# PINNACLE BANKSHARES CORPORATION

2014 ANNUAL REPORT

# BOARD OF DIRECTORS

**Front Row: C. Bryan Stott, James E. Burton, IV (Chairman), Aubrey H. Hall, III, A. Patricia Merryman**

**Back Row: Robert L. Finch, Jr., Robert L. Johnson, II, Judson H. Dalton, Thomas F. Hall, Michael E. Watson, Carroll E. Shelton**

# SENIOR MANAGEMENT

**Front Row: Vivian S. Brown, Aubrey H. Hall, III (President and CEO), Judith A. Clements**
**Back Row: Thomas R. Burnett, Jr., Tony J. Bowling, Bryan M. Lemley, William J. Sydnor, II**

**PINNACLE BANKSHARES CORPORATION**
**AND SUBSIDIARY**

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## PINNACLE BANKSHARES CORPORATION
## AND SUBSIDIARY

# First National Bank Office Locations

**ALTAVISTA**

MAIN OFFICE
622 Broad Street
Altavista, Virginia 24517
Telephone: (434) 369-3000

VISTA OFFICE
1303 Main Street
Altavista, Virginia 24517
Telephone: (434) 369-3001

**LYNCHBURG**

AIRPORT OFFICE
14580 Wards Road
Lynchburg, Virginia 24502
Telephone: (434) 237-3788

TIMBERLAKE OFFICE
20865 Timberlake Road
Lynchburg, Virginia 24502
Telephone: (434) 237-7936

OLD FOREST ROAD OFFICE
3309 Old Forest Road
Lynchburg, Virginia 24501
Telephone: (434) 385-4432

**FOREST**

FOREST OFFICE
14417 Forest Road
Forest, Virginia 24551
Telephone: (434) 534-0451

**AMHERST**

AMHERST OFFICE
130 South Main Street
Amherst, Virginia 24521
Telephone: (434) 946-7814

**RUSTBURG**

RUSTBURG OFFICE
1033 Village Highway
Rustburg, Virginia 24588
Telephone: (434) 332-1742

**PINNACLE BANKSHARES CORPORATION**
**AND SUBSIDIARY**

**Officers of Pinnacle Bankshares Corporation**

| | |
|---|---|
| Aubrey H. Hall, III | President & Chief Executive Officer |
| Bryan M. Lemley | Secretary, Treasurer & Chief Financial Officer |
| William J. Sydnor, II | Vice President |

**Officers and Managers of First National Bank**

| | |
|---|---|
| Aubrey H. Hall, III | President, Chief Executive Officer & Trust Officer |
| Bryan M. Lemley | Senior Vice President, Cashier & Chief Financial Officer |
| William J. Sydnor, II | Senior Vice President & Chief Credit Officer |
| Judith A. Clements | Senior Vice President & Director of Human Resources |
| Thomas R. Burnett, Jr. | Senior Vice President & Chief Lending Officer |
| Vivian S. Brown | Senior Vice President & Branch Administration Officer |
| Tony J. Bowling | Senior Vice President & Chief Operating Officer |
| Lucy H. Johnson | Senior Vice President & Data Processing Manager |
| Pamela R. Adams | Vice President & Loan Operations Manager |
| James M. Minear | Vice President & Commercial Officer |
| Shawn D. Stone | Vice President & Commercial Officer |
| Daniel R. Wheeler | Vice President & Commercial Officer |
| Tracie A. Gallahan | Vice President & Mortgage Division Manager |
| Cecilia L. Doyle | Vice President & Senior Credit Analyst |
| John E. Tucker | Vice President & Investment Consultant |
| Lisa M. Landrum | Vice President & Dealer Finance Officer |
| Tarry R. Pribble | Vice President & Collections and Recovery Manager |
| Melissa T. Campbell | Assistant Vice President & Branch Operations Manager |
| Nancy J. Holt | Assistant Vice President & Branch Manager (Main) |
| Janet H. Whitehead | Assistant Vice President & Branch Manager (Airport) |
| M. Amanda Ramsey | Assistant Vice President & Branch Manager (Amherst) |
| Andria C. Smith | Assistant Vice President & Branch Manager (Rustburg) |
| Kathleen P. Morgan | Assistant Vice President & Branch Manager (Forest) |
| Arin L. Brown | Assistant Vice President & Branch Manager (Vista) |
| Ann W. King | Assistant Vice President & Branch Manager (Timberlake) |
| Christine A. Hunt | Assistant Vice President & Internal Auditor |
| Vicki G. Greer | Assistant Vice President & Financial Analyst |
| Dianna C. Hamlett | Assistant Vice President, Compliance & Bank Secrecy Act Officer |
| Anita M. Jones | Assistant Vice President & Loan Production Officer |
| Romonda F. Davis | Assistant Vice President & E-Commerce Sales Officer |
| Allison G. Daniels | Assistant Vice President & Loan Quality Control Officer |
| Ann L. Dalton | Assistant Vice President & Real Estate Loan Portfolio Manager |
| Jennifer S. Krantz | Assistant Vice President & Human Resources Officer |
| Patricia D. Canada | Acting Branch Manager (Old Forest Road) |
| Tammie W. Griffin | Retail Business Development Officer (Main) |
| Doris N. Trent | Retail Business Development Officer (Main) |
| Cheria B. Taylor | Retail Business Development Officer (Vista) |
| Sarah M. Bell | Retail Business Development Officer (Forest) |
| Nickolas R. Gillan | Retail Business Development Officer (Timberlake) |
| Scott W. Martin | Retail Business Development Officer (Airport) |
| Jennifer T. Edgell | Credit Analyst |
| Cathy C. Simms | Dealer Finance Officer |
| Lynne H. Barrett | Collection Officer |
| Shirley B. Brooks | Collection Officer |

DEAR SHAREHOLDERS,

I am pleased to report to you that Pinnacle Bankshares Corporation, the one-bank holding company for First National Bank, extended its trend of steady and sustained improvement by increasing core operating net income in 2014 for the sixth straight year. And just as economic activity appears to be ratcheting up; Pinnacle has shifted its focus to increasing market share and expanding its presence across Central Virginia. We have been patient and deliberate in the steps taken to ensure that our infrastructure and balance sheet are positioned to handle the level of growth required to sustain progress. The future is now for your company and we intend to successfully execute the plans that have been developed to grow banking relationships and further enhance your returns.

For 2014 Pinnacle generated net income of $2,149,000, which was an 11% increase as compared to 2013's core operating net income of $1,940,000, excluding insurance and taxes related to the rebuild of the Vista Branch Office that was destroyed by fire. The "core" figure has been consistently referenced for comparison purposes due to the insurance anomaly. Profitability as commonly measured by return on average assets and return on average equity improved to .60% and 6.59% respectively. The improvement was largely driven by net interest income growth of $347,000 as the decline in our cost of funds continued to outpace decreasing asset yields. We attribute our lower interest expense to growth of demand deposits and other low cost funding sources. Non-interest expense was $220,000 lower than 2013, primarily due to a significant decrease in retirement plan expense resulting from the Company's improved funding position and the positive performance of underlying retirement plan assets. Retirement plan savings were offset to a degree by increased salaries due to several new positions as well as fees paid to our core system provider for data processing, new platforms and applications. New positions and core system improvements have been part of Pinnacle's on-going effort to develop appropriate infrastructure to support future growth. A lower provision for loan losses also contributed positively to 2014's improvement, which declined by $52,000 as asset quality continues to strengthen due to fewer problem loans.

Pinnacle's overall core operating net income improvement in 2014 was limited by a $315,000 decrease in non-interest income resulting from a fall off in revenues generated by the Company's Mortgage and Investment Divisions, which faced regulatory, staffing and market challenges throughout the year. In past years these divisions have provided material contributions to the bottom line and have offset lower net interest income and higher provision for loan losses. Both Mortgage and Investments have regrouped and are experiencing positive momentum as we begin 2015.

From a balance sheet perspective Pinnacle experienced limited growth during 2014, achieving the referenced improvement without excessive leverage. Total assets as of the end of 2014 were $362,188,000, up approximately 1% compared to the end of 2013. The principal component of the Company's assets was $283,519,000 in total loans, which increased 2% or $5,761,000. This growth was largely due to volume generated by the Dealer and Commercial Divisions, which benefited from increased demand for automobile and business loans. For the year securities remained relatively flat, while cash balances declined due to the loan growth. Total liabilities, consisting primarily of deposits, were $329,534,000 as of year-end, which was an increase of less than 1%. During the year demand deposits, savings and NOW accounts (interest checking) grew over $9,000,000, reflecting our continued focus on the expansion of core deposit relationships, which has been the catalyst for the Company's lower cost of funds. This increase was partially offset by a decrease in time deposits, which declined $6,604,000 or approximately 5%. Pinnacle's total stockholders' equity as of December 31, 2014 was $32,654,000, representing an increase of $712,000 or 2% as compared to the prior year end. Pinnacle and First National Bank remain "well capitalized" per all current regulatory definitions and currently meet the new Basel III capital standards that began to take effect on January 1, 2015 and are scheduled to be fully implemented in 2019.

Your Board and Management Team are extremely pleased that a return has been paid to you in the form of a cash dividend over the last nine quarters and that the amount of the cash dividend was increased from $0.075 per share to $0.085 per share during the third quarter of 2014. Total annual cash dividends for 2014 increased 42% as compared to 2013. We are also encouraged by the increase in the trading price of Pinnacle's stock, which ended the year up 18% at $17.80. While the trading price of our stock continues to improve, we believe that it still does not fully reflect the true value of your Company. For this reason the Board approved the continuance of the Company's Share Repurchase Program to potentially increase trading volume in our stock and provide liquidity in the market, which we believe are in the best interests of our shareholders.

First National Bank's reorganization of its Operations Department during the third quarter of 2014 was the last phase of an infrastructure overhaul intended to improve efficiency, productivity and customer service. As part of the reorganization, Tony Bowling, a long-term First National employee and the Bank's prior Network Administrator, was named Senior Vice President and Chief Operating Officer responsible for technology, core system management, facilities and branch support. Mr. Bowling is an experienced and talented leader, who has already proven to be more than capable of handling the critical responsibilities of this new role.

The Bank rolled out a new, fully integrated online bill payment platform during 2014 as well as a new mobile banking application that includes mobile capture; the ability to deposit a check using your smart phone device. Online banking customers with iPhone and Droid smart phones can download our easy to use, free app – *First Nat Mobile App*. Customer feedback to date has been extremely positive regarding these enhancements to our delivery channels intended to ensure that First National stays on top of new technology.

Lastly, I am extremely excited about the announcement of our Lynchburg Market Plan, which was developed to increase First National's presence and visibility in Central Virginia. The plan includes renovation and expansion of the Bank's Timberlake Road branch, relocation of its Old Forest Road branch to a new facility on Old Forest Road, and the construction of a new branch and Lynchburg headquarters building on Odd Fellows Road. Functions currently performed at our Altavista Main Office will remain at that location. As referenced, we have focused much of our time, attention and resources over the past three years on infrastructure as it relates to systems and technology, people and positions, and organizational structure. All the while we have improved our financial performance and strengthened our capital position. As we move forward we are now focusing on modest growth within the Central Virginia area, specifically Lynchburg. The Timberlake Road, Old Forest Road and Odd Fellows Road projects will help us better serve our existing client base, expand those relationships and acquire new relationships consisting of core deposits, loans and value added services. The Bank has engaged a local project manager and architectural firm and plans to work with local contractors to complete all three projects by the end of 2016.

To hear more about the performance and direction of Pinnacle Bankshares Corporation, please plan to attend our **Annual Meeting of Shareholders** to be held at **11:00 a.m., Tuesday, April 14, 2015** in the Fellowship Hall of Altavista Presbyterian Church, 707 Broad Street, Altavista, Virginia. We are hopeful that you will be able to join us for this occasion.

As always, thank you for your support, confidence and the opportunity to serve your interests as President and Chief Executive Officer of Pinnacle Bankshares Corporation.

Sincerely,

Aubrey H. Hall, III

Aubrey H. Hall, III "Todd"
President & Chief Executive Officer

**PINNACLE BANKSHARES CORPORATION**
**AND SUBSIDIARY**

Selected Consolidated Financial Information
(In thousands, except ratios, share and per share data)

| | | Years ended December 31, | | | | |
|---|---|---|---|---|---|---|
| | | **2014** | **2013** | **2012** | **2011** | **2010** |
| **Income Statement Data:** | | | **As Restated** | | | |
| Net interest income | $ | 12,056 | 11,709 | 11,601 | 12,091 | 10,776 |
| Provision for loan losses | | 91 | 143 | 1,177 | 2,227 | 1,878 |
| Noninterest income | | 3,162 | 4,554 | 3,443 | 3,253 | 3,134 |
| Noninterest expense | | 12,008 | 12,228 | 11,910 | 11,544 | 11,037 |
| Income tax expense | | 970 | 1,241 | 619 | 510 | 308 |
| Net income | | 2,149 | 2,651 | 1,338 | 1,063 | 687 |
| **Per Share Data:** | | | | | | |
| Basic net income | $ | 1.42 | 1.75 | 0.89 | 0.71 | 0.46 |
| Diluted net income | | 1.40 | 1.74 | 0.89 | 0.71 | 0.46 |
| Cash dividends | | 0.32 | 0.23 | 0.05 | 0.00 | 0.05 |
| Book value | | 21.60 | 21.08 | 18.63 | 18.01 | 17.71 |
| **Weighted-Average Shares Outstanding:** | | | | | | |
| Basic | | 1,512,661 | 1,512,545 | 1,503,952 | 1,496,260 | 1,492,137 |
| Diluted | | 1,530,831 | 1,523,105 | 1,503,952 | 1,496,260 | 1,492,137 |
| **Balance Sheet Data:** | | | | | | |
| Assets | $ | 362,188 | 358,601 | 348,694 | 342,484 | 337,113 |
| Loans, net | | 280,449 | 274,349 | 273,672 | 267,123 | 265,030 |
| Securities | | 29,125 | 29,125 | 22,206 | 24,769 | 26,517 |
| Cash and cash equivalents | | 35,457 | 35,457 | 35,790 | 37,547 | 32,533 |
| Deposits | | 322,130 | 322,130 | 315,157 | 310,393 | 306,954 |
| Stockholders' equity | | 32,654 | 31,942 | 28,089 | 26,947 | 26,482 |
| **Performance Ratios:** | | | | | | |
| Return on average assets | | 0.60% | 0.75% | 0.39% | 0.31% | 0.21% |
| Return on average equity | | 6.59% | 8.96% | 4.83% | 3.95% | 2.62% |
| Dividend payout | | 22.48% | 12.86% | 5.61% | 0.00% | 10.92% |
| **Asset Quality Ratios:** | | | | | | |
| Allowance for loan losses to total loans, net of unearned income and fees | | 1.08% | 1.23% | 1.31% | 1.48% | 1.50% |
| Net charge-offs to average loans, net of unearned income and fees | | 0.15% | 0.12% | 0.57% | 0.84% | 0.59% |
| **Capital Ratios:** | | | | | | |
| Leverage | | 9.25% | 8.88% | 8.49% | 8.12% | 7.74% |
| Risk-based: | | | | | | |
| Tier 1 capital | | 10.96% | 10.84% | 10.15% | 9.99% | 9.36% |
| Total capital | | 11.98% | 12.03% | 11.39% | 11.24% | 10.61% |
| Average equity to average assets | | 9.11% | 8.33% | 8.04% | 7.93% | 7.88% |

## Results of Operations

(in thousands, except ratios, share and per share data)

### Cautionary Statement Regarding Forward-Looking Statements

The following discussion is qualified in its entirety by the more detailed information and the consolidated financial statements and accompanying notes appearing elsewhere in this Annual Report. In addition to the historical information contained herein, this Annual Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements, which are not statements of historical fact and are based on certain assumptions and describe future plans, strategies, and expectations of management, are generally identifiable by use of words such as “believe,” “expect,” “intend,” “anticipate,” “estimate,” “project,” “may,” “will” or similar expressions. These forward-looking statements may include, but are not limited to, anticipated future financial performance, impairment of goodwill, funding sources including cash generated by banking operations, loan portfolio composition, trends in asset quality and strategies to address nonperforming assets and nonaccrual loans, adequacy of the allowance for loan losses and future provisions for loan losses, securities portfolio composition and future performance, interest rate environments, deposit insurance assessments, and strategic business initiatives.

Although we believe our plans, intentions and expectations reflected in these forward-looking statements are reasonable, we can give no assurance that these plans, intentions, or expectations will be achieved. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain, and actual results, performance or achievements could differ materially from those contemplated. Factors that could have a material adverse effect on our operations and future prospects include, but are not limited to, changes in: the effectiveness of management’s efforts to improve asset quality and control operating expenses; the quality, composition and growth of the loan and investment portfolios; interest rates; decrease in net interest margin; declining collateral values, especially in the real estate market; general economic conditions, including stagnation in general business and economic conditions and in the financial markets; unemployment levels; the legislative/regulatory climate, including the impact of any policies or programs implemented pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) or other laws; monetary and fiscal policies of the U.S. government, including policies of the U.S. Treasury and the Board of Governors of the Federal Reserve System; demand for loan products; deposit flows; competition; demand for financial services in our market area; regulatory compliance costs; accounting principles, policies and guidelines; and an increase in shareholders that would require the Company to be subject to the reporting obligations of the Securities Exchange Act of 1934, as amended. These risks and uncertainties should be considered in evaluating forward-looking statements contained herein. We base our forward-looking statements on management's beliefs and assumptions based on information available as of the date of this report. You should not place undue reliance on such statements, because the assumptions, beliefs, expectations and projections about future events on which they are based may, and often do, differ materially from actual results. We undertake no obligation to update any forward-looking statement to reflect developments occurring after the statement is made.

### Company Overview

Pinnacle Bankshares Corporation, a Virginia corporation (“Bankshares”), was organized in 1997 and is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended. Bankshares is headquartered in Altavista, Virginia. Bankshares conducts all of its business activities through the branch offices of its wholly owned subsidiary bank, First National Bank (the “Bank”). Bankshares exists primarily for the purpose of holding the stock of its subsidiary, the Bank, and of such other subsidiaries as it may acquire or establish.

First National Bank was organized in 1908 and currently maintains a total of eight offices to serve its customers. The Main Office and Vista Branch are located in the Town of Altavista, the Airport Branch, Timberlake Branch and Rustburg Branch in Campbell County, the Old Forest Road Branch in the City of Lynchburg, the Forest Branch in Bedford County and the Amherst Branch in the Town of Amherst. The Bank also maintains an administrative and training facility in the Wyndhurst section of the City of Lynchburg.

A total of one-hundred ten full and part-time staff members serve the Bank's customers.

With an emphasis on personal service, the Bank today offers a broad range of commercial and retail banking products and services including checking, savings and time deposits, individual retirement accounts, merchant bankcard processing, residential and commercial mortgages, home equity loans, consumer installment loans, agricultural loans, investment loans, small business loans, commercial lines of credit and letters of credit. The Bank also offers a full range of investment, insurance and annuity products through its association with Infinex Investments, Inc. and Banker's Insurance, LLC. The Bank has two wholly-owned subsidiaries: FNB Property Corp., which holds title to future Bank premises real estate as needed; and First Properties, Inc., which holds title to other real estate owned acquired through foreclosures.

**Results of Operations**

Results for 2013 are restated to properly recognize an additional $366 tax expense and deferred tax liability associated with insurance proceeds received during the prior year in connection with the rebuild of the Vista Branch office that was destroyed by fire. As a result of this restatement, the Company is reporting net income of $2,651 for the year ended December 31, 2013, a decrease from the previously reported figure of $3,017. For additional information, see Note 17 to the Company's audited financial statements.

The Company had net income of $2,149 for the year ended December 31, 2014, compared to net income of $2,651 for the year ended December 31, 2013, a decrease of 18.94%. The Company's net income decreased due in large part to insurance proceeds net of tax expense totaling $711 that were recognized as noninterest income during the second quarter of 2013; the Company received no similar insurance proceeds during 2014. The proceeds were received in connection with the rebuild of the Vista Branch Office that was destroyed by fire in April of 2012. Exclusive of the insurance proceeds, 2014 net income increased 10.77% over 2013 net income. This increase in net income was driven mainly by a $347, or 2.96% increase in net interest income, a $52 or 36.36% decrease in provision for loan losses and a $220, or 1.80%, decrease in noninterest expense. These positive factors that contributed to the increase in net income, exclusive of the insurance proceeds, were partially offset by a $315, or 9.06% decrease in noninterest income, exclusive of the insurance proceeds.

Net interest income increased as net interest margin grew from 3.47% in 2013 to 3.60% in 2014. Provision for loan losses declined due to strengthened asset quality. Noninterest expense decreased as defined benefit plan expense, a component of salaries and employee benefits expense, declined from $624 in 2013 to $16 in 2014 due to contributions market returns and a higher discount rate. The defined benefit plan expense is expected to increase to $127 in 2015.

Large gains in net income for 2015 will be challenging due to front end expenses associated with the execution of our Lynchburg Market Plan. The Company is well positioned if interest rates increase in 2015, which we would expect to result in an increase in net interest margin. We expect an increase in noninterest income in 2015 with additional sales staff. Finally, we expect an increase in noninterest expense in 2015 due to additional personnel and an increase in our defined benefit plan expense as referenced previously.

Profitability as measured by the Company's return on average assets (ROA) was 0.60% in 2014, compared to 0.75% in 2013. Return on average equity (ROE), was 6.59% for 2014, compared to 8.96% for 2013.

Total assets as of December 31, 2014 were $362,188, up 1.00% from $358,601 as of December 31, 2013. The principal components of the Company's assets at the end of the year were $29,451 in cash and cash equivalents, $29,277 in securities and $280,449 in net loans. During the year ended December 31, 2014, gross loans increased 2.06% or $5,732. The Company's lending activities are a principal source of income.

Total liabilities as of December 31, 2014 were $329,534, up 0.88% from $326,659 as of December 31, 2013, due to an increase in total deposits of $3,074 or 0.95%, to $325,204 as of December 31, 2014 from $322,130 as of December 31, 2013. Noninterest-bearing demand deposits increased $3,295 or 6.94% and represented 15.62% of total deposits as of December 31, 2014, compared to 14.75% as of December 31, 2013. Savings and NOW accounts increased $6,383 or 4.14% and represented 49.37% of total deposits as of December 31, 2014, compared to 47.86% as of December 31, 2013. Time deposits decreased $6,604 or 5.48% and represented 35.01% of total deposits as of December 31, 2014, compared to 37.39% as of December 31, 2013. The Company's deposits are provided by individuals and businesses located within the communities served. The Company had no brokered deposits as of December 31, 2014 and December 31, 2013.

Total stockholders' equity as of December 31, 2014 was $32,654, including $28,219 in retained earnings. As of December 31, 2013, stockholders' equity totaled $31,942, including $26,554 in retained earnings. The increase in stockholders' equity resulted from the Company's net income of $2,149 and partially offset by a decline in other accumulated comprehensive loss due a large increase in unrealized losses of our defined benefit plan obligations.

***Net Interest Income***. The net interest spread increased to 3.47% for the year ended December 31, 2014 from 3.28% for the year ended December 31, 2013. Yield on earning assets was 4.19% and cost of funds was 0.72% for the year ended December 31, 2014 as compared to a yield on earning assets of 4.41% and a cost of funds of 1.13% for the year ended December 31, 2013. The net interest margin increased to 3.60% for the year ended December 31, 2014 from 3.47% for the year ended December 31, 2013 as the cost to funds earning assets was 0.59% for the year ended December 31, 2014 as compared to the cost to fund earning assets of 0.94% for the year ended December 31, 2013. Net interest income was $12,056 for the year ended December 31, 2014, compared to $11,709 for the year ended December 31, 2013, and is attributable to interest income from loans, federal funds sold and securities exceeding the cost associated with interest paid on deposits and other borrowings. In 2014, the Company's deposits repriced at lower rates more rapidly than its loans in the low interest rate environment, and the Company's higher-cost time deposits declined while lower-cost demand, savings and NOW deposits grew, causing the Company's interest rate spread to increase.

***Provision for Loan Losses.*** The provisions for loan losses for the years ended December 31, 2014 and 2013 were $91 and $143, respectively. The provision for loan losses decreased in 2014 and has been on the steady decline since 2011, as the Company continues to strengthen its asset quality. The provision for loan losses decreased 36.36% from 2013 to 2014 as criticized and classified loans declined due to the continued success of an aggressive asset quality improvement plan implemented in 2011. The Company expects continued improvement in its loan portfolio in 2015 and is working to minimize its losses from non-accrual and past due loans.

***Noninterest Income.*** Total noninterest income for the year ended December 31, 2014 decreased $1,392, or 30.57%, to $3,162 from $4,554 in 2013 mainly due to insurance proceeds of $1,077 received in 2013 in connection with the rebuild of the Vista Branch Office that was destroyed by fire. The Company's principal sources of noninterest income are service charges and fees on deposit accounts, particularly transaction accounts, interchange fees from debit cards, fees on sales of mortgage loans, and commissions and fees from investment, insurance, annuity and other bank products. Noninterest income exclusive of insurance proceeds decreased $315, or 9.06% to $3,162. The decrease in 2014 is primarily attributable to a $240, or 38.90%, decrease in commission and fees from investment and insurance sales and a $151, or 27.81% decrease in mortgage loan fees. This decrease was partially offset by a $10, or 0.62% increase in service charges on deposit accounts and a $39, or 18.57% increase in loan fees due to increased volume.

***Noninterest Expense.*** Total noninterest expense for the year ended December 31, 2014 decreased $220, or 1.80%, to $12,008 from $12,228 in 2013. The decrease in noninterest expense is primarily due to a $579, or 8.80%, decrease in salary and employee benefits as defined benefit plan expense decreased $609, or 97.47%, while salaries and commissions increased $181, or 3.82%. Furniture and equipment expense decreased by $240, or 38.90% due to a reclassification of our core system provider expense to other operating expenses as the Company outsourced data processing. Other operating expenses increased $642, or 22.05% due to this reclassification and also due to a $65 expense to buy out a contract that provided online bill pay services to our customers. Other increases in other operating expenses included $32 in consulting services and $38 in automobile car loan expenses.

***Income Tax Expense***. Applicable income taxes on 2014 earnings amounted to $970, resulting in an effective tax rate of 31.10% compared to $1,241, and an effective tax rate of 31.89%, in 2013.

## Investment Portfolio

Investment securities available-for-sale as of December 31, 2014 totaled $23,597, an increase of $191, or 0.82% from $23,406 as of December 31, 2013. Investment securities held-to-maturity decreased to $5,680 as of December 31, 2014 from $5,719 as of December 31, 2013, a decrease of $39 or 0.68%. Available-for sale investments totals remained relatively consistent with 2013 totals as securities that were called, paid down or matured were replaced with purchases of new bonds with similar characteristics. Held-to-maturity securities decreased slightly in 2014 as some of the Company's municipal portfolio bonds matured or were called.

## Loan Portfolio

The Company's net loans were $280,449 as of December 31, 2014, an increase of $6,100, or 2.22%, from $274,349 as of December 31, 2013. This increase resulted primarily from a $5,262 increase in commercial loans and a $4,881 increase consumer loan originations during 2014. These increases were offset by a $4,412 decrease in real estate loans. The Company's ratio of net loans to total deposits was 86.24% as of December 31, 2014 compared to 85.17% as of December 31, 2013.

## Bank Premises and Equipment

Bank premises and equipment increased $1,134, or 15.54% in 2014 due in part to the purchase of our Timberlake Road Office that was previously leased. The Company plans to renovate and expand this office in 2015. The increase also includes the purchase of land on Old Forest Road in Lynchburg to relocate our Old Forest Road Office and the purchase of land on Odd Fellows Road to build a future Lynchburg headquarters and branch office. The Odd Fellows Road office will not replace our Altavista headquarters but will relocate our administrative and training facility currently leased in the Wyndhurst section of Lynchburg and provide a new branch location.

## Deposits

Average deposits were $321,154 for the year ended December 31, 2014, a decrease of $2,910 or 0.90% from $324,064 of average deposits for the year ended December 31, 2013. As of December 31, 2014, total deposits were $325,204 representing an increase of $3,074, or 0.95%, from $322,130 in total deposits as of December 31, 2013. The change in deposits during 2014 was primarily due to increased deposit balances in previously existing deposit accounts, new deposit accounts opened as a result of new banking relationships, growth at the Company's branch locations and competitive pricing of the Company's products and services.

## Capital Resources

The Company's financial position as of December 31, 2014 reflects liquidity and capital levels currently adequate to fund anticipated funding needs and budgeted growth of the Company. Capital ratios are in excess of required regulatory minimums for a "well-capitalized" institution. The assessment of capital adequacy depends on a number of factors such as asset quality, liquidity, earnings performance, and changing competitive conditions and economic forces. The adequacy of the Company's capital is reviewed by management on an ongoing basis. Management seeks to maintain a capital structure that will assure an adequate level of capital to support anticipated asset growth and to absorb potential losses.

The primary indicators relied on by bank regulators in measuring the capital position at December 31, 2014 and 2013 are the Tier 1 capital, total risk-based capital and leverage ratios. Tier 1 capital consists generally of common and qualifying preferred stockholders' equity less goodwill. Total capital generally consists of Tier 1 capital, qualifying subordinated debt and a portion of the allowance for loan losses. Risk-based capital ratios are calculated with reference to risk-weighted assets. The Company's Tier 1 capital ratio was 10.96% as of December 31, 2014 and 10.84% as of December 31, 2013. The total capital ratio was 11.98% as of December 31, 2014 and 12.03% as of December 31, 2013

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These ratios exceed the mandated minimum requirements of 4% and 8%, respectively. As of December 31, 2014 and 2013, the Company and Bank met all regulatory capital ratio requirements and were considered "well capitalized" in accordance with the Federal Deposit Insurance Corporation Improvement Act. The Company currently meets all requirements of the new Basel III capital standards that began to take effect on January 1, 2015 and are scheduled to be fully implemented in 2019.

Stockholders' equity was $32,654 as of December 31, 2014 compared to $31,942 as of December 31, 2013.

The leverage ratio consists of Tier 1 capital divided by quarterly average assets. As of December 31, 2014, the Company's leverage ratio was 9.25% compared to 8.88% as of December 31, 2013. Each of these leverage ratios exceeds the required minimum leverage ratio of 4%. The dividend payout ratio was 22.48% and 12.86% in 2014 and 2013, respectively, with the increase due to a $0.32 per share dividend paid in 2014 as compared to the $0.225 per share dividend paid in 2013.

## PINNACLE BANKSHARES CORPORATION AND SUBSIDIARY
## CONSOLIDATED BALANCE SHEETS

December 31, 2014 and 2013
(In thousands of dollars, except share data)
(Audited)

| **Assets** | | **2014** | | **2013** |
|---|---|---|---|---|
| | | | | **As Restated** |
| Cash and cash equivalents (note 2): | | | | |
| Cash and due from banks | $ | 29,451 | $ | 35,457 |
| Securities (note 3): | | | | |
| Available-for-sale, at fair value | | 23,597 | | 23,406 |
| Held-to-maturity, at amortized cost | | 5,680 | | 5,719 |
| Federal Reserve Bank stock, at cost (note 1(d)) | | 144 | | 142 |
| Federal Home Loan Bank stock, at cost (note 1(d)) | | 322 | | 418 |
| Loans, net (notes 4, 9 and 11) | | 280,449 | | 274,349 |
| Bank premises and equipment, net (note 5) | | 8,432 | | 7,298 |
| Accrued interest receivable | | 887 | | 978 |
| Bank owned life insurance | | 6,288 | | 3,113 |
| Goodwill | | 539 | | 539 |
| Other real estate owned | | 1,107 | | 1,297 |
| Other assets (notes 7 and 8) | | 5,292 | | 5,885 |
| Total assets | $ | 362,188 | $ | 358,601 |

### Liabilities and Stockholders' Equity

| | | | | |
|---|---|---|---|---|
| Liabilities: | | | | |
| Deposits (note 6): | | | | |
| Demand | $ | 50,801 | $ | 47,506 |
| Savings and NOW accounts | | 160,549 | | 154,166 |
| Time | | 113,854 | | 120,458 |
| Total deposits | | 325,204 | | 322,130 |
| Note payable under line of credit (note 1(e)) | | 1,368 | | 1,630 |
| Accrued interest payable | | 169 | | 223 |
| Other liabilities (note 7) | | 2,793 | | 2,676 |
| Total liabilities | | 329,534 | | 326,659 |
| Stockholders' equity (notes 7, 12 and 15): | | | | |
| Common stock, $3 par value. Authorized 3,000,000 shares, issued and outstanding 1,511,970 shares in 2014 and 1,515,007 shares in 2013 | | 4,497 | | 4,507 |
| Capital surplus | | 1,004 | | 1,035 |
| Retained earnings | | 28,219 | | 26,554 |
| Accumulated other comprehensive loss, net | | (1,066) | | (154) |
| Total stockholders' equity | | 32,654 | | 31,942 |
| Commitments, contingencies and other matters (notes 9, 10 and 12) | | | | |
| Total liabilities and stockholders' equity | $ | 362,188 | $ | 358,601 |

See accompanying notes to consolidated financial statements.

**PINNACLE BANKSHARES CORPORATION AND SUBSIDIARY**
**CONSOLIDATED STATEMENTS OF INCOME**
Years ended December 31, 2014 and 2013
(In thousands of dollars, except per share data)
(Audited)

| | 2014 | 2013 As Restated |
|---|---|---|
| Interest income: | | |
| Interest and fees on loans | $ 13,463 | $ 14,271 |
| Interest on securities: | | |
| U.S. Government agencies | 267 | 278 |
| States and political subdivisions (taxable) | 79 | 75 |
| States and political subdivisions (tax-exempt) | 122 | 160 |
| Other | 100 | 112 |
| Interest on federal funds sold | 4 | 3 |
| Total interest income | 14,035 | 14,899 |
| Interest expense: | | |
| Interest on deposits: | | |
| Savings and NOW accounts | 441 | 491 |
| Time - under $100,000 | 1,024 | 1,637 |
| Time - $100,000 and over | 514 | 1,062 |
| Total interest expense | 1,979 | 3,190 |
| Net interest income | 12,056 | 11,709 |
| Provision for loan losses and unfunded commitments (note 4) | 91 | 143 |
| Net interest income after provision for loan losses | 11,965 | 11,566 |
| Noninterest income: | | |
| Service charges on deposit accounts | 1,627 | 1,617 |
| Commissions and fees | 377 | 617 |
| Mortgage loan fees | 392 | 543 |
| Service charges on loan accounts | 249 | 210 |
| Insurance proceeds | - | 1,077 |
| Other operating income | 517 | 490 |
| Total noninterest income | 3,162 | 4,554 |
| Noninterest expense: | | |
| Salaries and employee benefits (note 7) | 6,001 | 6,580 |
| Occupancy expense | 757 | 753 |
| Furniture and equipment expense | 794 | 1,062 |
| Office supplies and printing | 215 | 216 |
| Federal deposit insurance premiums | 235 | 270 |
| Capital stock tax | 248 | 242 |
| Advertising expense | 204 | 193 |
| Other operating expenses | 3,554 | 2,912 |
| Total noninterest expense | 12,008 | 12,228 |
| Income before income tax expense | 3,119 | 3,892 |
| Income tax expense (notes 8 and 17) | 970 | 1,241 |
| Net income | $ 2,149 | $ 2,651 |
| Basic net income per share (note 1(q)) | $ 1.42 | $ 1.75 |
| Diluted net income per share (note1(q)) | $ 1.40 | $ 1.74 |

See accompanying notes to consolidated financial statements.

**PINNACLE BANKSHARES CORPORATION AND SUBSIDIARY**
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
Years ended December 31, 2014 and 2013
(In thousands of dollars)
(Audited)

| | 2014 | 2013 As Restated |
|---|---|---|
| Net income | $ 2,149 | $ 2,651 |
| Other comprehensive income, net of related income taxes: | | |
| Unrealized gains (losses) on availabile-for-sale securities | | |
| Before tax | 88 | (552) |
| Income tax (expense) benefit | (30) | 189 |
| Changes in plan assets and benefit obligation of defined benefit pension plan | | |
| Before tax | (1,469) | 2,794 |
| Income tax (expense) benefit | 499 | (951) |
| Total other comprehensive gain(loss) | (912) | 1,480 |
| Comprehensive income | $ 1,237 | $ 4,131 |

See accompanying notes to consolidated financial statements.

**PINNACLE BANKSHARES CORPORATION AND SUBSIDIARY**
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**
Years ended December 31, 2014 and 2013
(In thousands of dollars, except share and per share data)
(Audited)

| | Common Stock | | Capital | Retained | Accumulated Other Comprehensive | |
|---|---|---|---|---|---|---|
| | Shares | Par Value | Surplus | Earnings | Income (Loss) | Total |
| Balances, December 31, 2012 | 1,507,589 | $ 4,492 | $ 987 | $ 24,244 | $ (1,634) | $ 28,089 |
| Net income (As Restated) | | | | 2,651 | | 2,651 |
| Other Comprehensive Income | | | | | 1,480 | 1,480 |
| Issuance of restricted stock and related expense | 10,000 | 15 | 39 | | | 54 |
| Stock-based compensation expense | | | 9 | | | 9 |
| Restricted Stock for tax purpose | (2,496) | | | | | |
| Paid out owners of partial shares (dividend reinvestment plan) | (86) | | | | | |
| Cash dividends declared by | | | | | | |
| Bankshares ($0.225 per share) | | | | (341) | | (341) |
| Balances, December 31, 2013 (As Restated) | 1,515,007 | $ 4,507 | $ 1,035 | $ 26,554 | $ (154) | $ 31,942 |
| Net income | | | | 2,149 | | 2,149 |
| Other Comprehensive Loss | | | | | (912) | (912) |
| Issuance of restricted stock and related expense | 8,400 | 26 | 138 | | | 164 |
| Stock option exercised | 628 | | | | | |
| Repurchased stock | (12,065) | (36) | (169) | | | (205) |
| Cash dividends declared by | | | | | | |
| Bankshares ($0.32 per share) | | | | (484) | | (484) |
| Balances, December 31, 2014 | 1,511,970 | $ 4,497 | $ 1,004 | $ 28,219 | $ (1,066) | $ 32,654 |

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2014 and 2013
(In thousands of dollars)
(Audited)

| | 2014 | 2013 As Restated |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $ 2,149 | $ 2,651 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation of bank premises and equipment | 458 | 488 |
| Accretion of unearned fees, net | 30 | 20 |
| Net amortization of premiums and discounts on securities | 50 | 74 |
| Provision for loan losses | 91 | 143 |
| Provision (benefit) for deferred income taxes | 56 | (1,282) |
| Accrual of stock option vesting | 164 | 63 |
| Increase in cash value of life insurance | (175) | (96) |
| Net decrease (increase) in: | | |
| Accrued interest receivable | 91 | 15 |
| Prepaid FDIC insurance | - | 703 |
| Other assets | (340) | (2,977) |
| Net increase (decrease) in: | | |
| Accrued interest payable | (54) | (175) |
| Other liabilities | 128 | 2,319 |
| Net cash provided by operating activities | 2,648 | 1,946 |
| Cash flows from investing activities: | | |
| Purchases of available-for-sale securities | (4,450) | (513) |
| Purchases of held-to-maturity securities | - | (15,014) |
| Proceeds from maturities and calls of held-to-maturity securities | - | 1,705 |
| Proceeds from maturities and calls of available-for-sale securities | 4,067 | 6,102 |
| Proceeds from paydowns and maturities of available-for-sale mortgage-backed securities | 161 | 176 |
| Sale (purchase)of Federal Reserve Stock | (2) | 95 |
| Sale (purchase) of Federal Home Loan Bank stock | 96 | (2) |
| Net (increase) decrease in loans made to customers | (6,055) | 282 |
| Purchases of bank premises and equipment | (1,594) | (1,473) |
| Puchase of bank owned life insurance | (3,000) | - |
| Net cash used in investing activities | (10,777) | (8,642) |
| Cash flows from financing activities: | | |
| Net increase in demand, savings and NOW deposits | 9,678 | 22,550 |
| Net decrease in time deposits | (6,604) | (15,576) |
| Repurchase of common stock | (205) | - |
| Repayment of line of credit | (262) | (270) |
| Cash dividends paid | (484) | (341) |
| Net cash provided by financing activities | 2,123 | 6,363 |
| Net decrease in cash and cash equivalents | (6,006) | (333) |
| Cash and cash equivalents, beginning of year | 35,457 | 35,790 |
| Cash and cash equivalents, end of year | $ 29,451 | $ 35,457 |
| Supplemental disclosure of cash flows information | | |
| Cash paid during the year for: | | |
| Income taxes | $ 990 | $ 850 |
| Interest | 2,033 | 3,365 |
| Supplemental schedule of noncash investing and financing activities: | | |
| Transfer from loans to repossessed properties | $ 24 | $ (26) |
| Loans charged against the allowance for loan losses | 630 | 621 |
| Unrealized gains (losses) on available-for-sale securities | 88 | (552) |
| Defined benefit plan adjustment per ASC topic *Compensation-Retirement Benefits* | (1,469) | 2,794 |

See accompanying notes to consolidated financial statements.

## (1) Summary of Significant Accounting Policies and Practices

Pinnacle Bankshares Corporation, a Virginia corporation (the "Company" or "Bankshares"), was organized in 1997 and is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended. Bankshares is headquartered in Altavista, Virginia. Bankshares conducts all of its business activities through the branch offices of its wholly owned subsidiary bank, First National Bank (the Bank). Bankshares exists primarily for the purpose of holding the stock of its subsidiary, (the "Bank"), and of such other subsidiaries as it may acquire or establish. The Company has a single reportable segment for purposes of segment reporting.

The accounting and reporting policies of Bankshares and its wholly owned subsidiary (collectively, the "Company"), conform to generally accepted accounting principles in the United States of America ("GAAP") and general practices within the banking industry. The following is a summary of the more significant accounting policies and practices:

### *(a) Consolidation*

The consolidated financial statements include the accounts of Bankshares and the Bank. All material intercompany balances and transactions have been eliminated.

### *(b) Use of Estimates*

In preparing the consolidated financial statements in accordance with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the consolidated balance sheets and revenues and expenses for the years ended December 31, 2014 and 2013. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant changes in the near term relate to the determination of the allowance for loan losses, payments/obligations under benefit and pensions plans, BOLI values, other real estate owned and fair value of investments.

### *(c) Securities*

The Company classifies its securities in three categories: (1) debt securities that the Company has the positive intent and ability to hold to maturity are classified as "held-to-maturity securities" and reported at amortized cost; (2) debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as "trading securities" and reported at fair value, with unrealized gains and losses included in net income; and (3) debt and equity securities not classified as either held-to-maturity securities or trading securities are classified as "available-for-sale securities" and reported at fair value, with unrealized gains and losses excluded from net income and reported in accumulated other comprehensive income, a separate component of stockholders' equity, net of deferred taxes. Fair value is determined from quoted prices obtained and reviewed by management. Held-to-maturity securities are stated at cost, adjusted for amortization of premiums and accretion of discounts on a basis, which approximates the level yield method. As of December 31, 2014 and 2013, the Company does not maintain trading securities. Gains or losses on disposition are based on the net proceeds and adjusted carrying values of the securities called or sold, using the specific identification method on a trade date basis.

Management evaluates securities for other-than-temporary impairment ("OTTI") on a 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. The Company assesses OTTI based upon whether it intends to sell a security or if it is likely that it would be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity. For debt securities, if the Company intends to sell the security or it is likely that the Company will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If the Company does not intend to sell the security and it is not likely that the Company will be required to sell the security but we do not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income ("OCI"). Impairment losses related to all other factors are presented as separate categories within OCI. For investment securities held to maturity, this amount is accreted over the remaining life of the debt security prospectively based on the amount and timing of future estimated cash flows. The accretion of the amount recorded in OCI increases the carrying value of the investment and does not affect earnings. If there is an indication of additional credit losses the security is re-evaluated according to the procedures described above.

***(d) Restricted Equity Investments***

As a member of the Federal Reserve Bank ("FRB") and the Federal Home Loan Bank ("FHLB") of Atlanta, the Company is required to maintain certain minimum investments in the common stock of the FRB and FHLB, which are carried at cost. Required levels of investment are based upon the Company's capital and a percentage of qualifying assets.

In addition, the Company is eligible to borrow from the FHLB with borrowings collateralized by qualifying assets, primarily residential mortgage loans, and the Company's capital stock investment in the FHLB.

Management's determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB, and (4) the liquidity position of the FHLB.

***(e) Borrowings***

As of December 31, 2014, the Company's available borrowing limit with the FHLB was approximately $46,940. The Company had $0 in borrowings from the FHLB outstanding at December 31, 2014 and 2013. The Company also has a $3,000 line of credit commitment with no outstanding balance secured by the authorized capital stock of the Bank with a correspondent bank. The Company has a term loan with the same correspondent bank with $1,368 outstanding as of December 31, 2014 and $1,630 outstanding as of December 31, 2013 with a 5.00% interest rate that matures on June 30, 2017.

***(f) Loans and Allowance for Loan Losses***

Loans are stated at the amount of unpaid principal, reduced by unearned income and fees on loans, and an allowance for loan losses. Income is recognized over the terms of the loans using methods that approximate the level yield method. The allowance for loan losses is a cumulative valuation allowance consisting of an annual provision for loan losses, plus any amounts recovered on loans previously charged off, minus loans charged off. The provision for loan losses charged to operations is the amount necessary in management's judgment to maintain the allowance for loan losses at a level it believes adequate to absorb probable losses inherent in the loan portfolio.

Management determines the adequacy of the allowance based upon reviews of individual credits, recent loss experience, delinquencies, current economic conditions, the risk characteristics of the various categories of loans and other pertinent factors. Management uses historical loss data by loan type as well as current economic factors in its calculation of allowance for loan loss. Management also uses qualitative factors such as changes in lending policies and procedures, changes in national and local economies, changes in the nature and volume of the loan portfolio, changes in experience of lenders and the loan department, changes in volume and severity of past due and classified loans, changes in quality of the Company's loan review system, the existence and effect of concentrations of credit and external factors such as competition and regulation in its allowance for loan loss calculation. Each qualitative factor is evaluated and applied to each type of loan in the Company's portfolio and a percentage of each loan is reserved as allowance. A percentage of each loan type is also reserved according to the loan type's historical loss data. Larger percentages of allowance are taken as the risk for a loan is determined to be greater. Loans are charged against the allowance for loan losses when management believes the principal is uncollectible. While management uses available information to recognize losses on loans, future additions to the allowance for loan losses may be necessary based on changes in economic conditions or the Company's recent loss experience. It is reasonably possible that management's estimate of loan losses and the related allowance may change materially in the near term. However, the amount of change that is reasonably possible cannot be estimated. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance for loan losses based on their judgments about information available to them at the time of their examinations.

Loans are charged against the allowance when, in management's opinion, they are deemed doubtful, although the Company continues to aggressively pursue collection. The Company considers a number of factors to determine the need for and timing of charge-offs including the following: whenever any commercial loan becomes past due for 120 days for any scheduled principal or interest payment and collection is considered unlikely; whenever foreclosure on real estate collateral or liquidation of other collateral does not result in full payment of the obligation and the deficiency or some portion thereof is deemed uncollectible, the uncollectible portion shall be charged-off; whenever any installment loan becomes past due for 120 days and collection is considered unlikely; whenever any repossessed vehicle remains unsold for 60 days after repossession; whenever a bankruptcy notice is received on any installment loan and review of the facts results in an assessment that all or most of the balance will not be collected, the loan will be placed in non-accrual status; whenever a bankruptcy notice is received on a small, unsecured, revolving installment account; and whenever any other small, unsecured, revolving installment account becomes past due for 180 days.

Loans are generally placed in non-accrual status when the collection of principal and interest is 90 days or more past due, unless the obligation relates to a consumer or residential real estate loan or is both well-secured and in the process of collection. All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Generally, loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured, which usually requires a minimum of six months of sustained repayment performance.

Impaired loans are required to be presented in the financial statements at net realizable value of the expected future cash flows or at the fair value of the loan's collateral. Homogeneous loans such as real estate mortgage loans, individual consumer loans and home equity loans are evaluated collectively for impairment. Management, considering current information and events regarding the borrower's ability to repay their obligations, considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impairment losses are included in the allowance for loan losses through a charge to the provision for loan losses. Cash receipts on impaired loans receivable are applied first to reduce interest on such loans to the extent of interest contractually due and any remaining amounts are applied to principal.

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 less cost to sell. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

***(g) Loan Origination and Commitment Fees and Certain Related Direct Costs***

Loan origination and commitment fees and certain direct loan origination costs charged by the Company are deferred and the net amount amortized as an adjustment of the related loan's yield. The Company amortizes these net amounts over the contractual life of the related loans or, in the case of demand loans, over the estimated life. Fees related to standby letters of credit are recognized over the commitment period.

***(h) Bank Premises and Equipment***

Bank premises and equipment are stated at cost, net of accumulated depreciation. Depreciation is computed by the straight-line and declining-balance methods over the estimated useful lives of the assets. Depreciable lives include 15 years for land improvements, 39 years for buildings, and 3 to 7 years for equipment, furniture and fixtures. The cost of assets retired and sold and the related accumulated depreciation are eliminated from the accounts and the resulting gains or losses are included in determining net income. Expenditures for maintenance and repairs are charged to expense as incurred, and improvements and betterments are capitalized.

***(i) Bank Owned Life Insurance***

The Company has purchased life insurance policies on certain key members of management. 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.

***(j) Goodwill***

The Company performs a goodwill impairment analysis on an annual basis as of December 31st. Additionally, the Company performs a goodwill impairment evaluation on an interim basis when events or circumstances indicate impairment potentially exists. During 2014, the Company reviewed its goodwill for impairment and determined that goodwill is not impaired. Management will continue to monitor the relationship of Bankshares' market capitalization to both its book value and tangible book value, which management attributes to both financial services industry-wide and Company-specific factors, and to evaluate the carrying value of goodwill.

***(k) Other Real Estate Owned***

Foreclosed properties consist of properties acquired through foreclosure or deed in lieu of foreclosure. At time of foreclosure, the properties are recorded at the fair value less costs to sell. Subsequently, these properties are carried at the lower of cost or fair value less estimated costs to sell. Losses from the acquisition of property in full or partial satisfaction of loans are charged against the allowance for loan losses. Subsequent write-downs, if any, are charged to expense. Gains and losses on the sales of foreclosed properties are included in determining net income in the year of the sale.

***(l) Impairment or Disposal of Long-Lived Assets***

The Company's long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used, such as bank premises and equipment, is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of, such as foreclosed properties, are reported at the lower of the carrying amount or fair value less costs to sell.

***(m) Pension Plan***

The Company maintains a noncontributory defined benefit pension plan, which covers substantially all of its employees. The net periodic pension expense includes a service cost component, interest on the projected benefit obligation, a component reflecting the actual return on plan assets, the effect of deferring and amortizing certain actuarial gains and losses, and the amortization of any unrecognized net transition obligation on a straight-line basis over the average remaining service period of employees expected to receive benefits under the plan. The Company's funding policy is to make annual contributions in amounts necessary to satisfy the Internal Revenue Service's funding standards, to the extent that they are tax deductible.

ASC Topic 715, *Defined Benefit Pension Plans* requires a business entity to recognize the overfunded or underfunded status of a single-employer defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in comprehensive income in the year in which the changes occur. Defined Benefit Pension Plans also requires a business entity to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions.

***(n) Advertising***

The Company recognizes advertising expenses as incurred.

***(o) Income Taxes***

Income taxes are accounted for under the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in net income in the period that includes the enactment date.

Deferred taxes are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

***(p) Stock Options and Restricted Stock***

The Company accounts for its stock based compensation plan by recognizing expense for options granted equal to the grant date fair value of the unvested amounts over their remaining vesting periods. There were 8,400 shares of restricted stock granted in 2014 compared to 10,000 shares of restricted stock granted in 2013. There were 58,000 stock options outstanding as of December 31, 2014 compared to 37,000 stock options outstanding as of December 31, 2013. Future levels of compensation cost recognized related to share-based compensation awards may be impacted by new awards and/or modification, repurchases and cancellations of existing awards after the adoption of this standard.

### *(q) Net Income per Share*

Basic net income per share excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted net income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock that are not anti-dilutive were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company.

The following is a reconciliation of the numerators and denominators of the basic and diluted net income per share computations for the periods indicated:

| Year ended December 31, 2014 | Net income (numerator) | Shares (denominator) | Per share amount |
|---|---|---|---|
| Basic net income per share | $ 2,149 | 1,512,661 | $ 1.42 |
| Effect of dilutive stock options | — | 18,170 | |
| Diluted net income per share | $ 2,149 | 1,530,831 | $ 1.40 |

| Year ended December 31, 2013 (Restated) | Net income (numerator) | Shares (denominator) | Per share amount |
|---|---|---|---|
| Basic net income per share | $ 2,651 | 1,512,545 | $ 1.75 |
| Effect of dilutive stock options | — | 10,560 | |
| Diluted net income per share | $ 2,651 | 1,523,105 | $ 1.74 |

Options to purchase 24,000 shares, which were outstanding as of December 31, 2014, and options to purchase 37,000 shares which were outstanding as of December 31, 2013, were not included in the computation of diluted EPS because the effect would have been anti-dilutive.

### *(r) Consolidated Statements of Cash Flows*

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash on hand, amounts due from banks (with original maturities of three months or less), and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

### *(s) Comprehensive Income*

ASC Topic *Comprehensive Income,* requires the Company to classify items of "Other Comprehensive Income" (such as net unrealized gains (losses) on available-for-sale securities) by their nature in a financial statement and present the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of a statement of financial position. The Company's other comprehensive income consists of net income, and net unrealized gains (losses) on securities available-for-sale, net of income taxes, and adjustments relating to its defined benefit plan, net of income taxes.

### *(t) Fair Value Measurements*

ASC Topic, *Fair Value Measurements and Disclosures* establishes a framework for using fair value. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date.

In accordance with *Fair Value Measurements and Disclosures*, the Company groups its financial assets and financial liabilities in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. The most significant instruments that the Company measures at fair value are available-for-sale securities.

All available-for-sale securities fall into Level 2 fair value hierarchy. Valuation methodologies for the fair value hierarchy are as follows:

Level 1 – Valuations are based on quoted prices for identical assets and liabilities traded in active exchange markets, such as the New York Stock Exchange.

Level 2 – Valuations for assets and liabilities are obtained from readily available pricing sources via independent providers for market transactions involving similar assets or liabilities, model-based valuation techniques, or other observable inputs.

Level 3 – Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and are not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining fair value assigned to such assets and liabilities.

***(u) Current Accounting Developments***

In June 2014, the FASB issued Accounting Standards Update ("ASU") 2014-11, *Transfers and Servicing (Topic 860)*. The amendments in this ASU require that repurchase-to-maturity transactions be accounted for as secured borrowings consistent with the accounting for other repurchase agreements. In addition, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty (a repurchase financing), which will result in secured borrowing accounting for the repurchase agreement. The amendments require an entity to disclose information about transfers accounted for as sales in transactions that are economically similar to repurchase agreements, in which the transferor retains substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction. In addition the amendments require disclosure of the types of collateral pledged in repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions and the tenor of those transactions. This ASU is effective for first interim or annual periods beginning after December 15, 2014. The Company has no repurchase agreements and the ASU does not impact the Company's consolidated financial statements.

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU was developed as a joint project with the International Accounting Standards Board to remove inconsistencies in revenue requirements and provide a more robust framework for addressing revenue issues. The ASU's core principle is that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. The ASU is effective for nonpublic entities for annual and interim periods beginning after December 15, 2017. The ASU may be adopted using either a modified retrospective method or a full retrospective method and early adoption is not permitted. The Company is currently evaluating the impact of the adoption of this ASU on its consolidated financial statements.

In January 2014, the FASB issued ASU 2014-04, *Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40)*. 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 public entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. For entities other than public entities, the amendments in this ASU are effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. The amendments are not expected to have a significant impact on the Company's consolidated financial statements.

## (2) Restrictions on Cash

To comply with Federal Reserve regulations, the Company is required to maintain certain average reserve balances. The daily average reserve requirements were approximately $3,258 and $3,098 for the weeks including December 31, 2014 and 2013, respectively.

## (3) Securities

The amortized costs, gross unrealized gains, gross unrealized losses and fair values for securities as of December 31, 2014 and 2013 are as follows:

| | | 2014 | | | |
|---|---|---|---|---|---|
| **Available-for-Sale** | | **Amortized costs** | **Gross unrealized gains** | **Gross unrealized losses** | **Fair values** |
| U.S. Treasury securities and obligations of U.S. Government corporations and agencies | $ | 20,538 | 62 | (181) | 20,419 |
| Obligations of states and political subdivisions | | 1,746 | 126 | — | 1,872 |
| Mortgage-backed securities – government | | 1,275 | 32 | (1) | 1,306 |
| Total available-for-sale | $ | 23,559 | 220 | (182) | 23,597 |

| | | 2014 | | | |
|---|---|---|---|---|---|
| **Held-to-Maturity** | | **Amortized costs** | **Gross unrealized gains** | **Gross unrealized losses** | **Fair values** |
| Obligations of states and political subdivisions | $ | 5,680 | 148 | (6) | 5,822 |

| | | 2013 | | | |
|---|---|---|---|---|---|
| **Available-for-Sale** | | **Amortized costs** | **Gross unrealized gains** | **Gross unrealized losses** | **Fair values** |
| U.S. Treasury securities and obligations of U.S. Government corporations and agencies | $ | 20,751 | 124 | (278) | 20,597 |
| Obligations of states and political subdivisions | | 2,106 | 67 | — | 2,173 |
| Mortgage-backed securities – government | | 489 | 37 | — | 526 |
| Other securities | | 110 | — | — | 110 |
| Total available-for-sale | $ | 23,456 | 228 | (278) | 23,406 |

| | | 2013 | | | |
|---|---|---|---|---|---|
| **Held-to-Maturity** | | **Amortized costs** | **Gross unrealized gains** | **Gross unrealized losses** | **Fair values** |
| Obligations of states and political subdivisions | $ | 5,719 | 100 | (20) | 5,799 |

The following table shows the gross unrealized losses and fair value of the Company's investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of December 31, 2014:

| | Less than 12 months | | Total | |
|---|---|---|---|---|
| **Description of Securities** | **Fair value** | **Gross unrealized losses** | **Fair value** | **Gross unrealized losses** |
| U.S. Treasury securities and obligations of U.S. Government corporations and agencies | $ 3,462 | 25 | 3,462 | 25 |
| Mortgage-backed securities-government | 482 | 1 | 482 | 1 |
| Total temporarily impaired securities | $ 3,944 | 26 | 3,944 | 26 |

| | More than 12 months | | Total | |
|---|---|---|---|---|
| **Description of Securities** | **Fair value** | **Gross unrealized losses** | **Fair value** | **Gross unrealized losses** |
| U.S. Treasury securities and obligations of U.S. Government corporations and agencies | $ 16,156 | 162 | 16,156 | 162 |
| Total temporarily impaired securities | $ 16,156 | 162 | 16,156 | 162 |

The following table shows the gross unrealized losses and fair value of the Company's investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of December 31, 2013:

| | Less than 12 months | | Total | |
|---|---|---|---|---|
| **Description of Securities** | **Fair value** | **Gross unrealized losses** | **Fair value** | **Gross unrealized losses** |
| U.S. Treasury securities and obligations of U.S. Government corporations and agencies | $ 16,801 | 293 | 16,801 | 293 |
| Total temporarily impaired securities | $ 16,801 | 293 | 16,801 | 293 |

| | More than 12 months | | Total | |
|---|---|---|---|---|
| **Description of Securities** | **Fair value** | **Gross unrealized losses** | **Fair value** | **Gross unrealized losses** |
| U.S. Treasury securities and obligations of U.S. Government corporations and agencies | $ 272 | 5 | 272 | 5 |
| Total temporarily impaired securities | $ 272 | 5 | 272 | 5 |

The Company does not consider the unrealized losses other-than-temporary losses based on the volatility of the securities market price involved, the credit quality of the securities, and the Company's ability, if necessary, to hold the securities until maturity. For 2014, the securities include 4 bonds that have continuous losses for less than 12 months and 19 bonds that have continuous losses for more than 12 months. For 2013, the securities include 19 bonds that had continuous losses for less than 12 months and 2 bonds that had continuous losses for more than 12 months. There were no gross realized gains or losses on securities sold in 2014 and 2013.

The amortized costs and fair values of available-for-sale and held-to-maturity securities as of December 31, 2014, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | | 2014 | | | |
|---|---|---|---|---|---|
| | | Available-for-Sale | | Held-to-Maturity | |
| | | Amortized costs | Fair values | Amortized costs | Fair values |
| Due in one year or less | $ | — | — | 300 | 304 |
| Due after one year through five years | | 20,359 | 20,290 | 3,554 | 3,579 |
| Due after five years through ten years | | 1,925 | 2,001 | 1,826 | 1,939 |
| | | 22,284 | 22,291 | 5,680 | 5,822 |
| Mortgage-backed securities | | 1,275 | 1,306 | — | — |
| Totals | $ | 23,559 | 23,597 | 5,680 | 5,822 |

Securities with amortized costs of approximately $4,312 and $4,312 (fair values of $4,404 and $4,695, respectively) as of December 31, 2014 and 2013, respectively, were pledged as collateral for public deposits and to the Federal Reserve for overdraft protection.

## (4) Loans, Allowance for Loan Losses and Credit Quality

A summary of loans as of December 31, 2014 and 2013 follows:

| | | 2014 | 2013 |
|---|---|---|---|
| Real estate loans: | | | |
| Residential-mortgage | $ | 108,128 | 104,046 |
| Residential-construction | | 8,927 | 8,776 |
| Commercial | | 81,025 | 89,670 |
| Loans to individuals for household, family and other consumer expenditures | | 53,872 | 48,991 |
| Commercial and industrial loans | | 31,635 | 26,373 |
| Total loans, gross | | 283,587 | 277,856 |
| Less unearned income and fees | | (68) | (98) |
| Loans, net of unearned income and fees | | 283,519 | 277,758 |
| Less allowance for loan losses | | (3,070) | (3,409) |
| Loans, net | $ | 280,449 | 274,349 |

In the normal course of business, the Bank has made loans to executive officers and directors. As of December 31, 2014 and 2013, loans to executive officers and directors totaled $197 and $248 respectively. During 2014, new loans made to executive officers and directors totaled $0, advances totaled $25 and repayments amounted to approximately $76. Loans to companies in which executive officers and directors have an interest amounted to $0 as of December 31, 2014 and 2013. All such loans were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with unrelated persons, and, in the opinion of management, do not involve more than normal risk of collectability or present other unfavorable features.

The following table presents information on the Company's allowance for loan losses and recorded investment in loans:

**Allowance for Loan Losses and Recorded Investment in Loans**
**For the Year Ended December 31, 2014**

| | Commercial | Commercial Real Estate | Consumer | Residential | Total |
|---|---|---|---|---|---|
| Allowance for Loan Losses: | | | | | |
| Beginning balance | $211 | $1,697 | $434 | $1,067 | $3,409 |
| Chargeoffs | (23) | (97) | (374) | (136) | (630) |
| Recoveries | 5 | 2 | 189 | 8 | 204 |
| Provision | 71 | (807) | 271 | 552 | 87 |
| Ending Balance | $264 | $795 | $520 | $1,491 | $3,070 |
| Allowance: | | | | | |
| Ending balance: individually evaluated for impairment | $- | $- | $- | $- | $- |
| Ending balance: collectively evaluated for impairment | $264 | 795 | 520 | 1,491 | 3,070 |
| Loans: | | | | | |
| Total loans ending balance | $31,635 | 81,025 | 53,872 | 117,055 | 283,587 |
| Ending balance: individually evaluated for impairment | $- | 2,125 | 4 | 2,155 | 4,284 |
| Ending balance: collectively evaluated for impairment | $31,635 | 78,900 | 53,868 | 114,900 | 279,303 |

**For the Year Ended December 31, 2013**

| | Commercial | Commercial Real Estate | Consumer | Residential | Total |
|---|---|---|---|---|---|
| Allowance for Loan Losses: | | | | | |
| Beginning balance | $324 | $1,462 | $445 | $1,415 | $3,646 |
| Chargeoffs | (33) | (35) | (269) | (284) | (621) |
| Recoveries | 23 | 6 | 223 | 52 | 304 |
| Provision | (103) | 264 | 35 | (116) | 80 |
| Ending Balance | $211 | $1,697 | $434 | $1,067 | $3,409 |
| Allowance: | | | | | |
| Ending balance individually evaluated for impairment | $- | $- | $- | $- | $- |
| Ending balance: collectively evaluated for impairment | $211 | 1,697 | 434 | 1,067 | 3,409 |
| Loans: | | | | | |
| Total loans ending balance | $26,373 | 89,670 | 48,991 | 112,822 | 277,856 |
| Ending balance: individually evaluated for impairment | $65 | 930 | 114 | 1,477 | 2,586 |
| Ending balance: collectively evaluated for impairment | $26,308 | 88,740 | 48,877 | 111,345 | 275,270 |

The Company utilizes a risk rating matrix to assign a risk grade to each of its loans. A description of the general characteristics of the risk grades is as follows:

Pass – These loans have minimal and acceptable credit risk.

Special Mention – These loans have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan at some future date.

Substandard – These loans are inadequately protected by the net worth or paying capacity of the obligor or collateral pledged, if any. Loans classified as substandard must have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. A substandard loan is characterized by the distinct probability that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful – These loans have all of the weakness inherent in one classified as substandard with the added characteristic that the weaknesses make collection liquidation in full, on the basis of the currently existing facts, conditions and values, highly questionable and improbable.

The following table illustrates the Company's credit quality indicators:

**Credit Quality Indicators**
**As of December 31, 2014**

| Credit Exposure | Commercial | Commercial Real Estate | Consumer | Residential | Total |
|---|---|---|---|---|---|
| Pass | $30,844 | $77,824 | $53,454 | $113,846 | $275,968 |
| Special Mention | 450 | 1,352 | 76 | 1,641 | 3,519 |
| Substandard | 341 | 1,849 | 342 | 1,568 | 4,100 |
| Doubtful | - | - | - | - | - |
| Total | $31,635 | 81,025 | 53,872 | 117,055 | 283,587 |

**As of December 31, 2013**

| Credit Exposure | Commercial | Commercial Real Estate | Consumer | Residential | Total |
|---|---|---|---|---|---|
| Pass | $25,852 | $85,290 | $48,765 | $111,120 | $271,027 |
| Special Mention | 450 | 721 | - | 15 | 1,186 |
| Substandard | 71 | 3,659 | 226 | 1,687 | 5,643 |
| Doubtful | - | - | - | - | - |
| Total | $26,373 | 89,670 | 48,991 | 112,822 | 277,856 |

The following table represents an age analysis of the Company's past due loans:

**Age Analysis of Past Due Loans**
**As of December 31, 2014**

| | 30-59 Days Past Due | 60-89 Days Past Due | Greater Than 90 Days | Total Past Due | Current | Total Loans | Recorded Investment 90 Days and Accruing |
|---|---|---|---|---|---|---|---|
| Commercial | $27 | - | - | 27 | 31,608 | 31,635 | - |
| Commercial real estate | - | - | 2,125 | 2,125 | 87,827 | 89,952 | - |
| Consumer | 53 | 41 | 4 | 98 | 53,774 | 53,872 | - |
| Residential | 123 | 124 | 2,155 | 2,402 | 105,726 | 108,128 | - |
| Total | $203 | 165 | 4,284 | 4,652 | 278,935 | 283,587 | - |

**Age Analysis of Past Due Loans**
**As of December 31, 2013**

| | 30-59 Days Past Due | 60-89 Days Past Due | Greater Than 90 Days | Total Past Due | Current | Total Loans | Recorded Investment 90 Days and Accruing |
|---|---|---|---|---|---|---|---|
| Commercial | $107 | - | 65 | 172 | 26,201 | 26,373 | - |
| Commercial real estate | 74 | - | 930 | 1,004 | 88,666 | 89,670 | - |
| Consumer | 334 | 9 | 114 | 457 | 48,534 | 48,991 | - |
| Residential | 265 | 134 | 1,477 | 1,876 | 110,946 | 112,822 | - |
| Total | $780 | 143 | 2,586 | 3,509 | 274,347 | 277,856 | - |

As of December 31, 2014 and 2013, the recorded investment in loans for which impairment has been identified totaled approximately $4,284 and $2,586, respectively, with no corresponding valuation allowances for either year. The average recorded investment in impaired loans receivable during 2014 and 2013 was approximately $3,436 and $2,716, respectively. Interest income recognized on a cash basis on impaired loans during 2014 and 2013 was approximately $64 and $87, respectively.

The following table presents information on the Company's impaired loans and their related allowance for loan losses:

**Impaired Loans**

**For the Year Ended December 31, 2014**

| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | |
| Commercial | $- | - | - | 33 | - |
| Commercial real estate | 2,125 | 2,125 | - | 1,528 | 9 |
| Consumer | 4 | 4 | - | 59 | - |
| Residential | 2,155 | 2,155 | - | 1,816 | 55 |
| Total: | | | | | |
| Commercial | - | - | - | 33 | - |
| Commercial real estate | 2,125 | 2,125 | - | 1,528 | 9 |
| Consumer | 4 | 4 | - | 59 | - |
| Residential | $2,155 | 2,155 | - | 1,816 | 55 |
| Total | $4,284 | 4,284 | - | 3,436 | 64 |

**For the Year Ended December 31, 2013**

| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | |
| Commercial | $65 | 65 | - | 88 | 7 |
| Commercial real estate | 930 | 930 | - | 1,064 | 27 |
| Consumer | 114 | 114 | - | 99 | 1 |
| Residential | 1,477 | 1,477 | - | 1,465 | 52 |
| Total: | | | | | |
| Commercial | 65 | 65 | - | 88 | 7 |
| Commercial real estate | 930 | 930 | - | 1,064 | 27 |
| Consumer | 114 | 114 | - | 99 | 1 |
| Residential | $1,477 | 1,477 | - | 1,465 | 52 |
| Total | $2,586 | 2,586 | - | 2,716 | 87 |

The following presents information on the Company's nonaccrual loans:

**Loans in Nonaccrual Status**
**As of December 31, 2014 and 2013**

| | 2014 | 2013 |
|---|---|---|
| Commercial | $- | $65 |
| Commercial real estate | 2,125 | 930 |
| Consumer | 4 | 114 |
| Residential | 2,155 | 1,477 |
| Total | $4,284 | $2,586 |

The Company had eight restructured loans totaling $2,608 as of December 31, 2014 and had four restructured loans totaling $2,980 as of December 31, 2013. All of these restructured loans constituted troubled debt restructurings as of December 31, 2014 and 2013.

The Company offers a variety of modifications to borrowers. The modification categories offered can generally be described in the following categories.

*Rate Modification* is a modification in which the interest rate is changed.

*Term Modification* is a modification in which the maturity date, timing of payments or frequency of payments is changed.

*Interest Only Modification* is a modification in which the loan is converted to interest only payments for a period of time.

*Payment Modification* is a modification in which the dollar amount of the payment is changed, other than an interest only modification described above.

*Combination Modification* is any other type of modification, including the restructuring of two or more loan terms through the use of multiple categories above.

There were no additional commitments to extend credit related to these troubled debt restructurings that were outstanding as of December 31, 2014 or December 31, 2013.

The following tables present troubled debt restructurings as of December 31, 2014 and 2013:

| | December 31, 2014 | | |
|---|---|---|---|
| | Accrual Status | Non-Accrual Status | Total Modifications |
| Commercial | $ - | - | - |
| Commercial real estate | - | 1,474 | 1,474 |
| Consumer | - | - | - |
| Residential | - | 1,134 | 1,134 |
| Total | $ - | 2,608 | 2,608 |

| | December 31, 2013 | | |
|---|---|---|---|
| | Accrual Status | Non-Accrual Status | Total Modifications |
| Commercial | $ - | - | - |
| Commercial real estate | 1,968 | - | 1,968 |
| Consumer | - | - | - |
| Residential | 555 | 457 | 1,012 |
| Total | $2,523 | 457 | 2,980 |

For 2014, there were two commercial real estate loans that were considered combination modifications that had a pre-modification balance of $138 and a post modification balance of $138. There were also two residential loans that were considered combination modifications that had a pre-modification balance of $387 and a post modification balance of $390. For loans modified and classified as troubled debt restructurings in 2014, none experienced payment defaults. During 2013, there was one commercial real estate loan that was considered a combination modification that had a pre-modification balance of $1,327 and a post modification balance of $1,327. For loans modified and classified as troubled debt restructurings in 2013, none experienced payment defaults.

## (5) Bank Premises and Equipment

Bank premises and equipment, net were comprised of the following as of December 31, 2014 and 2013:

| | 2014 | 2013 |
|---|---|---|
| Land improvements | $ 571 | 571 |
| Buildings | 7,270 | 6,798 |
| Equipment, furniture and fixtures | 5,214 | 5,046 |
| | 13,055 | 12,415 |
| Less accumulated depreciation | (7,255) | (6,797) |
| | 5,800 | 5,618 |
| Land | 2,632 | 1,680 |
| Bank premises and equipment, net | $ 8,432 | 7,298 |

## (6) Deposits

A summary of deposits as of December 31, 2014 and 2013 follows:

| | 2014 | 2013 |
|---|---|---|
| Noninterest-bearing demand deposits | $ 50,801 | 47,506 |
| Interest-bearing: | | |
| Savings and money market accounts | 89,127 | 85,255 |
| NOW accounts | 71,422 | 68,911 |
| Time deposits – under $100,000 | 77,697 | 82,318 |
| Time deposits – $100,000 and over | 36,157 | 38,140 |
| Total interest-bearing deposits | 274,403 | 274,624 |
| Total deposits | $ 325,204 | 322,130 |

At December 31, 2014, the scheduled maturity of time deposits is as follows: $54,559 in 2015; $12,050 in 2016; $4,998 in 2017, $24,733 in 2018 and $17,514 in 2019.

In the normal course of business, the Bank has received deposits from executive officers and directors. As of December 31, 2014 and 2013, deposits from executive officers and directors were approximately $906 and $2,223, respectively. All such deposits were received in the ordinary course of business on substantially the same terms and conditions, including interest rates, as those prevailing at the same time for comparable transactions with unrelated persons.

## (7) Employee Benefit Plans

The Bank maintains a noncontributory defined benefit pension plan that covers substantially all of its employees. Benefits are computed based on employees' average final compensation and years of credited service. Pension expense amounted to approximately $11 and $620 in 2014 and 2013, respectively. The change in benefit obligation, change in plan assets and funded status of the pension plan as of December 31, 2014 and 2013 and pertinent assumptions are as follows:

| Change in Benefit Obligation | | Pension Benefits 2014 | 2013 |
|---|---|---|---|
| Benefit obligation at beginning of year | $ | 6,506 | 8,259 |
| Service cost | | 361 | 434 |
| Interest cost | | 314 | 320 |
| Actuarial income (loss) | | 1,239 | (1,227) |
| Benefits paid | | (391) | (1,208) |
| Settlement Loss | | — | (72) |
| Benefit obligation at end of year | $ | 8,029 | 6,506 |
| **Change in Plan Assets** | | | |
| Fair value of plan assets at beginning of year | | 8,786 | 5,367 |
| Actual return on plan assets | | 433 | 1,627 |
| Employer contribution | | — | 3,000 |
| Benefits paid | | (391) | (1,208) |
| Projected fair value of plan assets at end of year | $ | 8,828 | 8,786 |
| **Funded Status at the End of the Year** | | 799 | 2,280 |
| **Amounts Recognized in the Balance Sheet** | | | |
| Other liabilities, accrued pension | | 799 | 2,280 |
| **Amounts Recognized in Accumulated Other Comprehensive Income Net of Tax Effect** | | | |
| Unrecognized net actuarial loss | | 1,090 | 121 |
| Benefit obligation included in accumulated other comprehensive income | $ | 1,090 | 121 |
| **Funded Status** | | | |
| Benefit obligation | | (8,029) | (6,506) |
| Fair value of assets | | 8,828 | 8,786 |
| Unrecognized net actuarial loss | | 1,653 | 183 |
| Prepaid benefit cost included in the balance sheet | $ | 2,452 | 2,463 |

| Weighted Average Assumptions as of December 31, 2014 and 2013 : | Pension Benefits 2014 | 2013 |
|---|---|---|
| Discount rate | 4.00% | 5.00% |
| Expected long-term return on plan assets | 7.75% | 8.00% |
| Rate of compensation increase | 3.00% | 3.00% |

## Pension Benefits

| | | 2014 | 2013 |
|---|---|---|---|
| Net (gain)/loss | $ | 970 | (1,843) |
| Prior service cost | | - | - |
| Amortization of prior service cost | | - | - |
| Net obligation at transition | | - | - |
| Amortization of net obligation at transition | | - | - |
| Total recognized in other comprehensive income | $ | 970 | (1,843) |
| **Total Recognized in Net Periodic Benefit Cost and Other Comprehensive Income** | $ | 1,480 | (2,172) |

The estimated portion of prior service cost and net transition obligation included in accumulated other comprehensive income that will be recognized as a component of net periodic pension cost over the next fiscal year are each $128.

The Company selects the expected long-term rate-of-return-on-assets assumption in consultation with its investment advisors and actuary. This rate is intended to reflect the average rate of return expected to be earned on the funds invested or to be invested to provide plan benefits. Historical performance is reviewed especially with respect to real rates of return (net of inflation) for the major asset classes held or anticipated to be held by the trust, and for the trust itself. Undue weight is not given to recent experience, which may not continue over the measurement period, and higher significance is placed on current forecasts of future long-term economic conditions.

Because assets are held in a qualified trust, anticipated returns are not reduced for taxes. Further, solely for this purpose, the plan is assumed to continue in force and not terminate during the period during which assets are invested. However, consideration is given to the potential impact of current and future investment policy, cash flow into and out of the trust, and expenses (both investment and non-investment) typically paid from plan assets (to the extent such expenses are not explicitly estimated within periodic cost).

The components of net pension benefit cost under the plan for the years ended December 31, 2014 and 2013 is summarized as follows:

| | | Pension Benefits | |
|---|---|---|---|
| | | 2014 | 2013 |
| Service cost | $ | 360 | 434 |
| Interest cost | | 314 | 320 |
| Expected return on plan assets | | (663) | (639) |
| Recognized net (gain)/loss due to settlement | | — | 368 |
| Net amortization | | — | — |
| Recognized net actuarial loss | | — | 137 |
| Net pension benefit cost | $ | 11 | 620 |

### Projected Benefit Payments

The projected benefit payments under the plan are summarized as follows for the years ending December 31:

| | |
|---|---|
| 2015 | $ 674 |
| 2016 | 88 |
| 2017 | 1,166 |
| 2018 | 322 |
| 2019 | 31 |
| 2020-2024 | 2,165 |

### Plan Asset Allocation

Plan assets are held in a pooled pension trust fund administered by the Virginia Bankers Association. The pooled pension trust fund is sufficiently diversified to maintain a reasonable level of risk without imprudently sacrificing return, with a targeted asset allocation of 25% fixed income and 75% equities. The Investment Manager selects investment fund managers with demonstrated experience and expertise, and funds with demonstrated historical performance, for the implementation of the pension plan’s investment strategy. The Investment Manager will consider both actively and passively managed investment strategies and will allocate funds across the asset classes to develop an efficient investment structure.

It is the responsibility of the Virginia Bankers Association to administer the investments of the pooled pension trust fund within reasonable costs, being careful to avoid sacrificing quality. These costs include, but are not limited to, management and custodial fees, consulting fees, transaction costs and other administrative costs.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. Following is a description of the valuation methodologies used for assets measured at fair value.

*Mutual funds-fixed income and equity funds*: Valued at the net asset value of shares held at year-end.

*Cash and equivalents*: Valued at cost which approximates fair value.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine fair value of certain financial instruments could result in a different fair value measurement as of December 31, 2014 and 2013.

The following table presents the fair value of the assets, by asset category, as of December 31, 2014 and 2013.

| | | 2014 | 2013 |
|---|---|---|---|
| Mutual funds-fixed income | $ | 2,207 | 2,109 |
| Mutual funds-equity | | 6,621 | 6,677 |
| Total assets at fair value | $ | 8,828 | 8,786 |

The following table sets forth by level, within the fair value hierarchy, the assets carried at fair value as of December 31, 2014 and 2013.

| | Assets at Fair Value as of December 31, 2014 | | | | |
|---|---|---|---|---|---|
| | | Level 1 | Level 2 | Level 3 | Total |
| Mutual funds-fixed income | $ | 2,207 | - | - | 2,207 |
| Mutual funds-equity | | 6,621 | - | - | 6,621 |
| Total assets at fair value | $ | 8,828 | - | - | 8,828 |

| | Assets at Fair Value as of December 31, 2013 | | | | |
|---|---|---|---|---|---|
| | | Level 1 | Level 2 | Level 3 | Total |
| Mutual funds-fixed income | $ | 2,109 | - | - | 2,109 |
| Mutual funds-equity | | 6,677 | - | - | 6,677 |
| Total assets at fair value | $ | 8,786 | - | - | 8,786 |

### Contributions

The Company expects to contribute $180 to its pension plan in 2015 to fund our accrued pension liabilities resulting mainly from the market performance of underlying pension assets.

The Company also has a 401(k) plan under which the Company matches employee contributions to the plan. In 2014 and 2013, the Company matched 100% of the first 1% of salary deferral and 50% of the next 5% of salary deferral to the 401(k) plan. The amount expensed for the 401(k) plan was $109 during the year ended December 31, 2014 and $118 during the year ended December 31, 2013.

## (8) Income Taxes

Income tax expense attributable to income before income tax expense for the years ended December 31, 2014 and 2013 is summarized as follows:

| | | 2014 | 2013 As Restated |
|---|---|---|---|
| Current | $ | 914 | (41) |
| Deferred | | 56 | 1,282 |
| Total income tax expense | $ | 970 | 1,241 |

Reported income tax expense for the years ended December 31, 2014 and 2013 differed from the amounts computed by applying the U.S. Federal income tax rate of 34% to income before income tax expense as a result of the following:

| | | 2014 | 2013 |
|---|---|---|---|
| Computed at statutory Federal tax rate | $ | 1,060 | 1,323 |
| Increase (reduction) in income tax expense resulting from: | | | |
| Tax-exempt interest | | (41) | (60) |
| Disallowance of interest expense | | 2 | 4 |
| Other, net | | (51) | (26) |
| Reported income tax expense | $ | 970 | 1,241 |

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of December 31, 2014 and 2013 are as follows:

| | | 2014 | 2013 As Restated |
|---|---|---|---|
| Deferred tax assets: | | | |
| Loans, principally due to allowance for loan losses | $ | 585 | 696 |
| Defined benefit plan valuation adjustments | | 562 | 61 |
| Loans, due to unearned fees, net | | 8 | 12 |
| Net unrealized loss on available-for-sale securities | | — | 18 |
| Other | | 250 | 175 |
| Total gross deferred tax assets | | 1,405 | 962 |
| Deferred tax liabilities: | | | |
| Bank premises and equipment, due to differences in depreciation | | (514) | (508) |
| Accrued pension, due to actual pension contributions in excess of accrual for financial reporting purposes | | (833) | (837) |
| Net unrealized gains on available-for-sale securities | | (13) | - |
| Other | | (176) | (162) |
| Total gross deferred tax liabilities | | (1,536) | (1,507) |
| Net deferred tax liability, included in other liabilities | $ | (131) | (545) |

The Bank has determined that a valuation allowance for the gross deferred tax assets is not necessary as of December 31, 2014 and 2013, since realization of the entire gross deferred tax assets can be supported by the amounts of taxes paid during the carry back periods available under current tax laws.

The Company did not recognize any interest or penalties related to income tax during the years ended December 31, 2014 and 2013. The Company does not have an accrual for uncertain tax positions as deductions taken and benefits accrued are based on widely understood administrative practices and procedures and are based on clear and unambiguous tax law. Tax returns for all years 2011 and thereafter are subject to future examination by tax authorities.

## (9) Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include mortgage sale lock commitments, commitments to extend credit and standby letters of credit. These instruments may involve, to varying degrees, credit risk in excess of the amount recognized in the balance sheets. The contract amounts of these instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

Credit risk is defined as the possibility of sustaining a loss because the other parties to a financial instrument fail to perform in accordance with the terms of the contract. The Company's maximum exposure to credit loss under commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The Company requires collateral to support financial instruments when it is deemed necessary. The Bank evaluates such customers' creditworthiness on a case-by-case basis. The amount of collateral obtained upon extension of credit is based on management's credit evaluation of the counterparty. Collateral may include deposits held in financial institutions, U.S. Treasury securities, other marketable securities, real estate, accounts receivable, inventory, and property, plant and equipment.

Financial instruments whose contract amounts represent credit risk:

| | | December 31, | |
|---|---|---|---|
| | | 2014 | 2013 |
| Commitments to extend credit | $ | 61,953 | 59,322 |
| Standby letters of credit | $ | 3,575 | 3,023 |

In the ordinary course of business, the Company may enter into mortgage rate lock commitments that are subsequently funded by the Company. The Company then sells the mortgage loan to a secondary market bank that had underwritten the mortgage loan before the Company funded the loan. The secondary market bank pays a fee that was agreed upon on the lock commitment date to the Company and buys the loan within five days of the initial funding by the Company. As of December 31, 2014 and 2013, the Company had no outstanding mortgage rate lock commitments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements, including bond financing and similar transactions. Unless renewed, substantially all of the Company's standby letters of credit commitments as of December 31, 2014 will expire within one year. Management does not anticipate any material losses as a result of these transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

**(10) Leases**

The Company leases premises and equipment under various operating lease agreements. Generally, operating leases provide for one or more renewal options on the same basis as current rental terms. Certain leases require increased rentals under cost-of-living escalation clauses. The following are future minimum lease payments as required under the agreements:

| Year | Payments |
|---|---|
| 2015 | $150 |
| 2016 | 149 |
| 2017 | 152 |
| 2018 | 152 |
| 2019 | 152 |
| After 2019 | 1,449 |
| Total | $2,204 |

The Company entered into a lease of the Amherst branch facility, with an entity in which a director of the Company has a 50% ownership interest, in 2009. The original term of the lease is twenty years and may be renewed at the Company's option for two additional terms of five years each. The Company's current rental payment under the lease is $141 annually.

## (11) Concentrations of Credit Risk and Contingencies

The Company grants commercial, residential and consumer loans to customers primarily in the central Virginia area. As a whole, the portfolio is affected by general economic conditions in the central Virginia region.

The Company's commercial and real estate loan portfolios are diversified, with no significant concentrations of credit other than the geographic focus on the central Virginia region. The installment loan portfolio consists of consumer loans primarily for automobiles and other personal property. Overall, the Company's loan portfolio is diversified and is not concentrated within a single industry or group of industries, the loss of any one or more of which would generate a materially adverse impact on the business of the Company.

The Company has established operating policies relating to the credit process and collateral in loan originations. Loans to purchase real and personal property are generally collateralized by the related property. Credit approval is primarily based on the creditworthiness of the borrower, the ability to repay and the value of the collateral pledged.

At times, the Company may have cash and cash equivalents at a financial institution in excess of insured limits. The Company places its cash and cash equivalents with high credit quality financial institutions whose credit rating and financial condition is monitored by management to minimize credit risk.

In the ordinary course of business, various claims and lawsuits are brought by and against the Company. In the opinion of management, there is no pending or threatened proceeding in which an adverse decision could result in a material adverse change in the Company's consolidated financial condition or results of operations.

## (12) Dividend Restrictions and Capital Requirements

Bankshares' principal source of funds for dividend payments is dividends received from its subsidiary Bank. For the years ended December 31, 2014 and 2013, dividends from the subsidiary Bank totaled $1,016 and $892, respectively.

Substantially all of Bankshares' retained earnings consist of undistributed earnings of its subsidiary Bank, which are restricted by various regulations administered by federal banking regulatory agencies. Under applicable federal laws, the Comptroller of the Currency restricts, without prior approval, the total dividend payments of the Bank in any calendar year to the net profits of that year, as defined, combined with the retained net profits for the two preceding years. As of December 31, 2014, retained net profits of the Bank that were free of such restriction approximated $5,238.

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

Quantitative measures established by regulation to ensure capital adequacy require Bankshares and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2014, that Bankshares and the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2014, the most recent notification from Office of the Comptroller of the Currency categorized Bankshares and the Bank as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized," as of December 31, 2014 and 2013, Bankshares and the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed Bankshares and the Bank's category.

Bankshares and the Bank's actual capital amounts and ratios are presented in the table below.

| | Actual | | For Capital Adequacy Purposes | | To Be "Well Capitalized" Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of December 31, 2014: | | | | | | |
| Total Capital | | | | | | |
| (to Risk Weighted Assets): | | | | | | |
| Bankshares consolidated | $ 36,521 | 11.98% | $ 24,379 | 8.0% | $ N/A | N/A |
| Bank | 36,828 | 12.12% | 24,310 | 8.0% | 30,387 | 10.0% |
| Tier 1 Capital | | | | | | |
| (to Risk Weighted Assets): | | | | | | |
| Bankshares consolidated | 33,385 | 10.96% | 12,189 | 4.0% | N/A | N/A |
| Bank | 33,692 | 11.09% | 12,155 | 4.0% | 18,232 | 6.0% |
| Tier 1 Capital (Leverage) | | | | | | |
| (to Average Assets): | | | | | | |
| Bankshares consolidated | 33,385 | 9.25% | 14,434 | 4.0% | N/A | N/A |
| Bank | 33,692 | 9.36% | 14,399 | 4.0% | 17,999 | 5.0% |

| | Actual | | For Capital Adequacy Purposes | | To Be "Well Capitalized" Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of December 31, 2013: (As Restated) | | | | | | |
| Total Capital | | | | | | |
| (to Risk Weighted Assets): | | | | | | |
| Bankshares consolidated | $ 35,028 | 12.03% | $ 23,298 | 8.0% | $ N/A | N/A |
| Bank | 35,901 | 12.36% | 23,236 | 8.0% | 29,045 | 10.0% |
| Tier 1 Capital | | | | | | |
| (to Risk Weighted Assets): | | | | | | |
| Bankshares consolidated | 31,557 | 10.84% | 11,649 | 4.0% | N/A | N/A |
| Bank | 32,430 | 11.17% | 11,618 | 4.0% | 17,427 | 6.0% |
| Tier 1 Capital (Leverage) | | | | | | |
| (to Average Assets): | | | | | | |
| Bankshares consolidated | 31,957 | 8.88% | 14,219 | 4.0% | N/A | N/A |
| Bank | 32,430 | 9.14% | 14,187 | 4.0% | 17,284 | 5.0% |

## (13) Disclosures about Fair Value of Financial Instruments

Generally accepted accounting principles require the Company to disclose estimated fair values of its financial instruments.

The following methods and assumptions were used to estimate the approximate fair value of each class of financial instrument for which it is practicable to estimate that value.

### *(a) Securities*

The fair value of securities is estimated based on bid prices as quoted on national exchanges or bid quotations received from securities dealers. The fair value of certain state and municipal securities is not readily available through market sources other than dealer quotations; so fair value estimates are based on quoted market prices of similar instruments, adjusted for differences between the quoted instruments and the instruments being valued.

### *(b) Loans*

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, real estate - residential, real estate - commercial, loans to individuals and other loans. Each loan category is further segmented into fixed and adjustable rate interest terms.

The fair value of fixed rate loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan as well as estimates for prepayments. The estimate of maturity is based on the Company's historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of current economic and lending conditions.

### *(c) Deposits*

The fair value of demand deposits, NOW accounts, and savings deposits is the amount payable on demand. The fair value of fixed maturity time deposits, certificates of deposit is estimated by discounting scheduled cash flows through the estimated maturity using the rates currently offered for deposits or borrowings of similar remaining maturities.

### *(f) Commitments to Extend Credit and Standby Letters of Credit*

The only amounts recorded for commitments to extend credit and standby letters of credit are the deferred fees arising from these unrecognized financial instruments. These deferred fees are not deemed significant as of December 31, 2014 and 2013, and as such, the related fair values have not been estimated.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on and off-balance sheet financial instruments without attempting to estimate the value of anticipated funding needs and the value of assets and liabilities that are not considered financial instruments. Significant assets that are not considered financial assets include deferred tax assets and premises and equipment and other real estate owned. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

### *(g) Fair Value Methodologies*

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

Available-for-Sale Securities

Available-for-sale securities are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available, and would in such case be included as a Level 1 asset. The Company currently carries no Level 1 securities. If quoted prices are not available, valuations are obtained from readily available pricing sources from independent providers for market transactions involving similar assets or liabilities. The Company's principal market for these securities is the secondary institutional markets, and valuations are based on observable market data in those markets. These would be classified as Level 2 assets. The Company's entire available-for-sale securities portfolio is classified as Level 2 securities. The

Company currently carries no Level 3 securities for which fair value would be determined using unobservable inputs.

Loans

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and a specific allowance for loan losses is established for that loan. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC Topic, *Impairment of a Loan.* The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of a similar debt, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans at which fair value of the expected repayments or collateral exceed the recorded investments in such loans. As of December 31, 2014, substantially all of the impaired loans were evaluated based on the fair value of the collateral. In accordance with *Impairment of a Loan*, impaired loans where an allowance is established based on the fair value of the collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as a nonrecurring Level 2 asset. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as a nonrecurring Level 3 asset. For substantially all of the Company's impaired loans as of December 31, 2014 and December 31, 2013, the valuation methodology utilized by the Company was collateral based measurements such as a real estate appraisal and the primary unobservable input was adjustments for differences between the comparable real estate sales. The discount to reflect current market conditions and ultimately collectability ranged from 0% to 25% for each of the respective periods.

Other Real Estate Owned

Other real estate owned is adjusted to fair value less estimated selling costs upon transfer of the loans to foreclosed assets. Subsequently, other real estate owned is carried at the lower of carrying value or fair value less estimated selling costs. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on observable market price or a current appraised value, the Company records the foreclosed asset as a nonrecurring Level 2 asset. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the other real estate owned as a nonrecurring Level 3 asset. For substantially all of the Company's other real estate owned as of December 31, 2014 and December 31, 2013, the valuation methodology utilized by the Company was collateral based measurements such as a real estate appraisal and the primary unobservable input was adjustments for differences between the comparable real estate sales. The discount to reflect current market conditions ranged from 0% to 25% for each of the respective periods.

The following tables present information about certain assets and liabilities measured at fair value:

**Fair Value Measurements on December 31, 2014**

| **Description** | Total Carrying Amount in The Consolidated Balance Sheet | Assets/Liabilities Measured at Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|---|
| Available-for-sale securities | $23,597 | $23,597 | $- | $23,597 | $- |
| Loans, net of unearned income and fees | $283,519 | $287,399 | $- | $- | $287,399 |
| Impaired loans (nonrecurring) | $4,284 | $4,284 | $- | $- | $4,284 |
| Other Real Estate Owned (nonrecurring) | $1,107 | $1,297 | $- | $- | $1,107 |
| Deposits | $325,204 | $323,888 | $- | $- | $323,888 |

**Fair Value Measurements on December 31, 2013**

| **Description** | Total Carrying Amount in The Consolidated Balance Sheet | Assets/Liabilities Measured at Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|---|
| Available-for-sale securities | $23,406 | $23,406 | $- | $23,406 | $ - |
| Loans, net of unearned income and fees | $277,758 | $281,842 | $- | $- | $281,842 |
| Impaired loans (nonrecurring) | $2,586 | $2,586 | $- | $- | $2,586 |
| Other Real Estate Owned (nonrecurring) | $1,297 | $1,297 | $- | $- | $1.297 |
| Deposits | $322,130 | $323,856 | $- | $- | $323,856 |

The following table sets forth a summary of changes in the fair value of the Company's nonrecurring Level 3 assets for the year ended December 31, 2014:

| | | Level 3 Assets Year Ended December 31, 2014 | |
|---|---|---|---|
| | | Impaired Loans | Other Real Estate Owned |
| Balance, beginning of the year | $ | 2,586 | 1,297 |
| Purchases, sales, issuances, and settlements (net) | | 1,698 | (190) |
| Balance, end of year | $ | 4,284 | 1,107 |

There were no transfers between Level 1 and Level 2 investments during the year ended December 31, 2014.

The following table sets forth a summary of changes in the fair value of the Company's nonrecurring Level 3 assets for the year ended December 31, 2013:

| | | Level 3 Assets Year Ended December 31, 2013 | |
|---|---|---|---|
| | | Impaired Loans | Other Real Estate Owned |
| Balance, beginning of the year | $ | 2,843 | 2,393 |
| Purchases, sales, issuances, and settlements (net) | | (257) | (1,096) |
| Balance, end of year | $ | 2,586 | 1,297 |

There were no transfers between Level 1 and Level 2 investments during the year ended December 31, 2013.

## (14) Parent Company Financial Information

Condensed financial information of Bankshares ("Parent") is presented below:

### Condensed Balance Sheets

| Assets | | December 31, 2014 | 2013 As Restated |
|---|---|---|---|
| Cash due from subsidiary | $ | 16 | 5 |
| Investment in subsidiary, at equity | | 33,165 | 32,814 |
| Other assets | | 865 | 777 |
| **Total assets** | $ | 34,046 | 33,596 |
| **Liabilities and stockholders' equity** | | | |
| Notes payable | $ | 1,367 | 1,630 |
| Other liabilities | | 25 | 24 |
| **Total liabilities** | $ | 1,392 | 1,654 |
| Stockholders' equity | | | |
| Common stock of $3 par value, authorized 3,000,000 shares; issued and outstanding 1,511,970 shares in 2014 and 1,515,007 in 2013 | $ | 4,497 | 4,507 |
| Capital surplus | | 1,004 | 1,035 |
| Retained earnings | | 28,219 | 26,554 |
| Accumulated other comprehensive income (loss), net | | (1,066) | (154) |
| **Total stockholders' equity** | **$** | 32,654 | 31,942 |
| **Total liabilities and stockholders' equity** | **$** | 34,046 | 33,596 |

### Condensed Statements of Income

| | | Years ended December 31, 2014 | 2013 As Restated |
|---|---|---|---|
| Income: | | | |
| Dividends from subsidiary | $ | 1,016 | 892 |
| Equity in undistributed net income of subsidiary | | 1,302 | 1,949 |
| Total Income | | 2,318 | 2,841 |
| Expenses: | | | |
| Other expenses | | 257 | 288 |
| Income before income tax benefit | | 2,061 | 2.553 |
| Applicable income tax benefit | | 88 | 98 |
| Net income | $ | 2,149 | 2,651 |

**Condensed Statements of Cash Flows**

| | | Years ended December 31, 2014 | Years ended December 31, 2013 As Restated |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Net income | $ | 2,149 | 2,651 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Equity in undistributed net income of subsidiary | | (1,302) | (1,949) |
| Increase in other assets | | (89) | (97) |
| Net cash provided by operating activities | | 758 | 605 |
| Cash flows from financing activities | | | |
| Cash dividends paid | | (484) | (341) |
| Repayment of line of credit | | (264) | (272) |
| Increase (decrease) in other liabilities | | 1 | (3) |
| Net cash used in financing activities | | (747) | (616) |
| Net increase (decrease) in cash due from subsidiary | | 11 | (11) |
| Cash due from subsidiary, beginning of year | | 5 | 16 |
| Cash due from subsidiary, end of year | $ | 16 | 5 |

## (15) Stock-based Compensation

The Company's 2004 Incentive Stock Plan (the "2004 Plan"), pursuant to which the Company's Board of Directors may grant stock options and other equity-based awards to officers and key employees, was approved by shareholders on April 13, 2004 and became effective as of May 1, 2004. The 2004 Plan authorized grants of up to 100,000 shares of the Company's authorized, but unissued common stock. All stock options were granted with an exercise price equal to the stock's fair market value at the date of the grant. As of December 31, 2014, the 2004 Plan has expired and no additional awards may be granted under this plan.

Stock options granted under the 2004 Plan generally have 10-year terms, vest at the rate of 25% per year, and become fully exercisable four years from the date of grant.

Under the 2004 Plan during 2014, 23,500 options for shares were granted, and in 2013 no stock options were granted. On May 1, 2013, 10,000 shares, of restricted stock were granted to employees. The 2013 grants will vest on the third anniversary of the grant date.

At December 31, 2014, options for 34,750 shares were exercisable at an exercise price of $9.00 per share under the 2004 Plan.

On April 8, 2014, shareholders approved the 2014 Incentive Stock Plan (the "2014 Plan"), pursuant to which the Company's Board of Directors may grant stock options and other equity-based awards to officers and key employees. The 2014 Plan authorizes grants of up to 150,000 shares of the Company's authorized, but unissued common stock. All stock options are granted with an exercise price equal to the stock's fair market value at the date of the grant. As of December 31, 2014, there were 141,600 shares available for grant under the 2014 Plan.

On May 1, 2014, 8,400 shares of restricted stock were granted to employees pursuant to the 2014 Plan. The 2014 restricted stock grants will vest on the third anniversary of the grant date.

At December 31, 2014, no options for shares were exercisable under the 2014 Plan.

The Company expensed $3 in 2014 in compensation expense as a direct result of the issuance of the 34,750 incentive stock options with tandem stock appreciation rights in previous years and recognized $57 in compensation expense related to 23,500 unvested stock options. For the 2004 Plan stock options granted May 1, 2010, the fair value of $3.96 per share of each option grant is estimated on the grant date using the Black-Scholes option-pricing model with the following weighted average assumptions used: dividend yield of 2.065%, expected volatility of 45.61%, a risk-free interest rate of 4.63%, and expected lives of 9 years. For the 2004 Plan stock options granted February 11, 2014, the fair value of

$5.45 per share of each option grant is estimated on the grant date using the Black-Scholes option-pricing model with the following weighted average assumptions used: dividend yield of 4.00%, expected volatility of 44.70%, a risk-free interest rate of 2.69%, and expected lives of 9 years.

The Company also expensed $110 in 2014 in compensation expense as a direct result of the granting of 11,000 shares of restricted stock in 2012, 10,000 shares of restricted stock in 2013 and 8,400 shares of restricted stock to 2014 and will recognize $103 in 2015 and $65 in 2016 on such restricted stock.

Stock option activity during the years ended December 31, 2014 and 2013 is as follows:

| | Number of Shares | Weighted Average Exercise Price |
|---|---|---|
| Balance as of December 31, 2012 | 37,250 | $9.00 |
| Forfeited | 250 | 9.00 |
| Exercised | - | |
| Granted | - | |
| Balance as of December 31, 2013 | 37,000 | $9.00 |
| Forfeited | 250 | $9.00 |
| Exercised | 2,000 | $9.00 |
| Granted | 23,500 | $18.10 |
| Balance as of December 31, 2014 | 58,250 | $12.67 |

The following table summarizes information about stock options outstanding as of December 31, 2014:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Exercise Price | Number Outstanding at 12/31/14 | Weighted-Average Remaining Contractual Life (in years) | Weighted-Average Exercise Price | Number Exercisable at 12/31/2014 | Weighted-Average Exercise Price |
| $ 9.00 | 34,750 | 5.4 | $ 9.00 | 34,750 | $ 9.00 |
| 15.70 | 23,500 | 9.4 | 15.70 | - | - |

The aggregate intrinsic value of options outstanding was $355, of options exercisable was $306, and of options unvested and expected to vest was $49 as of December 31, 2014. The aggregate intrinsic value of restricted stock granted was $150 for 2014 and $491 for 2013. The total intrinsic value (market value on date of exercise less exercise price) of options exercised $19 for the year ended December 31, 2014 and $0 for the year ended December 31, 2013.

The following table summarizes information about stock options outstanding at December 31, 2013:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Exercise Price | Number Outstanding at 12/31/13 | Weighted-Average Remaining Contractual Life (in years) | Weighted-Average Exercise Price | Number Exercisable at 12/31/2013 | Weighted-Average Exercise Price |
| $ 9.00 | 37,000 | 6.4 | $ 9.00 | 27,750 | $ 9.00 |

**(16) Share Repurchase Program**

On November 12, 2013, the Board of Directors adopted a resolution authorizing the repurchase of up to $500 worth of shares of the Company's common stock. The Board of Directors extended this resolution on May 13, 2014 and November 11, 2014. Purchases are made, as conditions warrant, from time to time in the open market. The current resolution expires May 11, 2015 and the timing of future purchases will depend on market conditions. As of December 31, 2014, the Company repurchased 12,065 shares of its common stock under the stock repurchase program and expensed $205 during 2014 for these repurchases. The timing and amount of future repurchases will depend upon the market price for our common stock, securities laws restricting repurchases, asset growth, earnings, and our capital plan.

**(17) Restatement of Prior Period Financial Statements**

The Company is restating select financial results for the year ended December 31, 2013. The Company previously reported receiving during 2013 net insurance proceeds of $1,077 related to insurance proceeds received in connection with the rebuild of the Vista Branch office that was destroyed by fire. These nontaxable insurance proceeds were improperly included in the effective tax rate in the financial statements and, therefore, the Company is restating the 2013 consolidated financial statements by increasing its deferred tax liability and increasing income tax expense by $366 as shown in the table below.

| | 2013 As Previously Reported | Adjustments | 2013 As Restated |
|---|---|---|---|
| Balance Sheet Line Items: | | | |
| Net Deferred Tax Liability | (179) | (366) | (545) |
| Income Statement Line Items: | | | |
| Income Tax Expense | 875 | 366 | 1,241 |

**(18) Subsequent Events**

The Company has evaluated subsequent events for potential recognition and/or disclosure in the December 31, 2014 consolidated financial statements through March 5, 2015, the date the consolidated financial statements were available to be issued.

***Management's Report on Internal Control over Financial Reporting.***

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management assessed the effectiveness of the Company's 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 *Internal Control – Integrated Framework*. Based on this assessment, our management concluded that, as of December 31, 2014, the Company's internal control over financial reporting was effective based on those criteria.

This annual report does not include an attestation report of the Company's independent auditor regarding internal control over financial reporting.

Cherry Bekaert LLP
CPAs & Advisors

## Report of Independent Auditor

To the Board of Directors and Stockholders
of Pinnacle Bankshares Corporation
Altavista, Virginia

### Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Pinnacle Bankshares Corporation and Subsidiary (the "Company"), which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of operations, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### Management's Responsibility for the Consolidated Financial Statements

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

### Auditor's Responsibility

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

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

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

### Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pinnacle Bankshares Corporation and Subsidiary as of December 31, 2014 and 2013, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

### Emphasis of a matter

As discussed in Note 17, the 2013 consolidated financial statements have been restated to correct a misstatement. Our opinion is not modified with respect to this matter.

Cherry Bekaert LLP

Raleigh, North Carolina
March 5, 2015

# IN MEMORIAM

**Charlene A. Thompson**

*June 9, 1955 to December 7, 2014*

Joined First National Bank on July 16, 2007

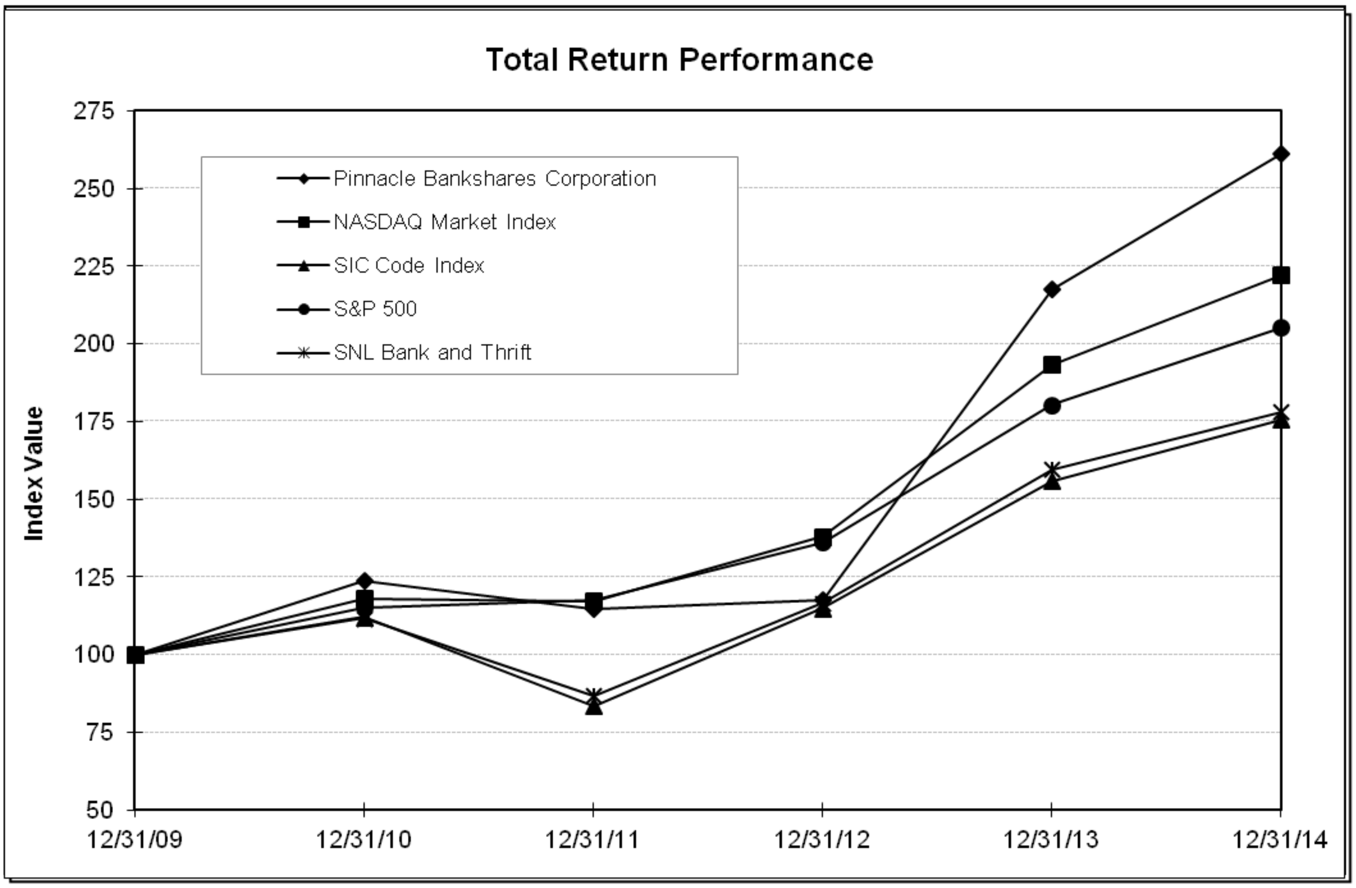
Assistant Vice President & Branch Manager of the
Rustburg Branch, which opened in March of 2009

## Shareholder Information

### PERFORMANCE GRAPH

The graph below compares total returns assuming reinvestment of dividends of Pinnacle Bankshares Corporation Common Stock, the NASDAQ Market Index, and an Industry Peer Group Index(the "SIC Code Index"). In addition, we have included the S&P 500 and the SNL Bank and Thrift Index and will use these as our peer groups going forward as we have determined that the companies included in these indices more closely match our Company characteristics than the companies included in the SIC Code Index. The graph assumes $100 invested on January 1, 2009 in Pinnacle Bankshares Corporation Common Stock and in each of the indices. In 2014, the financial holding companies in the SIC Code Index consisted of 239 banks with the same standard industry code of 6021 as Pinnacle Bankshares Corporation.

# *Pinnacle Bankshares Corporation*




| *Index* | *Period Ending* 12/31/09 | 12/31/10 | 12/31/11 | 12/31/12 | 12/31/13 | 12/31/14 |
|---|---|---|---|---|---|---|
| Pinnacle Bankshares Corporation | 100.00 | 123.86 | 114.85 | 117.66 | 217.66 | 261.29 |
| NASDAQ Market Index | 100.00 | 118.15 | 117.22 | 138.02 | 193.47 | 222.16 |
| SIC Code Index | 100.00 | 112.09 | 83.56 | 114.99 | 155.83 | 175.60 |
| S&P 500 | 100.00 | 115.06 | 117.49 | 136.30 | 180.44 | 205.14 |
| SNL Bank and Thrift | 100.00 | 111.64 | 86.81 | 116.57 | 159.61 | 178.18 |

## Shareholder Information

### Annual Meeting

The 2015 Annual Meeting of Shareholders will be held on April 14, 2015, at 11:00 a.m. at the Fellowship Hall of Altavista Presbyterian Church, located at 707 Broad Street, Altavista, Virginia.

### Market for Common Equity and Related Stockholder Matters

The Company's Common Stock is quoted on the OTC Bulletin Board. The following table presents the high and low bid prices per share of the Common Stock, as reported on the OTCQB marketplace, and dividend information of the Company for the quarters presented. The high and low bid prices of the Common Stock presented below reflect inter-dealer prices and do not include retail markups, markdowns or commissions, and may not represent actual transactions.

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | High | Low | Dividends | High | Low | Dividends |
| First Quarter | $17.00 | $15.10 | $0.075 | $13.45 | $8.31 | $0.05 |
| Second Quarter | $18.50 | $17.00 | $0.075 | $13.20 | $11.75 | $0.05 |
| Third Quarter | $18.40 | $17.51 | $0.085 | $13.10 | $11.90 | $0.05 |
| Fourth Quarter | $18.05 | $17.52 | $0.085 | $16.00 | $13.10 | $0.075 |

Each share of Common Stock is entitled to participate equally in dividends, which are payable as and when determined by the Board of Directors after consideration of the earnings, general economic conditions, the financial condition of the business and other factors as might be appropriate. The Company's ability to pay dividends is dependent upon its receipt of dividends from its subsidiary. Prior approval from the Comptroller of the Currency is required if the total of all dividends declared by a national bank, including the proposed dividend, in any calendar year will exceed the sum of the bank's net profits for that year and its retained net profits for the preceding two calendar years, less any required transfers to surplus. This limitation has not had a material impact on the Bank's ability to declare dividends during 2014 and 2013 and is not expected to have a material impact during 2015.

As of March 1, 2015, there were approximately 311 shareholders of record of Bankshares' Common Stock.

### Requests for Information

Requests for information about the Company should be directed to Bryan M. Lemley, Secretary, Treasurer and Chief Financial Officer, P.O. Box 29, Altavista, Virginia 24517, telephone (434) 369-3000.

Shareholders seeking information regarding lost certificates and dividends should contact Computershare Inc. in College Station, Texas, telephone (800) 368-5948. Please submit address changes in writing to:

*Shareholder correspondence should be mailed to:*
Computershare Shareholder Services
P.O. Box 30170
College Station, TX 77842-3170

*Overnight correspondence should be mailed to:*
Computershare Shareholder Services
211 Quality Circle, Suite 210
College Station TX 77845

PINNACLE BANKSHARES CORPORATION

622 Broad Street • Post Office Box 29 • Altavista, Virginia 24517 • (434) 369-3000