

2017 Annual Report

100724



1K First
Keystone
Corporation

FINANCIAL HIGHLIGHTS

(Dollars in thousands, except per share data) **2017** 2016 2015 2014 2013

SUMMARY OF OPERATIONS

Interest income	\$32,268	\$31,643	\$ 31,711	\$ 31,019	\$ 30,961
Interest expense	6,548	5,282	4,966	4,452	4,954
Net interest income	25,720	26,361	26,745	26,567	26,007
Provision for loan losses	267	2,083	2,277	433	1,372
Net investment securities gains	938	1,764	2,131	2,756	2,900
Net income	8,648	9,472	9,172	10,211	10,273

PER COMMON SHARE DATA

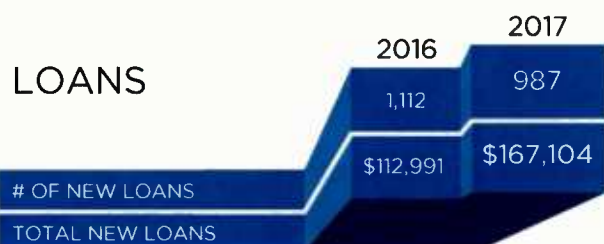
Net income	\$ 1.52	\$ 1.68	\$ 1.64	\$ 1.84	\$ 1.87
Dividends	1.08	1.08	1.08	1.05	1.04

BALANCE SHEET DATA

Total assets	\$990,121	\$984,283	\$983,489	\$912,353	\$901,514
Total investment securities	350,218	379,641	385,267	348,722	354,770
Net loans	551,910	515,025	509,871	481,071	439,999
Total deposits	778,146	725,982	720,598	661,562	690,075
Total stockholders' equity	116,719	109,685	108,438	106,271	96,351

PERFORMANCE RATIOS

Return on average assets	0.86%	0.96%	0.96%	1.13%	1.23%
Return on average equity	7.54%	8.23%	8.43%	9.90%	10.12%
Dividend payout	71.05%	64.30%	65.79%	56.95%	55.64%
Average equity to average assets	11.45%	11.68%	11.40%	11.45%	12.10%



LOAN BREAKDOWN



DEPOSIT BREAKDOWN



Dollars in thousands

NEW INITIATIVES

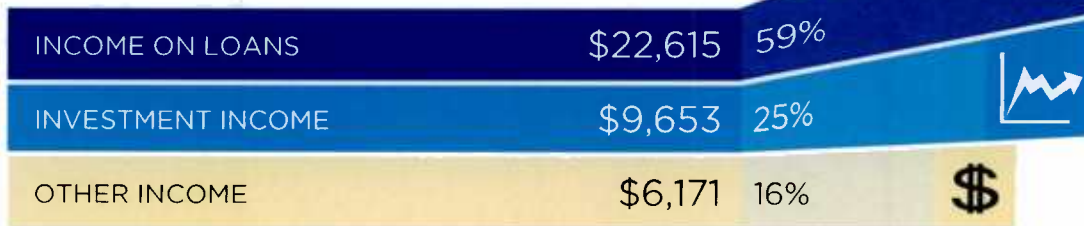
- Launched the Keystone Rewards suite of deposit products supported by the "We Believe Life Should Be Rewarding" marketing campaign
- Collaborated with and supported Bloomsburg University in the nationwide event "Conference of State Bank Supervisors Community Bank Case Bank Study Competition"
- Sponsored high school students by providing scholarships to Pennsylvania Free Enterprise Week
- Developed and implemented the Keystone Banker training and career path program for frontline employees

COMMUNITY OFFICES

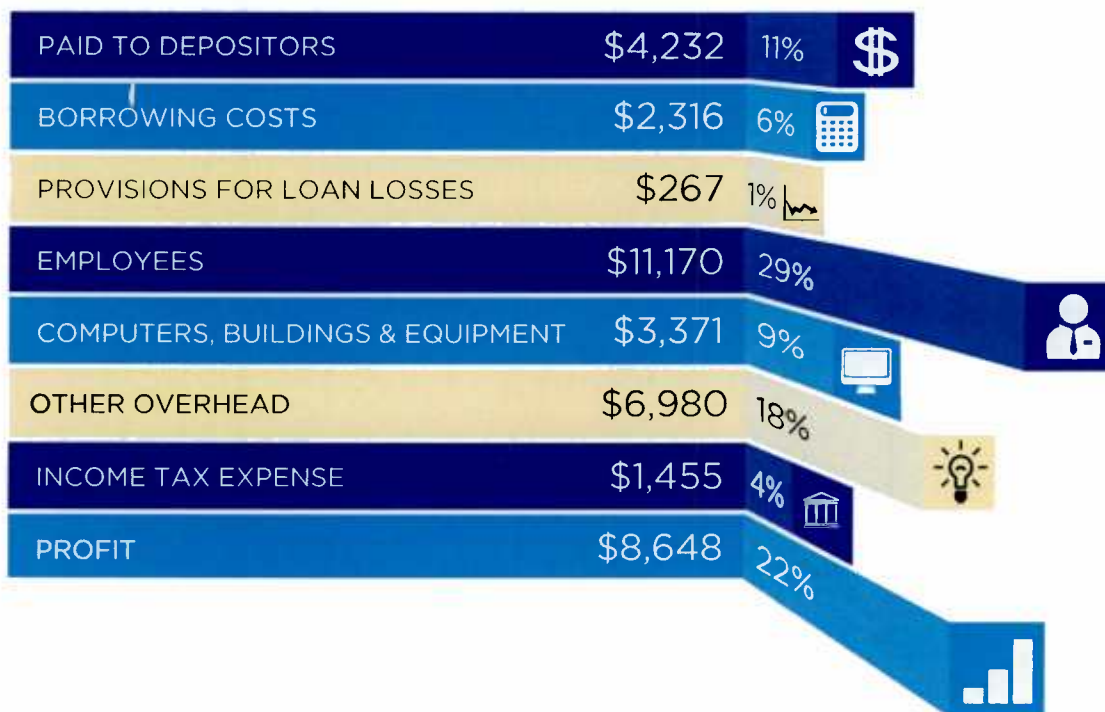
- Dallas Office exterior renovations
- FKCB employees volunteered 2100 hours of community outreach initiatives including but not limited to supporting non-profit organizations
- FKCB employees regularly attended municipality meetings to proactively understand community progress plans.

INCOME STATEMENT IN GRAPHIC FORM

How we generated \$38,439 in income:



How we used our \$38,439 in income:



COMPONENTS OF OTHER INCOME



Dollars in thousands

TO OUR SHAREHOLDERS

Community Is In Our Name

*At First Keystone Community Bank, we are dedicated to supporting healthy local communities. The center pages of this year's Annual Report to Shareholders outlines the many ways in which we support the communities where we live, work, and play. We contribute dollars, but more importantly, we contribute our time and our energy. Whether educating school students, assisting military veterans, raising funds for the YMCA, helping local economic development agencies or donating to the many charitable organizations in our community, our goal is to improve the health and prosperity of the communities we serve. Our aim is to be: **First Keystone Community Bank.....the bank for your community.***

Financial Highlights

During the fiscal year ended December 31, 2017, First Keystone Corporation had net income of \$8,648,000 compared to income of \$9,472,000 for the same period in 2016. Net income in 2017 was impacted negatively by a compressed net interest margin, fewer net gains realized on sales of investment securities, and higher non-interest expense. A lower provision for loan losses and a lower average tax rate affected net income positively. Net income per share was \$1.52 for 2017, while dividends per share were \$1.08.

Interest income for 2017 was \$32,268,000 as compared to \$31,643,000 in 2016, a 2.0% increase. Interest income rose as a result of higher average balances in loans and higher yields on the investment portfolio. At year-end, total loans were \$559,397,000, an increase of \$37,015,000 or 7.1%. Loan growth was centered in commercial real estate and commercial and industrial loans, while residential mortgage loans declined slightly. We will continue to place emphasis on loan growth in 2018 as a primary driver of net interest income. We have plans to open a loan production office in downtown Bethlehem, in the Lehigh Valley, as a way to develop additional lending opportunities. We expect the lending office to open during the second quarter of 2018.

Interest expense grew considerably in 2017 as compared to 2016. Interest expense related to deposits and short-term borrowings increased as a result of the three increases in short-term interest rates by the Federal Reserve Bank during 2017. At year-end 2017, total deposits stood at \$778,146,000. That is a 7.2% increase, or \$52,164,000, as compared to year-end 2016. Non-interest bearing deposits grew by \$11,101,000 or 10.1%. In order to reduce our dependence on short-term borrowings and municipal deposits, both of which are sensitive to rising interest rates, our focus will be to continue the growth of core deposits in 2018.

First Keystone added \$267,000 to the allowance for loan losses in 2017. During the year, total charge-offs were \$333,000, or 0.06% of average loans. Recoveries totaled \$196,000, putting net charge-offs at \$137,000 for the year. This is a strong performance indicator of the strength of the bank's asset quality in the loan portfolio. While non-performing assets increased during 2017, total impaired loans were lower. A strong credit culture has and will remain the clear objective of our underwriting process, even as we seek to grow the loan portfolio in 2018.

Non-interest income, excluding net investment securities gains and gains from life insurance proceeds, a non-GAAP measure, was \$5,233,000 in 2017. This compares favorably to the \$5,165,000 in 2016. Trust department income, service charges and fees and ATM and debit card income all were higher. Income on bank owned life insurance and gains on sales of residential mortgages fell. We have several initiatives underway to grow non-interest income in 2018, principally the addition of residential mortgage lending sales personnel which is designed to grow both secondary-market mortgage and portfolio mortgage lending.

Non-interest expense increased by 5.8%, or \$1,173,000, in 2017 as compared to 2016. Higher salaries and employee benefits were primarily the result of the addition of sales positions in commercial and residential lending, as well as a 19.4% increase in medical insurance for employees. Advertising and professional fees were also higher in 2017.

Income tax expense was lower in 2017 as compared to 2016. During 2017 the corporation recorded \$1,455,000 in income tax expense. The effective tax rate for the year was 14.4% as compared to 16.3% in 2016. Income tax expense was lower due to an increase in tax-exempt income from municipal investments in the securities portfolio and an increase in tax credits from investments in low-income housing partnerships. The Tax Cuts and Jobs Act of 2017 reduces the company's tax rate from 34% to 21% effective January 1, 2018. We expect the effective tax rate of the bank to be lower in 2018 as compared to 2017.

At year-end 2017, total assets increased only slightly as compared to year-end 2016. Total assets were \$990,121,000 at December 31, 2017. While loans increased, as noted above, investment securities were lower at the end of 2017, due to planned reductions in anticipation of loan growth in 2018.

As a result of the increase in deposits at December 31, 2017 as compared to 2016, short-term borrowings were significantly lower. In addition, during 2017 the bank retired \$10,000,000 in long-term borrowings.

As a result of increases in retained earnings, common stock and surplus, total stockholder's equity grew by \$7,034,000, an increase of 6.4%.

During 2017, we paid a dividend of \$1.08 per share, the same as in 2016. Based upon the closing share price on December 31, 2017 of \$28.25, this produced a dividend yield of 3.8%. One hundred dollars invested in the Corporation's stock on December 31, 2007, with dividends reinvested, would have been worth \$283.42 as of December 31, 2017.

The primary role of First Keystone Corporation is to provide a consistent and fair return to you, its owners. By providing exceptional value to our customers we can ensure that fair return to our shareholders. By supporting our employees, they deliver our products and services in a way that provides value. And, by giving back, to strengthen and grow our communities, we get an excellent return on our investment.



Matthew P. Prosseda
President & Chief Executive Officer



FIRST KEYSTONE PUTS COMMUNITY IN BANK

Partnering with our customers and prioritizing their needs is one of the foundations of First Keystone Community Bank's overall business philosophy. You could say it is one of our keystones.

When the word 'community' was added to our title in 2010, it emphasized our focus on providing traditional banking services and financial solutions in our local communities and neighborhoods. "Community banks are important to the economies of the places we serve," said President and CEO Matthew P. Prosseda. "Our competitive advantage that sets us apart is that we are connected to the local people and understand the needs of the community. We think of them as our partners."



At First Keystone, community means more than sharing a zip code. This is evidenced by the wide variety of groups and organizations that have benefited from collaborating with First Keystone, such as the McBride Memorial and Hoyt Libraries; Berwick, Bloomsburg and Stroudsburg YMCAs; Central Susquehanna Community Foundation and the Women's Giving Circle; Pocono Services for Families and Children; Berwick Industrial Development Association (BIDA); Columbia Montour Chamber of Commerce; Columbia Alliance for Economic Growth, and the Children's Service Center of Wyoming County.

The Bank also assembled a large "Relay for Life" team, participated in the "Walk to Defeat ALS," and supported the "Warrior of the Quarter" program at the Tobyhanna Army Depot, which honors military veterans from all over Northeastern Pennsylvania. From local community groups like fire companies, food pantries, animal shelters and little league teams, to more widely known entities such as United Way and Salvation Army, First Keystone is first in line to lend a helping hand.

Another major element of First Keystone's dedication to its community partnerships centers on education and fostering the next generation of business and community leaders. Members of the Bank's staff visited local high schools throughout the 2017 school year to teach students about banking, touching on topics such as checking and savings accounts, credit and debit cards, and managing debt. This initiative reached over 1,500 students.



In addition to supporting Junior Achievement of Northeastern PA, the Danville Child Development Center, and the "Newspapers in Education Program," First Keystone annually sponsors four students to attend Pennsylvania Free Enterprise Week (PFEW), a residential summer camp that teaches high school juniors and seniors to understand and celebrate private enterprise and gets them excited about business, entrepreneurship, and career opportunities in Pennsylvania.



In the spring of 2017, First Keystone's executive staff spent many hours helping Bloomsburg University's team in the nationwide "Community Bank Case Study Competition," facilitated by the Conference of State Bank Supervisors. The competition, which was open to undergraduate students in all fields of study, was an opportunity for students to gain valuable first-hand knowledge of the banking industry, as well as the opportunities and challenges facing community banks in the 21st century. Bloomsburg University was one of five finalists among the 33 institutions that participated.



FKCB employees also support worthy causes themselves. For example, "Denim Day" is held one Friday per month, with the proceeds donated to various local programs. In addition to monetary donations, contributions also come from the dedication of time and service by our employees, totaling more than 2,100 hours donated in 2017, with one FKCB employee alone volunteering more than 200 hours.

"Since we obtain most of our core deposits locally and make the majority of our loans to local individuals and businesses, taking care of the community in the places we live, work and play is very important to all of us at First Keystone Community Bank," Prosseda said.

True to our mission — "Yesterday's traditions. Tomorrow's vision." — First Keystone Community Bank is a leader in providing products and services that stress convenience and flexibility, such as bill payment, mobile banking, remote deposit capture, online account opening, and our Keystone Rewards suite of accounts featuring high-yield checking and savings accounts.

Experience, stability, and our team of professional bankers makes all the difference. By working together, our mission and our passion is to help our customers reach their financial goals with a wide range of personal and business banking solutions and expertise. We firmly believe that doing business this way is essential for mutual success.

**"OUR AIM IS TO BE: FIRST KEYSTONE COMMUNITY BANK
THE BANK FOR YOUR COMMUNITY."**



FIRST KEYSTONE CORPORATION BOARD OF DIRECTORS



DR. JOSEPH B. CONAHAN, JR.
Ophthalmologist

ROBERT E. BULL
Retired Attorney
Bull & Bull LLP

DAVID R. SARACINO
Retired Vice President & CFO
First Keystone Community Bank

MATTHEW P. PROSEDA
President & CEO
First Keystone Community Bank

JOHN ARNDT
Owner
Arndt Insurance Agency

JOHN G. GERLACH
Retired President
First Keystone Community Bank,
Pocono Division

NANCY J. MARR
Owner/President
Marr Development Companies

DON E. BOWER
President
Don E. Bower, Inc.

ROBERT A. BULL
Chairman
Attorney
Bull & Bull LLP

JEROME F. FABIAN
Owner/President
Tile Distributors of America, Inc.

OFFICERS

ROBERT A. BULL
Chairman

JOHN ARNDT
Vice Chairman

MATTHEW P. PROSEDA
President & Chief Executive Officer

DIANE C.A. ROSLER
Chief Financial Officer

DAVID R. SARACINO
Secretary

CHERYL L. WYNINGS
Assistant Secretary

ELAINE A. WOODLAND
Treasurer

FIRST KEYSTONE COMMUNITY BANK OFFICERS*

ROBERT A. BULL
Chairman of the Board

JOHN ARNDT
Vice Chairman

DAVID R. SARACINO
Secretary

EXECUTIVE MANAGEMENT

MATTHEW P. PROSEDA
President
Chief Executive Officer

ELAINE A. WOODLAND
Executive Vice President
Chief Operating Officer
Treasurer

MATTHEW W. MENSINGER
Senior Vice President
Director of Lending

DIANE C.A. ROSLER
Senior Vice President
Chief Financial Officer & Cashier

BARBARA J. ROBBINS
Senior Vice President
Deposit Operations
Manager

MARK J. MCDONALD
Senior Vice President
Chief Credit Officer

JEFFREY T. WOZNAK
Senior Vice President
Senior IT Manager &
Information Security Officer

J. RICHARD PRICE
Senior Vice President
Director of Wealth Management

VICE PRESIDENT

JODI L. ALLEY
Loan Operations Manager

LESA A. ANGELL
Retail Banking & Sales Manager

STACIA L. ARNAUD
Commercial Services Officer

ANTHONY P. CARTIGLIA
Commercial Services Officer

CARMELITA A. CLEAVER
Retail Operations Officer

EDGAR A. GOWER, JR.
Commercial Services Officer

BRENDA L. GRASLEY
Consumer Loan Manager

TINA M. GRAY
Community Office Manager

LEE A. HESS
Loan Workout Officer/
Security Officer

JUNE GEORGE
Consumer Loan Underwriter/
Processor

DONNA J. KEEFER
Training/Systems Support Manager

KEVIN KRIEGER
Compliance Officer

JONATHAN LITTLEWOOD
Commercial Services Officer

MARISOL LOPEZ
Regional Branch Administrator

EUGENE W. MORRISON
Commercial Services Officer

MICHAEL REIS
Commercial Services Officer

LEIGHTON B. WALSH
Mortgage Services Manager

LINDA K. YERGES
Human Resource Manager

VICE PRESIDENT

ROBERT A. YOUNG
Loan Review Officer

ASSISTANT VICE PRESIDENT

LAUREN DUANE
Business Deposit Specialist

ELIZABETH GOLL
Assistant Community Office Manager

LAURIE GRADY
Community Office Manager

REBECCA A. HOOPER
Trust Officer

KATHLEEN M. JARSKI
Community Office Manager

BRIAN M. KLINEFELTER
Credit Department Manager

LINDA M. MESHINSKI
Regional Branch Administrator

KIM R. MURREN
Community Office Manager

MARY E. PASCUCCI
Training Director

FRANCES I. SEWARD
Community Office Manager

KIMBERLY S. SHINER
Community Office Manager

SHERRI A. SITLER
Deposit Review Officer

NATALIE J. STACKHOUSE
Accounting Manager

CHERYL L. WYNINGS
Executive Administrative Assistant/
Assistant Secretary

CHRISTOPHER ZLOBIK
Assistant IT Manager

ASSISTANT CASHIER

SANDRA L. COLE
Community Office Manager

JOHN DOUGHERTY
Community Office Manager

JILLIAN GUENTHER
Fraud Analyst & BSA Officer

HERBERT HARMON, JR.
Facilities Manager

LILIANA HENRICKSON
Community Office Manager

JASON P. HOLLOWAY
Commercial Services Officer

AMANDA JARSKI
Credit Analyst

RACHEL JENNINGS
Post-Closing Document Specialist

STACY GORDNER
Accounting Department Analyst

STEVEN M. KOTCH
Collector

MICHELLE E. KOZAK
Marketing Manager

MARTIN B. LEANDRI
Financial Consultant

ANGELA MACKERT
Community Office Manager

KRISTI A. MCCLINTOCK
Commercial Loan Document Specialist

ASHLEY MILLOWAY
Mortgage Loan Consultant

BONNIE NEVEL
Trainer

LAURIE NUDO
Community Office Manager

KIMBERLY A. VOLKEL
Community Office Manager

*Officers as of December 31, 2017

ADVISORY BOARDS

COLUMBIA-MONTOUR

Michael E. Boone
Adam Bowman
Walter Deacon
Dan W. Hartman
Michael H. Kuziak

WYOMING VALLEY

Timothy Connolly
Daniel Fierman
Michael Jezewski
Steven Phillips
Edward H. Poggi, III
James V. Reino, Jr.

POCONO COMMUNITY

Richard W. Berkowitz
Richard L. Price, Jr.
William E. Rinehart
Joel D. Rossi
Jacob E. Seip, Jr.

CORPORATE INFORMATION

THE CORPORATION

First Keystone Corporation is a bank holding company incorporated under the Pennsylvania Business Corporation Laws. Its assets consist primarily of the assets of its wholly-owned subsidiary, First Keystone Community Bank.

First Keystone Community Bank serves Columbia, Montour, Luzerne, and Monroe Counties. The Bank engages in general banking business and also provides fiduciary services.

CORPORATE HEADQUARTERS

First Keystone Corporation
111 West Front Street
Berwick, Pennsylvania 18603
Telephone: 570-752-3671
Fax: 570-752-4022

NOTICE OF ANNUAL MEETING

The 2018 Annual Meeting of Shareholders will be held at 10:00 a.m., Eastern Daylight Time, on Thursday, May 10, 2018 at:

McBride Memorial Library, Community Room
500 Market Street
Berwick, Pennsylvania 18603

ANNUAL REPORT ON FORM 10-K

The Annual Report on Form 10-K as filed with the Securities and Exchange Commission may be obtained, without charge, by writing to:

Cheryl Wynings
Investor Relations
P.O. Box 289
Berwick, PA 18603
Telephone: 1-888-759-2266, extension 1175
Locally: 570-752-3671, extension 1175

TRANSFER AGENT AND REGISTRAR

To change or transfer registration of your stock, report a lost certificate, or other related inquiries, please contact our transfer agent at:

Computershare
Regular Mail:
P.O. Box 505000
Louisville, KY 40233-5000
United States
Telephone: 1-800-368-5948
Website: computershare.com/investor

Overnight Delivery:
462 South 4th Street, Suite 1600
Louisville, KY 40202
United States

DIRECT DEPOSIT

Shareholders may have their cash dividends deposited directly into the account of their choice at any banking institution, with no charge. Additional information and enrollment materials for direct deposit can be obtained by calling 1-800-368-5948.

DIVIDEND REINVESTMENT

The Plan, open to residents of Pennsylvania, provides the opportunity to have dividends automatically reinvested into First Keystone Corporation stock. Participants in the Plan may also elect to make cash contributions to purchase additional shares of common stock. For information regarding the Plan, contact the Plan Administrator at:

Computershare
P.O. Box 505000
Louisville, KY 40233-5000
Telephone: 1-800-368-5948

INVESTOR INFORMATION

Information regarding First Keystone Corporation is available online at www.firstkeystonecorporation.com. The website also includes additional information of interest to shareholders such as: historical stock prices, dividend declarations, press releases and governance documents.

Requests for information or assistance regarding the corporation should be directed to Shareholder Relations at

1-888-759-2266, extension 1175
Locally: 570-752-3671, extension 1175

STOCK LISTING

First Keystone Corporation common stock is traded on OTC Pink under the symbol "FKYS".

STOCK PURCHASE INQUIRIES

The following brokerage firms make a market in First Keystone Corporation common stock:

RBC Dain Rauscher, 800-223-4207
Janney Montgomery Scott LLC, 800-526-6397
Stifel Nicolaus & Co. Inc., 800-679-5446
Boenning & Scattergood, Inc., 800-883-1212

INDEPENDENT PUBLIC ACCOUNTANTS

Baker Tilly Virchow Krause, LLP
1000 Commerce Park Drive, Suite 430
Williamsport, PA 17701
United States
Telephone: 570-323-6023

OFFICE LOCATIONS



FIRST KEYSTONE COMMUNITY BANK

MAIN OFFICE
111 West Front Street
Berwick, PA 18603
570-752-3671

SALEM TOWNSHIP OFFICE
400 Fowler Avenue
Berwick, PA 18603
570-759-2628

FREAS AVENUE OFFICE
701 Freas Avenue
Berwick, PA 18603
570-752-1244

BRIAR CREEK OFFICE
50 Briar Creek Plaza
Berwick, PA 18603
570-802-0541

NESSCOPECK OFFICE
437 West Third Street
Nescopeck, PA 18635
570-759-2767

MIFFLINVILLE OFFICE
133 West Third Street
Mifflinville, PA 18631
570-752-5750

SCOTT TOWNSHIP OFFICE
2301 Columbia Boulevard
Bloomsburg, PA 17815
570-784-0354

DANVILLE OFFICE
1049 Bloom Road
Danville, PA 17821
570-275-8000

HANOVER TOWNSHIP OFFICE
1540 Sans Souci Highway
Hanover Township, PA 18706
570-825-7352

KINGSTON OFFICE
299 Wyoming Avenue
Kingston, PA 18704
570-718-1110

MOUNTAIN TOP OFFICE
18 North Mountain Boulevard
Mountain Top, PA 18707
570-715-0720

PLYMOUTH OFFICE
463 West Main Street
Plymouth, PA 18651
570-719-1400

DALLAS OFFICE
2325 Memorial Highway
Dallas, PA 18612
570-674-1030

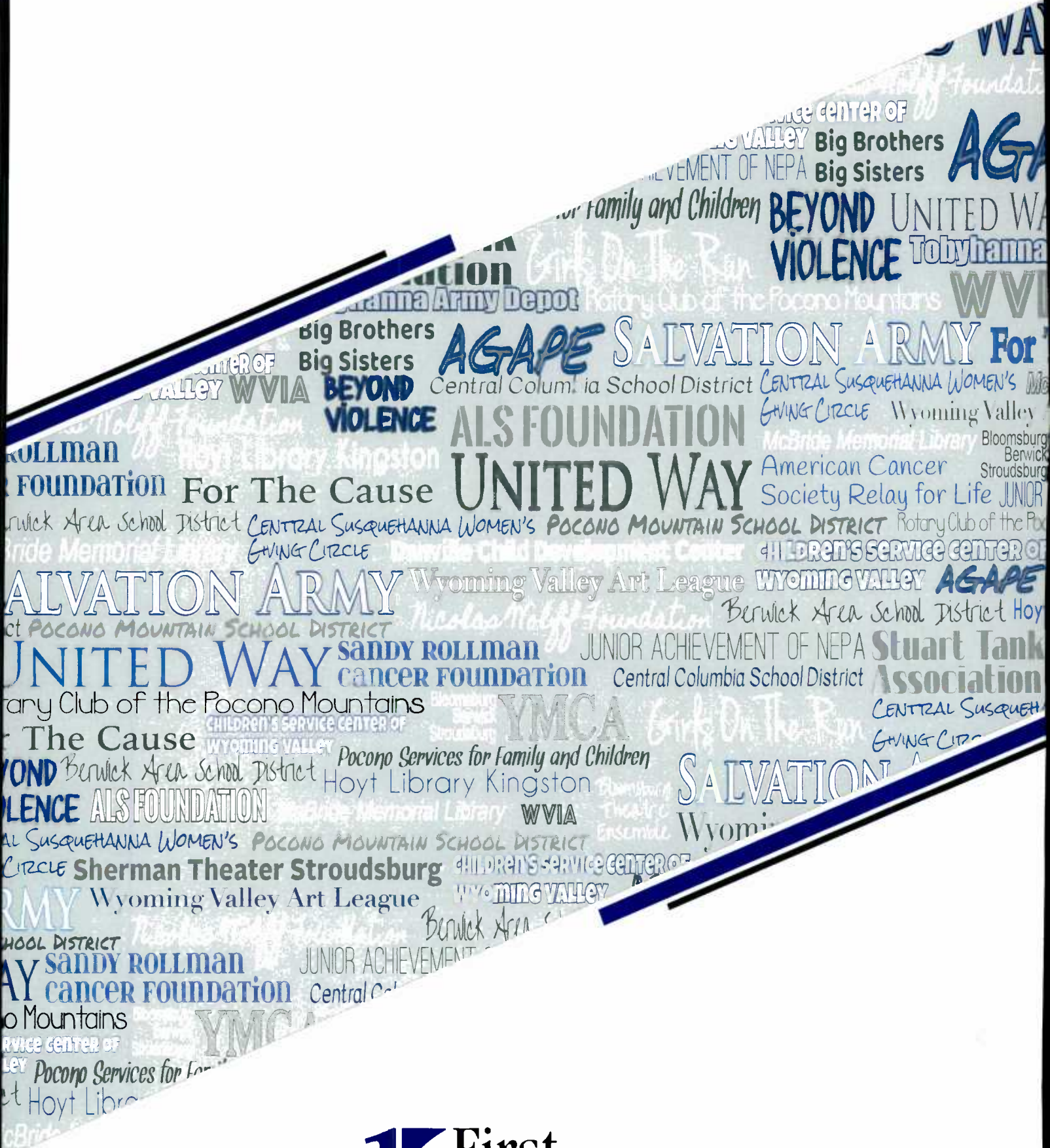
SHICKSHINNY OFFICE
107 South Main Street
Shickshinny, PA 18655
570-542-6060

STROUDSBURG OFFICE
559 Main Street
Stroudsburg, PA 18360
570-424-9700

MOUNTAINHOME OFFICE
1154 Route 390
Cresco, PA 18326
570-595-9700

SWIFTWATER OFFICE
2070 Route 611
Swiftwater, PA 18370
570-839-7880

BRODHEADSVILLE OFFICE
2022 Route 209
Brodheads ville, PA 18322
570-402-2008



**First
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