") of the Company has met at least every six months during the prior fiscal year with the senior risk officers of the Company to discuss and evaluate senior executive officer compensation plans and employee compensation plans and the risks these plans pose to the Company;
- (2) The Compensation Committee has identified and limited the features in the senior executive officer compensation plans that could lead senior executive officers to take unnecessary and excessive risks that could threaten the value of the Company, has identified any features in the employee compensation plans that pose risks to the Company, and has limited those features to ensure that the Company is not unnecessarily exposed to risks;
- (3) The Compensation Committee has reviewed at least every six months the terms of each employee compensation plan and identified and limited the features in the plan that could encourage the manipulation of reported earnings of the Company to enhance the compensation of an employee;
- (4) The Compensation Committee will certify to these reviews;
- (5) The Compensation Committee will provide a narrative description of how it limited the features in (i) senior executive officer compensation plans that could lead senior executive officers to take unnecessary and excessive risks that could threaten the value of the Company, (ii) employee compensation plans to ensure that the Company is not unnecessarily exposed to risks, and (iii) employee compensation plans that could encourage the manipulation of reported earnings of the Company to enhance the compensation of an employee;
- (6) The Company has required that all bonuses, retention awards, and incentive compensation of the senior executive officers and next twenty most highly compensated employees be subject to a provision for recovery or "clawback" by the Company if the payments were based on materially inaccurate financial statements or any other materially inaccurate performance metric criteria;
- (7) The Company has prohibited any golden parachute payment to the senior executive officers and the next five most highly compensated employees. For this purpose, a golden parachute payment is any payment triggered by involuntary termination with or without cause; bankruptcy, insolvency or receivership of the Company; or a change in control of the Company;
- (8) The Company has limited bonuses, retention awards, and incentive compensation paid to or accrued by employees to whom the bonus payment limitation applies;
- (9) The Company will permit a non-binding shareholder resolution on the senior executive officer compensation disclosures provided under the Federal securities laws in accordance with any guidance, rules, and regulations promulgated by the SEC;
- (10) The Company and its employees have complied with the excessive or luxury expenditures policy, as defined in the regulations and guidance established under section 111 of EESA; and any expenses that, pursuant to the policy, required approval of the Board of Directors, a committee of the Board of Directors, a senior executive officer, or an executive officer with a similar level of responsibility were properly approved;
- (11) The Company will disclose the amount, nature, and justification for the offering of any perquisites whose total value exceeds \$25,000 for each of the employees subject to the bonus payment limitations;
- (12) The Company will disclose whether the Company, the Board, or the Compensation Committee has engaged a compensation consultant, and the services the compensation consultant or any affiliate provided;
- (13) The Company has prohibited any tax gross-ups on compensation to the senior executive officers and the next twenty most highly compensated employees;
- (14) The Company has substantially complied with any compensation requirements set forth in the agreement between the Company and the Treasury, as may have been amended;
- (15) The Company has submitted to Treasury a complete and accurate list of the senior executive officers and the twenty next most highly compensated employees for the current fiscal year, with the non-senior executive officers ranked in descending order of level of annual compensation, and with the name, title, and employer of each senior executive officer and most highly compensated employee identified; and,
- (16) The officer certifying understands that a knowing and willful false or fraudulent statement made in connection with the certification may be punished by fine, imprisonment or both.

Dated: March 30, 2015

By: /s/ Phillip W. Barnhouse
Phillip W. Barnhouse
Chief Financial Officer